STUDIES IN CALIFORNIA STATE TAXATION 1910-1935

BY

MARVEL M. STOCKWELL

PUBLICATIONS OF THE
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To PROFESSOR CARL C. PLEHN, *Professor Emeritus, University of California, in recognition and remembrance of his work in public finance, and especially California finance, this study is dedicated*

PREFACE

California state finances for the quarter-century 1910–1935 present an interesting story, not only to the specialized student in public finance, but also in some measure to the general reader in the field. Although it is true that for a substantial part of this period the California fiscal structure remained largely unchanged, the nature of the tax system during that time was such as to command much attention in California and to arouse appreciable interest outside the state as well. Then, too, the fundamental changes which occurred during the later days gave a certain glamour to the series of developments transpiring during these twenty-five years.

No attempt has been made in these pages to deal exhaustively with all the details. To have done so would have made too cumbersome a treatment, when the primary purpose is to outline the essentials of fiscal history in the state from the time when separation of sources became effective down to the day when that particular plan of taxation was abandoned. A former study published by the University of California Press in 1913, *A Financial History of California,* by William C. Fankhauser, told the story of California finances from the earliest days to the close of the first decade of the century. The present study resumes the narrative at that point and carries it down to July, 1936, when this work was concluded. The presentation is topical rather than chronological, although in the larger aspects of the subject matter order in time is observed.

The writer wishes gratefully to acknowledge the invaluable assistance of his wife in the preparation of this work. Her active interest in the content and composition of these studies was indispensable to their completion. To the author's niece, Marjorie, is also due much credit for assistance in original typing of the manuscript. Likewise to Dr. Malcolm M. Davisson, assistant professor of economics, University of California, Berkeley, an acknowledgment of indebtedness and an expression of appreciation are due for time and effort expended in his careful reading of the manuscript. Many helpful suggestions were made by the members of the Board of Editors for the Series in Social Sciences, University of California at Los Angeles—Professors David K. Bjork, Louis K. Koontz, J. A. C. Grant, Lewis A. Maverick, and George M. McBride. Finally the author wishes gratefully to remember the painstaking work of editing done by Martha L. Willard, assistant editor of the University Press.

MARVEL M. STOCKWELL

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I. INTRODUCTION

Taxation is a kind of universal jigsaw puzzle. With its maze of technicalities, labyrinth of theory, diversity of views, varying principles of application, specific problems in connection with each particular kind of tax, conflicts of interest among taxpaying groups—with all these shapes and forms of the problem and with many more, the tax student and administrator must continually be concerned. The fragments of the picture change from day to day and from year to year. New facts, new ideas, new principles, new necessities, are the forces with which one must reckon in any attempt at a sensible solution of difficult problems. Fiscal ideas of various forms and hues come scrambled together. The task of the fiscal scientist is to make from these variegated elements if possible some sort of harmonious whole.

The situation in California during the quarter-century 1910–1935 has been strikingly illustrative of the truth of what has just been said. It is the purpose of this introductory chapter to indicate in broad outline the principal developments of twenty-five years of state fiscal history. Subsequent chapters will trace more completely the particular phases of this development.

From the time of the organization of the state government until 1911 the state relied mainly upon the general property tax. In 1910 approximately 70 per cent of its revenue came from this source. This tax, similarly to those in other states, was superimposed upon local levies for local purposes and was, of course, based upon assessments made locally except as such assessments were equalized by the State Board of Equalization and except that the board exercised some supervision over the assessment of railroad property.

Inasmuch as the property owner was subject to state as well as to local levy upon the locally assessed value of property, there was a continual incentive for local officials to underassess property in the respective counties in order to enable property owners in those counties to escape paying as much as possible of the state tax. Hence there arose the familiar and objectionable practice of assessing property at 40, 30, or even 20 per cent of its full cash value. Under these conditions the State Board of Equalization had a definite task to perform in attempting some equalization of the bases of assessment in the several counties so that the state tax would not fall with too great inequality. But equalization was to an appreciable degree a political and sectional procedure and, to say the least, was no adequate remedy for the evils of the property tax. There was, however, some justification for the existence of the board, but with the change in the state's tax system which took place in 1911 the usefulness of the board was largely lost. Not until 1933, with the necessity for equalization of assessed values consequent upon the return of public utility property to the local tax rolls,[1] did the board again come into its own.

There were evils in connection with the old system other than that of competitive undervaluation of property, such as inadequate assessment of the larger utilities, inadequate contributions from banks and insurance companies, and so forth. In the November election of 1910, Constitutional Amendment No. 1 was voted, becoming effective in 1911, which provided for the separation of sources of state and local revenue. That is to say, the general property tax was abandoned as a source of revenue for the state government, although of course it was retained by the local governments. The state thereafter received the larger part of its revenue from a gross receipts tax on public service corporations; a franchise tax on corporations; a gross premiums tax on insurance companies; a capital stock tax upon banks; and an inheritance tax. The essential point was that the state no longer depended for its income on the general property tax.

Under this new system, then, the so-called operative property of the utilities (railroads and street railroads, express companies, the Pullman Company, gas and electric companies, telephone and telegraph companies, and all other utilities with the exception of water companies), the stocks of banks (both state and national), insurance companies, corporation franchises, and inheritances were taxed exclusively by the state for state purposes and were entirely unavailable for local taxation. All other property was reserved solely for local taxation except that in the event of a deficiency in state revenue the provision was made that all property, both that taxed by the state and that taxed locally, could be levied upon to make good such deficiency. This was the constitutional provision for the levy of an ad valorem tax, a provision which, although frequently referred to in more recent years, has never been invoked.

The property thus reserved for state taxation, particularly that of the utilities, was not, strictly speaking, taxed upon an ad valorem basis.

[1] For notes, see below, pp. 14–15.

The utilities were classified and varying rates were applied to the gross receipts of each class of utility on the theory that the gross receipts of each class bore some relationship to property value. Furthermore the burden of the gross receipts tax upon public service corporations relative to property values was presumed to correspond to the burden resting upon common property locally taxed. It was this particular theory or aspect underlying the new tax system which subsequently resulted in much difficulty in adjusting relative tax burdens.

Thus the new system of taxation was designed to improve and strengthen the fiscal structure of the state. Undoubtedly it was an improvement, a distinct step forward. But taxation is a disconcerting problem. Scarcely had the new law been put into operation than certain deficiencies became apparent. At the rates originally established, adequate revenue to support state functions was not forthcoming. Utility classifications had to be revised. It further appeared that common property locally taxed was bearing a tax burden disproportionate to that borne by property taxed upon the gross receipts method by the state. Hence there were continual rate adjustments during the ensuing decade and continuing discussion of the whole basis of the state's revenue system, a discussion which found its focus in various tax commission or committee reports, especially those of 1917, 1929, and 1931. The situation finally came to an acute stage as the result of a series of United States Supreme Court decisions respecting the taxation by states of shares of stock of national banks.

In California since 1906 many special reports upon taxation have been presented to the state legislature.[2] The 1929 and 1931 California reports were noteworthy partly because of the differences between them and partly because of the description in them of the principal tax problems of the state. The 1929 report was especially thorough and comprehensive. The following brief statement of certain broad aspects of taxation in California is based mainly upon the substance of these two reports. We may first notice, however, the comment of the 1917 tax commission upon the separation plan after it had been in operation for six years. Various advantages had been claimed for separation, such as that it would do away with the competitive undervaluation of property, would permit state use of taxes not well adapted to local governments such as inheritance and corporation taxes, and would reduce by the amount of the previous state tax the burden upon real property. The commission held that the new system was an improvement over the old one so far as the separation of assessment of public utility and intangible property was concerned and that it would be unwise to return to the old method. But it pointed to the following deficiencies: (1) with the original rates it failed as a revenue producer; (2) it did not result in equality, either as between the corporations and the people or as between the various classes of corporations; (3) it had not tended to correct the evil of undervaluation by counties; (4) it had not lightened the burden upon real property; (5) it had complicated the tax system by compelling an unnecessary dual method of fixing tax rates on the property of public utilities—first a rate according to property value, and then a corresponding one upon gross receipts.[3]

The Martin commission[4] reporting in 1929 likewise gave an appreciable part of its report to a consideration and condemnation of separation of sources in California. The view expressed clearly confirmed that of the 1917 commission, which upon the counts just set forth criticized the actual working of the separation plan. Not only, the Martin commission said, had many of the advantages claimed for separation failed of realization, but in operation the plan had developed serious positive faults—faults "so fundamental as to demand the substitution of some more satisfactory system."[5] This judgment led to the proposal of an entirely new tax system for the state. In the words of the commission, "This plan . . . should ultimately consist of three distinct but complementary elements: First, a property tax of reduced scope; second, a business tax upon all business activities carried on within the borders of the state; and third, a personal tax levied upon all residents of the state."[6] The commission thus envisaged complete and thoroughgoing reform in the state's tax system. This was particularly evident from the first four of the ten distinct recommendations made by the commission—the four recommendations which presented the antithesis of the existing system of separation of sources.[7]

The 1931 joint legislative committee on taxation, appointed for the purpose, among others, of studying the report of the Martin commission and making recommendations thereon, first suggested that for the present the then existing system of state taxation involving separation of sources be retained.[8] A part of this first recommendation was that the legislature be empowered to make such further classifications and subclassifications of utility groups as might be necessary in order to achieve a more equitable distribution of the tax burden. Likewise the committee suggested an extension of studies by the State Board of Equalization with respect to average tax burdens upon utility and common property.[9]

With respect to the suggestion for further classifications of utility groups, it is interesting to observe that the State Board of Equalization had expressed some doubt of the desirability of further classification. The board stated that, although from such studies as it had made the tax burden on public utilities was found to be $1.466 on each $100 of actual value of operative property and $1.757 on nonoperative property, the difference was not sufficient cause for concern or immediate revision of rates. It argued, also, concerning inequality within classes of utilities, that there were "always exceptional cases in which the tax burden will be either too low or too high. If we attempt to provide for all of these, the overrefinement resulting from our effort to produce absolute equality is more than apt to cause serious disturbance to the whole tax system."[10]

The problem of gross receipts tax rate determination was a leading factor responsible for rejection of the existing state tax system by the Martin commission. This commission had said, "The determination of rates which should be imposed upon gross receipts has proved a task incapable of satisfactory solution."[11] The joint committee replied that the adoption of the plan of the Martin commission would introduce unknown factors to such a degree as to make largely fortuitous any improvement in the existing situation in this particular respect.[12] It was "constrained to recommend the retention of the existing method rather than to change to one, the effects of which are uncertain."[13]

Aside from this basic difference of opinion on abandonment or retention of the essential aspect of the state's taxation system, there were several other significant matters in which divergence appeared. The Martin commission, seeking a uniform business franchise tax on all corporations, had recommended taxation of utilities on the same basis as banks and other corporations, but the joint committee argued that, although the state might and should continue to tax banks and corporations on the basis of income, it seemed "inadvisable to place public utilities in the same class."[14] The Martin commission further had recommended that an opportunity be given the people of the state to record their desire for a personal income tax.[15] The joint committee was still more conservative—with the exception of one member who in a minority report vigorously advocated such a tax[16]—feeling that too little was known of the effects of an income tax in relation to the burden upon real estate.[17] The joint committee, "because of lack of proper information," made no recommendations concerning the revisions in rates of tax and elimination of reinsurance deductions on insurance companies proposed by the Martin commission.[18] With respect to motor vehicle taxation the committee was concerned over the enactment of such legislation as would effectively place such property upon the county tax roll.[19] The Martin commission had recommended the discontinuance of the local personal property tax on motor vehicles and an increase in the state license tax to an amount sufficient to reimburse the counties for the loss of revenue involved.[20] The Martin commission had advised also the abolition of the State Board of Equalization and the establishment of an appointive, permanent, professional tax commission. It had conditioned its other recommendations for changes in the tax system upon the creation of such a body.[21] Since the joint committee did not accept the basic changes urged in the Martin report, it did not recommend such a commission. Its proposal rather was for a research department within the State Board of Equalization.[22]

Further aspects of the tax problem as it developed in California are evident from a perusal of the remaining part of the joint committee's report. The substance of several other recommendations of the committee may be summarized as follows:

"That the constitution be amended to eliminate the requirement that the counties contribute an amount equal to the contribution of the State for elementary schools and a sum twice the amount contributed by the State for the support of high schools...

"That the research bureau ... give consideration to devising ways and means of relieving the present excessive tax burden borne by homes, farms and all other real estate taxed locally.

"Among other things attention is directed to the following suggestions which this committee believes will aid materially in accomplishing the above:

(*a*) Proper tax limitation methods;
(*b*) Transference to the State of certain general governmental functions now performed locally;
(*c*) Determination of proper sources of new revenue;
(*d*) Correction of certain abuses connected with special assessments."[23]

In view of the importance which expenditure limitation subsequently assumed under the so-called Riley-Stewart act, it is worth noting that the joint committee considered briefly a number of possible methods of tax limitation but decided that none was effective enough to warrant recommendation to the legislature. Its concluding remark was that "only through rigid economy, careful scrutiny of proposed bond issues and restriction of special assessment and tax levies, coupled with the courage to admit that many desirable things cannot be afforded, can any appreciable reduction in local taxes be secured."[24] The State Board of Equalization had made a similar observation.[25]

To delve further at this time into the details of the various tax commission reports would carry us beyond the confines of an introductory survey chapter. More in due course will be said concerning matters but lightly touched upon here and concerning matters which, although important, have not here been mentioned. The existing Riley-Stewart act affords a transition between the past and the present in California taxation. It will be in point to observe briefly the essential provisions of this law, reserving until a later chapter an attempt at appraisal and an evaluation of experience with it to the present time.

The provisions of the present Riley-Stewart act of 1933 may be summarized conveniently under the headings of revenue, relief, and expenditure control. Fundamentally the act involved abandonment of the plan of separation of sources of revenue employed in the state since 1911. Thus we have witnessed in part the acceptance of the program recommended by the Martin commission. Public utility property was returned to the local tax rolls there to be taxed as other property is taxed. The local property tax base was thus broadened by approximately one-sixth. The utility property is centrally assessed by the State Board of Equalization. This assessment involved the accompanying task of equalizing assessed values of all property in counties throughout the state. The state relinquished the gross receipts tax upon public service corporations amounting at the time to some $60,000,000 per biennium. Attempted relief to real property was another aspect of this legislation. This was presumed to result from the facts that, first, as just noted, the local property tax base was broadened and that, second, the state took over a substantial part of the burden of educational support formerly borne by the localities. This added financial responsibility of the state, amounting currently to about $80,000,000 per biennium, is taken care of by the proceeds from the sales tax. It must be remembered in this connection, however, that the sales tax, strictly speaking, was not an integral part of the Riley-Stewart plan but came as a result of the plan. It was generally understood that a sales tax would be adopted as a means of providing the necessary revenue. Finally the Riley-Stewart act attempted to limit the increase in expenditures of both the state and local governments. Except under certain conditions—a two-thirds vote of the electorate or approval of the State Board of Equalization—expenditures of an ensuing fiscal period may not exceed those of a preceding one by more than 5 per cent. In evaluating the results of this recent tax legislation to date it is necessary to be somewhat critical. One may concede that the attempt to relieve real estate was laudable, that the sales tax did provide the wherewithal to support the schools in a time of depression, and that the attempted limitation of expenditures was a good feature of the law. Yet several questions arise relative to this newest phase of California finances. These will be considered in the chapter given over to an analysis of the Riley-Stewart act.

Any adequate study of California state finances obviously must review the major sources of revenue from which support of the government has been or is being obtained. California has employed or is now employing a number of different types of tax, such as gross receipts taxes on public service corporations, franchise, inheritance, gasoline, sales, and income taxes, as well as others. The conspicuous exception since 1911 under the separation plan was the property tax. In connection with each of these taxes interesting questions have arisen, changes have occurred, and new developments have taken place. Nor would the story be entirely complete without some reference to various taxes proposed from time to time, such as single, severance, ad valorem, and gross transactions taxes. California taxation intricacies, however, cannot be confined within the limits of the difficulties that happen to appear with the individual tax. There are broader and more general problems which require their due share of attention.

What, for instance, shall be done with the so-called fixed charges established by statutory enactment or constitutional provision which make up a large proportion of the total expenditures of the state? How shall the seriously unbalanced state budget be balanced? Should the state borrow to finance this deficit and to finance a program of capital expenditures? How shall the state undertake to finance the cost of enlarged social services which it will be called upon to supply in the years to come? Should all highways be included within the state system? Should gasoline tax money be diverted to pay principal and interest on earlier incurred state indebtedness for highway construction? Should an ad valorem tax be employed to obtain revenue for the state government? Granted that economy is necessary, where and to what degree should it be introduced? Is there not, without prolonged study, grave danger of indiscriminate economy which will not adequately appraise the comparative contribution of institutions and services to the general community welfare? How shall we reconcile the conflict of interest among different taxpaying groups called upon to contribute to the support of the governmental services? In accordance with what principles and in what specific manner shall the tax burden be distributed? Should we tax chain stores, oil and gas pipe lines, and oleomargarine? Should we repeal the sales tax and the personal income tax? In short, and after all, what sort of a philosophy of taxation and expenditure shall we construct? We may pause for a moment to consider the first two of the general problems which are mentioned in this paragraph.

The fixed charges determined by either constitutional or statutory mandate constitute some 76 per cent of the state's general fund expenditures. Under the head of uncontrollable expenditures ordinarily referred to as fixed charges there are some ten items. The three provided for in the Constitution are elementary and high school educational support, debt service, and legislative salaries. Those provided for by statute are old age pensions, aid to orphans, tuberculosis subsidies, vocational education, teachers' retirement salaries, state employees' pensions, and salaries of superior court judges.

It is not difficult to marshal objections to these fixed charges. It is inadvisable to legislate in too detailed a manner in the fundamental law of a state. It is in times of stress that problems induced thereby become acute. As a matter of strict fiscal policy, control of expenditures probably should be left with the legislature in order that the garment may be made to fit the cloth. Inability to reduce expenditures in a financial emergency, unwillingness to economize in the protected fields, disinclination of lesser departments to cut their expenditures if the major departments remain uncontrolled—these are the obvious objections to any program of fixed charges. On the other hand, from the point of view of maintaining a minimum educational program, of protecting education from bearing the brunt of retrenchment, of preventing further inequalities in the distribution of the tax burden, and of changing the Constitution for expediency we may have proceeded well thus far in not having modified our fundamental law. Certainly if we are to argue for and to retain the sales tax on the basis of a present-day broad diffusion of benefits resulting from government expenditure, there would seem to be some prima-facie case for fixed charges, particularly as they relate to education as the most important of these items. And if we are some day to subject provision for all these matters to legislative control, then likewise our extensive highway expenditures should be subjected to control by the legislative body.

Space does not here permit a detailed discussion of the current problem of balancing the state budget. There are two ways in which a budget may be balanced. One is to spend less. The other is to tax more. So far as the first is concerned, California need not be too hopeful or too naïve. If we put aside the consideration that there is nothing inherently unsound in a collective expenditure of a substantial part of the social income, the fact remains that any measurable economy as an effective means of balancing the state budget is largely in the realm of dreams. Economy in this degree, it has been pointed out, would be both impossible and unwise—impossible because of the fixed charges and because of the fact that the 1933 legislature reduced the controllable items some 26 per cent; and unwise because of the danger of indiscriminate economy and because of the advisability of supplementing private by public expenditure during a time of business recession.[26] A further fact must also be remembered. A large part of our state budget is in effect a local budget. The State Director of Finance has pointed out that, of the $347,000,000 of total budget for 1935–1937, $193,000,000, or 55 per cent, consists of subventions to the local governments. Economy is not likely to be popular if it comes home in this way. So far as taxing more is concerned there is no dearth of ideas. Many are buzzing about seeking where they may come to rest. Some of these various schemes already have caught up with us. Others will catch us even if we do watch out.

This introductory survey of the broad aspects of fiscal conditions in California may be brought to a close by pointing out that the situation in this state illustrates a number of the outstanding issues in modern taxation. One of the most commanding of these issues is the burden of taxation, both with respect to its amount and with respect to its distribution. A burden all too obvious needs no extended recounting. As a conservative estimate, the total of federal, state, and local taxes consumes 20 per cent of the social income. And yet the vital question is not simply the percentage of our income expended by government, but whether or not we are getting value received, whether or not the money yields a larger return when spent by government than when spent by individuals. Such amenities of life as education, good roads, recreational facilities, public health, and economic security are not to be ignored. Individuals may spend far less wisely than does the state which imposes taxes for these social services. We cannot say with finality what part of the social income can be taken in taxes before we reach the point of encroaching too severely upon individual and community resources. But we can properly insist that public funds be expended economically and wisely. The problem of the amount of the burden of taxation becomes, therefore, in large part a problem in the wise control of public expenditures through such means as sound budgetary procedure, administrative reorganization where necessary, a proper selection and perspective in governmental functions performed, central control of local finances, effective but flexible tax rate and debt limitations, and an informed and interested citizenry. Although we may stoutly insist that since we have been and are buying less of other things we should like also to buy less government, the fact remains that modern complex communities demand large expenditures for social services. Unless we are willing to forego these services, and apparently we are not, we cannot greatly reduce tax burdens. The larger the proportion of the social income taken by government the more important it becomes that the burden be fairly distributed. Inequalities are due to a number of circumstances, among which are the nature of the taxes employed and faulty administration.

A second modern issue in taxation, a serious problem for practically all governmental units, is that of balancing budgets. Expenditures were lately geared to flush times. They did not decrease as revenue fell off. In fact certain expenditures such as those for relief had to be increased. The important thing is to attempt to adjust income to outgo by courageous but wise economy and by increased taxation however momentarily regretful that may be. For the future the task is to build up reasonable reserves in prosperous years and at the same time to relate expenditures to the average and not to the peak of the social income.

Closely related to this second issue in taxation is a third one, namely, what taxes shall be used—property, income, sales, transactions, severance, or some other? It is not new to say that in California, as elsewhere, relatively less emphasis than heretofore should be placed upon the property tax. A reduction in the relative burden of the property tax with still more reliance upon other forms of taxation is one of the needs of the day. The income tax can readily be adjusted to ability to pay. It therefore should be given consideration for wider scope in modern tax systems. That it is a class tax, that in a time of depression it does not constitute a sufficiently broad base for taxation, that it is complex—these, for example, are not completely conclusive objections but rather suggest obvious directions of reform and adjustment. For various reasons the income tax should be neither weakened nor abandoned, but strengthened, improved, and extended. Sales taxes in general possess the virtue of productivity but the defect of inequality. They take a larger percentage of small than of large incomes. Consequently from the point of view of equality in the distribution of the tax burden they should be used with reserve and discriminating care. Although we may call them reëmployment, relief, or school taxes,[27] these psychological devices will not alter the facts respecting the distribution of the total tax burden nor will they alter the fact that these taxes, as well as some others, will tend to have certain inescapable, repressive effects upon industry. The use of any given tax should be determined not alone upon the basis of the merits or demerits of the particular tax, but also upon the basis of its place in a properly organized and properly coördinated system of taxation in order that the entire burden of taxation may be equitable in its distribution.

A fourth issue in modern taxation relates to the use of public credit. When is it legitimate or justifiable to borrow? Without here suggesting an answer to that question, we may say in general that, contrary to practice in the past, there should be much wider use of the pay-as-you-go policy, first, because this would bring down the ultimate cost of government by reducing existing expenditures made up of interest charges and redemption of principal on public debt and, second, because it would operate to preserve and improve the public credit so that it would be available as a resource in time of emergency.

A final issue in modern taxation that may be mentioned relates to the broad problem of establishing standards in a fiscal system. These standards are largely in the realm of the ideal. We cannot attain but can only approximate them. One of them already noted is the achievement of equality in the distribution of the ever growing tax burden. Another has to do with elasticity in the revenue system, that is, the expansion and contraction of revenues in accordance with changing revenue needs so as to prevent either too great deficits or excessive surpluses. A third standard involves flexible adjustment to new conditions. Frequently the difficulty is due to the fact that features of tax laws which should be purely legislative are written into the constitutions. The basic law should contain only general provisions applicable over changing periods and under changing economic and social conditions. Finally, there is the ideal of a coördinated tax system with properly selected and related taxes assigned to definite taxing jurisdictions in order to limit indiscriminate duplicate use by different taxing authorities of the same sources of revenue. Without such a system, with merely some happy-go-lucky and catch-as-catch-can hodgepodge, we cannot hope to provide necessary revenue, to satisfy the taxpayer, and in general to settle these modern issues in taxation which relate to its burden, the balancing of budgets, the question of what taxes to employ, the use of public credit, and the determination of proper standards in the collecting and spending of public money.

NOTES TO CHAPTER I

[1] This return of the utility property to local tax rolls, effective January 1, 1935, with its accompanying necessity for equalization of assessed values between utility and common property was an aspect of the so-called Riley-Stewart act passed by the 1933 legislature. This act is discussed in detail in chapter vi of this study.

[2] These reports included: *Preliminary Report of the Commission on Revenue and Taxation of the State of California* (August, 1906), 71 pp.; *Report of the Commission on Revenue and Taxation of the State of California* (1906), 296 pp.; *Report of the Commission on Revenue and Taxation* (Sacramento, 1910), 77 pp.; *Foreword on Taxation in California, State Tax Commission* (August, 1916); *Report of the State Tax Commission of the State of California* (1917), 280 pp.; *Special Report of the California Tax Commission—The Taxation of Banks, Corporate Franchises, Securities and Solvent Credits* (August 10, 1928); *Final Report of the California Tax Commission* (Sacramento, March 5, 1929), 305 pp.; *Report of the Joint Legislative Committee on Taxation*, in *Assembly Daily Journal* (January 23, 1931); *Summary Report of the California Tax Research Bureau* (December 1, 1932); and *Report of the California Tax Research Bureau* (January 23, 1933).

[3] *Report of the State Tax Commission* (1917), p. 9.

[4] Governor C. C. Young in announcing his appointments to this body remarked that he had purposely chosen a commission of an even number "partly to give equal representation to both ends of the state and partly to insure that no action shall be taken or recommendation made by majority of a single vote." The Governor further said: "In appointing the Commission, I have refrained from attempting to represent special classes, interests or occupations. I have also refrained from naming those actively connected with tax problems, such as county assessors and the like. Having assumed that much of the work of tax investigation will be performed by recognized tax experts employed for the purpose, I have tried to select an impartial body of men who shall pass upon the work of those experts and who are so well known throughout the State that their fairness, integrity and ability will be widely acclaimed."

The tax commission membership was as follows: Irving Martin, Stockton publisher, chairman; H. L. Carnahan, former corporation commissioner; Senator W. J. Carr, railroad commissioner; R. B. Hale, San Francisco merchant; Dr. John R. Haynes, regent of the University of California; A. R. Heron, director of the State Department of Finance; Ray L. Riley, state controller; and Chester H. Rowell, publicist. Professor Robert M. Haig of Columbia University was retained as the tax expert of the commission.

[5] *Final Report of the California Tax Commission* (March 5, 1929), p. 73.

[6] *Ibid.*, p. 75. The report then develops in some detail the aspects of the proposed new tax system (see pp. 75–132).

[7] The ten recommendations are set forth in the opening pages of the report, pp. xxii–xxiv. The first four recommendations are as follows:

"First: That the operative real estate of all public utilities be valued by the state and then returned to the counties to be added to the local tax rolls and subjected to the same tax rates as are imposed upon the real estate of corporations and individuals.

"Second: That a franchise tax be imposed by the state on all public utilities measured by their net income in the same manner and at the same rate as the similar tax on banks and other corporations.

"Third: That the state levy a direct tax on property in general, including the real estate of the public utilities, to make good any deficiencies in revenue which may arise after the adjustments herein recommended are made.

"Fourth: That the personal property taxes of corporations now paid to the localities and then offset against the new franchise tax be abolished (suitable compensation being made to the localities for the loss of revenue involved) and that the rate of this franchise tax, applying to all corporations, banks and public utilities, be then increased from 4 per cent to 5 per cent, in case the experience during the next three years indicates that such an increase is desirable."

[8] *Report of the Joint Legislative Committee on Taxation*, in *Assembly Daily Journal*, January 23, 1931, p. 24.

[9] *Ibid.*

[10] *Report of the State Board of Equalization* (1929–1930), pp. 30–31.

[11] *Final Report of the California Tax Commission* (1929), p. 73.

[12] *Report of the Joint Legislative Committee* (1931), pp. 20–21.

[13] *Ibid.*, p. 21.

[14] *Ibid.*, pp. 20–21.

[15] *Final Report of the California Tax Commission* (1929), p. 95.

[16] *Report of the Joint Legislative Committee* (1931), pp. 36–37 (statement of Assemblyman Isaac Jones):

"I believe the tax situation as it exists in California not only justifies but emphatically demands that a personal income tax be provided. The constitution authorizes a personal income tax. The Tax Commission of 1917 suggested a personal income tax and the Martin Commission recorded a belief in the justice and equity of taxation that would come about with the enactment of a law providing for a well considered income tax. . . .

"I believe that the people of California will approve a personal income tax. I am certain that the enactment of a personal income tax law will provide a more equitable spread of the tax burden. Therefore, I approve Recommendation No. 6 of the Martin Commission but feel that it does not go far enough and believe that the commission should have emphatically recommended that a personal income tax law be enacted for the State of California."

[17] *Ibid.*, p. 22.

[18] *Ibid.*, p. 23.

[19] *Ibid.*

[20] *Final Report of the California Tax Commission* (1929), pp. xxiv, 103.

[21] *Ibid.*, p. xxiv.

[22] *Report of the Joint Legislative Committee* (1931), p. 24.

[23] *Ibid.*, pp. 10–11.

[24] *Ibid.*, p. 27.

[25] *Report of the State Board of Equalization* (1929–1930), p. 9.

[26] Professor Elmer D. Fagan, Stanford University, "Fiscal Policy in California during the Depression," in Tax Policy League, *Taxbits*, vol. II, no. 3 (January, 1935), p. 12.

[27] See statement by State Controller Ray L. Riley in National Tax Association, *Proceedings* (1933), pp. 133–134.

II. SEPARATION OF SOURCES OF REVENUE

THE INTRODUCTORY CHAPTER to this volume already has briefly portrayed the distinctive character of the California system of taxation as it existed for the quarter-century from 1910 to 1935. That system traced its origin to the report of the 1906 California tax commission.[1] This commission studied the problem from the standpoint of the actual working of the property tax, which then constituted the mainstay of state as well as of local revenues.[2] Its main purpose, in the words of a later commission, was "to devise methods which would bring about a complete and accurate assessment of an objective and impersonal property tax in the State of California. With this end in view it recommended the plan which has come to be known as separation of sources."[3] This plan, since that time, has been subjected to so much criticism that we are likely not to appreciate the background of the recommendation made by the 1906 commission. The purpose of this chapter will be to trace something of the history of separation in California—its theory and problems, the claims made for it, objections urged against it—and finally to attempt a brief evaluation of it based on the experience of a quarter-century.

The 1906 commission found the property tax then in force so unsatisfactory as to call for fundamental change in an attempt to eliminate the evils permeating the whole tax structure. The commission, in its preliminary report, listed some sixteen faults of the old tax system which had been set up in the Constitution of 1879.[4] It was full of inequalities[5] which imposed a handicap upon the growth of the state, particularly placing an undue burden upon agriculture, the foundation of the wealth of the state; it failed to reach personal property; money and credits escaped taxation almost entirely; banks were inequitably taxed; "equalization," so-called, did not equalize and could not do so; original inequalities in assessment were "intensified by the constant piling up of tax on tax on the same base"; revenue obtained from large general corporations like the railroads, and rightfully belonging to the people of the state as a whole, was distributed "most inequitably among the local divisions of the State which have no proper claim to it whatsoever"; the system was a "school for perjury," put a "penalty on honesty," and paid "high premiums for dishonesty."

[1] For notes, see below, pp. 42–48.

This indictment of the old system called for something constructive to replace it. The answer, as already stated, was separation of sources of revenue, under which plan the state would relinquish the property tax and in lieu thereof would acquire certain definite revenue sources of its own, whereas the localities would continue as before with the property tax. The plan as thus conceived and developed involved an experiment more extensive and extreme than had been undertaken in any other state[6] and differed in two important respects from the procedures followed in other states. "Separation was adopted without a preliminary development of special taxes; and valuable public utility properties were withdrawn from the local tax base."[7] The purposes of such a program were listed as follows:

"First. To separate State from local taxation as to sources of revenue, so as to abolish the necessity for equalization between counties and to enable the counties and cities to raise more money for local purposes, if they so desire, without, as now, being punished for so doing by being compelled to pay an increased amount of State taxes.

"Second. To lessen the burden of taxation on the now overtaxed farmer and small real estate owner.

"Third. To insure a steady, adequate and non-political taxation of public-service corporations and of the banks."[8]

Prior to its achievement in 1910, there had been an earlier attempt at separation of sources. The proposals of the 1906 commission found embodiment in a constitutional amendment submitted to the electorate in 1908. The proposition, however, did not carry, the vote being 87,977 for it and 114,104 against it.[9] Several reasons were subsequently assigned for the failure of the measure to carry as originally submitted. A reorganized tax commission, reporting in 1910, listed the following criticisms which had been directed against the amendment of 1908: (1) no provision had been made for meeting a possible deficit without again amending the Constitution; (2) public service corporations had not been made clearly liable for their share of past bonded indebtedness; (3) in the event that a state tax on property had been found necessary, the property of the corporations taxed for state purposes would have been exempt from the levy; (4) no provision had been made for varying the rates imposed on corporations.[10]

The defeat of the 1908 measure, however, did not discourage the tax reformers. As the 1931 legislative committee remarked, the vote "was not regarded as indicative of public satisfaction with the existing system or of absolute condemnation of the plan proposed as a substitute therefor."[11] Accordingly, with the commission unanimous in the view that the measure should again be submitted, a new amendment, substantially the same, but meeting the objections raised against the former one, was placed upon the ballot. "At the election of November 8, 1910, 141,312 votes were cast in favor of the adoption of the amendment and 96,493 against it."[12] Thus was introduced the adjustment that for twenty-four years was destined to be the distinctive aspect of the tax structure of California.[13] In order to give a clear and concise impression of the tax system just before and after the adoption of Amendment No. 1, as it came to be known, there are reproduced here, from the *1929 Report of the California Tax Commission,* two tables, one of which outlines the tax system as of July 1, 1910, and the other as of July 1, 1911.[14] A perusal of the amendment which appears as Appendix A to this volume will shed further light upon the new tax system.[15]

Amendment No. 1 did not solve all the state's tax problems. Before we delve, however, into such matters as the underlying theory of separation, the claims made for it, and the difficulties induced by it, it will be well to abstract briefly the principal provisions of the amendment.

Essentially its purpose was to separate the objects of state taxation from those of local taxation. To this end there was reserved exclusively and entirely for the state, except as otherwise provided, all taxes levied and collected upon railroads, including street railways; car, express, telegraph and telephone, gas or electric, and insurance companies; banks; and franchises. All railroad and street railway, car, express, telegraph and telephone, gas or electric companies were to pay annually a gross receipts tax at varying percentages fixed in the amendment for each class of public service corporation. When companies operated partly within and partly without the state, gross receipts within the state were defined as "all receipts on business beginning and ending within this state, and a proportion, based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into, or out of this state."[16] Insurance companies doing business with the state were to pay a tax upon gross premiums less return premiums and reinsurance with provision for deduction from the state tax of real estate taxes paid locally. Banks were to pay a tax upon the basis of the value of capital stock to be determined with reference to capital, surplus, and undivided profits minus the locally assessed value of real estate. Educational expenditures were given a preferred claim against all state revenues. Provision was included for the levy upon all property, including that specifically enumerated as reserved for state taxation, of an ad valorem tax to meet any deficiency in state revenues. All the enumerated property, with the exception of that of the banks, could be levied upon to meet principal and interest of outstanding local indebtedness existing prior to the adoption of the amendment, the taxes thus paid being deducted from the total amount paid in taxes for state purposes. Finally the amendment provided for reimbursement to counties for loss of revenue occasioned by the withdrawal of railroad property from local tax rolls. Although there was no specific statement in the amendment itself to that effect, the rates applicable to the different classes of corporations, the taxation of which was reserved to the state, were adjusted so that the average tax for each group was approximately equal to one per cent of the full value of the property.[17] In this way an attempt was made to equate the tax burden upon the corporations with that upon common property taxed by the localities. The 1906 commission had estimated one per cent upon full value to be the extent of the burden borne by property locally taxed.[18] It was assumed throughout the separation period in California that the law required an equality of tax burden between common and corporate property.

Having now traced the background and observed the provisions of Amendment No. 1, we next may outline the basic theory upon which the sponsors of separation rested their case. Throughout this part of the discussion it must be remembered that the objective of the new plan was a more equitable distribution of the tax burden. Separation was defended upon the basis of source of privilege granted, the nature of property, that is, whether general or local in character, the benefit principle, and the factor of need. The *1906 Report* put the theoretical argument as follows:

"The right to do business that is enjoyed by corporations is a privilege granted by the state, and not by the cities or counties. Therefore, any tax that may be levied upon the revenues derived from the enjoyment and use of the state privileges used by corporations, especially public service corporations, ought to be paid into the state treasury for the support of the state government, from which the privileges are derived, rather than into city and county treasuries.

"Obviously there is a perfectly clear line of demarkation between

TABLE 1

CALIFORNIA STATE TAX SYSTEM AS OF JULY 1, 1910

Legal citation	Title	Basis	Measure	Rate	Administration	Disposition of yield		Yield, 1910-11
						State	Local	
Political Code, secs. 3607, 3831	General property tax	Real property, personal property (tangible and intangible)	Full cash value	Fixed annually by State Board of Equalization to yield amount biennially fixed by legislature	State assessment of certain railway property. County assessment of other property. State levy. County collection	General fund	..	$8,379,000
Statutes 1905, p. 311, as amended	Inheritance tax	Transfer of property by will or intestate or homestead law or in contemplation of death	Appraised value of property less deductions	1-15%	State appraisal. County collection	$250,000 to school fund. Excess to general fund	..	1,507,000
Statutes 1905, p. 493, as amended	Corporation license	Filing annual report	Par value of capital stock	$10 on capital stock under $10,000 to $250 on capital stock over $5,000,000	State	General fund	..	872,000

Political Code, secs. 3839-3862	Poll tax	Male inhabitants 21 to 60 years	Flat sum	$2 for each person	County	School fund	..	$ 739,000
Political Code, sec. 416	Corporation organization fee	Filing articles of incorporation	Par value of stock	$15 to $100 tax on stock under $1,000,000; $50 per $500,000 over $1,000,000	State	General fund	..	280,000
Political Code, sec. 622*a*	Foreign insurance tax	Gross premiums	Value of gross premiums less return premiums and reinsurance	2%	State	General fund	..	112,000
Statutes 1905, p. 816, as amended	Motor vehicle license	Registration	Flat sum	$2 per car	State	General fund	..	41,000

TABLE 2

CALIFORNIA STATE TAX SYSTEM AS OF JULY 1, 1911

Legal citation	Title	Basis	Measure	Rate	Administration	Disposition of yield		Yield, 1911-12
						State	Local	
Statutes 1911, p. 530	Public utility gross receipts tax	Operative property	Gross receipts from operation	Railroad companies, 4% Car companies, 3% Express companies, 2% Telephone and telegraph companies, 3½% Gas and electric companies, 4%	State assessment, levy, and collection	General fund	..	$6,617,000
Statutes 1911, p. 530	Bank share tax	Shares of capital stock	Value (amount paid in plus pro rata of surplus and undivided profits)[a]	1%	State assessment, levy, and collection	General fund	..	1,628,000
Statutes 1911, p. 530	Franchise tax on corporations	Franchise	Actual cash value	1%	State assessment, levy, and collection	General fund	..	1,620,000

Constitution, Art. IV, sec. 22	General property tax	Real property, personal property (tangible and intangible)	Full cash value	Fixed annually by State Board of Equalization to yield $1,250,000 annually	State assessment of certain railway property. County assessment of other property. State levy. County collection	Panama-Pacific International Exposition	..	$1,467,000
Statutes 1911, p. 713	Inheritance tax	Transfer of property by will or intestate or homestead law or in contemplation of death	Appraised value of property less deductions	1-25%	State appraisal. County collection	$250,000 to school fund. Excess to general fund	..	1,083,000
Statutes 1905, p. 493, as amended	Corporation license	Filing annual report	Par value of capital stock	$10 on capital stock under $10,000 to $250 on capital stock over $5,000,000	State	General fund	..	844,000
Political Code, secs. 3839-3862	Poll tax	Male inhabitants 21 to 60 years	Flat sum	$2 for each person	County	School fund	..	802,000

[a] Less assessed value of real estate.

(Continued)

TABLE 2—(*Continued*)

Legal citation	Title	Basis	Measure	Rate	Administration	Disposition of yield		Yield, 1911-12
						State	Local	
Statutes 1911, p. 530	Insurance gross premiums tax	Gross premiums of all insurance companies	Value of gross premiums less return premiums and reinsurance	1½%	State assessment, levy, and collection	General fund	..	$ 521,000
Political Code, sec. 416	Corporation organization fee	Filing articles of incorporation	Par value of stock	$15-$100 up to $1,000,000 stock; $50 per $500,000 over $1,000,000	State	General fund	..	328,000
Statutes 1905, p. 816, as amended	Motor vehicle license	Registration	Flat sum	$2 per car	State	General fund	..	63,000

property local in character which should be subject to local taxation and property or industries general in character which should be subject to general or state taxation.

"To accomplish separation it is necessary to define clearly and sharply the boundary line between state and local powers of taxation. This boundary line having been once defined, neither of the two parties shall trespass upon the territory set apart for the other."[19]

Pursuing the theoretical argument farther, the 1906 commission contended that local activities "redound distinctly, directly, and peculiarly to the benefit of local real estate owners, or local industries and enhance and sustain the value of real estate and of other tangible property in the localities. On the other hand the activities of the state are all broad and general. Corresponding almost precisely to the general activities of the state government, we find the properties and business of the great public service corporations which pervade the whole state. There is little or nothing localized about them, nor do they benefit, save, possibly, in so far as their local franchises are concerned, in the same peculiar and direct manner as does private individual real estate by the activities of the local government. There is, thus, ample theoretical ground for making a separation as to the sources of state taxation from those of local taxation."[20]

Thus it is seen that the 1906 commission rested separation largely upon the bases of the source of privileges granted corporations, the general, nonlocal character of public utility and other corporation property, and the source of benefits accruing to property. With these views the 1929 commission did not entirely agree. It could not well agree and still recommend, as it did, the abandonment of the separation of sources plan, an outcome transpiring in 1935.[21] The 1929 commission, in thus taking issue upon theoretical grounds with the earlier body, itself was laying the foundation for its advocacy of a return of utility property to the local tax rolls.

The later commission argued that there was no generally accepted line of division between property which was local and that which was general in character. Granting, it said in effect, that the value of public utility property was traceable to other than local causes, yet the same thing would hold true for other values that were retained under separation as a part of the local tax base. It pointed out that, although the 1906 commission emphasized the general, nonlocal character of public utility property, separation as administered resulted in the exemption from local taxation of ordinary city office buildings owned by utilities, property which, on the basis of the theoretical distinction involved, should have been proper object of taxation by local units. It questioned the proposition that the value of real estate was attributable solely to local causes[22] and insisted that due regard must be given to the benefits which the property received from governmental activities on the part of the county in which the property was situated and to the expense which the property occasioned the county government unit. Finally, after noting that the state's claim to exclusive taxation of utilities could be defended upon the basis of administrative efficiency rather than upon that of need for revenue as contrasted with the localities, the 1929 commission concluded that the theoretical arguments advanced in 1906 were "more cogent when applied to the intangible or franchise element in a utility property than to its real estate."[23]

Whatever the merit of this theoretical controversy, the fact is that under the Riley-Stewart act of 1933 utility property was returned on January 1, 1935, to the local tax rolls. This restoration was based on the theory that the geographical location of property should determine its situs for taxation. This, concedes Professor Plehn, responsible for the 1906 recommendation, is a tenable and defensible theory. "But I have held and still hold that properties like railroads should be taxed by the state because the physical or geographical location does not stand in any proper relation to government needs. Why should San Bernardino County, for example, tax upwards of 800 miles of railroads in sparsely populated districts when San Francisco can tax only 16 miles?"[24]

We have thus far reviewed the history, provisions, and theory of Amendment No. 1. Let us now turn to a consideration of the various claims which were advanced for separation at the time this program of taxation was first presented. We may at the same time consider whether or not these claims were realized in the years following the adoption of the plan.

The 1906 commission listed an imposing array of advantages and objectives which it felt would be attained through the adoption of the new tax plan. Among these were the following: (1) full-value assessments of common property; (2) the elimination of the necessity for equalization among counties; (3) a natural distribution of functions of assessment; (4) "home rule" in taxation; (5) certainty and definiteness in the asssessment of corporations; (6) relief to real estate; (7) stability of rates; (8) equitable distribution of tax burden among classes and among individual corporations; (9) progress toward tax reform. Aside from these alleged advantages there would seem to have been a number of others, though possibly less obvious ones. Let us consider each in order.

The 1906 commission argued, seemingly logically enough, that if the state did not use a property tax, that if there were no state levy superimposed upon the local tax base, the chief incentive to a low valuation upon property would be removed. In fact the commission was so sanguine as to remark that then there would exist inducements to an assessment more nearly approximating the full market value in order that the assessor might avoid the charge of favoritism among citizens and in order that the local district might enjoy the advertising advantage of a low tax rate.[25]

Unfortunately the hopes of the commission with respect to assessments were not realized. The 1929 commission pointed out that conditions were worse in 1928 than in 1906,[26] and that, based on statements of assessors to the commission, the ever present possibility of a state ad valorem tax (a provision of the amendment which could be invoked in the event of a deficit in state finances) had been a factor holding county assessments down. The commission found the 1928 assessment ratio for real estate to have been 41.63 per cent,[27] whereas in 1906 it had been estimated at 60 per cent.[28] The most recent determination has been that employed by the State Board of Equalization as its basis for equalizing thoroughout the counties the assessed values of common and utility property in order to carry out the provisions of the Riley-Stewart act. The board found the average assessment ratio for common property to range from 26.24 per cent in Modoc County to 58.69 per cent in Mono County.[29] The evidence is convincing that assessment of property was not improved as a result of separation and one may conclude with the 1929 commission and with others that "improvement in local assessments seems to come with increasing state supervision, and not with separation."[30]

A second advantage of separation envisioned by the 1906 commission was the elimination of the necessity for equalization among the counties. This gain was of course largely realized.[31] The relinquishment by the state of the property tax meant that differences in assessment ratios among the counties were no longer of any particular concern. Equalization difficulties, however, did not disappear. On the contrary, an equalization problem of a new type arose during the experience with separation, and became so pronounced in character as to justify an argument for the abandonment of separation as a means of escape from the perennial dilemma. Throughout the entire period from 1910 to 1935, it was held that the rates applicable to the gross receipts of the various classes of public service corporations must be at levels which would equalize the tax burden upon them, upon a property basis, with the tax burden resting upon common property. Hence it became necessary to determine, first of all, the tax burden per $100 of actual value resting upon common property. This in turn involved the necessity of appraisals of property values in order that they might be compared with total taxes collected and the tax burden thus determined. In the second place, values of public utility properties had to be determined. This in turn involved many difficult questions of what method, or combination of methods, to employ in order to arrive at these values. Once these questions were answered it was then necessary to apply to the gross receipts of the corporations such rates as would yield sums which, when compared with the values of the utility properties as previously arrived at, would constitute the same burden upon utility property taxed upon a gross receipts basis as rested upon common property taxed upon an ad valorem basis.

It is obvious that herein lay many intricate questions, a complete discussion of which would carry us much beyond the reasonable confines of this chapter. The student wishing a detailed analysis must resort to the official literature, which is replete with discussions of this particular phase of the separation of sources program in California.[38] Enough may be said, however, to give some idea of the omnipresence of the problem. It must not be forgotten here, moreover, that the equalization task was really a twofold one, for there was the additional and accompanying problem of equalizing burdens among the different classes of corporations.

The original rates were established upon the assumption that general property was bearing approximately a one per cent burden. The 1906 commission reasoned that property values in the last analysis depended upon earnings and so arrived at these values through the capitalization process. Having determined the ratio of net earnings to gross earnings for each class of utility, the commission then determined by formula[39] what rate applied to gross earnings would equal the given percentage of property value as determined by the capitalized earnings.

This original determination of rates was but the beginning of a long series of adjustments in rates (at least six of them) in the effort to equalize the burden upon corporations and upon common property. Whether or not these adjustments were legally necessary was beside the point in the light of the legislative view that equalization was required.[34] Even if an equality of burdens was theoretically impossible, yet practically a serious attempt to achieve equality was "demanded in California, chiefly because of the exemption given utilities in local taxation."[35]

Perhaps a brief reference to the difficulties encountered by the 1929 commission in carrying out its instructions to "report upon the matter of the relative burden of taxes borne by general property values and such property values as are taxed directly by the state under the existing system of taxation"[36] will suffice to illustrate the complexity of the task of equalizing tax burdens with which tax administrators and legislators were continually faced from inception of the separation plan.[37]

The commission begins and ends with the same theme—the troubles encountered in the effort to make reasonably sure that the tax burden borne by the classes of corporations taxed by the state was fair in view of the tax burden borne by common property. Efforts to refine the process of determination of relative burden were held merely to demonstrate the inherent difficulties involved, "if not the complete futility of any attempt to arrive at a strictly scientific conclusion."[38]

In discussing the appraisals of public utility property the commission observed that the selection of the method of valuation was itself a "contentious matter," that the state used now one method and now another, and that the utilities showed a similar inconsistency. No one single method was adequate, apparently, to yield satisfactory results under all circumstances. The commission therefore pursued an eclectic policy in making appraisals upon a number of different bases, such as a stock and bond valuation, capitalization of net income at 6 per cent, historical cost less depreciation, and reproduction cost less depreciation, and derived from these an estimated fair value for purposes of taxation.[39] The commission further noted that all the various methods available, whether utilizing engineering or financial data, yielded only approximations and had to be used with discretion. Then there followed a discussion of the relative merits (or demerits) of the several bases of valuation, accompanied by illustrations of the reiterated observation that no one method was universally suitable. For instance, certain of the large railroads desired the stock and bond method, which would have broken down altogether if applied to the short-line railroads. Whereas the gas and electric companies generally favored reproduction cost less depreciation, such a method "would work an intolerable injustice upon the electric railway group."[40] The commission noted "that in a very large number of cases the theoretical basis which is defended as being most satisfactory for tax purposes is the basis which happens to yield the smallest figure for that particular utility."[41] Finally the commission pointed out that tax value and rate value were two fundamentally different things and that therefore what was proper for one purpose would not be proper for another.

Coming back to the problem of equalization—this time as between groups of utilities and as between individual companies within the same group—the commission presented figures, based upon its valuation data, to show the difficulty of imposing equal burdens.[42]

Following this discussion of the problems involved in public utility valuations, there appeared a review of those involved in the appraisals of common property and in the determination of the total taxes borne by it in order that from these facts there might be determined the burden of taxation resting upon such property. On the basis of its estimates the commission was inclined to select a figure somewhere between 1.52 per cent and 1.73 per cent.[43] It then suggested certain adjustments in rates of gross receipts taxes which would in its judgment be necessary in order to equalize the tax burden between utility and common property.[44]

Having done all this, in accordance with its instructions, the commission concluded with the following statement: "Not only is the determination of the rates of the gross receipts taxes a task incapable of satisfactory solution, even with the most refined technique available, but the gross receipts method itself, even when applied to a revised and complicated grouping of the utilities, yields results which from the point of view of equity are crude beyond any reasonable limit of tolerance."[45]

Space does not permit a further elaboration of the hope of the 1906 commission that, with separation of sources introduced, equalization difficulties would vanish. One equalization problem was eliminated, but a new and perplexing one took its place. As far back as 1917, the tax commission of that year criticized the "costly and unsatisfactory" equalization procedure, and the view expressed in 1929 simply restated and fortified the conviction of earlier observers. Inequalities in taxation in California existed before separation, they existed during it, and they will undoubtedly exist after it.[46] We must seemingly under any system reckon with the necessity for continuing adjustment if we are to approximate the ideal of equality. Like any other standard in a tax system, equality is a relative value and not an absolute one.

The next two and closely related claims for separation—that it would result in a natural distribution of the functions of assessment and provide "home rule" in taxation—may be considered together. The thought back of the first of these claims was simply the now familiar one that the local assessors were not competent to assess corporate property. The 1929 commission observed with respect to this argument that "the central assessment of corporate property may be contemplated without at the same time proposing that the entire yield from the taxes on such corporations should accrue to the state."[47]

The "home rule" claim for separation was expressed in 1906 by the commission when it said that "within strictly defined limits the county, or, respectively, the city, should be permitted to determine its own policy concerning the raising of revenue. This does not preclude general laws intended to bring about a certain amount of uniformity as to methods, but it does preclude that constant deference to the effect of state or other surtaxes which tends to divert the attention of the assessing officers from their primary duty, which is to establish uniformity and equality of taxation between man and man."[48]

There was in 1906, and still is at the present time, considerable "home rule" sentiment in California.[49] However, the verdict seems justified, particularly in the light of later developments,[50] that the strength of the sentiment for and the advantages of "home rule" have been overemphasized. "Home rule" as implying merely a relief from the friction accompanying the ordinary type of equalization procedure is one thing. This, perhaps, is mainly what the 1906 commission had in mind. "Home rule" which involves the complete absence of central control or supervision of local assessments is another thing. There is now general agreement that separation was defective in so far as it involved the sacrifice of this desirable centralized responsibility.[51] Separation of sources with its attendant "home rule" has been criticized also upon the grounds that it provided little *positive* freedom to the local governments in taxation and that it resulted in an inflexible system of state and local revenues.[52]

As to the claim of certainty and definiteness in the assessment of corporations, various practical advantages were expected to result from the use of a gross receipts tax. Ease of computation of the tax in advance and of administration; greater certainty because of the lessened likelihood of shifting of gross receipts taxes; a solution of the problem of taxing the franchise value of public utilities—all these were contemplated as gains to be realized under the new system. In part these expectations were fulfilled and in part they were not. The 1929 commission, reviewing these claims, concedes the ease of computation of gross receipts taxes. Ease of administration it considered as having been partly achieved, the limiting factor being the equalization problem, which has already been discussed. As to shifting, the commission expressed the view that under a system of public utility regulation "a substantial portion of the public utility taxes are shifted to the consumers of the services offered by the public utilities."[53] Only a partial solution, it felt, had been found for the problem of the taxation of franchises. This was due to the perennial question of the adequacy of the tax rates and the degree to which, in this connection, franchise values should be considered as a factor in measuring relative tax burdens.

Relief to real estate, the next claim advanced for separation, has a strangely familiar current sound. It was quite natural, in view of the relinquishment by the state of the property tax, to expect that the burden of that tax would be reduced. "As the overtaxation of real estate is far and away the very worst evil of our present system," reads the *1906 Report*, "the Commission feels particularly gratified that it has been able to devise a plan which will afford this class of taxpayers so substantial relief."[54] The expected relief, however, failed to materialize. It was early appreciated that the abolition of the state ad valorem tax was likely to be followed by increased local levies upon property, thus defeating one of the purposes of separation of state and local taxes.[55] In San Francisco County, property tax rates from 1908 to 1915 were as follows:[56]

1908–1909	State and local rate combined	$1.90
1909–1910	State and local rate combined	1.96
1910–1911	State and local rate combined	2.00
1911–1912	Local rate only	2.00
1912–1913	Local rate only	2.05
1913–1914	Local rate only	2.20
1914–1915	Local rate only	2.25

The comment upon these figures was, "The basis of valuation, approximately 50 per cent according to the assessor, has remained unchanged. The table shows, therefore, that San Francisco, as a local taxing district, absorbed the savings promised to the taxpayer by the Revenue and Taxation Commission. Practically every local taxing district in the State has followed the same practice, with the result that the burden on real estate is as great or greater than before separation went into effect."[57] The 1929 commission likewise pointed out that the expected absolute relief did not develop, although it did not try to answer the question whether the tax burden on common property had been less than it otherwise would have been.

The seemingly assumed comparative stability in rates[58] upon the various classes of corporations selected for taxation by the state likewise failed of realization, as has already been indicated in the discussion of the rate adjustments made from time to time in order to equalize relative tax burdens. The 1929 commission remarked, apropos of this alleged advantage, that it was based upon certain assumptions which in time were revealed as unjustified. These assumptions were that the burden on common property would remain constant at one per cent; that the relationship between gross receipts and net income would remain reasonably constant; that the value of corporate property could be determined fairly accurately by capitalizing a net income determined inferentially from gross receipts; and that the revenue needs of the state would be amply provided for from the special taxes at the recommended rates.[59]

The remaining claims of the 1906 commission for separation may be presented briefly. The end sought—a more equitable distribution of burden among classes, that is, common and corporate property—has already been considered earlier in this chapter in connection with the discussion of the basic theory underlying the separation plan. As to the achievement of a more equitable distribution of burden among individual corporations, that, too, has been touched upon in preceding pages. Suffice it here to make but two remarks. First, it was the contention of the 1906 commission that a gross earnings tax in certain instances "would result in a far closer approximation to justice and equality than any other tax which this state could select."[60] Second, the 1929 commission, from its studies of the facts, concluded that the "approximation to justice and equity as among individual corporations... is rough indeed."[61] Finally, with regard to the claim that separation was "the one feasible pathway for tax reform,"[62] here again the later commission questioned, in fact denied, the conclusions of an earlier day.[63] It contended among other things that other states choosing a different pathway to tax reform had made more progress than had California in the development of a satisfactory tax system. It especially emphasized what the 1906 commission had rejected, "the significance of the development of the taxes on persons and on business based upon net income, instead of an exaggerated emphasis upon objective property taxes."[64] Inasmuch as a later chapter discusses the income tax, no further reference is made to it at this time.

Mention should be made of one or two other arguments which at the time were advanced by others in behalf of separation of sources of revenue. The first one had to do with the inadequacy of the property tax as applied to corporations. The general property tax was considered unsatisfactory from the standpoint of reaching the new classes of property which had arisen in the industrial and commercial world. Professor Plehn, author of the separation plan, remarked on one occasion that the assessment of power companies, made piecemeal by local assessors, was extremely low.[65] Nor was the assessment of telegraph and telephone companies satisfactory.[66] It was also contended, some years after separation had been adopted, that there could be "no possible return to a system which permits the assessment of corporate property by a hundred or more local assessors, the gerrymandering of 'shoestring' taxing districts, and the almost total escape of 'intangible' values, including national bank stock, franchises, etc."[67]

The second of these other arguments for separation was that it would take the corporations out of politics so far as taxation was concerned. Professor Plehn thus regarded the plan. Restricting the local assessors and boards of supervisors in their powers of taxation, he thought, would have healthful results. "It is one of the merits of the new system that it applies to the corporations a mathematical rule that takes their taxation out of politics."[68] In retrospect one cannot say that political activity on the part of the corporations disappeared. The frequent attempts to adjust the utility rates so that the corporate burden would be commensurate with that upon common property led to unseemly political struggles in the legislature. "It is a story," wrote the 1929 commission, "of friction and bickering which consumed vast quantities of energy which might better have been invested in more constructive ventures."[69]

With this review of the various advantages claimed for separation, let us turn to a brief consideration of some of the problems which arose in connection with the actual carrying out of the program. To this part of the discussion may be appended a mention of the several objections to separation other than those which already have been cited in appraising the claims of the commission in 1906. The chapter may then conclude with a summary evaluation of the separation plan.

Naturally various legal questions were early raised. These might be discussed at some length but to do so would be to depart from the purpose of this chapter, which is to consider basic principles rather than legal technicalities. The Board of Equalization in its 1911–1912 report quotes from the report of the Attorney General to the Governor. The Attorney General brought out several facts. Proceedings had been instituted even at that early date by every class of corporation specified in the amendment. Most of the cases, upon one ground or another, attacked the state assessment of the corporate franchise. Other cases concerned "the proper interpretation of the term 'gross receipts from operation' and the inclusion in such gross receipts of specific earnings." Other cases involved questions of double taxation, and two of them questioned the validity of the entire system of taxation upon the ground that the taxes imposed under the amendment contravened the Federal Constitution, which prohibits a state from imposing any burden upon interstate commerce.[70] Later cases involved the legal definition of operative property,[71] and so forth.

A second problem to which the successive reports of the State Board of Equalization and of the State Controller gave considerable attention was that of bond refunds. It will be remembered that the amendment provided for the taxation of public utility, as well as common, property to meet principal and interest of indebtedness outstanding prior to the effective date of the amendment.[72] Failure to include such a provision had been one of the factors responsible for the defeat of the similar measure in 1908. The argument had been that, since "the withdrawn property was legally taxable at the time the bonded indebtedness was incurred, in justice and fairness such property should remain taxable until the bonded indebtedness had been paid."[73] To carry out the requirement of the amendment, the legislature provided for the separate assessment of such withdrawn property by the local assessors, the filing of such "operative" assessments with the State Board of Equalization, and the equalization by that body of these assessments.[74]

To discuss completely this particular problem of bond refunds would result in undue emphasis upon a passing phase of the separation plan in California. There were a number of interesting aspects to the question not the least of which was the increase in these bond refunds, when of course a decrease normally was to be expected with the retirement of part of the indebtedness. This increase was attributed to a number of factors such as the disproportionately higher local assessments of operative property, the filing of claims by certain cities which formerly had been servicing the debt from the revenue derived from water plants or other municipally owned utilities, the local assessment of operative property that had come into existence since 1910, and the local assessment of corporate franchises.[75] There were likewise other aspects to the problem such as the varying local tax rates for meeting bonded indebtedness, the determination of the exact amount of indebtedness outstanding on November 8, 1910, the exception of irrigation and reclamation districts as entitled to refunds on the ground that their levies were assumed to constitute assessments rather than taxes, and the loss of interest by the corporations in property assessments when the state assumed the burden of paying the taxes to meet the bond obligations.[76] The problem, on the whole, was somewhat vexatious, but it nevertheless did not revolve around a fundamental principle of the separation plan.

There was next the problem induced by the withdrawal of operative railroad property from the local tax roll. The constitutional provision here read: "Until the year 1918 the state shall reimburse any and all counties which sustain loss of revenue by the withdrawal of railroad property from county taxation for the net loss in county revenue occasioned by the withdrawal of railroad property from county taxation. The legislature shall provide for reimbursement from the general funds of any county to districts therein where loss is occasioned in such districts by the withdrawal from local taxation of property taxed for state purposes only."[77] Thus the county was required to reimburse the district upon all withdrawn operative property; the state to reimburse the county upon withdrawn railroad property only.

The 1929 commission reviewed the history of this problem brought about by the withdrawal of operative property from local tax rolls. Various local districts, as has already been pointed out, were materially affected by this narrowing of the tax base.[78] Naturally they felt then, and continued to feel, that they were subjected to a discrimination;

that the more taxes lost through inability to levy upon utility property the more money must be raised by individual taxpayers to meet county expenses; and that they had something of a vested right in the taxation of the property located within their borders. This attitude persisted despite the very substantial compensation in the form of the removal of the state tax from the local property base.[79]

The 1917 commission took the position that, in fairness, adjustment should be made for net losses incurred by counties because of the withdrawal of all, and not merely railroad, operative property.[80] The 1929 commission referred to various groups that had made representations before it for return of utility property to local rolls,[81] remarked that accurate determination of hypothetical gains and losses was then difficult if not impossible, and finally said that "the Commission is convinced the 1906 commission went further than their reasoning justified."[82] This latter point suggested the difference between the two commissions on the basic theory of separation, a matter which has already been presented. At the election of November 4, 1930, there was presented to the electorate a proposed constitutional amendment[83] to reimburse the counties for losses from state taxation. The amendment, receiving unanimous approval of both houses of the legislature, was defended upon the usual grounds. "It changes nothing at all except it takes money out of the State treasury to pay those counties which at present are paying more than their share of State taxes."[84] It was criticized partly upon the ground of its uncertain consequences financially for the state and partly upon the ground that it was merely a palliative whereas the tax system was in need of thoroughgoing revision.[85] The amendment failed to carry.

Still another problem, upon which the 1929 commission felt called upon to comment, related to the exemption of publicly owned utilities from the gross receipts tax and the consequently alleged discrimination in their favor, as contrasted with the privately owned utilities, and in favor of the communities in which the publicly owned utilities operated as against the communities served by the private companies. The commission recognized that a substantial tax differential between publicly and privately owned companies did exist but felt that there were "mitigating circumstances" in the competitive situation with respect to the publicly owned companies such as arbitrary amortization requirements and the rule requiring a two-thirds vote for approval of bond issues. Likewise, as against the complaint of higher utility rates in communities served by private companies, the commission placed the doubt of complete shifting of gross receipts taxes to customers of utilities and the possible salutary effect of rates charged by publicly owned companies upon those charged by private companies, although it admitted such a factor could not be quantitatively measured. The commission concluded that the importance of the issue had been overemphasized from the standpoint of any revenues which the taxation of publicly owned utilities would have yielded and that, so far as discrimination against communities without public ownership was concerned, the problem largely could be solved through its proposed plan of returning utility property to the local rolls. "Under such a plan," it said, "if a community assumed the ownership of a utility, the effect would be to reduce its own tax base. Against this action the other communities would have no substantial ground for complaint."[96]

Still another problem arose. The classification of utilities for purposes of taxation has already been referred to in the preceding discussion relating to equalization of tax burdens under separation. The original classifications proved inadequate. The legislature of 1921 subclassified the electric railways, removing them from the railroad group. The rate on the former was retained at 5.25 per cent, whereas on the latter it was raised to 7 per cent. In 1926 by constitutional amendment the rate on the gross receipts of the short-line steam railroads was reduced to 5.25 per cent.[97] In 1930 by constitutional amendment the rate on the gross receipts of the street railways was fixed at 4.25 per cent. The amendment was urged as being necessary to meet the competition of private automobiles with the electric railways and to equalize the burden of taxation with that of common property at the rate of $1.79.[98]

Of more significance, perhaps, than these more or less incidental adjustments from time to time was the conclusion of the 1929 commission that "the possibilities of eliminating inequities and achieving fairness as among companies through a thoroughgoing revision of the existing grouping of public utilities . . . are very strictly limited."[99] This conclusion seems fully justified despite the view of the 1931 joint legislative committee, unwilling to accept the thoroughgoing revision advocated by the 1929 commission, that this part of the California tax tangle could adequately be dealt with if the legislature were empowered "to make such further classification and subclassification of utility groups . . . as may be necessary in order to achieve a more equitable distribution of the tax burden."[100]

Finally, in this review of the problems accompanying separation of sources of revenue, what should be said with respect to the incidence of the gross receipts taxes? There were varying views on this question. It has already been observed that the 1906 commission felt that these taxes would be "less likely to be shifted from the taxpayer to someone else than any other tax."[91] This was, however, as the 1929 commission noted, before the day of effective regulation of utilities. With this thought in mind it expressed itself as "convinced that a substantial portion of the public utility taxes are shifted to the consumers of the services offered by the public utilities,"[92] although elsewhere it expressed doubt that they are completely shifted, except that with respect to the electric light and power companies "the shifting is probably more nearly complete than is the case in some of the other groups."[93]

It has already been pointed out that certain communities served by privately owned utilities have complained against the tax exemption of publicly owned enterprises in other communities on the ground that where taxes exist they are passed on to consumers of the utility services with the consequence that consumers in these localities have to bear an undue proportion of the expense of supporting the state government. The utilities themselves, in their campaigns against the frequent upward adjustments of the gross receipts tax rates, disseminated the doctrine that such rates were but reflected in increased charges for utility services.[94] It is doubtful, however, if these utilities were always actuated by altruistic motives. Their interest, after all, was probably a selfish one. This does not imply necessarily that their argument was an entirely incorrect one. It may rather mean, as has often been pointed out, that friction accompanies the process of shifting. There may be a lag in rate adjustments to cover increased taxes and, moreover, such increases in rates as may be granted by the regulatory body may be insufficient to cover completely the added tax burden.[95]

In the last analysis, the question of shifting or nonshifting must be answered in the light of attendant circumstances. If regulation is lacking, if rates for service are already yielding the maximum returns, if there are abnormalities of demand, if competition exists, then taxes cannot be shifted easily if at all.[96] In general, the conclusions must be that some of these taxes in California have been shifted and some have not been shifted. But to give any precise quantitative statement is impossible.

In the discussion as it has developed, various objections to or difficulties in connection with separation of sources have been indicated. One further observation along this line may be presented. It relates to the fiscal aspects of separation. The plan has been charged, first of all, with contributing to extravagance in public expenditures. This charge has been based on various grounds, such as the opportunity afforded local governments to increase their property levies consequent upon the withdrawal of the state tax;[97] the absence of any direct state property tax, which led to the impression that corporations were footing the bill, thus encouraging the legislative body to spend more money than it otherwise would have spent;[98] and the loss of interest by corporations in local expenditures. The 1929 commission took cognizance of this charge of extravagance. It concluded that so far as state expenditures were concerned no statistical demonstration could be given to support the view that undue spending was encouraged by prevalence of the notion, if it existed at all, that corporations paid the state tax bill.[99] So far as local expenditures were concerned, they too, like state expenditures, increased, but the available evidence led to the conclusion that separation was not the cause of the increase, or at least not the major cause.[100]

A further criticism of the fiscal aspects of separation was directed against the rigidity of the rates, fixed in the Constitution and unchangeable except by a two-thirds vote of each house of the legislature. This provision operated in such a way as to prevent or delay any close adjustment between state revenues and state needs. There was the further fact, too, as has elsewhere been brought out, that the amount of revenue obtained for state needs was determined by an extraneous factor, namely, the adjustment of the gross receipts tax rates so as to approximate a burden upon corporate property equal to that on common property. These two criticisms were valid, although up until about the close of the decade of the twenties the separation plan seemed to meet fairly well the test of fiscal adequacy so far as the state government was concerned.

So far as the objections to the separation plan were concerned, we may conclude by reference again to the attitude of the 1917 and 1929 commissions. Each felt that the objections to separation were numerous enough and strong enough to justify the suggestion of alternatives to the existing separation plan.[101] The earlier commission had suggested three possible alternatives.[102] The 1929 commission favored a return of utility property to local rolls and in general advocated a broad comprehensive revenue system based upon property, business, and personal taxes. The property tax of an objective but restricted character would be primarily for local revenue, the business tax based on net income would provide essentially state revenue, and the personal tax, based upon ability to pay, would supply revenue to both agencies.[103] Much of what was recommended by this later commission, with modifications of course, has since been enacted into legislation. Most notable in this respect were the abandonment of separation with return of utility property to local rolls there to be taxed as is other property and the adoption of the state personal income tax. Each of these developments is discussed in ensuing chapters.

In retrospect one must say that separation largely failed to achieve the results claimed for it. On the other hand, there is danger of forgetting the evils of the tax system replaced by the new one in 1910. Agreement is general that separation was better than that which it replaced. If it is true that separation blocked the way to reform, it is also true that it brought with it some advantages. It did simplify in some ways the taxation of corporations, obtain a more adequate contribution from them, and provide sufficient revenues to carry the state government. Had conditions not changed so radically during the quarter-century, separation undoubtedly would have been more workable than ultimately it proved to be. The authors and sponsors of the plan were not prophets envisioning the indefinite future but practical men endeavoring to reform the tax system of their day. Perhaps much was claimed for separation that was not of its essence. If that be true, there then remains but little doubt that much of what was advanced in behalf of the amendment of 1933 will also be found in the searching light of historical perspective to have missed its mark. For it is a striking truth that, "of the arguments used *for* separation of sources in California twenty years ago, nearly every one was employed to secure the repeal of separation in 1933."[104]

NOTES TO CHAPTER II

[1] *Report of the Commission on Revenue and Taxation of the State of California* (Sacramento, December, 1906), xi + 296 pp. (hereafter referred to as the *1906 Report*). Professor Carl C. Plehn of the University of California, secretary of the commission, was largely responsible for the content of the report. In August a preliminary report of 71 pages had been issued.

[2] "The total cash revenues of the state government at this time amounted to approximately nine and one-half million dollars, of which nearly seven million was collected by means of a direct state tax on general property."—*Final Report of the California Tax Commission* (Sacramento, 1929), p. 13 (hereafter referred to as the *1929 Report*).

[3] *Ibid.*, p. 15.

[4] *Preliminary Report of the Commission on Revenue and Taxation of the State of California* (Sacramento, August, 1906), pp. 11–12.

[5] So far as the property tax was concerned these inequalities were due to the escape of large amounts of property from the roll, to the failure to appraise accurately such property as was assessed, and to the failure of the State Board of Equalization to correct the inequalities of assessments among the counties. See the *1906 Report*, p. 31.

[6] *1929 Report*, p. 42.

[7] *Ibid.*, pp. 42–43. "In California, however, almost no special state taxes, aside from inheritance and poll taxes, were employed prior to 1910. . . . The only special corporation tax was one on gross premiums of foreign insurance companies."

"The second important difference was the exemption of all operative property of public utilities from local taxation. The local districts were materially affected by this change. The city of Los Angeles, for instance, lost 14 per cent of its taxable property; San Francisco lost 15 per cent; and twelve counties lost from 20 to 35 per cent each of their taxable property. California, in exempting such property, carried separation of sources farther than any other state." These figures were gleaned by the commission from State Board of Equalization, *Special Report on Taxation Showing First Effects of Separation* (1911), pp. 12–13.

[8] From a *Preliminary Statement of the State Commission on Revenue and Taxation* (August, 1910). This statement will be found in Commonwealth Club of California, *Transactions*, 5 (1910), 386–392.

[9] William C. Fankhauser, *A Financial History of California* (*Univ. Calif. Publ. Econ.*, vol. 3 [1913]), p. 372. In the *1929 Report* the assertion is made (p. 18) that the measure was defeated by a vote of "nearly two to one." There is a noticeable discrepancy between the two statements.

[10] *Report of the Commission on Revenue and Taxation* (Sacramento, 1910), pp. 12–13. For further brief discussion along these lines see Fankhauser, *op. cit.*, p. 372, and Commonwealth Club of California, *Transactions*, 5 (1910), 338–339. Also see *Report of the State Board of Equalization* (1913–1914), p. 7.

[11] *Assembly Daily Journal*, January 23, 1931, p. 16.

[12] Fankhauser, *op. cit.*, p. 373.

[13] So firmly entrenched became the plan of Amendment No. 1 that the 1929 commission remarked (*1929 Report*, p. 37): "With the adoption of Amendment Number One the system became ossified. Modification of the system, except mere changes in rates, meant a fundamental disturbance to a highly articulated machine. For nearly two decades, California has stood almost stationary in tax reform while various other states have swept rapidly ahead."

[14] *Ibid.*, pp. 14 and 16–17, respectively.

[15] *California Constitution*, Art. XIII, sec. 14.

[16] *Ibid.*, sec. 14 (*a*).

[17] See table 2 for the initial rates applied to the various classes of corporations.

[18] *1906 Report*, p. 99.

[19] *Ibid.*, p. 78. The same view found expression elsewhere. For instance: "The different classes of corporations enumerated in the amendment have no distinct local situs as does a piece of land. Such property and industries are general. They belong to the people of the State as a whole and not to any particular community in which by accident their rails, wires or offices may be."—Hon. J. Harry Scott, in Commonwealth Club of California, *Transactions*, 5 (1910), 346.

Or again, "... there is the principle of separation which in its application to California cannot be challenged. It is axiomatic that those properties which have not a strictly local situs determining their value should be taxed by the State and the proceeds spent in such a way as to distribute the benefits throughout the whole State."—*The Problem of Taxation in California*, p. 7. (This is a pamphlet dated February 20, 1915, and published by a group calling itself the California State Tax Association.)

[20] *1906 Report*, pp. 79–80.

[21] The details of this development are set forth in the chapter dealing with the so-called Riley-Stewart plan.

[22] *1929 Report*, p. 70. The views of the commission here summarized will be found on pp. 49–50, 70.

[23] *Ibid.*, p. 70.

[24] Letter from Professor Plehn dated June 13, 1933.

[25] *1906 Report*, pp. 62–63.

[26] *1929 Report*, p. 45.

[27] *Ibid.*

[28] *1906 Report*, p. 98.

[29] *Report of the State Board of Equalization* (1933–1934), p. 33. For further details of this nature, see p. 172 in the chapter on the Riley-Stewart act. Likewise there will be found further facts in an excellent, concise article by Earl C. Campbell, "Separation of Sources of State and Local Tax Revenues in California," *American Economic Review*, XXVI (March, 1936), 42–43. Mr. Campbell here, for instance, calls attention to the conclusions of Professors Martin and Stephenson from their recent studies that the condition of assessments was generally worse in separation than in nonseparation states and that "decentralization of administration, an incidental by-product of separation, is the decisive argument against the plan which this analysis discloses."

[30] *1929 Report*, p. 45.

[31] The only state levy on property in the whole separation period was that levied until 1915 for the Panama-Pacific Exposition. The total of this levy was $5,000,000. Also the State Board of Equalization was responsible for seeing that assessments of public utility property by local assessors for the purpose of determining bond refunds were equalized with assessments of common property. By terms of the amendment, as before stated, all enumerated properties other than banks were liable for local indebtedness outstanding prior to adoption of the amendment.

[32] See particularly the following: *Special Report of the California State Board of Equalization on the Relative Burden of State and Local Taxes in 1912* (Sacramento, 1913); *Report of the State Tax Commission of the State of California* (Sacramento, 1917) (hereafter referred to as the *1917 Report*); *1929 Report*, part 2 and Appendices. On pp. 135–144 of this last-named report will be found a historical survey of the studies of comparative burdens preceding that made by the commission itself. These studies were made in 1906, 1912, 1914, 1917, 1921, 1922, 1924, and 1926. Following the compara-

tive-burden study by the 1929 commission, the Tax Research Bureau, in its *Report of 1933*, delves once more into the subject.

[33] The formula was $t = \frac{n \times r}{i}$, in which t equals the rate sought to apply to gross earnings, n equals the percentage of net earnings to gross, i equals the interest rate on the investment, and r equals the given tax rate on general property.

[34] For discussion of this interesting point see *Biennial Report of the State Board of Equalization* (1916), pp. 25–28. Also note the statement of Controller Ray L. Riley, in "The California Tax Problem," National Tax Association, *Proceedings* (1928), p. 55: "The federal courts have ruled that the measure of the state tax was in substance the needs of the state, irrespective of the burden on common property, provided the rates were not in fact confiscatory; therefore, there was no necessity on the part of the state to make comparative studies and ascertain the burden of taxation as between the two groups of taxpayers."

[35] Earl C. Campbell, *op. cit.*, p. 44.

[36] *Cal. Stats.* (1927), ch. 455, sec. 2.

[37] The summary statement here presented is an abstract of the material to be found on pp. 52–68 of the *1929 Report.*

[38] *Ibid.*, p. 53.

[39] There appears, facing p. 228 of the *Report* in Appendix C, Table II-*C*, entitled "Summary of Valuations of Public Utility Properties on Various Engineering and Financial Bases and an Estimate of Their 'Fair Value' for Purposes of Taxation as of December 31, 1927," by Messrs. L. S. Ready and W. C. Fankhauser.

[40] *1929 Report*, p. 56.

[41] *Ibid.*, p. 57.

[42] ". . . the gross receipts taxes on the utilities as a whole are shown to amount to 1.51 per cent of the value of their property. But when the utilities are considered by groups, the short-line railroads are found to be paying only 1.01 per cent while the very important group of gas and electric companies are paying only 1.26 per cent and if this group is broken down so as to segregate the electric properties from the gas properties, the electric properties are paying only 1.05 per cent while the gas properties are paying 1.96 per cent."—*1929 Report*, p. 58. The figures for individual companies given in the text are not cited here, but they reveal similar inequalities.

[43] *1929 Report*, p. 62.

[44] *Ibid.*, p. 63.

[45] *Ibid.*, p. 66.

[46] Earl C. Campbell (*op. cit.*, pp. 45–46) expresses doubt whether the 1933 amendment abandoning separation will provide a means of escape from inequalities. He assigns three reasons: "The old problem of inter-county equalization will reappear with all the difficulties incident thereto. . . . There is no guarantee that the *ad valorem* burden placed upon utility property will be equal to that of other property. . . . The problem of allocating utility properties to the various counties must be faced again."

[47] *1929 Report*, p. 46.

[48] *1906 Report*, p. 79.

[49] The joint legislative committee on taxation in 1931, for instance, was dubious about the feasibility of various proposed tax limitation or expenditure control devices. "It seems improbable," the committee said (*Assembly Daily Journal*, January 23, 1931, p. 26), "that the several communities of California would surrender such power to a state agency." But see the discussion with respect to expenditure limitation in the chapter dealing with the Riley-Stewart plan.

[50] See preceding footnote.

[51] *1929 Report*, pp. 46–47, and Earl C. Campbell, *op. cit.*, p. 47. Mr. Campbell makes reference to various authorities and their works in support of this view, viz., Professor Mabel Newcomer and Professors Blakey, Martin, and Stephenson.

[52] For a discussion of these points see Earl C. Campbell, *op. cit.*, pp. 47–48.

[53] *1929 Report*, p. 47.

[54] *1906 Report*, p. 88.

[55] Controller Ray L. Riley (*Biennial Report* [1920–1922], p. 12) refers back to Controller Nye's report of 1910 in which this outcome was anticipated. Mr. Riley then remarks, "It is obvious that the State Controller at that time fully appreciated precisely what has occurred."

[56] *The Problem of Taxation in California*, p. 4.

[57] *Ibid.*, p. 5.

[58] The rates should be fixed, according to the *1906 Report* (p. 12), "for a period of six years by constitutional enactment, after which time they may be amended by the legislature, but not more frequently than once every six years."

[59] *1929 Report*, pp. 48–49.

[60] *1906 Report*, p. 92.

[61] *1929 Report*, p. 51.

[62] *1906 Report*, p. 77.

[63] *1929 Report*, p. 51.

[64] *Ibid.*

[65] Commonwealth Club of California, *Transactions*, 5 (1910), 371.

[66] *Ibid.*

[67] *The Problem of Taxation in California*, p. 7.

[68] Professor Plehn, Commonwealth Club of California, *Transactions*, 5 (1910), 381.

[69] *1929 Report*, p. 39.

[70] *Report of the State Board of Equalization* (1911–1912), pp. 11–12. On the constitutional point involved refer to H. L. Lutz, *Public Finance* (2d ed.; New York: Appleton, 1929), p. 476, and to W. J. Shultz, *American Public Finance and Taxation* (rev. ed.; New York: Prentice-Hall, 1935), pp. 255, 495. Shultz summarizes the situation as follows (p. 255): "The courts will also uphold a property tax on a public service corporation where the measure of the tax is gross receipts, including gross receipts from inter-state commerce, provided that the gross receipts tax is clearly in lieu of all elements of property taxation and that the general tax burden so resulting on public service corporations of that class does not exceed the burden that would have resulted from the application of the general property tax rate to their property." The case cited is *Cudahy Packing Co.* v. *Minnesota*, 246 U. S. 450 (1918).

[71] *Report of the State Board of Equalization* (1927–1928), pp. 12–13.

[72] *California Constitution*, Art. XIII, sec. 14(*e*). The section provided that taxes paid upon operative property to meet indebtedness should be deducted from the total amount paid in taxes for state purposes. However, this was not quite the procedure followed owing to a difference in the tax-collection dates between the state and local governments. See *Cal. Stats.* (1911), ch. 335, sec. 22, or *Biennial Report of the State Controller* (1920–1922), pp. 27–28.

[73] *Report of the State Board of Equalization* (1913–1914), p. 7.

[74] *Cal. Stats.* (1911), ch. 335, as amended by *Cal. Stats.* (1913), ch. 320.

[75] *Biennial Report of the State Controller* (1912–1914), pp. 18–24. There was outstanding in county, city, and district debt on November 8, 1910, a total of $77,682,312.28. More than $700,000 a year was required to meet the state's obligation (*ibid.*, p. 25).

[76] *Biennial Report of the State Controller* (1910–1912), pp. 28–30, and *Report of the State Board of Equalization* (1913–1914), p. 7.

[77] Art. XIII, sec. 14(*b*).

[78] See footnote 7.

[79] "The 1906 Commission computed the loss suffered by local tax rolls at 11.35 per cent. At the same time the counties gained, on an average, 29.75 cents in local tax rates. According to its figures, 53 out of 57 counties gained by the change, while serious losses were suffered by only 3 counties."—Earl C. Campbell, *op. cit.*, p. 49.

[80] *1917 Report*, pp. 126–127.

[81] *1929 Report*, p. 69. These groups were from representatives of the large interior counties in the southern part of the state, the Sacramento Advisory Council of the California Development Association, whose analysis covered the twenty interior counties in the northern part of the state, and the San Francisco Board of Supervisors.

[82] *Ibid.*, pp. 69–70.

[83] Assembly Constitutional Amendment No. 21.

[84] *Proposed Amendments to the Constitution and Proposed Laws* (Sacramento, November 4, 1930), p. 26. The argument for the proposed amendment was formulated by Assemblyman Kline and that against it by David P. Barrows, at that time professor of political science in the University of California, and formerly president of the University.

[85] *Ibid.*, pp. 26–27. A further discussion of the proposed measure was presented in "The Practicability and Effect of Assembly Constitutional Amendment Number 21," California Farm Bureau Federation, Research Department, *Bulletin No. 10* (May 6, 1930). Among the findings were listed (p. 1) the following: (1) "Assembly Constitutional Amendment No. 21 would be merely corrective and not remedial in its nature"; (2) the immediate net effect "would be detrimental to agriculture as an industry"; (3) the detrimental net effect "would be cumulative with time if a probable procedure were followed, namely, reimbursement of city governments for losses sustained through the withdrawal from their tax rolls of the property taxed for State purposes."

[86] The discussion of the commission summarized in this paragraph will be found in the *1929 Report*, pp. 67–68.

[87] Art. XIII, sec. 14(*aa*). As far back as the time of the report of the 1917 commission, although no action resulted until 1926, cognizance was taken of the problem of the short-line steam railroads. The commission observed that the tax fell uniformly heavier upon the smaller roads and then quoted an excerpt from a Mr. D. M. Swobe representing an organization of many of the short-line railroads of the state. Mr. Swobe's communication (*1917 Report*, p. 40) is reproduced here inasmuch as it gives further reasons for the difficulties of this class of carriers:

"It is a well known fact and recognized by many of the railroad commissions in the western states that the development of the interior of the country falls to the lot of the short line railroads. Trunk lines follow the course of least resistance between large producing and large consuming centers but the short lines are the pioneers of opening up the sparsely settled country far into the interior and therefore they have no expensive terminal facilities which are exempt from local taxation.

"The short lines operate, as I have said, through a sparsely settled country producing a small tonnage, and generally through a barren or mountainous country where operating expenses are extremely high, and due to their remoteness from the market their necessary supplies are much higher than those of a trunk line serving the large markets by their own rails; therefore the rates on the short lines, due to the extremely heavy operating cost and small volume of traffic, are of necessity much higher than those of the trunk lines. Their net earnings after deduction of their operating cost are extremely low and in a majority of cases in California, in the 'red.' Many of our short lines were originally plant facilities and have become common carriers in order to build up and develop the country they serve. There is very little inducement under the present method of taxation for any plant facility to become a common carrier, for if they are to meet their operating cost in any way they must of necessity have high rates, and therefore I believe it is clearly shown that a tax on the gross earnings of such lines works a great injustice. If this tax could be made to apply on the net earnings in case of the short lines, or a percentage of their gross much less than the present rate, it would be no more than equitable. I am satisfied that this principle would be admitted by any one familiar with the present basis of taxation of the short lines."

[88] Art. XIII, sec. 14(*ab*); and *Proposed Amendments to the Constitution* (Sacramento, November 4, 1930), p. 8.

[89] *1929 Report*, p. 66.

[90] *Assembly Daily Journal*, January 23, 1931, p. 24.

[91] *1906 Report*, p. 93.

[92] *1929 Report*, pp. 47, 71–72. Although certain additional factors are later introduced, the commission statement here seems slightly inconsistent, for on p. 72 appears the sentence: "Consequently, although a precise quantitative statement cannot be made, it is the considered judgment of the Commission that certainly part, and perhaps a substantial part, of the gross receipts taxes are not shifted to the consumers of public utility services."

[93] *Ibid.*, pp. 67–68, 71.

[94] For instance, Mr. C. E. Grunsky argued in 1932 (Commonwealth Club of California, *Transactions*, 26 [1932], 501): "We are inclined to think, for example, that the cost of our state government is carried by the corporations, but a moment's reflection will show that we have here a species of sales or consumption tax collected at its source. In every railroad ticket, for example, in every freight bill, in every power and light bill, in every nickel paid for a street car ride, on a privately owned line, there is a tax increment, generally with some profit added."

[95] *1929 Report*, p. 72.

[96] *Ibid.*, pp. 71–72. On p. 72 is found this statement: "With railroads, for example, which are in competition with water and truck transportation and whose rates are determined often with little direct reference to local conditions, an increase or decrease in the state tax would probably be reflected only slightly in the rates charged for their services. With certain of the short-line railroads and electric railways, permission to charge a higher rate would be a ghastly joke because the conditions surrounding the demand for their services are such that an increased rate would mean less rather than more gross revenue. With the gas and electric group and the telephone and telegraph group, the conditions conducive to the shifting of the tax appear to be present to a much larger degree."

[97] *1917 Report*, p. 12.

[98] *Biennial Report of the State Controller* (1918–1920), p. 14.

[99] *1929 Report*, p. 71.

[100] For a more complete discussion of this point see Earl C. Campbell, *op. cit.*, pp. 49–50.

[101] The *1917 Report* (p. 9) listed the following objections: (1) "With the original rates it failed as a revenue producer, . . ." (2) "It has not resulted in equality, either as between the corporations and the people or as between the various classes of corporations." (3) "It has not . . . tended to correct the evil of undervaluation by counties." (4) "It has not . . . lightened the burden upon real property." (5) "The provision requiring a two-thirds vote . . . to increase rates . . . would ordinarily prove prohibitive and should be remedied." (6) "It has complicated the tax system, by compelling an altogether unnecessary dual method of fixing rates on the property of public utilities—first a rate according to property value, and then a corresponding rate upon gross receipts."

The indictment of the 1929 commission was in similar vein. The system had gone to extremes in providing for complete withdrawal of operative property from taxation. It had not improved local assessments, nor achieved stability in rates, nor brought relief to real estate, nor equitably distributed the tax burden. It had developed certain positive faults. Rigidity, in both rates and methods of taxation, had appeared. Political disputes had arisen. There developed discrimination against communities served by privately owned utilities. It had penalized certain counties from which large amounts of property had been withdrawn from the local tax base. "In short, Amendment Number One must be abandoned. Its faults are so serious and so fundamental as to demand the substitution of some more satisfactory system."—*1929 Report*, p. 73.

[102] *1917 Report*, pp. 129–130. Briefly summarized, these were: (1) assessment and taxation of property at situs with, however, retention of central assessment of public utilities and liquid property, and central control of all assessments; (2) adoption of true separation by leaving all tangible property for assessment in the localities where situated; and (3) elimination of existing constitutional restrictions to give the legislature freedom of action in revenue matters.

[103] *1929 Report*, pp. xxi, 75 ff., 89–90, 94 ff.

[104] Earl C. Campbell, *op. cit.*, p. 52. For discussion of the 1933 amendment turn to the chapter on the Riley-Stewart act.

III. THE INHERITANCE TAX

Of those taxes which the state levies today, only one existed before the separation of sources in 1911: the inheritance tax, now the oldest state tax in California. The state's experience with this source of revenue differs little from that of other inheritance tax states. Though she was neither the first nor the last to adopt or to improve it, neither the highest nor the lowest in rate severity, California's death tax history is interesting nevertheless.

In 1893, when other states had already adopted the policy of levying upon legacies, California enacted her first inheritance tax. From that time to the present, the development of the tax has been a slow evolution of a system of rates and exemptions, the construction of machinery for collections, and the solution of practical questions arising in the course of applying the tax to situations which have occurred in the forty-odd years of its life.

California's first death tax, as befitted the ideas of the nineties, levied a tax upon inheritances received by collateral heirs and strangers in blood at the proportional rate of five dollars for every hundred dollars of the bequest. It was not a well-planned tax: it exempted spouses, descendants, parents, adopted children, brothers and sisters, and tax-free institutions, but subsequent amendments were necessary to clarify the position of grandparents, and of nieces and nephews; its exemption to tax-free institutions did not apply to such bequests as that to Stanford University by the founder; administration was entrusted to the county officials, especially to the county treasurers. Though its sins of omission resulted in amendments by four subsequent legislatures, the act remained on the statute books until 1905. The greatest changes were the exemption of ancestors and those brought about by the Amendment of 1897 making brothers and sisters, nieces and nephews taxable.[1]

This tax was replaced in 1905 by the latest model of its day. Following the much-bruited Wisconsin Act of 1903, California introduced the principles of relationship discrimination and of rate progression both with respect to relationship and with respect to size of inheritance. Like the earlier law, it was a tax on distributive shares. Heirs were grouped in five classes: class A, which included the widow, minor children, adult children, lineal ancestors, widower, and adopted children; class B, brothers and sisters and their descendants, sons-in-law

[1] For notes, see below, pp. 80–87.

TABLE 3

EXEMPTIONS AND RATES OF 1905

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $500,000 (Percentage)	In excess of $500,000 (Percentage)
A	Widow, minor child	$10,000	1	1½	2	2½	3
	Husband, descendant, ancestor	4,000					
B	Brother, sister, son-in-law, daughter-in-law	2,000	1½	2¼	3	3¾	4½
C	Uncle, aunt, descendant of either	1,500	3	4½	6	7½	9
D	Granduncle, grandaunt, descendant of either	1,000	4	6	8	10	12
E	Remote kin, stranger	500	5	7½	10	12½	15

TABLE 4

EXEMPTIONS AND RATES OF 1911

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $500,000 (Percentage)	In excess of $500,000 (Percentage)
A	Widow, minor child	$24,000	1	2	3	4	5
	Husband, descendant, lineal ancestor	10,000					
B	Brother, sister, descendant, son-in-law, daughter-in-law, son's widow	2,000	2	4	6	8	10
C	Uncle, aunt, descendant of either	1,500	3	6	9	12	15
D	Granduncle, grandaunt, descendant of either	1,000	4	8	12	16	20
E	Remote kin, stranger	500	5	10	15	20	25

and daughters-in-law, or sons' widows; class C, uncles and aunts and descendants of either; class D, granduncles and grandaunts and descendants of either; class E, more remote heirs, strangers in blood, and institutions. This relationship schedule was still further complicated by differentiation of class-A heirs into two groups, the widow and the minor children being allowed special exemptions which did not apply to the other members of class A. Exemptions were low and rates high for the period. This law, suggested by Governor Pardee, is the foundation of all subsequent laws. Details have changed, but in essential outlines the law of 1905 set the mold for the California inheritance tax.[2]

The period from 1905 to 1921 was one of experiment with this new law. In general during these years rates were higher and exemptions were lower than at any other time in California death taxation. In 1911, on the first $25,000, California made basic rates for the five classes of 1, 2, 3, 4, and 5 per cent, and on bequests in excess of $500,000 rates of 5, 10, 15, 20, and 25 per cent. These rates were more severe than those of the New York "Reign of Terror Act" of the preceding year,[3] but were not discarded in succeeding measures. Exemptions more liberal than those of 1905 were at the same time given to widows and minor children, and to other direct heirs. While these exemptions were retained, the rates soared even higher in the laws of 1913, 1915, and 1917. One important change was made in the classes of heirs by the Act of 1915: class D (granduncles and grandaunts and their descendants) was merged in the class of remote kin and strangers, a simplification of the schedule that was commendable.[4]

After ten years of severe rates, the schedule was revised downward in the Act of 1921. Several factors were responsible for the change. High rates on collateral heirs and strangers did not benefit the state greatly, because large fortunes are rarely left to persons outside the direct line.[5] When fortunes were so left, the California tax in combination with the federal estate tax became a real burden, and aroused opposition to both. Moreover, since the high rates of both taxes were in part a result of the war, the end of the conflict might naturally witness a lowering of these rates. The Inheritance Tax Department recommended a reduction of the tax in the higher brackets to 12, 18, 20, and 20 per cent, and the retention of the scale of exemptions and the basic rates upon the four classes of heirs. These recommendations were carried out in the Act of 1921, which remained in force with unchanged rates for eight years, when it was replaced by the less severe Act of 1929.[6]

TABLE 5

Exemptions and Rates of 1913

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $250,000 (Percentage)	$250,000 to $500,000 (Percentage)	$500,000 to $1,000,000 (Percentage)	In excess of $1,000,000 (Percentage)
A	Widow, minor child	$24,000	1	2	3	4	5	7½	10
	Husband, lineal descendant, lineal ancestor	10,000							
B	Brother, sister, descendant of either, son-in-law, daughter-in-law, son's widow	2,000	2	4	6	8	10	12½	15
C	Uncle, aunt, descendant of either	1,500	3	6	9	12	15	17½	20
D	Granduncle, grandaunt, descendant of either	1,000	4	8	12	16	20	22½	25
E	Remote kin, stranger	500	5	10	15	20	25	27½	30

TABLE 6

Exemptions and Rates of 1915*

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $200,000 (Percentage)	$200,000 to $500,000 (Percentage)	$500,000 to $1,000,000 (Percentage)	In excess of $1,000,000 (Percentage)
A	Widow, minor child	$24,000	1	2	4	7	10	12	15
	Husband, lineal descendant, lineal ancestor, adopted child	10,000							
B	Brother, sister, descendant of either, son-in-law, daughter-in-law, son's widow	2,000	3	6	9	12	15	20	25
C	Uncle, aunt, descendant of either	1,000	4	8	10	15	20	25	30
D	Remote kin, stranger	500	5	10	15	20	25	30	30

* These rates were those of the 1917 law as well. The extreme character of the rates in the higher brackets was softened in application by the fact that fortunes of such large amounts are not often left to remote kin or to strangers.

TABLE 7

Exemptions and Rates of 1921

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $200,000 (Percentage)	$200,000 to $500,000 (Percentage)	In excess of $500,000 (Percentage)
A	Widow, minor child	$24,000	1	2	4	7	10	12
	Husband, lineal descendant, lineal ancestor, adopted child	10,000						
B	Brother, sister, descendant of either, son-in-law, wife or widow of son	2,000	3	6	9	12	15	18
C	Uncle, aunt, descendant of either	1,000	4	8	10	15	20	20
D	Remote kin, stranger in blood	500	5	10	15	20	20	20

TABLE 8

Exemptions and Rates of 1929

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $200,000 (Percentage)	$200,000 to $300,000 (Percentage)	$300,000 to $500,000 (Percentage)	In excess of $500,000 (Percentage)
A	Widow	$50,000	. .	. .	4	6	7	8	8
	Minor child	24,000	1	2	4	7	9	9	10
	Husband, lineal descendant, lineal ancestor, adopted child	10,000							
B	Brother, sister, descendant of either, husband of daugher, wife or widow of son	5,000	3	6	9	12	12	12	12
C	Uncle, aunt, descendant of either	1,000	4	8	10	12	12	12	12
D	Remote kin, stranger	500	5	10	12	12	12	12	12

TABLE 9

EXEMPTIONS AND RATES OF 1935

Class	Degree of relationship	Exemption	To $25,000 (Percentage)	$25,000 to $50,000 (Percentage)	$50,000 to $100,000 (Percentage)	$100,000 to $200,000 (Percentage)	$200,000 to $500,000 (Percentage)	In excess of $500,000 (Percentage)
A	Widow	$24,000						
	Minor child	10,000	2	3	4	7	9	10
	Husband, lineal descendant, lineal ancestor	5,000						
B	Brother, sister, descendant of either, daughter's husband, son's wife or widow	2,000	5	7	10	12	14	15
C	Uncle, aunt, descendant of either	500	6	9	12	12	15	15
D	Remote kin, stranger	50	7	10	12	12	15	16

Thanks to surpluses in the state treasury, to multiple taxation, to high rates, and to the federal estate tax, agitation for reduction of death tax rates was prevalent in the state during the prosperous twenties. California became worried about the effect Florida's action in forbidding inheritance taxes would have on Pacific Coast business. It was charged that California's steep rates, or rather her reputation for severity, was keeping out of the state some two billion dollars of capital which would otherwise enter into industry. The existence of a surplus, it was thought, called for a reduction in all taxes. Although careful to record its belief in the principle of the tax, the California state tax commission in its final report advised a revision of the rates and exemptions to lighten the tax, on the ground that the tax looked "more drastic than it really is, because of the presence in the rate scale of certain high percentages which in practical operation almost never apply." The commission recommended a $50,000 exemption to widows, $24,000 to minor children, and lower rates in the higher brackets. "The adoption of the changes in the rate scales and exemptions will bring about a situation where California may be said to offer substantially as favorable treatment as obtains generally throughout the country with reference to the taxation of the estates of the wealthy." The Act of 1929 embodied these recommendations.[7]

These relaxations could not withstand the pressure caused by the deficit in 1933. Although the inheritance tax ranked but third as a single source of state revenue for the general fund, and had fallen off in returns since 1932, it still could give substantial aid in the state's need. Therefore in 1933 we enter another period of rising rates. The legislature of that year lowered the exemptions of widows to $24,000 and of minor children to $10,000, but retained the rates as in 1929. The legislature of 1935 was more severe. Exemptions on class-A heirs other than widows and minor children were set at $5,000; class-B heirs, $2,000; class-C heirs, $500; class-D heirs, $50. Basic rates on these classes of heirs became 2, 5, 6, and 7 per cent; those in the highest brackets, 10, 15, 15, and 16 per cent. The basic rates are now higher than ever before, although those in the higher brackets are far short of the levels of 1911 and 1921. In practice, however, the present rates may prove more severe than any previously enacted in California.[8]

Like rates, the matters of exemptions and deductions were not worked out immediately, but developed with the life of the tax. Exemptions were made by the state under considerations of public welfare. Proceeds of federal war risk insurance were exempted in 1929 as a sort of war contribution by the state.[9] The question of exemptions to nonprofit institutions engaged in charitable, educational, or other like work was not so definitely settled. The Act of 1893 exempted "societies, corporations, and institutions now exempted by law from taxation," a statement that was amended in 1897 to read, "any public corporation, or to any society, corporation, institution, or association of persons engaged in or devoted to any charitable, benevolent, educational, public, or other like work (pecuniary profit not being its object or purpose), or to any person, society, corporation, institution, or association of persons in trust for or to be devoted to any charitable, benevolent, educational, or public purpose."[10] The occasion for this lengthy change was the plight of the endowment for Stanford University, which was not exempt under the loose language of the preceding law. The amendment, which was enacted too late, however, to help Stanford University, remained in the law until 1917.[11] Under it, bequests to such institutions anywhere in the United States or in foreign countries were exempt from the California inheritance tax. By 1917, this provision seemed too generous. In that year was added the provision that to be tax-free the institution must be located within the state.[12] This proviso has remained in the law. It has aroused some opposition on the grounds that many California residents desire to leave substantial gifts to institutions in the states from which they came, and that the knowledge that such gifts would be taxed deterred many people of wealth from becoming residents of the state.[13] At the end of the twenties, when reciprocity between states was in the air, a further proviso was added, to the effect that California would not tax gifts if the state or foreign country in which the institution is located either (*a*) does not tax gifts or (*b*) taxing such gifts, exempts those to California institutions under a reciprocity agreement.[14]

In the course of time, a series of deductions has been built into the law. From the beginning, the expenses of the funeral and last illness, state, municipal, and county taxes owing at death, and the ordinary expenses of administration have been legitimate deductions from the estate before appraisal for the inheritance tax.[15] The law also provides that debts owing at death are deductions; court decision limited this provision for nonresident decedents by pronouncing that debts owing in the state of domicile cannot be subtracted from the estate in California.[16] Generally, American states have not permitted the deduction of debts owing outside the state. The deduction of the amount paid as federal estate tax, a practice not permitted under the law of 1917, has been law since 1921.[17] From 1921 to 1935 the amount paid as inheritance tax to other states or to foreign countries was deductible, but the reciprocity agreements with respect to multiple taxation made possible the omission of this clause in the Act of 1935. The intent of the legislature to make deductions as few as possible is expressed in the present act. "This subdivision is intended as a limitation on deductions, and it is not its purpose to allow as a deduction anything that does not actually reduce the amount of the transfer."[18] To prevent too frequent taxation of the same estate, the law exempts an estate from another tax within five years from the first.[19]

Study of the rates and exemptions suggests several conclusions. One such reflection is the frequency of changes in the law. Since 1893 every legislature except three has done something in the way of amending the inheritance tax; eight legislatures have changed rates. The inheritance tax can endure very little instability because it is levied once in a lifetime, not once a year. Since people do not choose to die according to the rates of the tax, frequent changes result in inequality between estates. California's history in this respect has been more commendable than that of most states. Through the nation generally, the evil has been so great as to call forth a declaration from the National Tax Association that rates must be stabilized.[20]

However, the inheritance tax structure has remained fairly stable despite these frequent changes of the law. For example, the exemption for widows and minor children has been approximately $25,000 for all but four of the years since 1911. Exemptions for other class-A heirs were $10,000 from 1911 to 1935. The exemption for class-D heirs (remote kin and strangers in blood) was $500 from 1911 to 1935. The greatest change has occurred in the higher-bracket rates upon collateral heirs and strangers, where the fluctuation has ranged from 12 to 30 per cent.

Relationship discrimination with its accompanying progression was one of the most lauded aspects of the Act of 1905. In recent years the practice has been questioned by tax experts. Discrimination in favor of the widow and minor children is surely justified because these are dependent upon the decedent. Favor shown to parents and grandparents is justified also, because in practice bequests are rarely made to them unless they have needed the decedent's help. The practice of allowing exemptions to adult children may be justified by the encouragement it gives to effort. Otherwise, careful grouping of degrees of relationship would seem to be the result of influence from Europe, where the larger family unit is powerful. A man's taxpaying ability is not increased because he is a more distant relative, nor does he receive any greater benefit because he is a stranger rather than a cousin. It may well be, as when a pension assuring a livelihood is granted to a faithful old servant, that the stranger really should receive the favor at the hands of the law. Greater justice in discrimination would be obtained on the basis of need of the recipient if it were possible so to draw a statute as to recognize this factor. For greater simplicity, heirs might be classified as dependents and nondependents.[21] By discriminating in favor of direct heirs, the California scheme of rates does justice at the expense of revenue to the state.

The legislature's constitutional right to levy an inheritance tax was early settled. Within the first year of its existence, the tax was tested in the case of the *Estate of Wilmerding*. Wilmerding had left legacies to his brothers and sisters and to a nephew. In handing down its decision that the legacy to the nephew was taxable under the Act of 1893, but that the bequests to the brothers and sisters were not, the Supreme Court of California said:

"The right of inheritance, including the designation of heirs and the proportions which the several heirs receive, as well as the right of testamentary disposition, are entirely matters of statutory enactment, and within the control of the legislature. As it is only by virtue of the statute that the heir is entitled to receive any of his ancestor's estate, or that the ancestor can divert his estate from the heir, the same authority which confers this privilege may attach to it the condition that a portion of the estate so received, shall be contributed to the state, and the portion thus to be contributed is peculiarly within the legislative discretion.... There is, however, no necessary connection between inheritance and taxation, and, in making laws relating to these two subjects, the legislature is not required to consider them together. Having plenary authority in reference to each, it is not required to shape its legislation concerning one in the form or with any regard to the manner in which it has shaped it concerning the other."[22]

In later decisions[23] the Supreme Court has reaffirmed its position.

"The state has the right to place any burden or encumbrance it wishes upon the interest which any heir, devisee, or legatee may take in the estate of a decedent, inasmuch as the inheritance tax is not a property tax, but is essentially a tax upon the statutory privilege of testamentary transfer or succession."

"The power of testamentary disposition and the privilege of inheritance are subject to state taxation, . . . There are two elements in every transfer of a decedent's estate: the one is the exercise of the legal power to transmit at death; the other is the privilege of succession. Each is subject to taxation."

These decisions have been accepted as final settlement of the state's right to levy inheritance taxes. Minutiae of the succeeding laws were occasionally challenged, but never the principle behind them. To prevent confusion in the event that some detail of a law should be declared unconstitutional, each tax act contains a provision that the unconstitutionality of part of a law does not affect the validity of the whole.[34]

Death taxes have been justified by any one of three theories, or by a combination of them: the general taxing powers of a state, the state's right to regulate succession, and the state's feudal right to the property of the deceased. In Europe, the first of these is considered such ample justification for the death tax that the second and third have been little used. In Anglo-Saxon countries, and especially in the United States with its system of division of powers between state and federal government, the right of the state to regulate succession has been the mainstay of the courts in upholding state inheritance taxes. The theory is that the right to bequeath property or to inherit it is not a natural right but a creature of statute; that a man's control over his possessions ceases at death; that the property which he leaves would naturally belong to society did not social custom or statute law provide for other disposition. The California Supreme Court, in its decisions to which reference was made above, has declared itself in support of these views concerning death duties. The feudal theory has been more frequently used in Great Britain, yet has had its influence in the United States. In California the argument has sometimes been used that, since the property could not have been acquired without the existence of society and the protection of the state, the state is justified in levying upon it.

In California, too, the ability theory of taxation also has been invoked to support the inheritance tax. Such a tax falls due at the time of supreme taxpaying ability, that is, when the testator has no further use for his property, and when the heir receives an unexpected windfall, which is still an occasion for rejoicing even after the tax is deducted. Progressive rates with regard to size of inheritance are justified by ability, even though relationship discrimination may not be, because such discrimination takes no account of need, except as it favors dependents. The tax has been defended further on the ground that it reaches intangibles which escape levy under other forms of taxation.

Friends of the tax usually are betrayed into justifying it on ethical grounds; and thus are led to discussions of the social value of inheritance as an institution, and especially of its danger to democracy. Granted that the social consequences of the institution of inheritance are far-reaching, there yet remains a place for consideration of the purely fiscal aspects of the inheritance tax. Whether the tax should be used to achieve any end other than that of providing revenue and serving as a corrective to certain regressive taxes is debatable. Into this controversy we need not enter. Suffice it to say that in California fiscal rather than social aspects of the tax have been predominant.

Until recently, California was ahead of most inheritance tax states in devising effective administrative machinery. The law of 1893, typical of the time, left the collection of the tax entirely to the county treasurers, who received for their services 5 per cent of the first $50,000, 3 per cent of the second $50,000, and 1 per cent of the remainder. Except for a change in the amount of fees (3 per cent of the first $50,000, 1½ per cent of the second $50,000, and ½ per cent of all receipts above $100,000) and for the allowance of a 5 per cent discount in return for the payment of all the tax within six months, these arrangements lasted until 1911.[35] At the present time county treasurers are responsible for the collection and payment to the State Controller of all inheritance taxes. The tax reports must be sent to the State Controller twice a year, before the fifteenth of January and of June; the money must follow before the first of February and of July, else the county treasurers pay 10 per cent interest. For these services the county treasurers may retain as fees 3 per cent of the first $50,000, 1½ per cent of the second $50,000, and 1 per cent on all additional sums; but no county treasurer of first-, second-, or third-class counties may retain more than $500, and no treasurer of other classes of counties more than $200, from the tax due on any one estate. The year's total fees may not be more than $12,000 in a county of the first class or the second class, $8,000 in a county of the third class, and $5,000 in any other county.[36] It was expected that the fees would stimulate the county treasurers to greater activity. Nevertheless, entrusting the collection of the tax to local agencies did not prove entirely satisfactory, especially in the matter of appraisement. Appraisement differed between counties, both with respect to accuracy in determining the market value of property and with respect to industry in investigating estates to be taxed.[27] Central control was apparently necessary, and was advocated by State Controller John S. Chambers as early as 1914.

The superior courts exercise much power over the collection of the inheritance tax. Jurisdiction rests with the court of the county in which the decedent's real property is situated, or, if he had none, in the superior court of the county in which he resided. The superior court, or a judge of it, fixes the compensation of the inheritance tax appraiser and may even appoint him, if no appointment has been made; the court delegates to the appraiser the power to subpoena witnesses and conduct hearings; refusal to answer his summons is contempt of court. The inheritance tax appraiser reports to the court, which then by court order fixes the amount of the tax, or declares no tax is due. When the State Controller has reason to believe a tax is due, his method is to petition the superior court of the proper county.[28]

California was a pioneer in enacting legislation for state control of collections. An act of 1909 created the office of deputy inheritance tax collector to investigate taxable estates. The Inheritance Tax Act of 1911 authorized the State Controller to appoint and remove at pleasure "one or more persons in each county of the state." These appraisers were and still are to be paid out of the inheritance tax money in the hands of the treasurer of the county in which they are serving. The amount of the fee is fixed by the superior court of that county, according to statute and subject to the approval of the State Controller; the appraiser is also allowed expenses including those for witnesses; the taking of any other fee or reward in connection with the case is a misdemeanor and is so punished.[29] One of the three appraisers in every probate appraisement must be an inheritance tax appraiser. Inheritance tax appraisers are responsible both to the superior court of the county and to the State Controller, and report to both. The state does not use the appraisal of the federal government, but makes its own.

In two respects the law providing for appraisers brought the office of State Controller into the inheritance tax machinery. By reason of his powers of appointment and his control of funds, the Controller has grown continually more important. In 1913 the Political Code was amended to create the Inheritance Tax Department as the part of the

Controller's Office which should take care of the inheritance tax.[30] Specifically, the department should gather and publish data concerning the laws of other states and should advise and assist the inheritance tax appraisers or any other local officers concerned with the inheritance tax. One of its most important duties is to suggest changes in the statute. Even the personnel of the department is prescribed by the law. Its three offices are maintained in Sacramento, San Francisco, and Los Angeles. The Sacramento office has upon its staff an investigator, an inheritance tax attorney, and an assistant inheritance tax attorney; besides clerks and stenographers, the San Francisco and Los Angeles offices each have two assistant inheritance tax attorneys, one of whom in each office is paid at the same rate as the inheritance tax attorney in Sacramento. The work of the department and its personnel increased until 1931. In 1933 the Senate fact-finding committee recommended that because of decrease of business the number of the staff be reduced.[31]

This is the double management under which California collects an inheritance tax. The county treasurers and superior courts belong to the local government, the State Controller and his Inheritance Tax Department to the state government,[32] whereas the appraisers are responsible to both administrations. No important changes in administration have been introduced since 1913; the machinery then created has merely been expanded. Since there is no desire to change, we may assume that it works fairly well, though double jurisdiction may be cumbersome. Since probate proceedings take place in county courts, and since county treasurers may be expected to have first-hand information concerning the property in their districts, perhaps it is well that California has not completely centralized her collection under a state tax commission or under her existing State Board of Equalization. Nevertheless centralization would be a step forward, for "the collection of state taxes by county officers or courts never has been and never can prove effective; until centralized collection of inheritance taxes is universal throughout the United States, a premium is placed on evasion and the honest man is branded a fool."[33]

Such centralization would be a more efficient check upon evasion, and for this reason state administration is recommended in the report of the National Tax Association's committee on inheritance and estate taxation.[34] At any rate, California is not among the backward states who still rely exclusively upon local administration, even though she may no longer have one of the most advanced systems of the day.

Although the inheritance tax escapes some of the major difficulties which disturb tax authorities, such as the problem of incidence, its own peculiar problems have brought some worry to legislators and to administrators. California has had her portion of such questions, most of which she shares with other states, some of which are hers alone. She has had her own methods of exorcising these vexations; sometimes she has led other states, sometimes she has fallen behind them. These problems and California's solutions to them we shall discuss in the following paragraphs.

In the past, the first of these problems has been multiple taxation of the same inheritance by several states, all of which claimed tax jurisdiction. Frequently proceedings have been necessary in ten, fourteen, or even twenty states. The problem may become even international, owing to the fluid character of investment. Not only large estates but many small ones under $50,000 have had taxes levied on them by more than one jurisdiction. As a result of all these state taxes plus the federal estate tax, an inheritance might theoretically be taxed 200 or 300 per cent.[85] A secondary but nevertheless heavy burden was the delay and expense of court procedure in so many states. There was the case of the Hearst estate, which because of its widespread properties required four years to settle. There was also the amusing case of Harkness, who was declared beyond the taxing jurisdiction of California, Kentucky, and perhaps New York, and who must have lived legally nowhere.[86] Multiple taxation bore more heavily on small estates than on large ones, since people of wealth could more readily plan their investments with expert advice. Not at all a purely American problem, but an international one which has occupied the League of Nations,[87] multiple taxation became especially acute in the United States by reason of the migratory tendency of the American people, and by reason of the economic unity of the nation and the ease with which capital crosses state lines.

Although the problem became most acute over the taxation of corporate securities, other forms of property also were involved. When inheritance taxes were adopted in the states, two principles of taxation were in conflict: the principle of residence or domicile, which derives from the idea of nationality; and that of situs, which springs from territoriality.[88] At the time inheritance taxation began, situs had been victorious in respect to real property; consequently the state in which the real property is located is the only state with inheritance tax jurisdiction over that real estate.[39] The common law and court decisions have been responsible for this result.

Over tangible personal property the conflict of principles was more acute, sometimes one and sometimes the other being in the ascendancy. Under the common-law rule that *mobilia sequuntur personam,* states attempted to tax all tangible personal property of resident decedents wherever it was located. Using the principle of situs, some states made an attempt to tax any tangible personal property located within their borders. In an endeavor to produce some uniformity, the model tax laws of the National Tax Association twice recommended that tangible personal property be taxed in the state where it was located.[40] States, however, continued to use both principles. The question was finally settled by the decision of the United States Supreme Court in the Frick case, June 1, 1925, which pronounced tangible personal property taxable in the state where it is located. Even those who believed otherwise welcomed the decision as settling a vexatious question.[41]

Before this decision of the United States Supreme Court had been handed down, California had taxed all personal property of her residents, wherever it was located. The law made it quite clear that it intended to include tangible personal property of residents. In settling the estate of Hodges, a resident of California who left an estate including chattels, bonds, and stocks of foreign corporations, all in Massachusetts, the California Supreme Court held "that personal property of a resident decedent dying testate or intestate, located outside of this state, and which is never brought into this state for purposes of administration, is subject to an inheritance tax in this state under the application of the familiar maxim *mobilia sequuntur personam,* for by this rule the right of succession to such property is governed by the law of domicile and not by the law of the locality of the property. This rule is subject to the limitation that there be no rule to the contrary in the state where the personal property is located. But there is no rule to the contrary in Massachusetts."[42]

These questions were easily settled in comparison with the great problem of taxation of intangible personal property, for tangible personal property is a small part of wealth in these days; indeed, intangibles are 70 per cent of the wealth passing in California. With intangibles, too, the states at first applied the rule *mobilia sequuntur personam,* but after 1900 other ideas sprang up, especially in newly developed regions. Both in the western states of the United States and in the British dominions, the question was one not merely of law, but of fundamental economic conflict between the older investing communities and the newer regions where the money was invested. California adopted both principles; as a pioneer community with resources not fully developed, she was one of the situs states; as the home of retired persons whose investments were in other states, she gained by applying the rule of domicile, in company with Massachusetts and New York. The California law reads, and has read since 1905: "A tax shall be and is hereby imposed upon the transfer of any property, real, personal, or mixed . . . When the transfer is . . . from any person dying seized or possessed of the property while a resident of this state; . . . When the transfer is of property within this State and the decedent was a nonresident of the State at the time of his death."[43]

The conflict over the inheritance tax jurisdiction of states in regard to intangibles arose in four ways:

1. The state of domicile of the owner taxes all intangibles owned by its resident decedents. The jurisdiction of the state of domicile has been accepted without question, and is general in the United States. California applied this rule as did other states. In the Hodges' decision just quoted, the California Supreme Court pronounced the right of the state to tax the stocks and bonds, even though they were in Massachusetts and were not securities of California corporations.[44]

2. A state might tax corporate securities of nonresidents when the securities were deposited or temporarily located in the state. Few cases of this sort arose in the nation. In California, the only one which came to the Supreme Court was that of McCahill, a resident of Minnesota who had formed the habit of spending his winters in California for the sake of his health. He usually brought with him for safekeeping bonds of out-of-state corporations; when he went home in the spring, he took them with him. It so happened that in 1910 he left the bonds when he went home on what was his last journey. The California Supreme Court declared that the bonds were not taxable, because they had been brought here for deposit and not for business purposes, and because they were bonds of foreign corporations. The ruling of the State Controller also prevented such taxation.[45]

3. The states believed that they had jurisdiction over the securities of firms incorporated under their laws, regardless of the domicile of the owner of the stock. Here was the greatest single problem of multiple taxation. The practice of taxing such securities was so common

that it was generally accepted as correct. Said Albert Handy, "The right to tax the transfer of stock of a domestic corporation is conceded; it has the support of a long line of well-reasoned cases in numerous jurisdictions."[46] California's Supreme Court twice pronounced in favor of such taxes. The case of *McDougald* v. *Lilienthal* involved stock of a California corporation, the Lilienthal Company, owned by a resident of New York, who died in New York, where the certificates of stock were. The court held that the stock was taxable. "The state may reverse the rule *mobilia sequuntur personam* and tax personal property of a nonresident when such property is within this state. Shares of stock in a domestic corporation, even though the certificates are outside of this state, constitute property within this state for taxation purposes." On another occasion, the court stated: "For the purposes of the Inheritance Tax Law, the situs of stock in a corporation is in the state of the incorporation."[47] Whether the state had the same jurisdiction over bonds of domestic corporations was settled in California by the decision in *Chambers* v. *Mumford:* "The interest of a non-resident testator in the proceeds of a promissory note, acquired by contract and held in this state, does not constitute property within this state and is not subject to an inheritance tax in view of the rule in this state that the situs of choses in action follows the domicile of the owner." After this decision, the only forms of intangible personal property on which nonresidents were taxed in California were stocks in domestic corporations.

4. No case arose of the sort that so vexed the western states generally: the right of a state to tax the securities of foreign corporations which held real property within the taxing state, when these securities were owned by nonresidents. This form of tax originated in Wisconsin, but was finally declared unconstitutional by Wisconsin courts.

It was evident what confusion worse confounded resulted in the inheritance tax when the state of domicile taxed its residents on all intangibles, the state of incorporation taxed the stock and sometimes the bonds of domestic corporations, even when owned by nonresidents, and the state where the corporations' property was situated taxed nonresident owners of their stock. The attempt to apply both domicile and situs was disastrous to taxpayer and to state.[48] In an effort to bring order by interstate agreement, the National Tax Association upheld the principle of domicile, which it urged in both of the model inheritance tax laws it recommended to the states.[49] New York and Massachusetts—

not California—put this view into practice, and then, weary of being the only virtuous in a nation of the unjust, reverted to the old abuses. Logical as was the plan of the National Tax Association, it was not just to the states of the West, and favored states like New York and California, where live holders of securities of Nevada and Arizona mines. The case for situs has been stated by the North Carolina Supreme Court in the decision concerning the Rhode Island Hospital Trust, and by Schultz.[50]

Failing to obtain the general adoption of domicile, the National Tax Association recommended the adoption of the Matthews flat-rate plan, which called for the taxation of all securities under a 2 per cent rate,[51] and a reciprocity clause, which provided that a state would not tax the intangible property of residents of another state if (*a*) that other state had no inheritance tax, (*b*) that other state, though having a tax, exempted the citizens of the first state. These reciprocal exemption clauses were much discussed in the National Tax Association's conferences on inheritance and estate taxation in 1924 and 1925, received the support of chambers of commerce, and were widely adopted by legislatures. California made the Matthews plan an alternative in 1925, and adopted the reciprocity clause as well.[52]

Meanwhile the courts had made the whole question one of historical interest. The North Carolina case of *Rhode Island Hospital Trust Co.* v. *Doughton* had gone to the United States Supreme Court, which held that shares of stock could be taxed only at the domicile of the owner. The court reiterated its decision in 1932. By these decisions all intangibles became taxable only by the state of domicile.[53] The entire question of tax jurisdiction may be considered settled, except that the courts still have to determine what is domicile.[54]

No problem in death taxes has caused so much irritation as the relation between the federal estate tax and the inheritance taxes of the states. Naturally the states which already were levying death taxes did not abandon them in 1916 when the federal government entered the field. Because the federal estate tax was held to be an emergency measure, no action was considered for some years after its passage; during these years both federal government and states levied upon the same estates, with results that were sometimes more than confiscatory, especially where the wealth consisted of intangible personal property.[55]

This situation lasted in California from 1917 to 1927. As a rule, the federal government took more from the large estates than did the state of California, because the federal estate tax, levied on property before division, reached the higher brackets more often than did the state taxes on individual shares. One area was reached by state alone: since the federal exemption was set at $50,000 (1916–1924) and $100,000 (1924–1934), all below was fair game for the state—not a great gain, however, since a very small part of the tax, as we shall see later, comes from these estates. In 1921, California tried to solve the problem as between the two taxing powers by making deductible from the taxable estate the amount paid the United States government as an estate tax; this provision has remained in the law ever since.[66]

To California, as to all inheritance tax states, relief came in 1924 with the enactment of the 25 per cent credit provision of the federal estate tax. This provision was the result of a nation-wide demand fathered largely by the National Tax Association. By the very existence of the new law the federal government announced that it was not intending to abandon so lucrative a field of taxation; at the same time, however, it acknowledged the situation by allowing for the payment of state death taxes up to 25 per cent of the federal estate tax. Thus, if a state had no death tax, the federal government would collect all of its tax, but otherwise it would collect an amount varying from 75 per cent upward, according to the severity of the state rates. This 25 per cent credit clause had three results upon the states: it encouraged states without inheritance taxes to adopt them; it promoted uniformity among the states by making it profitable to set the rate so as to reap one-quarter of the federal tax; and it led to the enactment of supplementary estate taxes so that the state might get the difference between its own inheritance tax (if less than 25 per cent) and the credit allowed.

Not much time was permitted for the execution of this provision before the federal law was changed in 1926 to increase the 25 per cent to an 80 per cent credit. This action was the result of an attempt to bring about the withdrawal of the federal government from the field of death taxes in favor of the states on the ground that the latter had more need of the revenue. United States Secretary of the Treasury, Andrew Mellon, favored the movement, which had also the support of the National Tax Association and of various taxpayers' associations throughout the nation. The National Tax Association, indeed, favored gradual withdrawal, to be accomplished in six years' time, and supported an 80 per cent credit clause as an ad interim measure.[67] The movement for repeal of the federal estate tax reached its height and then subsided in the Congress of 1928, but meantime it had left the 80 per cent credit clause in the federal estate tax.[58] The effects of this provision upon the states resembled those of the earlier clause, but were more potent.

California's legislature of 1927 took advantage of federal generosity by providing that, "where the tax imposed by this act is less than the 80% credit, the tax shall be increased so that the full amount of tax collected by the state shall be equal to 80% of the federal tax."[59] State and federal agencies make their own appraisals on each estate in all respects.[60]

In general, the people of the state have not seemed to regard the federal estate tax as unjust. In the nineteen-twenties the concerted national movement for repeal of the federal tax had some support in California. Of the California representatives at the National Tax Association's conferences on estate and inheritance taxation, some were for immediate federal withdrawal. These people may have hoped that, in the event of repeal, competition with Florida would force California to repeal her tax, or to lower the rates. More support was given to the plan for gradual withdrawal. Chester Rowell, then a member of the California tax commission, may be considered to have spoken for the moderates of the state when he said that immediate repeal would result in a race between Florida and California in attracting decrepit millionaires.[61] These views were also those of Mark Graves, member of the New York state tax commission.[62]

A problem in relation to the federal estate tax peculiarly California's own involves the institution of community property. Although the state is one of eight having this institution, California was set apart in that the federal government at first collected the estate tax on all the estate instead of exempting the wife's share of the community as her own. This action was due to early decisions of the California courts which declared the wife's interest to be that of an heir expectant, whereas in other states it was declared a present fixed and vested interest.[63]

One of the greatest problems facing all American tax administrations is that of evasion. Although American fiscal writers condemn evasion as immoral and unpatriotic, American taxpayers attempt to see how much of their legal share of the tax they can escape. Representatives of the industry which gives advice in this respect are to be found in California as elsewhere, and the business of collecting the inheritance tax becomes a duel between the state and the taxpayer. There is room for the education of Californians—as of all American citizens—to the idea that the support of government is a patriotic duty shirked only by slackers. Many warm friends of the inheritance tax maintain that one of its greatest virtues is that it is the most difficult of all taxes to evade. There is, nevertheless, plenty of evasion in connection with it.[64] Like the Old Man of the Sea, evasion takes so many forms that the state must be a Hercules to deal with them all. Some of the most common, and California's provisions for checking them, will be considered here.

Failure either to report the estate or to report it at its full value has been common, especially with respect to intangibles. Real property cannot very well be hidden. California's investigator and the inheritance tax appraisers check most of such evasion, since the property cannot be transferred without probate. California is one of the few states that maintain regularly a paid officer to search for evasion—the inheritance tax investigator.[65] The ferreting out of properties legally subject to tax is the duty of the State Controller and the Inheritance Tax Department of his office. When he believes a tax is due, the State Controller and the inheritance tax attorneys have the power to inspect any books or any other papers of the estate; the divulging of any information thus acquired, except for enforcement of the tax, is a felony. No firm or corporation may refuse the State Controller permission to see or to copy the books or papers without being guilty of felony. No firm or corporation may transfer the ownership of shares of stock without the written consent of the State Controller.[66] A common form of evasion where intangibles are concerned is the use of safety deposit boxes. This sort of evasion has been a difficult problem in many states, where the banks or other institutions renting such boxes permit the heirs to have access to and to remove papers without the knowledge of the state. California forbids any person to have access to a safety deposit box after the death of any person who used it without the written consent of the State Controller. No safety deposit company may transfer any property, after the death of one of those who had access to the box, before the payment of the tax. The institution which disregards these provisions is subject to a penalty of $20,000.[67] Because of these precautions no large amounts of property would be likely to escape through failure to report.

More common now than evasion by failure of the heirs to declare the estate is evasion planned by the decedent before his death in collusion with his heirs. In this connection nothing a man does with his property before his death is evasion until his property passes to his heirs. Knowing that he is ill, or feeling merely the approach of old age, he can give his property to his heirs during his life with the sole end of evading the tax. California tries to check this practice by taxing transfers made in contemplation of death or intended to take effect at death, made as advancements, or made as revocable trusts. The inheritance tax law is by title a "tax on gifts, legacies, inheritances, bequests, devises, successions, transfers, joint tenancies and insurance."[68] Though no time is set within which gifts are taxable (as in the federal gift tax), the statute declares that "the words contemplation of death" shall be taken to include that "expectancy of death which actuates the mind of a person on the execution of his will, and in nowise shall said words be limited and restricted to that expectancy of death which actuates the mind of a person making a gift *causa mortis;* and it is hereby declared to be the intent and purpose of this act to tax any and all transfers which are made in lieu of or to avoid the passing of property transferred by testate or intestate laws."[69] In order to check evasion through transfer by simulated sales, by loading the estate with debts so that nothing will be left to tax, or by creating revocable trusts, the law regards as taxable all transfers made without "adequate and valuable consideration." In general, the courts have upheld these attempts to check evasions.[70]

Joint ownership is a device by which the decedent transfers his property to himself and the heir as cotenants. Sometimes this device takes the form of the organization of a firm to which the property is transferred. The survivor would then succeed to all or part of the property untaxed. Since 1921, California has checked this form of evasion by taxing the survivor as if he were heir to the whole.[71]

Life insurance policies are taxed above an exemption of $50,000, the tax being prorated among the beneficiaries; taxed also are estates in expectancy, contingent estates, and life estates, whose value is determined from the actuaries' tables of mortality.

Penalties for nonpayment have not changed since 1921. The tax is a lien upon the estate until paid, and must be paid even when the estate is lost to the heirs through misappropriation. The tax is due at date of death of the decedent, and if not paid within two years of that date a 10 per cent penalty accrues. The law expects that estates will be settled within eighteen months, but if for any reason necessary litigation requires more time a 7 per cent penalty is charged from the eighteen-month limit until the estate is settled.[72]

California meets a special inheritance tax problem in her community-property law. She is one of the eight states which derive their laws concerning the property relation of husband and wife from the Spanish system.[73] The California law reads: "All property of the wife, owned by her before marriage, and that acquired afterward by gift, bequest, devise, or descent, with the rents, issues and profits thereof, is her separate property.... All property owned by the husband before marriage, and that acquired afterward by gift, bequest, devise or descent, with the rents, issues, and profits, is his separate property.... All other property acquired by either husband or wife, or both, including real property situated in this state, and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this state, is community property; but whenever any property is conveyed to a married woman by an instrument in writing, the presumption is that the title is thereby vested in her as her separate property."[74]

The question then arises, what is the wife's right in community property? Has she merely the interest of an expectant heir, or has she a present fixed and vested interest? The answer to this question determines whether or not the surviving wife shall be taxed on her half of the community property. Since the community-property concept is based on the theory that both partners have worked together to accumulate the estate, such taxation of the wife on the whole of it, especially when her earnings are included in the community property, would seem to be unjust. Nevertheless, the fact that the community property has been entirely at the disposal of the husband, who can dispose of the personalty as he pleases without consulting the wife, and could until 1917 dispose of the realty, including the home, has led the courts to certain decisions about the wife's interest. The first of these antedated the inheritance tax by more than thirty years. In the case of *Van Maren* v. *Johnson*, before 1860, the Supreme Court decided that "in the common property the interest of the wife is a mere expectancy, like the interest which an heir may possess in the property of his ancestors."[75] In the Moffitt case, decided April 20, 1908, and upheld November 28, 1910, the Supreme Court of California decided: "The widow's half of the community property is taxable. She takes her share upon the death of her husband by succession as his heir and consequently the transfer comes within the provisions of the Inheritance Tax Act."[76] Because of these decisions, California was apart from other community-property states, in which the wife was permitted to make a separate return for the federal income tax, and for both the federal estate tax and the state inheritance tax was regarded as the actual possessor, not the heir, of half the community property. Both the federal estate tax and the state inheritance tax were levied upon the whole community property falling to a California widow, since the United States Supreme Court had refused to review the decisions of the California courts, on the ground that the question which was involved was a purely local one.[77]

Public opinion and the attitude of the State Controller forced moderation of the law on this question. In 1917 it was made necessary for the wife to sign instruments for the alienation of real property. In 1917, also, the Inheritance Tax Department and the Controller, influenced by the apparent injustice of the decision in the *Estate of Moffitt*, suggested that the legislature include in the law the provision "that for the purpose of this act the one-half of the community property which goes to the surviving wife... shall not be deemed to pass to her as heir to her husband, but shall, for the purposes of this act, be deemed to go, pass, or be transferred to her for valuable and adequate consideration, and her one-half of the community shall not be subject to the provisions of this act."[78] This was incorporated in the Inheritance Tax Act of 1917,[79] and since that time the widow's share has been tax-free as her own, not as a legacy from her husband. The provision is not retroactive: in the case of *Roberts* v. *Wehmeyer* [218 Pac. 22] the courts decided that community property acquired before 1917 was subject to the inheritance tax.

These changes made in the law in 1917 were not sufficient to affect the federal estate and income taxes. Basing their action upon the decisions of the United States Supreme Court in *Wardell* v. *Blum* [258 U. S. 617] and in *U. S.* v. *Robbins* [269 U. S. 315], the federal Treasury continued to collect the estate tax on the whole of the community property, and to prohibit separate returns for the income tax. Because the wife could not dispose of her half by will, and because her debts were not chargeable against the community property, both California and United States courts declared that she was still an heir. The California legislature countered by amendments designed to strengthen the wife's position: the amendment of 1923 gave her limited right to dispose of her half by will; in 1925 a clause in the inheritance tax law provided that when the husband made his will without regard to community property, and the surviving wife elected to abide by the will, her share should be exempt up to the value of half of the community. The California courts did not change their position. After lengthy consideration the federal Treasury finally declared all community property taxable to the husband in the income tax and the wife still taxable for the estate tax. However, in 1927, the California legislature added section 161*a* to the California Code, declaring that "the respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172*a* of the Civil Code. This section shall be construed as defining the respective interests of husband and wife in community property." This section was tested in the Malcolm case in 1931 [282 U. S. 792], in which the United States Supreme Court declared that the wife's interest is a present one, not that of an heir. Since 1927, then, the wife is not taxable on her share of the community property under the federal estate tax, and separate returns are permitted under the federal income tax. The amendment is not retroactive; all community property which was acquired before the effective date of the amendment is still taxable.

Other heirs to community property may be treated briefly. The surviving husband has never been taxed on any community. Other heirs, since they do not belong to the original partnership, are taxed exactly as they would be taxed on any other legacy.

Does California's community-property law give widows more favorable treatment than they receive in other states? The question becomes important when we consider that about 50 per cent of the inheritance tax is paid by widows. On the one hand, banks that maintain especial inheritance services assert that this "fortunate situation" makes possible such liberality toward widows that "few states can compare favorably with California."[80] On the other hand, the California Taxation Improvement Association in its study of the inheritance tax found that the exemption of half the community property affected 18.14 per cent of the amount of property involved in the 1,996 estates transferred in 1924–1925. Of 1,017 estates probated in Los Angeles and San Francisco counties in 1923, only 27 per cent of the total value was in community property. The average for San Francisco County is higher than that for Los Angeles, where community property forms 24 per cent of the whole, as compared with San Francisco's 29 per cent. Out of the 1,996 estates for 1924-1925, only 167 were credited with community property for exemption from the tax. According to this study, "community property scarcely appears in estates up to $50,000; the bulk of it lies in estates from $200,000 to $500,000; in these estates community property formed 38% of the whole." The analysis draws the following conclusions: "The difficulty is that community property does not exist nearly as generally as is commonly believed.... Californians have been fooling themselves in regard to community property advantages. Her citizens generally believe that more than half of all property in the State is community property. It has been claimed that as high as 65 per cent of all property in California is of this nature and that the 1925 amendment to the inheritance tax act.... would add 15 per cent more, so that 80 per cent of all property probated in California courts will enjoy the lightest death taxes in America."[81]

Our conclusions may be different in part. Many residents of the state, who have come from sections of the country where the institution of community property is unknown, do not take advantage of it because they are unfamiliar with its workings. Estates of $50,000 or less would gain no advantage from the use of the institution so long as the wife's exemption remains high. We may expect an increase of claims to community property in these estates whenever this exemption is lowered. True, the bulk of the largest fortunes at present is separate property, coming by gift or legacy to husband or wife, but in these instances the livelihood of the widow is assured in any event. We may conclude that the institution of community property is of greatest benefit to those who acquire estates by their own efforts. When we take into consideration the exemption of one-half the community, plus the $24,000 exemption on any legacy from her husband, and the low rates on the rest of her inheritance, we decide that the state of California treats widows very well.

California's receipts from her inheritance tax have formed an important part of her revenue system. From 1908 to 1933, the tax was the second contributor to the general fund in richness of returns; in 1933, it dropped to third place, where it remains at present, behind the retail sales tax and the corporation franchise tax. The net returns to the state, after the fees which are due county officials have been subtracted, have been as follows:[88]

1894....	$ 1,365.26	1908....	$ 608,943.19	1923....	$ 4,777,950.35
1895....	32,787.90	1909....	937,073.17	1924....	6,463,325.76
1896....	102,670.95	1910....	883,314.23	1925....	6,423,134.26
1897....	60,667.13	1911....	1,506,993.33	1926....	7,424,174.56
1898....	83,550.21	1912....	1,082,290.36	1927....	8,700,429.18
1899....	157,734.54	1913....	1,586,672.80	1928....	11,272,179.78
1900....	385,362.07	1914....	1,654,951.42	1929....	13,180,226.16
1901....	243,586.44	1915....	2,924,610.95	1930....	11,647,010.56
1902....	287,053.40	1916....	3,145,210.63	1931....	13,735,791.49
1903....	290,447.44	1917....	3,830,952.13	1932....	10,093,790.37
1904....	286,735.72	1918....	2,725,406.98	1933....	5,778,785.88
1905....	532,760.16	1919....	3,409,912.06	1934....	4,135,771.53
1906....	292,750.01	1920....	2,678,158.63	1935....	4,945,034.00
1907....	740,940.81	1921....	6,804,731.98	1936....	6,561,327.00
		1922....	6,344,619.35		

A perusal of these figures leads to some interesting conclusions about the inheritance tax. In the first place, the figures increased steadily but slowly until 1911, when the large pioneer estates created by men who came to the Coast in early manhood began to pass to heirs. From 1911 the increase was rapid until 1931, when the peak figure was reached at nearly fourteen million dollars; in the period of decline after 1931, the inheritance tax returns sank to a low of $4,135,000 in 1934. Much of the high collection in the twenties was a result of the swollen values of that careless decade; the subsequent shrinkage is due not only to the loss of fortunes during the depression, but to the shrunken value of the property that remained. The returns from the inheritance tax, then, are greater in years of prosperity, and fall with other values under conditions of business recession. Thus the tax can be expanded in inverse proportion to the needs of the state, which are greater in times of depression.

A second characteristic of these returns is that the productivity of the tax in any given year depends upon the number of wealthy individuals who die in that year. Although the amount collected from estates below $500,000 is not so negligible as some of the writers about this tax would have us believe, sometimes a few large estates double the returns. Thus the difference of more than four million dollars between the returns of 1920 and those of 1921 was due largely to heavy taxes upon the estate of Henry Miller, of the Miller and Lux partnership.[89] Only a few estates are large enough to feel the effects of the higher rates. In 1924–1925 fourteen estates each of more than one million dollars paid 55 per cent of the inheritance tax. In 1928–1929 thirty-two estates each valued at more than one million dollars paid $8,719,371 of the $13,334,000 total receipts.[84] This dependence of the tax upon the deaths of a few wealthy men results naturally in fluctuations of returns even during years of prosperity. Incidentally, it has led to an unseemly competition between states for residence of wealthy individuals, especially after the passage of the constitutional amendment by Florida, in 1924, forbidding all inheritance taxes. At the meeting of the second national conference on inheritance and estate taxation, held in New Orleans in 1925, Mark Graves, of the New York state tax commission, remarked: "Last year in the state of New York we collected twenty-three and one-half millions of dollars under our inheritance tax statute. We collected thirteen millions of that from ninety-eight out of seventeen or eighteen thousand estates. Ninety-eight people by removing from our state to one of the havens of refuge would cut our inheritance tax revenue in half."[85]

Most of this complication has disappeared since the enactment of the 80 per cent credit clause of the federal estate tax and Florida's repeal of her constitutional amendment; now that all the states but Nevada have death duties, the struggle for decrepit millionaires has diminished.[86]

A more minute analysis of each year's returns would give us important information about the relative percentages collected from direct heirs and collateral kindred. Naturally, these percentages have varied from state to state and from year to year. In Kentucky the direct heirs were estimated to pay 85 per cent of the tax, with 15 per cent left for brothers and sisters, more remote kin, and strangers all lumped together; the average for the states generally is placed at 75 per cent as a minimum for direct heirs. Because of the institution of community property, direct heirs in California pay a percentage slightly below the average.[87] Out of 1,996 estates closed in 1924–1925, and paying a total tax of $5,452,546.21, direct heirs (class-A: widows, lineal descendants, and lineal ancestors) paid $3,800,478.12, or 69.7 per cent of the total; class-B heirs paid 20.8 per cent; class-C heirs paid 8 per cent; and strangers, 1.4 per cent.[88]

From the foregoing discussion of the nature of inheritance tax returns, it would seem that the state should not depend upon so fluctuating a tax either for current expenses or for those expenses which belong to times of crisis. It could well be used for permanent public works, for paying a state's debts, or for building reserves in times of prosperity against the rainy day; but too much earmarking of these returns would be inadvisable. It would seem also that the high rates upon collateral relatives and strangers are not valuable to the state financially, however desirable they may be from motives of balance in the tax system.

The relatively low cost of collection has ranged from 0.016 per cent in 1929 to 0.049 per cent in 1920.[89] Though costs do not seem to follow any particular curve, they apparently were higher from 1916 to 1920, a fact which can be explained by the resentment felt at the burden imposed by both federal and state taxes. There is a question how far the state finds it profitable to increase the cost of collections in order to obtain greater revenue. There is a point of efficiency beyond which the state loses more than it gains.[90]

Before 1905, all the receipts from the inheritance tax were paid into the school fund. After 1905, the first $250,000 were paid into the school fund, the rest into the general fund. Under the statute of 1913, the first $250,000 went into the school fund, 5 per cent of the remainder into the teachers' retirement fund, and the balance to the general fund. Through the next decade, efforts were made to double the amount assigned to schools, but unsuccessfully. In 1921, the first $250,000 went to the school fund, the rest to the general fund. In 1925, all the receipts were made payable to the general fund, an allocation which has continued to the present time.

Unsure as everything connected with taxation may be, a prophet can speak with more confidence about the future of the inheritance tax than of any other source of revenue. It has lasted forty-three years. Naturally, it met with opposition when it was new, but by the time of the separation of sources in 1911 this opposition was declining, and continued to do so even in spite of the high rates of the next decade. Any protests since have taken the form of dislike of the federal tax or of high rates. The principle of a state inheritance tax has been so far accepted that in 1918 the State Controller could write: "The people of this state, we are confident, are already committed to the wisdom of this form of taxation, and while they may consent to a modification of our rates, when this may seem reasonable, they will insist, nevertheless, that the principle of the tax should be upheld and that the burden of it should be put where it belongs, on the shoulders of the wealthy, not on the back of the poor."[91]

Now in 1936, the inheritance tax is no longer in controversy. One may look long for a mention of it in the daily press or in the recent files of the *Tax Digest.* As the state makes use of regressive motor vehicle and sales taxes, the hoary-headed inheritance tax is likely to become more firmly entrenched as a corrective. Nor does California seem seriously to be contemplating the estate tax in place of the form of tax she now possesses.[illegible] The popular verdict will probably endorse the former State Controller's words, spoken before these new revenues existed: "Ordinarily, the poor man and the man in moderate circumstances pays in taxes far more than his ability to pay. The inheritance tax is a very excellent corrective and its corrective feature should be maintained."[illegible] This advice California seems minded to follow.

NOTES TO CHAPTER III

[1] *Cal. Stats.* (1893), ch. 168, p. 193. The Act of 1893 and its subsequent amendments are described in *Revenue Laws of California* (Sacramento, 1924), p. 413; see also *Estate of Stanford,* 126 Cal. 112, in *Revenue Laws of California* (1924), p. 445.

[2] Inheritance Tax Act of 1905, *Cal. Stats.* (1905), ch. 314, p. 341; William C. Fankhauser, *A Financial History of California* (*Univ. Calif. Publ. Econ.,* vol. 3 [Berkeley, 1913]), p. 350.

[3] William J. Shultz, *The Taxation of Inheritance* (Boston: Houghton Mifflin Co., 1926), p. 125.

[4] Inheritance Tax Act of 1911, *Cal. Stats.* (1911), ch. 395, p. 713; Act of 1913, *Cal. Stats.* (1913), ch. 595, p. 1066; the act as amended in 1915, *Cal. Stats.* (1915), ch. 189, p. 418, and ch. 198, p. 435; Act of 1917, *Cal. Stats.* (1917), ch. 589, p. 880. These acts are summarized in *Revenue Laws of California* (1924), pp. 414, 437–439.

[5] California Taxation Improvement Association, *Inheritance Tax Analysis* (Los Angeles, 1927), p. 19. The research for this publication was directed by Rolland A. Vandegrift.

[6] Inheritance Tax Act of 1921, *Cal. Stats.* (1921), ch. 821, p. 1500; *Revenue Laws of California* (1924), pp. 417, 440; *Cal. Stats.* (1929), ch. 844, p. 1834.

[7] *Final Report of the California Tax Commission* (Sacramento, 1929), pp. 107–109; the law as amended in 1929, *Revenue Laws of California* (Sacramento, 1932), p. 399; secs. 5, 6, 6¾ deal with rates.

[8] Amendment of 1933, *Supplement to Revenue Laws of California of 1932* (Sacramento, 1934), p. 221; Inheritance Tax Act of 1935, secs. 4, 5, *Cal. Stats.* (1935), ch. 358, p. 1266; *Revenue Laws of California* (Sacramento, 1936), p. 625; *Final Calendar of Legislative Business* (1935), p. 623.

[9] Act of 1929, sec. 6, *Revenue Laws of California* (1932), p. 409.

[10] Act of 1893, Amendment of 1897, *Revenue Laws of California* (1924), pp. 413, 414. Also *Cal. Stats.* (1893), ch. 168, p. 193; (1897), ch. 83, p. 77.

[11] Gifts made in 1915 to Princeton University, Cheshire Public Library, and Cheshire Cemetery were declared untaxable. See *Estate of Fisk,* 178 Cal. 116; *Revenue Laws of California* (1924), p. 458.

[12] *Revenue Laws of California* (1932), p. 459.

[13] Probably this deterring effect was much exaggerated. See California Taxation Improvement Association, *California Inheritance Tax Analysis,* p. 20.

[14] Act of 1921, amended in 1929, sec. 6*b*, *Revenue Laws of California* (1932), p. 409.

[15] Act of 1905, *Revenue Laws of California* (1924), p. 414; *Cal. Stats.* (1905), ch. 314, p. 341.

[16] *McDougald* v. *Low,* 164 Cal. 107; *Revenue Laws of California* (1932), p. 448.

[17] *Estate of Miller,* 184 Cal. 674; *Revenue Laws of California* (1932), p. 460; *Estate of Watkinson,* 191 Cal. 591, affirmed by the United States Supreme Court, April 13, 1925; *Stebbins* v. *Riley,* 268 U. S. 137; Act of 1921, sec. 2, subdiv. 10, *Revenue Laws of California* (1924), p. 419.

[18] Inheritance Tax Act of 1935, sec. 2, subdiv. 11, *Cal. Stats.* (1935), ch. 358, p. 1266; *Revenue Laws of California* (1936), p. 631.

[19] Sec. 3 of the 1935 act, *Revenue Laws of California* (1936), p. 632.

[20] National Tax Association, *Proceedings* (1924), Appendix, p. 7. On p. 14 of the association's *Report of the National Committee on Inheritance Taxation to the National Conference on Estate and Inheritance Taxes* (1925) is to be found the following statement: "If uniformity and equality as between individual taxpayers, prime requisites of any just tax, are to be obtained in inheritance taxation, the laws and rates must be stabilized and placed on a more permanent basis. So long as the laws and rates are changed

with the varying moods of legislative bodies, inequalities and injustice will prevail. The committee recognizes that many changes in present inheritance tax laws will be necessary to accomplish uniformity and to correct the abuses which are pointed out in this report, but when once this necessary reform is put into effect the laws and rates should remain stable."

[21] For an extended discussion of relationship discrimination, see Shultz, *The Taxation of Inheritance*, p. 260.

[22] *Estate of Wilmerding*, 117 Cal. 281; *Revenue Laws of California* (1924), p. 445.

[23] *Estate of Watkinson*, 191 Cal. 591, affirmed by the United States Supreme Court, April 13, 1925; *Stebbins* v. *Riley*, 268 U. S. 137; *Revenue Laws of California* (1932), p. 466.

[24] Inheritance Tax Act of 1935, sec. 24.

[25] William C. Fankhauser, *op. cit.*, p. 352; *Revenue Laws of California* (1924), p. 413.

[26] California Inheritance Tax Act of 1935, secs. 19, 20.

[27] Shultz's comment on local collection (*The Taxation of Inheritance*, p. 143): "Unless the county is to receive some benefit from the tax, these officials are rarely likely to prove overzealous in their office. A partial remedy for this situation has been the sharing of the revenue from the tax between the state and the county."

The view of State Controller John S. Chambers (*Biennial Report of the State Controller* [1914], p. 42): "An aggressive enforcement of a law which offers such fruitful reward where violation is possible, must needs be supervised by a well organized central department."

[28] Inheritance Tax Act of 1935, sec. 15.

[29] *Revenue Laws of California* (1924), p. 414; Inheritance Tax Act of 1935, sec. 15. Also *Biennial Report of the State Controller* (1914), p. 41: "The question of providing for adequate compensation to the appraiser, without opening the door to difficulty in adjusting compensation, is one of the problems that will have to be solved by future legislation, but it seems wise, while the law is in the course of construction, to leave these matters to be settled when experience has developed a basis for some general system that can be applied to the varying conditions that exist in the various counties of the state."

[30] *Revenue Laws of California* (1932), p. 434. Also *Biennial Report of the State Controller* (1918), p. 31: "The time has now arrived when it seems best to enlarge upon the valuation side of the department's duties. Not only will this be a big advantage in the appraisement work itself, but also it will soon give the state an immense amount of information whereby we may approach some standardization in the valuations of our wonderfully variable lands. . . . It seems important, as far as possible to place some uniformity of valuations upon lands adaptable to similar uses. . . . Variations in similar lands in different sections have often been due to a difference in standards rather than to any intrinsic difference in value."

[31] The report of the fact-finding committee reads (*Senate Journal* [1933], p. 756): "It is felt that the reduction in the number and size of estates subject to the inheritance tax has been great enough to relieve the Inheritance Tax Department of the Controller's office of considerable work, and that a reduction in the budget allowance for this activity could be made."

[32] "Confiding the administration of the tax to the State Attorney General or the State Auditor is no assurance of administrative efficiency, because the assessment and collection of a death tax can never be more than an incidental function for these offices. Effective administration of state death taxes can be had only when the tax is handled by a state tax commission or some other body that can make the assessment and collection

of the tax one of its major interests."—William J. Shultz, *American Public Finance and Taxation* (rev. ed.; New York: Prentice-Hall, 1935), p. 582.

[33] William J. Shultz, *The Taxation of Inheritance*, p. 317.

[34] National Tax Association, *Report of the National Committee to the Second Conference on State and Inheritance Taxation* (New Orleans, 1925), p. 69: "The committee is firmly of the opinion that centralized administration of death taxes is imperative if the best results are to be obtained. The state tax commission is the natural vehicle for administration. States which do not have a tax commission will assign administration to some other appropriate state body or officer."

[35] National Tax Association, *Proceedings* (1924), Appendix, p. 5; Albert Handy, "Effect of Recent Decisions on the Taxation of Nonresident Estates," *ibid.*, p. 14; remarks of Fred R. Fairchild, in National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation* (New Orleans, 1925), p. 22.

[36] *Estate of Hearst*, 198 Cal. 77; *Estate of Harkness*, 176 Cal. 537. Decisions regarding the inheritance tax are quoted in *Revenue Laws of California* (1932), pp. 454, 471.

[37] William J. Shultz, *The Taxation of Inheritance*, pp. 130–139.

[38] *Ibid.*, pp. 234–259.

[39] "In this connection it is worthy of note that there has never been any serious objection to the inheritance tax as applied to real estate."—J. S. Matthews, assistant attorney general of New Hampshire, "Experience with the Flat Rate Plan for Taxing Nonresident Estates," in National Tax Association, *Proceedings* (1924), Appendix, p. 45.

[40] National Tax Association, *Model Inheritance Tax Law of 1910*, sec. 2; *Model Inheritance Tax Law of 1922*, sec. 2.

[41] *Frick* v. *Pennsylvania*, 268 U. S. (1925) 603.

"The result, while conflicting with some of our announced principles, and conflicting equally with the practices of some of our states, is nevertheless a solution of the problem which must, we believe, in the long run, commend itself to the sound judgment of the American people."—Fred R. Fairchild, in National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation* (New Orleans, 1925), p. 20.

Bills and specie in a safety deposit box outside the state of domicile are taxable in the state where they are located. See *Blodgett* v. *Silberman*, 277 U. S. (1928) 1; *Baldwin* v. *Missouri*, 281 U. S. (1930) 586.

[42] *Estate of Hodges*, 170 Cal. 492; *Revenue Laws of California* (1924), p. 451.

[43] Inheritance Tax Act of 1935, sec. 2.

[44] *Estate of Hodges, supra.*

"It is scarcely necessary for me to preface this extract by reminding this audience that the state of domicile of the decedent has without any question jurisdiction over intangible personal property, and it is safe to assume that such state will always impose this tax to the full extent of its ability."—Fred R. Fairchild, National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation*, p. 21.

[45] *Estate of McCahill*, 171 Cal. 482; *Revenue Laws of California* (1924), p. 452. Also *Biennial Report of the State Controller* (1924), p. 16: "Owing to California's geographical and climatic conditions, it was deemed advisable by the Controller within the past two months to issue a ruling to the effect that bank deposits and bonds in this state, at the time of a nonresident's death, would not be subject to inheritance taxation. The loss of revenue is so slight and the gain to the businesses of the state of such moment, that any small decrease in tax collections is offset by the state's material gain in other channels. Besides, the moral effect of the ruling must tend to make California the favored state of wealthy eastern tourists."

[46] "There has in recent years been a marked tendency on the part of legislative bodies

to extend the scope of death taxes, so as to include the property of nonresidents located within the taxing state. . . . Undoubtedly, if the property taxed is really within the jurisdiction, the tax is lawfully imposed."—Albert Handy, "Effect of Recent Decisions, etc.," in National Tax Association, *Proceedings* (1924), Appendix, p. 15.

[47] *McDougald* v. *Low*, 164 Cal. 107; *McDougald* v. *Lilienthal*, 174 Cal. 198; *Chambers* v. *Mumford*, 187 Cal. 228; *Revenue Laws of California* (1932), pp. 448, 454, 465. Also *Biennial Report of the State Controller* (1922), p. 13: "California is a desirable state as the principal place of business of corporations from an inheritance tax viewpoint. For this it is on the list of those states who do not tax a nonresident decedent who owns bonds issued by domestic corporations; thus removing a substantial barrier to the marketability of such securities."

State Controller Ray L. Riley in his biennial report of 1930 (p. 12) gave the four possible situses for the inheritance tax on intangibles as: (1) the state of the decedent's domicile; (2) the state of the debtor's domicile; (3) the state in which the instrument is physically located; (4) the state in which the intangible is an integral part of local business.

[48] "It has long been foreseen that a continuance of the taxation of the transfer of personal property of non-residents would eventually destroy the usefulness of an otherwise just and equal tax."—J. S. Matthews, "Experiences with the Flat-rate Plan for the Taxation of Non-resident Estates," in National Tax Association, *Proceedings* (1924), Appendix, p. 46.

[49] National Tax Association, *Model Inheritance Tax Law of 1910*, sec. 2; *Model Inheritance Tax Law of 1922*, sec. 1.

[50] The Supreme Court of North Carolina declared (*Rhode Island Hospital Trust Co.* v. *Doughton*, 121 S. E. 741): "The legislature intended to put aside the fiction of separate interests between the corporation and its shareholders and to impose an inheritance tax upon the transfer . . . of the interests of non-resident stockholders. . . . Unless this view is to prevail, a corporation, created under the laws of another state, may come into North Carolina, with all of its property located here and protected by our laws, with its entire business carried on in this state, and yet the holdings of every non-resident stockholder would be exempt from our inheritance tax laws. It was the purpose of the legislature to prevent such a contingency or possibility."

In presenting both sides of the question, William J. Shultz has summarized the argument for the "situs" states as follows: Undeveloped countries are usually exploited by corporations whose securities belong to residents of other communities. These undeveloped countries advocate situs as a principle for inheritance taxation of corporate securities because so large a part of corporate wealth is owned by outsiders; because the states which tax on domicile derive so large a part of their revenues from the undeveloped states; because absentee owners do not feel obligations toward the places whence their profits come. The Latin-American countries, the British dominions, the western American states all favor situs.

The "blue-sky" states give another angle to the problem. According to Shultz (*The Taxation of Inheritance*, p. 244), "Those states like New Jersey and Illinois which have large numbers of corporations formed under their laws are not going to see the wealth represented by these corporate activities pass out of their borders to swell the taxable wealth of the states where the security owners live, without seeking to divert some of this stream of wealth into their own coffers."

[51] For a full discussion of this plan, see J. S. Matthews, attorney general of New Hampshire, "Experiences with the Flat-rate Plan for the Taxation of Non-resident Estates," in National Tax Association, *Proceedings* (1924), Appendix, p. 44.

[52] The recommendations of these conferences of the National Tax Association are con-

tained in the *Report of the National Committee of the Conference on Estate and Inheritance Taxation* (1925), pp. 10, 40, 48. The reciprocity clause, which was adopted by 39 of the 47 inheritance tax states before 1932, was adopted by California in 1927, and is section 6 of the Inheritance Tax Act of 1935. See also F. S. Edmonds (chairman), "Report of the Committee on Reciprocity in Inheritance Taxation," in National Tax Association, *Proceedings* (1929), p. 200.

[53] For a list of these decisions, see William J. Shultz, *American Public Finance and Taxation* (1935 ed.), p. 575.

[54] The New York state tax commission ruled in 1916 that residence was the greater part of twelve consecutive months out of the last twenty-four of the decedent's life. The appellate court of New York decided that this rule was merely a presumption which could be destroyed by the evidence. See William J. Shultz, *The Taxation of Inheritance*, p. 237. See also Farwell Knapp, "Double Domicile in Inheritance Taxation," in National Tax Association, *Proceedings* (1935), pp. 201–213.

[55] See remarks of W. B. Belknap and of Mark Graves, in National Tax Association, *Proceedings* (1924), Appendix, pp. 4, 81; also *Biennial Report of the State Controller* (1916), p. 32.

[56] According to Controller Chambers (*Biennial Report of the State Controller* [1918], pp. 29, 30): "The inroads are beginning already to tell upon us and will tell upon us more. Far greater annual revenue is now collected in inheritance tax upon California property by the federal government than is collected by our state. Out of the Henry Miller estate alone the federal government is demanding about six million in tax and penalty, and the state less than a third of that. . . . We may look forward to a bitter attack on the state tax." He proposed that the federal tax reach the swollen millions and leave the state free to tax estates of less than ten millions. See also Inheritance Tax Act of 1921, sec. 2, clause 9; Inheritance Tax Act of 1935, sec. 2, clause 9.

[57] National Tax Association, *Report of the National Committee to the Second Conference on Inheritance and Estate Taxation* (1925), pp. 10, 29; Mark Graves, National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation* (1925), p. 10.

[58] 44 *U. S. Stats. at Large* (1926), p. 834 (the 25 per cent credit clause) and p. 2007 (the 80 per cent credit clause).

[59] California Inheritance Tax Act of 1921, as amended in 1927, sec. 2¾; Inheritance Tax Act of 1935, sec. 2, clause 12.

[60] *Supra*, p. 61.

[61] California Taxation Improvement Association, *The Vanguard* (December, 1927), p. 10. This publication contains an account of the activities of a delegation from California to Washington who were working for repeal of the federal estate tax.

[62] National Tax Association, *Proceedings of the Second National Conference on Estate and Inheritance Taxation* (New Orleans, 1925), p. 15. William J. Shultz (*The Taxation of Inheritance*, p. 322) was of the opinion that, "were it not for the existence of the federal estate duty, the action of a few states like Florida, Alabama, and Nevada in declining to levy inheritance taxes would have the effect of causing all the other states to greatly reduce their inheritance tax rates to check the shifting of tax domiciles to these states. The existence of the federal estate duty with its present 80% deduction to cover state inheritance taxes is the main safeguard of the states' income from their inheritance taxes."

[63] Corporation Trust Company, *Inheritance, Estate and Gift Tax Service*, vol. I (New York: Corporation Trust Co., 1935), pp. 217–219, par. 3452.06, 3451.173.

[64] According to Shultz (*The Taxation of Inheritance*, p. 316): "No estimate has been made of the evasion and avoidance of the American inheritance taxes, but it is no un-

usual occurrence for a man of reputed great wealth to leave a taxpaying estate of very moderate size, while the children or next of kin at this same period seem to experience considerable prosperity; could reliable figures be obtained, they would beyond all question prove startling."

The State Controller in his biennial report of 1914 wrote as follows (p. 40): "Evasions of the tax are usually planned in secret, the procuring of evidence is often hard, the state is frequently compelled to call as witnesses persons hostile to its payment. Those who usually know most about a decedent's affairs are those who are recipients of his bounty.

"Even where the property chargeable with tax is all before the court, it is possible for a difference of opinion to arise between the inheritance tax department and the estate chargeable, wherein the valuation contended for by the state may be double that contended for by the parties taxed. In estates that run into the millions, where the tax itself may run from a quarter to a half million, it is reasonable to suppose that the attorneys opposing the state will be skilled and highly paid, and that they will have at their service the best experts that money can buy."

[65] *Biennial Report of the State Controller* (1932), p. v.

[66] Inheritance Tax Act of 1935, secs. 12, 13. These sections were originally written in 1921, but the safety box provision has been part of the law since 1905.

[67] *Ibid.*, sec. 13. According to the State Controller (*Biennial Report of the State Controller* [1914], p. 41): "It may be fairly said that the examination which is required under section 13 is a guarantee that evasion will not take place." For an out-of-state discussion of this question of safety boxes, see the remarks of Frederick Vierling, in National Tax Association, *Proceedings* (1924), Appendix, p. 30.

[68] Inheritance Tax Act of 1935, sec. 1.

[69] *Ibid.*, sec. 2.

[70] Cases involving gifts without adequate and valuable consideration form a high percentage of those coming before the courts on questions concerned with the inheritance tax.

[71] Inheritance Tax Act of 1935, sec. 1, clause 5. How inefficient the collection of the inheritance tax may be under local administration is apparent from the comment (National Tax Association, *Proceedings* [1924], Appendix, p. 69) that in Virginia, before 1923, twenty-four of the richest counties had not paid a tax in five years.

[72] Inheritance Tax Act of 1935, secs. 3 and 7. The Act of 1921 applied the 10 per cent penalty eighteen months after the death of the decedent. See also the *Estate of Hite*, 159 Cal. 392; *Revenue Laws of California* (1932), p. 448.

[73] The Spanish law differed from the California law by providing that the income from the wife's separate property should be community property. The other community-property states are Arizona, Idaho, Louisiana, New Mexico, Nevada, Texas, and Washington. The only consecutive account of community property in relation to the California and the United States death taxes is Ralph W. Smith, "California Problems," in National Tax Association, *Proceedings* (1924), Appendix, p. 22.

[74] *Civil Code*, secs. 162, 163, 164.

[75] 15 Cal. 310.

[76] See *Estate of Sims*, 153 Cal. 365; *Estate of Moffitt*, 153 Cal. 359; 218 U. S. 400. Other decisions: *Estate of Brix*, 181 Cal. 667; *Chambers* v. *Gibb*, 186 Cal. 196; *McDougall* v. *Federal Trust Co. et al.*, 186 Cal. 243; *Revenue Laws of California* (1932), pp. 447, 459, 460.

[77] *Moffitt* v. *Kelly*, 218 U. S. 401.

[78] "It is my hope that the coming legislature will see fit to so amend that portion of the inheritance tax law of the state as to place the wife upon an equal footing with the husband in the matter of community property. . . . In view of the very important part

the wife plays in the accumulation of community property, justice requires that she be granted this exemption and not be kept at a disadvantage with the husband."—*Biennial Report of the State Controller* (1916), p. 31.

[79] Inheritance Tax Act of 1917, sec. 1.

[80] Security-First National Bank of Los Angeles, *California Inheritance Tax and Federal Estate Tax* (Los Angeles, 1934), p. 10 (pamphlet).

[81] California Taxation Improvement Association, *California Inheritance Tax Analysis*, p. 15.

[82] These figures are taken from *Biennial Report of the State Controller* (1914–1936); the figures for 1894–1907 are taken from William C. Fankhauser, *A Financial History of California*, p. 353; the figures for 1935 and 1936, from Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[83] California Taxation Improvement Association, *California Inheritance Tax Analysis*, pp. 10, 19. Also *Biennial Report of the State Controller* (1916), p. 27; (1924), p. 17; (1930), p. 13.

[84] California Taxation Improvement Association, *California Inheritance Tax Analysis*, pp. 10, 19; *Biennial Report of the State Controller* (1930), p. 13.

[85] National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation* (New Orleans, 1925), p. 15.

[86] A further comment of Mark Graves (*ibid.*, p. 17), follows: "We believe this, that Florida, nor any other state, no matter how beautiful the sunshine or how healthy the climate, can pay governmental expenses by those gifts of the Divine Being. . . . We believe that if the hopes and expectations of Florida are realized and as many people move to Florida as they hope will move there, that in the long run it will cost Florida just as much to furnish those people with the same kind of governmental service that we have been furnishing them in your state and mine, as it does us, and they will have to get money from somewhere. They will not finance it out of a nice climate or their beautiful beaches or anything of that sort. They will be confronted with the problem of building roads and streets and sewers and sidewalks, of building garbage disposal plants and waterworks; they will find that their school system is not as good as the school systems in some of our states; and in the final analysis some one will have to foot the tax bill. It may be, when the time comes, they will decide to raise it all on property, and the tax on intangibles, or may be that they will do as some of the other states have found it necessary to do, amend their constitution and levy an income tax and perhaps an inheritance tax."

[87] "We found from the best experience we could get that about 85%, approximately, of all death taxes were paid by people receiving the money in the direct line. That left in the other line brothers and sisters and all sorts of various degrees of relationship and strangers in blood only about 15% of the total tax—almost a negligible amount. The fact is, I have talked to innumerable men over the country and never found but one case where a large estate was ever left to a stranger in blood."—William B. Belknap, National Tax Association, *Proceedings of the Second National Conference on Inheritance and Estate Taxation* (New Orleans, 1925), p. 29. See also Alfred S. King and Malcolm M. Davisson, "Inheritance Taxation," in Bureau of Public Administration, University of California, *Publications*, Legislative Problem No. 6 (December 15, 1934), p. 6.

[88] California Taxation Improvement Association, *Inheritance Tax Analysis*, pp. 20, 21.

[89] *Biennial Report of the State Controller* (1912–1934), Index.

[90] "Normally, the percentage cost of collection will increase as the collections are increased. The matter of percentage cost of collection is largely a matter of diminishing returns. . . . How far the state should increase the cost of collection in order to increase

the revenue from this source seems to be largely a matter of diminishing returns."—*Biennial Report of the State Controller* (1914), p. 39.

[61] *Biennial Report of the State Controller* (1918), p. 30.

[62] The National Tax Association committee on inheritance and estate taxation recommended in 1925 that the states substitute estate taxes for their inheritance taxes. See National Tax Association, *Report of the National Committee on Estate and Inheritance Taxation* (New Orleans, 1925), p. 34.

[63] *Biennial Report of the State Controller* (1918), p. 30.

IV. TAXES ON AUTOMOBILES

STATE TAXES ON AUTOMOBILES and their operation are definitely the result of the need to finance a highway program. He who would comprehend the increased burden which the automobile has laid upon the government need but count the number of measures pertaining to motor vehicles at each legislative session. With motor vehicles came regulation, a special sort of police protection, and, most expensive of all, the thick, broad, hard-surfaced road. These services were too costly for local government to provide. Like other states, California began early in the century to adapt the machinery of the state government to the new problems. Like other states, she had to invent and develop a system of regulation, of highway construction, and of revenue to maintain these desirable activities.

When the automobile arrived, roads were being built by counties from the proceeds of the general property tax, the rural road tax, and bond issues. As soon as the automobile demanded a more expensive type of road, the state began to extend help by developing a state highway system supported by state funds.[1] These sums were appropriated from the general fund. In 1905 the state levied the first of its taxes on automobiles, the motor vehicle registration fee; as the state highway program developed beyond the capacity of this fee, appropriations, and bond issues, the fuel tax was added. With these new revenue sources established, theory shifted from the idea that road development benefited the property owner to the belief that the highway user was the receiver of the benefit, and therefore the proper taxpayer. The state revenue system as it has developed to the present time contains four taxes on automobiles. The first two of these, the registration fee and the motor vehicle fuel tax, are special taxes on the highway user for the use he makes of the roads. The second group contains taxes of a more general character, not at all taxes for the use of highways, although there is always present a muddled tendency to treat them as if they were: the business tax on motor vehicle transportation for hire, and the "in lieu" or value tax, which has supplanted the old personal property tax on automobiles.

California began levying a registration fee in 1905, when only five other states had such a tax. The purpose was purely regulatory; annual

[1] For notes, see below, pp. 115–123.

registration was not required.[2] Early license fees in the United States were experiments with levies in respect to weight, horsepower, piston displacement, or combinations of these; California bothered with no complications but levied a flat rate of $2.00 on all types of vehicles, a practice in which she followed the example of New York. When the New York law was changed in order that the state might obtain more revenues for the support of a highway program, California changed her law for the same reason, and enacted her first true motor vehicle code in 1913.

During the decade 1910–1920, horsepower was popular as a basis for determining registration fees. This California law of 1913, which was to produce not only "a handsome revenue but one that will grow,"[3] classified motor vehicles according to horsepower. The only exception to the rule was the motorcycle, which continued to pay a flat rate of $2.00. By creating the "motor vehicle fund" as a depository for these fees, instead of assigning them to the general fund, the law set a precedent for the many funds, and for the earmarking practices, which have characterized California highway finance ever since. When the receipts were deposited in the new fund, the Motor Vehicle Department might draw upon them for expenses up to $150,000. The device of issuing license plates (one for a motorcycle, two for each motor vehicle) was used to indicate which cars had paid the fee, and the expense was charged to the Motor Vehicle Department.[4] After this allowance of $150,000 had been made, one-half of the remainder was divided among the counties in proportion to the number of motor vehicles registered from each. The county share was to be placed in the county road fund and was to be spent only for roads. If a county did not have a road fund, its share was to be retained in the state motor vehicle fund until the county established a road fund. The state's share was to be spent by the Department of Engineering for improvement and maintenance of state roads. Thus there began early the practice of dividing between the counties and the state the highway revenues collected by the latter. The law of 1913 was repealed in 1915, but its general features were reiterated in the Motor Vehicle Act of 1915,[5] which replaced it. In spite of some opposition from county officers this act remained in force until 1923, and, when superseded, its constitutionality and usefulness were well established.

The Act of 1913 was less fortunate in the permanency of its schedule of fees.[6] In addition to a flat rate of $2.00 for every motorcycle, the schedule included the following charges on motor vehicles, based on horsepower rating:

Less than 20 horsepower	$ 5.00
20–30 horsepower	10.00
30–40 horsepower	15.00
40–50 horsepower	20.00
50–60 horsepower	25.00
Over 60 horsepower	30.00

These rates when put into operation were unsatisfactory. The Motor Vehicle Act of 1915 replaced them with new rates,[7] which were as follows:

Motorcycles	$2.00
Motor vehicles other than electric	.40 per horsepower

Motor vehicles with other than pneumatic tires and used for commercial purposes paid, in addition to horsepower rating:

Less than 4,000 pounds unladen	$ 5.00
4,000–6,000 pounds	10.00
6,000–10,000 pounds	15.00
Over 10,000 pounds	20.00

Manufacturers' registration: $25.00 for the first five vehicles and $2.00 for each one in excess

Electric motor vehicles: $5.00

A general reorganization of California highway finance took place in 1923, with the enactment of three measures: a new motor vehicle act, a motor vehicle fuel tax act, and a tax on motor vehicle transportation companies. The new motor vehicle act abandoned horsepower as a measure of the registration fee. Vehicles were divided into important classes: motorcycles, motorcars, electric vehicles, heavy motor vehicles, and heavy electric vehicles. Motorcycles continued to pay their original $2.00 fee for registration; all other motor vehicles except electric ones paid an annual flat-rate fee of $3.00 for each vehicle; electric passenger vehicles paid $10.00.[8] The registration fee was required for all motor vehicles except farm implements, and "special mobile equipment," and those owned by governmental units, nonresidents, and dealers; concerning these, special arrangements were to be made. The Act of 1923, with amendments, was in force until 1935. The Act of 1935 is the same in most of the important financial provisions, including the $3.00 and

\$10.00 flat-rate fees. The fee is payable to the Department of Motor Vehicles when the owner applies for a registration license.

Although California and the District of Columbia are the only jurisdictions with so low a registration fee, this state has had gratifying returns from it due to the large number of cars in proportion to the population. Even in 1913 the registrations were 106,000.[9] In 1929 California had one automobile for every 2.76 persons; though the number declined to one for every 3.11 in 1934, it is increasing now.[10] The registration fee ranks fifth in yield among the state taxes. Returns have been as follows:[11]

1914....	\$1,218,466.00	1922....	\$ 8,318,807.59	1930....	\$ 9,825,646.72
1915....	2,034,770.00	1923....	9,836,583.72	1931....	9,725,977.89
1916....	2,190,538.21	1924....	5,665,086.26	1932....	9,289,018.46
1917....	2,721,061.14	1925....	7,621,142.27	1933....	8,870,497.49
1918....	3,529,803.87	1926....	8,194,388.14	1934....	8,639,951.83
1919....	4,211,075.43	1927....	8,554,998.77	1935....	10,200,606.99
1920....	5,484,373.73	1928....	8,833,901.76	1936....	11,607,542.43
1921....	6,463,561.71	1929....	10,020,592.25		

Since 1913 the first charges against the fees have been the license plates and other costs of administration, and the state highway patrol; these amount to 35 per cent of the returns.[12] When these costs are satisfied, the remainder is divided equally between the state and the counties. The counties' share is distributed in proportion to the number of registrations from each county, and, as before, must be used for roads.

Flat-rate registration fees do not measure the amount of destructiveness to the highway. Ordinary passenger cars are not so expensive for the state as are heavy vehicles, such as buses and trucks, especially when the latter are too heavily loaded and are equipped with solid tires. Taking into consideration the greater destructiveness of heavy trucks,[13] the Act of 1923 introduced a special group of weight fees for these vehicles. The California scheme is based upon unladen rather than total weight, although the vehicle and the load combined really are the destructive agents. The fees which apply to all heavy motor vehicles except those owned by governmental units, and except those operated as common carriers during the years 1926–1935, are in addition to the \$3.00 and \$10.00 flat-rate fee. The greater destructiveness of solid tires has been recognized by the provision in all the acts from 1923 to 1935 that the rates on vehicles equipped with solid tires should be double the rates on those with pneumatic tires. The rates of 1929 are still in force.[14]

Although the simplest of the automobile taxes, the motor vehicle fuel tax is the most productive and bears the greatest share of the support of highways. The name by which it is commonly known, the "gas tax" or gasoline tax, is really not accurate, because the tax is laid on all fuels used by motor vehicles in traveling over the public highways. It is a relatively new tax. President Wilson advocated a one-cent federal fuel tax in 1915, but without result. Oregon made the first use of

TABLE 10

RATES UNDER THE LAWS OF 1923 AND 1925

Weight of vehicle	1923			1925		
	Electric	Solid-tired	Pneumatic-tired	Electric	Solid-tired	Pneumatic-tired
Less than 3,000 pounds, unladen.	$50	$10	$ 5	$40	$10	$ 5
3,000–6,000 pounds, unladen.	50	20	10	40	20	10
6,000–10,000 pounds, unladen.	50	30	15	60	30	15
10,000 pounds or more, unladen.	50	40	20	80	40	20

it in 1919; ten years later every state had such a tax, and the federal government followed their example in 1932.[18] The tax is based upon the benefit theory; by paying it, highway users contribute to the maintenance and construction of the roads they necessitate in proportion to the use they make of them. From the beginning, the tax has been earmarked for the use of roads, though under the financial stress of depression years some states have been forced to use it for other purposes, and have felt justified in so doing because of the contribution made to road building by the old county road tax. Surprisingly, the tax has been popular with everyone but the oil companies. Even the courts have looked on it with favor.

California levied her first motor vehicle fuel tax in 1923. Like most other states, she adopted it because the state was assuming a greater share of the cost of highways and because bond issues were at once too heavy for the general fund and inadequate to the highway needs of the state. Three bond issues, the $18,000,000 issue under the State Highways Act of 1909, the $15,000,000 issue of 1915, and the $40,000,000 issues of 1919 and 1920,[16] were not sufficient even for maintenance, to say nothing of new construction. Though the state's credit was so good that the Controller disposed of the bonds without difficulty, a continued expansion of borrowing was not desirable. Therefore the state legislature passed the Motor Vehicle Fuel Tax Act of 1923.

The act levied upon distributors of motor vehicle fuel in this state a tax of two cents for every gallon they sold for use in propelling vehicles over the public roads of the state. The proceeds were to be divided equally between the state and the counties and were to be used by both agencies in the maintenance of highways.[17] New highways could not be built from these funds, nor could the interest on the bonds used in the building of previous highways be paid from them. With amendments, which will be discussed later, this Act of 1923 remains in force at the present time.

TABLE 11

RATES UNDER THE LAWS OF 1927 AND 1929

Weight of vehicle	1927			1929		
	Electric	Solid-tired	Pneumatic-tired	Electric	Solid-tired	Pneumatic-tired
Under 3,000 pounds, unladen	$50	..	..	$50	..	..
3,000–6,000 pounds, unladen	50	$ 30	$15	50	$ 16	$ 8
6,000–10,000 pounds, unladen (total weight 22,000 pounds)	70	80	40	70	80	40
Over 10,000 pounds, unladen	90	100	50	90	100	50
Total weight of 22,000 pounds, but unladen weight 6,000 pounds	90	140	70	90	140	70

Once in operation, the act met with general approval from tax agencies, and from the public. The State Board of Equalization wrote of it: "The motor vehicle fuel tax has raised more funds for state purposes than any other levy. After five years of administration of this tax, we are led to conclude that it is the most scientific and, at the same time, the simplest and most economical method of raising revenue that the state has yet devised."[18] Indeed, a tax that raises large revenues and is also popular is not found every day. The fuel tax solved the problem of financing the state highway system.

Between 1923 and 1933 additions were made to the act. At successive sessions the legislature passed the various amendments[19] suggested by the State Controller and the State Board of Equalization in the interests of easier administration. In 1927 the popular demand that new construction be financed from the gasoline tax led to the passage of the one-cent tax, all of which went to the state for new roads.[20] Since California raised the rate to three cents a gallon, most of the other states have gone above her in rate, though not in amount of tax collected. Influenced by a desire to relieve those who paid the general property tax, the California Farm Bureau Federation and its Research Department proposed in 1931 that the fuel tax should be raised to four cents, and that the last cent should be returned to the counties to lessen the burden of the general property tax, a large percentage of which, it was estimated, went for county roads.[21] The Farm Bureau's proposal, although persistently kept before the legislature, failed to pass.

The illogical proceeding of collecting two taxes on motor vehicle fuel led in 1933 to further amendments which laid one three-cent tax; one-third of the receipts was to be distributed to the counties and two-thirds were to be retained by the state.[22] Amendments of 1935 had to do with the distribution of the returns. The narrative of the fuel tax is comparatively simple.

Administration of the tax proved easy. By the time the tax on motor vehicle fuel became law, state control of the collection of state funds had long been recognized; therefore the tax started with a whole central machinery for its administration. County authorities are not involved, except when the Attorney General sues in the local courts. Responsibility is fixed on three state agencies: the State Board of Equalization assesses it, the State Controller collects it, and the Attorney General prosecutes cases of delinquency.

Under the law of 1923, the tax was due forty days after the end of each quarter, the quarters ending December 31, March 31, June 30, and September 30. Twenty days after each of these dates, the distributor filed his report of gross receipts with the State Board of Equalization, which computed his tax and sent the information to the Controller. Within forty days after the quarter's end, the distributor was required to pay the tax to the Controller.[23] In 1925, the forty days' leeway was cut to thirty-five and penalties were stiffened. In 1931 the act was amended to make the tax payable monthly, and to provide that distributors might pay in weekly installments if they desired.[24] The monthly collection, by assuring the state a regular yield, exerts a stabilizing influence on the state's finances.

The most important administrative problems which arose had to do with methods of assessment. Since under the law the "distributor" is the taxpayer,[25] the State Board of Equalization needed some method of determining who were the distributors to be assessed. A method was provided in the law of 1923, which required that all distributors of motor vehicle fuel be licensed by the board within ten days after the act became effective.[26] Forms of application for a license, registration forms, etc., were to be supplied by the board. By the first law, twenty days after December 31, March 31, June 30, September 30, respectively, the distributor was required to file a record of all fuel manufactured, imported, or sold by him. To check his report, the board had access to his books and records, on the basis of which it assessed the tax. The law became more strict in 1931. Before April 1, 1931, every distributor was required to make application to the board for a license and was forbidden to engage in the business of selling motor vehicle fuel until he had one.[27] As early as 1924 the State Controller had recommended that the distributor give some sort of bond.[28] By the amendment of 1931, it became mandatory for the board to require of a distributor an annual bond fixed as near to the sum of twice his monthly license tax as the board could estimate (or twice his weekly license tax if he chose to pay weekly installments), but the total amount of the bond must in no instance be less than $1,000.[29] All producers and distributors are required to reregister yearly, the fee for reregistration being $10.[30] Amendments of 1933 made a license nontransferable.[31]

The small number of taxpayers has made for ease of administration. Owing to the high degree of organization in the motor fuel business, the taxpayers numbered only 65 or 70 in 1924, 80 in 1926, 150 in 1935.[32] The taxpayer is the first seller, and collection is kept near the source.

Once the taxpayer is determined upon, the next question is, "What is taxable?" All motor vehicle fuel is taxable if it is used to propel vehicles over the highways or public roads in the state. The first law defined motor vehicle fuel as "all gasoline, distillate, benzene, naphtha, liberty fuel, and other volatile and inflammable liquids produced or compounded for the purpose of, or which may be used in, operating or propelling motor vehicles, except kerosene and except unfinished products requiring rerun, blending, or compounding and which are not used or sold for use in such form for the purpose of operating or propelling motor vehicles."[33] So lengthy a definition was made necessary because of attempts to escape taxation by mixing fuels. Although the California Tax Research Bureau recommended that Diesel oil, butane, and other new compounds be included, these remained untaxed until 1937.[34] The 1933 law was not so generous as earlier ones; kerosene only is excepted; all fuels used in the explosion type of engine are taxable.

Not all sales of motor vehicle fuel are taxable; the distributor is allowed to deduct one per cent from his gross receipts to cover losses due to evaporation and handling.[35] Sales of fuel for purposes other than use on the public roads are also exempt, and the tax on these is refunded if collected.[36] Sales to the United States government, or sales made on land belonging to it, such as the presidios, are also tax-free.[37] Early in the history of the tax, distributors refused to pay the tax due on fuel sold under contracts entered into before the act became effective. This practice was stopped by an amendment of 1925 which eliminated the contract clause of the earlier law.[38] Sales for export are also exempt.[39] These sales must be reported, but the tax on them is refunded.

Refunds upon fuel sold for purposes other than use on the public roads make a problem peculiar to the fuel tax. Such refunds range from 5 to nearly 11 per cent and average 9.01 per cent of the entire collection. Sixty per cent of the refunds are paid to farmers "on account of an alleged use of motor vehicle fuel for agricultural purposes."[40] Refunds give so good an opportunity for evasion that tax administrators believe they should be discontinued. The practice has been to collect the tax on the entire amount sold, then refund the tax on the part sold for uses other than to propel motor vehicles. As times goes on the problem seems no nearer solution.

Evasion by failure to register is coped with fairly well by the law and its penalties, the severity of which has been increased from time to time.[41] Evasion by selling mixed fuel can be forestalled by including these fuels in the definition of taxable fuel. Another form of evasion is traceable to the fact that gasoline is colder when measured by the state than it is later, when the filling station sells it to the motorist. The distributor thus collects from the public more tax than he returns to the state. The difference due to expansion has been asserted to be 189,012,806 gallons, upon which would have been due $3,743,171 in taxes since 1923. In an effort to collect these taxes allegedly due, the legislature inserted in the 1935 fuel tax law a clause providing that the State Director of Finance might contract with private individuals to survey the tax delinquency and to collect the taxes on a commission basis.[42] Attorney General Webb handed down an opinion that the clause was unconstitutional, and that the legislature had exceeded its power in passing the bill. So ended a twentieth-century attempt to check evasion by farming out the taxes.

It was never the intent of the law that the incidence of the tax should come to rest upon the legal taxpayer, the distributor. In collecting from him, the state expected that he would reimburse himself by adding the tax to the price of motor fuel. No definite method of passing on the tax was suggested in the law; the tax might be hidden in the price or charged separately. The usual practice in the United States has been to charge it separately; so it was done in California. No estimate seems to have been made of the cost of the bookkeeping which the tax necessitated. The distributor quoted his price per gallon to the customer, and added "three cents tax." The American Petroleum Industries have conducted a survey which asserts that in the United States high gasoline taxes have been "a definite barrier in increased sales of motor vehicles and consumption of motor fuel, and indirectly curtail both State revenues and business income."[43] However true this statement may be for other states, California's moderate tax does not appear to have lessened the use residents and tourists have made of the public roads.

Until passage of the New York act, California stood first in the amount of revenue collected from the "gas tax." The tax has been so extremely productive that even during the period of general deficit after 1933 the state highway program has been maintained. Cost of administration has been two-tenths of one per cent.[44] Following are the net returns from the motor vehicle fuel tax,[45] after deduction of refunds:

Year	Net returns	Year	Net returns
June 30, 1924	$ 5,915,350.13	June 30, 1931	$38,636,675.38
June 30, 1925	13,869,922.41	June 30, 1932	37,202,958.22
June 30, 1926	16,375,713.12	June 30, 1933	35,520,658.37
June 30, 1927	16,904,258.20	June 30, 1934	36,562,576.93
June 30, 1928	25,303,736.45	June 30, 1935	36,607,928.65
June 30, 1929	31,151,481.41	June 30, 1936	43,372,100.55
June 30, 1930	33,873,549.92		

Of all the problems that have arisen concerning the fuel tax, the problem of disposition of the munificent returns has been so outstanding that sometimes it seems to be the only problem. It has precipitated between state and county, and between county and city, struggles that seem to gain in intensity as the years pass. Who shall spend the money, and where shall it be spent—these questions confront every legislature.

Under the law of 1923, the returns from the two-cent fuel tax were divided equally betwen the state and the counties. All the returns went into the motor vehicle fuel tax fund created by the law. After returns and refunds and cost of administration had been deducted, one-half of the remainder was distributed twice a year, in May and November, to the counties.[46] At first this distribution was made in proportion to the number of motor vehicles registered from each county; an amendment of 1929 changed this arrangement in favor of the sparsely populated counties by providing that each county should receive $5,000 for each quarter for the first 3,500 registered vehicles or less, if the total did not reach 3,500; the balance was to be distributed in proportion to the number of registered vehicles.[47] Since the thinly populated counties are recreation areas, this provision was not so unfair as it might seem. An amendment of 1931 put the payments on a quarterly basis, an arrangement which still holds. The share of each county must go into a special road fund, which may be spent as the county supervisors determine, either for maintenance or for construction of roads, but cannot be spent for any other purpose, except to pay county highway bonds (an amendment of 1933).[48] Since 1931 the supervisors may expend the money on streets within incorporated cities, or even outside the county limits, or may transfer the money to the State Highway Commission. The State Controller may withhold the county's warrant if he has reason to believe the money is not being spent for roads. After the combination of the two taxes into the three-cent tax in 1933, the counties received one-third, or one cent of the gas tax, the same proportion which they had received since 1927.

Since 1915 the amounts received by the counties from the motor vehicle fund[49] total as follows:

1915......	$ 591,228	1922......	$ 3,027,321	1929......	$14,961,140
1916......	932,493	1923......	3,786,596	1930......	15,609,123
1917......	964,785	1924[a].....	7,645,121	1931......	15,878,228
1918......	1,247,269	1925......	9,192,068	1932......	14,320,041
1919......	1,421,101	1926......	10,391,470	1933......	15,288,610
1920......	1,923,064	1927......	11,792,794	1934......	14,779,367
1921......	2,425,586	1928......	13,962,234	1935......	15,129,738
				1936......	16,316,673

[a] First year the fuel tax was in effect.

The other half of the money left in the motor vehicle fuel tax fund was transferred to the state highway maintenance fund, also created by the law of 1923, where it was at the disposal of the State Highway Commission for "maintenance, repair, widening, resurfacing, and reconstruction" of the state highways and the roads in state parks.[50] Because the state could not finance new construction from the two-cent tax, a one-cent tax law was enacted in 1927.[51] All the returns from the one-cent tax went to the state to be expended in new construction. After the passage of the three-cent tax in 1933, the state still received two cents. Since the amendments of 1931, the state's money is expended by the Department of Public Works, Division of Highways.

Since 1930 the critical question of fuel tax distribution has been the allocation to the cities. As we have seen, the county was authorized in 1931 to spend part of its apportionment for city streets.[52] The urban counties have done so in greater or less degree. The state began work on streets in 1925, when the legislature provided that, "whenever a State highway runs into or passes through any municipality which has a population" of less than 2,500, the state must construct or care for the street if the municipality requests it to do so. By this act, the state assumed responsibility for 131 miles of street.[53] Larger cities soon found that the increased travel over improved state highways caused an objectionable congestion upon their main streets. To remedy this situation, the state highway commission began setting aside funds to be used in coöperating with the cities in improving the streets over which the state highways ran. In 1933 two important aids to cities were provided: the federal government stipulated that not less than 25 per cent of the funds appropriated under the National Industrial Recovery Act of 1933 should be spent on federal-aid routings within municipalities; in the same year, the California legislature provided that a quarter of a cent of the state's share of the fuel tax be spent within the cities or incorporated municipalities.[54] By the law of 1935, the cities' share was raised to one-half cent.[55]

The advance of the cities to a share in the fuel tax has been opposed by rural counties and by rural districts in the counties containing cities. The California Farm Bureau Federation has campaigned against it since 1931.[56] Quite as naturally, the League of Municipalities and the cities generally have fought for it. The quarrel has had its geographical aspects too: northern California has inclined to the rural view, whereas southern California has been urban in its sympathy. When one reflects that 55.6 per cent of the total daily vehicle miles are run over city streets, that 25 per cent of city traffic runs over state highways, and that 75 per cent of the vehicles of California are urban-owned, the city apportionment of half a cent does not seem extreme.[97]

Least productive of revenue, the tax on commercial motor transportation has been the most difficult both to formulate and to administer of all the taxes on automobiles. As soon as commercial motor transportation was at all possible, it was enthusiastically received in California. At first, it supplanted the horse-drawn vehicles which from the advent of the earliest settlers had served so many of the undeveloped mountain and coastal regions. Californians easily transferred the word "stage" from the old conveyances to the new motorcars which ran over the same routes and supplied the same kind of service so much more efficiently. Motor stages carried passengers, mail, and a limited amount of baggage; then they accepted express; and finally they developed the regular transport of freight. By 1923 the stage lines were not only supplementing the railroads by entering districts where there was no other than stage transport, but were actually paralleling the satisfactory rail service through the central valleys. Growth of motor passenger transportation was rapid in the nineteen-twenties. It was followed by as rapid a growth in freight transportation.

So long as the commercial bus or truck remained in the wilderness, legislatures contented themselves with requiring registration fees only, but, when it rolled through the more thickly settled lands in the valleys and the urban territories, a demand arose for its taxation. In those states which have general taxes on business, the taxation of commercial motor transportation is really a phase of general business taxation. It is only the confusion in the public and the legislative mind concerning the nature of this tax and the disposition of the proceeds from it that justifies us in discussing it among the taxes on motor vehicles rather than among business taxes. In some respects, California was quicker than other states to understand the nature of the tax, for she had a well-developed practice in regard to the taxation of corporations and of public utilities because of the development of taxation under the separation of sources plan. It was necessary, then, only to classify commercial motor transportation companies as public utilities or as businesses, and to apply to them the principles already in use. In large measure, the confusion of legislatures and the public in the United States about the nature of this tax on motor vehicles operated for hire has been due to the confusion in the motor transportation industry itself—a confusion incident to the development of a strong new industry. As the nineteen-twenties passed into the nineteen-thirties, both the industry and the proper method of taxing it stand out a little more clearly from the enshrouding fog.

Commercial motor transportation was first taxed under the Motor Vehicle Transportation License Tax Act of 1923. Before this date, the state had tried to deal with buses and trucks through the weight and horsepower provisions of the registration fees; it was believed that the buses and trucks, as heavier vehicles, would pay enough more to offset the greater wear and tear upon the highways. As ease and speed increased the volume of motor transport, and as the state began to improve old roadbeds and to construct new ones, the inadequacy of these registration fees became obvious. When the state issued bonds, and began to pay interest and redemption charges from the general fund, the railroads and interurban carriers objected that they, who supplied their own roadbeds, were paying taxes to build a roadbed for a tax-free competitor. Steam and electric railways submitted in 1915 detailed accounts of the extent to which motor carriers had injured their receipts,[58] a total of $4,290,000, the state tax on which would have been $200,000.

The estimate of the tax loss to the state had been made even earlier, in 1913, by the State Board of Equalization.[59] "Indeed, the very wide use of the automobile for pleasure and for business of every sort cuts seriously into the revenues of all transportation companies. Four years ago there were no 'double deckers,' each carrying as many passengers as a street car can accommodate, and few auto stages and trucks competing with the railroads."[60] "While it is not necessarily to be assumed that all the passengers and freight carried by these vehicles would otherwise have moved over the railways, yet a large part of them would have done so."[61] The Board of Equalization recommended a constitutional amendment which would group motor transport companies with public utilities and subject them to a gross receipts tax. State Controller John S. Chambers remarked, "There is no way as the law stands by which the state may reach the automobile engaged in the general transportation business."[62] Both Board of Equalization and Controller believed that a state license tax, "the equivalent, perhaps of a tax upon their gross earnings as near as may be," would be feasible.[63] However, the state tax commission of 1917, although it recognized the loss to railway gross receipts, considered the bus not a state, but a local, tax problem, because "the greater portion of the service is carried on within the municipality or within the county," and warned the state against invading local territory while it adhered to the separation of sources.

Though legislatures considered the problem (one even passing a bill, which never became law, taxing commercial motor transport), no change occurred in the industry's tax-free status.[64] The mounting costs of wider and thicker roadbeds to accommodate trucks and buses brought the public also to demand taxation.[65] In spite of the opposition of large motor companies, the reorganization of highway taxes took place in 1923, and included a license tax on those operating motor vehicles for hire.

The Motor Vehicle Transportation License Tax Act of 1923[66] was designed, then, to correct these difficulties. It recognized the business as subject to a business tax. Henceforth, every operator of a motor vehicle "who transports or desires to transport for compensation or hire persons or property upon or over any public highway within this state shall apply to and secure" from the State Board of Equalization a license for each vehicle operated. At the end of each quarter of the calendar year the license was to be renewed by payment to the State Controller of 4 per cent of the gross receipts for the quarter minus the amount of any city or county licenses or taxes upon operative property of the motor transport company. The act did not apply to vehicles such as taxicabs, which do not run over regular routes, nor to hotel buses, nor to vehicles 15 per cent of whose receipts came from carrying the United States mail. Responsibility for administration was placed in several state agencies: the license was granted by the State Board of Equalization, which also presented the license plates and prescribed the forms of application; the tax was paid to the State Controller; suit for collection was brought by the Attorney General. For designing and manufacturing the plates, the State Board of Equalization was to have a revolving fund of $5,000 by appropriation from the general fund, this sum to be replenished when the cost of manufacture and delivery was charged to the operator of the motor vehicle.[67] The sums collected under this act were to be deposited in the motor vehicle fuel fund, one half to be distributed to the counties on the basis of the ratio of the number of motor vehicles registered in the county to the total number in the state, the other half to be spent by the state for repair and maintenance of highways.[68] The penalty for failure to pay was suspension of the license.

The next four years were a period of experiment. Once put into operation, the law of 1923 had a checkered career. After attempting to administer it for almost two years, State Controller Ray L. Riley declared it "very unsatisfactory from a tax standpoint" because administrative costs were excessive.[69] The Board of Equalization was friendlier: "It will be much more expensive of enforcement relatively than is true of the motor vehicle fuel tax, yet not necessarily more so than some of the other revenue sources"; the difficulty of collection was due to the fact that automobile association officers had told many operators that they were not taxable, hence these operators had failed to make returns. The "important operators who offered determined opposition to the adoption" of the law had coöperated well; "the act is a logical and equitable provision and is quite generally so accepted by those who are required to pay the tax."[70] In 1925 the legislature enacted a new law which repealed the earlier act but was substantially the same.[71] The Superior Court of Fresno County declared the Act of 1923 unconstitutional, a decision which was upheld by the California Supreme Court on the ground that the act made exemptions.[72] However, when the Act of 1925 was tested, the court declared that the acts of 1923 and 1925 were in the main constitutional legislation.[73]

At the general election of November 8, 1926, the people of California adopted section 15, Article XIII, of the Constitution. This amendment provided that highway transportation companies whose buses or trucks ran over regular routes between fixed termini, as common carriers, were to be classed as public utilities and were to be assessed on the basis of their gross receipts.[74] Those companies engaged in the transportation of persons, baggage, or express were to pay the state annually "upon their franchises, cars, equipment, and other property, or any part thereof, used exclusively in the operation of their business," a tax of 4¼ per cent of their gross receipts; those transporting freight, 5 per cent.[75] There were certain exceptions: buses used to transport children to and from school were exempt, no matter who owned them;[76] later, the Political Code was amended so that money received from the contract to transport the United States mail was not to be included in the taxable gross receipts.[77] The gross receipts tax was to be in lieu of all other taxes and licenses, state, county, and municipal, except the fuel tax and municipal franchise.[78] After the legislation of 1927, the common motor carrier has the same history as other public utilities and needs no separate treatment until the legislation of 1935. Collections from the tax upon common carrier motor transportation companies during these years were as follows:[79]

Year	Returns	Year	Returns
1928	$ 762,379.80	1932	$ 974,470.01
1929	901,397.44	1933	747,639.11
1930	1,024,558.12	1934	591,797.19
1931	1,087,590.63		

Before the separation of common carriers from the rest of the motor vehicle transportation companies, the whole of the tax had gone into the motor vehicle fund. Neither the public nor the legislature was seeing the question much more clearly in 1927 than in 1923; the tax on the gross receipts of common carriers was indeed assigned to the general fund with the taxes on other public utilities, but even when there it must be used entirely for highway purposes; one half must be devoted exclusively to the maintenance and repair of public highways within this state; the remaining half must be distributed to the counties in proportion to the number of motor vehicle registrations from each; the counties must use the money exclusively for county road purposes.[80]

With the removal of common carriers from its sphere, the motor vehicle transportation license tax had a brief life. Since it applied only to businesses local in character, the State Controller recommended that some other mode of taxing contract carriers be found "that will produce an equal revenue but [will be] more economical in administration."[81] The act was repealed, the repeal taking effect January 1, 1928.[82] The returns from the tax imposed in 1923 are indicative of the history just narrated. They were meager during 1924 and 1925; by reason of the collection of back taxes they rose to $860,602 during 1928. Cost of collection was always high. With the repeal of the act, California faced the problem of an equitable distribution of taxation as between common carriers and contract carriers.

Not only in California, but all over the United States, the proper taxation of contract carriers—the trucking businesses, which haul goods for one man today and for another tomorrow—represents one of the most difficult problems in the entire scheme of commercial motor transportation taxes. Because of their regularity of schedule, and likeness to public utilities, common carriers are comparatively easy to place in a general system of business taxation. Contract carriers are migratory; their business may be either local or state-wide, according to the particular contracts made. Complete exemption of the contract carrier, or even an appreciably lighter tax upon him, injures the business, especially the freight transportation business, of the common carrier. Too heavy taxation of contract carriers, and the consequent increase in the price charged for hauling, means that former customers buy their own trucks and do their own hauling, and the contract carriers are forced out of business. Not only the weight, but the kind of tax, is debatable ground.

California attacked the problem of taxing contract carriers in two ways: the tax administrators tried to classify as common carriers as many companies as possible; for the others, the legislature passed a graduated weight tax as a substitute for the license tax in the hope that the new weight tax would balance with the gross receipts tax on common carriers. We shall take up the second first. The Board of Equalization had recommended such a tax;[83] the legislature of 1928 passed it (known as the Wagy bill) in the form of a constitutional amendment;[84] it was adopted by referendum at the general election of 1928, and went into effect with the coming of the new year.[85]

The weight tax proved much easier to administer than the former gross receipts tax, but it proved unfair to the common carrier. In 1929 the California tax commission estimated that contract carriers paid only half as much tax per vehicle as common carriers. The California Tax Research Bureau wrote in 1932:

"An investigation of 23 trucking companies' taxes on their gross receipts . . . reveals that their total taxes based on 1931 gross receipts amounted to $114,702.41, whereas if they had been taxed in the same manner as other carriers . . . their taxes would have amounted to but approximately $56,680.19. Trucking companies taxed on their gross receipts are required to pay approximately twice as much in taxes as other motor carriers and are required to pay for the privilege of operating trucks and trailers over highways approximately 2.75 times as much as is required of other carriers for a similar privilege. No substantial reason has been adduced why trucks taxed on a gross receipts basis should be subjected to a greater charge for their use of the highway than is imposed on other trucks for the same privilege. Consequently, it would seem that there is an unjustifiable discrimination which requires correction. There is no basis for believing that the 5 per cent rate on gross receipts is, when considered alone, too high."
The bureau did not believe the rate on common carriers should be reduced; rather it would raise the rates on other cars, either by levying

a gross receipts tax on all carriers for hire, by increasing the net weight fees, by substituting a fee based on combined weight of vehicle and load, or by substituting a ton-mile tax.[86]

The problem was not made easier by failure of the attempt to extend the gross receipts tax as widely as possible. "In 1925 it was the general belief that all persons engaged in the business of transportation by motor vehicle for hire would come under the control of the State Railroad Commission and be subject to the gross receipts tax." By a series of decisions, the California Supreme Court removed so many buses and trucks from the common carrier class that very few were left.[87] At the same time, the court left the way open to remedy this situation by declaring that special charges for the use of the public highways by motor vehicles operating for hire were constitutional. With the situation as inequitable as it became in 1932, some action on the subject of raising the license fees of contract carriers was necessary. "The time has come when the State should cease to temporize with a problem which is becoming increasingly acute. Prompt and effective measures must be taken by the Legislature in order to avert serious disturbance of the public welfare from unsound taxation of highway use."[88]

In 1933 the legislature of California reënacted legislation providing for the taxation of contract carriers. The state tax commission reporting in 1929 and the Board of Equalization both had recommended that equity be established by an increase in gross weight and mileage taxes. The bill as introduced in the Senate contained approximately the graduated schedule recommended by the commission. During the passage of the bill through the Senate, the advocates of a gross receipts tax so drastically amended the measure that the whole was rewritten in the form of the present law. The Senate committee also had submitted an elaborate scheme by which the returns were to be distributed to the counties and municipalities, provided these did not levy a general property tax for road purposes; fortunately for simplicity, these schemes were given up in the final bill which the committee submitted in May. Once the bill reached its final form, its passage was rapid: the Senate passed it 30 to 4; the Assembly, 67 to 3; the Governor approved it May 15.[89]

Under the Act of 1933, the operator of a motor vehicle which transported persons or freight for hire must be licensed by the State Board of Equalization, and must pay to the State Controller a tax equal to 3 per cent of the gross receipts from this business.[90] When first enacted, the law applied to all carriers for hire except those under certificate from the State Railroad Commission, those operating as interstate carriers, and those operating exclusively within cities as common carriers.[91] The first two of those excepted ranked as common carriers and public utilities; so too did the city carriers, but these latter were exempted specifically in the new legislation. Practically, since most companies transporting passengers were classified as public utilities, the new act was a tax on commercial trucking businesses. The administration of the act was confided to the State Board of Equalization; to it the operator applied annually before December 31 for his license, sent his application fee of $25 or his renewal fee of $15 and his monthly report of his gross receipts. The board had the right to inspect his books, to give him his license plates, and to assess and levy the tax against him. The tax was to be paid to the State Controller in monthly instalments, before the tenth day of the month following. Penalties were suspension or revocation of license, 10 per cent and 25 per cent increase of tax; operation without a license was a felony.[92] An exceptional feature of this act was the provision for a 5 per cent limit upon the total amount of tax paid by the transportation company. If the sum of all the operator's taxes and licenses in one calendar year, state, county, and municipal, excepting the gas tax but including the 3 per cent gross receipts tax, on property used in his business of transportation exceeds 5 per cent of his gross receipts in the same calendar year, the difference between the amount he paid and 5 per cent of his gross receipts shall be credited on future taxes due under the act.[93]

The sums received from this tax were to be paid into the "motor transportation license fund." Ten per cent was appropriated for the use of the Board of Equalization, and 5 per cent to the State Controller for administrative expenses. The remainder was to be transferred to the general fund and by the Act of 1933 was appropriated to pay the interest and redemption charges on the highway bonds previously issued by the state. Since 1935 the money has been transferred to the general fund without restrictions.[94] The returns were as follows:[95]

1934	$1,136,383.71
1935	1,150,000.00
1936	2,000,000.00

These figures, as will be noted shortly, include the common carriers for 1935 and 1936.

The act is still in effect controlling those commercial motor vehicle transportation companies for which it was passed. The passage of Senate Constitutional Amendment No. 30, however, wrought a change in the status of motor vehicle common carriers. Like all public utilities, their real and personal property was returned to the local tax rolls, beginning January, 1935, and the public utility franchise tax was no more. Where other utilities fell under the corporation franchise tax, the motor vehicle common carriers were left in a peculiar position: Senate Constitutional Amendment No. 30, in its authorization of new sources of revenue, had left the legislature free to levy whatever tax it liked on them. On December 31, 1934, the State Board of Equalization advised that the provisions of the Motor Vehicle Transportation License Tax Act may be considered fully operative without change, but that, "since the motor vehicles of common carriers will be required to have fee paid licenses next year, their equipment will automatically come within the definition of the term motor vehicle" as contained in the Act of 1933.[96]

A question which has arisen in every state that taxes motor vehicles for hire is the matter of interstate commerce. Most common carriers, and a number of contract carriers, travel across state lines. Since California had already settled this problem in regard to railroads, the same solution was applied to buses and trucks. By the law of 1923 for all commercial motor carriers, by the Political Code provisions for common carriers (1926), and by the law of 1933, now applying to all who transport for hire, companies are required to keep records and are taxed on their gross receipts on business beginning and ending within the state, the proportion being based on the proportion of mileage within the state to the entire mileage.[97]

In 1935 collection of the value tax on automobiles was transferred from the local units to the state. Before that year, the local units had collected a personal property tax on automobiles, the tax having been assessed by the local assessor at the usual ratio of assessed valuation to market value. There had been a long period of discontent with the inequality of the local assessments both as between counties and as between individuals in the same county; the assessed value for cars of the same type and age varied from $90 to $500 between local units. Even worse was the undeniable fact that many cars, about one-fifth, when the number taxed was compared with the number registered, were escaping taxation altogether.[98]

Beginning in 1928, the State Department of Motor Vehicles sent a list of registrations from each county to the county assessor in order to check evasion.[99] This precaution was unsuccessful, because of the temporary or fictitious addresses given by applicants for licenses. The Farm Bureau's Research Department calculated the evasion to involve approximately 400,000 cars, or 20 per cent of the total number, and to amount to $2,370,000 in tax.[100] The Farm Bureau recommended either that each applicant for a license should send to the State Department of Motor Vehicles a receipt for the personal property tax upon his vehicle or that registration as well as tax be turned over to county officers.[101] Except the Controller, the state tax agencies recommended reform in the direction of state control of collection. The tax commission report of 1929, after pronouncing the personal property tax "the least satisfactory of the taxes on automobiles," recommended an increase in the state registration fee as a substitute that would really lower taxes for the conscientious automobile owners who did pay.[102]

The legislature of 1929 passed a bill embodying what for some time had been the Farm Bureau's recommendation that license plates be issued only when the applicant produced a certificate showing that he had paid the tax; this bill was vetoed by the Governor.[103] The legislature of 1929 passed a constitutional amendment known as Proposition No. 18, which required the legislature to provide for a tax on motor vehicles in lieu of personal property taxes thereon, to prescribe the basis and method of fixing the amount thereof, and to provide for the collection of the tax by the state department registering such vehicles.[104] The amendment regarded the state only as a tax-gathering agency for the counties; 95 per cent of the fund derived from the tax was to be paid annually to the counties, each county to receive the amount collected from cars in its borders. Each county's share was to be distributed between the county and other local subdivisions, as prescribed by the legislature. Proposition No. 18 was rejected at the general election of 1930, and the situation remained unchanged until 1935.

In that year Governor Merriam recommended that a state tax on the weight and value of motor vehicles be substituted for the personal property tax, the returns to compensate the state for the loss of public utility revenues.[105] The law as passed by the legislature of 1935 only partly embodied his recommendations. By the 1935 act, all motor vehicles except those owned by state or local governmental units were removed from the general property tax and from local taxation and the owners required to pay an annual tax or license fee equal to 1¾ per cent of the value of the vehicle. The tax becomes due on the first of January and is collected by the Department of Motor Vehicles, which publishes lists of the market values of cars and the taxes due. Evasion is checked by the fact that license plates cannot be obtained until this tax, in addition to the $3.00 registration fee and the weight taxes, is paid. The money collected is placed in the motor vehicle license fee fund, created by the law of 1935. One per cent is deducted for administration; 25 per cent of the remainder is paid quarterly to the cities, and cities and counties, of the state in the proportion which the population of each bears to the total population of the state, to be expended for law enforcement and regulation and fire protection of highway traffic; 12½ per cent of said remainder is paid quarterly to the counties, and cities and counties, in the same proportion, to be spent as seems necessary. The rest of the money is to be put in the general fund, and used to pay interest and redemption charges of the highway bonds. The act expires December 31, 1937.[106] A decision of the California Supreme Court declared the tax to be a privilege, not a property tax.[107] A second California Supreme Court decision in June, 1936, declared the tax constitutional, but held that the money could not be used for purely local purposes.[108] Between January 1 and April 1, 1936, the state collected approximately $7,000,000.

This study of California's highway taxes has shown that the state has been moving toward a well-considered and a balanced though still faulty system of highway taxation which will eventually fit properly into the general financial plan. As evidenced by their policy toward highway taxation, California administrators and legislators apparently have a clearer understanding of the problem than has the public generally. Because the taxes on automobiles have a unity at least in the disposition of their proceeds, criticism has been reserved for the conclusion of this chapter.

The special highway taxes (the registration fee and the fuel tax) are examples of the benefit theory of taxation. These taxes are commonly justified by the argument that the user of the highway should pay in proportion to the use he makes of it. Between them they are effective in measuring that use: the fuel tax measures distance and speed and the registration fee measures weight. California's practice of charging heavier fees for trucks in proportion to weight is entirely proper, because of the greater destructiveness of these heavy vehicles.

The often recommended practice of charging extra-weight fees to commercial transportation companies should not be followed; no difference should be made in the weight fees between trucks for hire and trucks used to transport the owner's property. The principle here involved is merely to hold responsible those whose operation is most expensive to the state. When the comparative cost of such wear and tear is discovered, the fees should be placed accordingly. California's special taxes are low, and could be justly higher; but since she has no need for more highway revenue, she would do well to continue her present policy.

The state, however, has an unusual situation in regard to these special highway taxes. Since California is so highly motorized, these taxes, which in other states are often inadequate for highway construction and maintenance, are so productive that the highway fund has more money than it needs; not more money than it can use, for good roads are unlimitedly greedy, but more than is necessary to supply an adequate arterial system.[109] In fact, through the years of deficit—even now while the state is registering warrants and is hard pressed to finance other services at least quite as essential, and while there is an outcry against increased state taxes—the State Highway Commission has continued its program, in order to use the funds at hand. Though in some measure continued highway building has helped in meeting the state's unemployment problem, it would seem that under the circumstances one of two paths of action should be followed: either the special highway taxes should bear the entire burden of highway costs, thus relieving other taxes for other purposes, or the special highway taxes should be reduced.

California highways need no help from the general fund of the state; yet up to the present time they have received a subsidy in that the interest and redemption charges of the highway bonds have been met from the general fund, an amount totaling $4,052,000 a year. For several years there have been attempts to make the bonds a charge against the special highway taxes. This transfer would be quite proper, for even though the highways built from the bonds are now antedated, who wore them out, except the highway user? The transfer would also be in keeping with federal provisions, for the federal highway laws expressly permit the payment of interest on highway bonds.[110] Governor Rolph in his budget message of 1933 spoke harshly about the "diverting of general fund moneys for highway purposes," a diversion which had amounted to $60,000,000 in the course of twenty-two years: "Had the diversion of general fund moneys for highway purposes been discontinued with the enactment of the gas tax law, as is commonly believed by the taxpayers of the State to have been done, there would have been no need for concern regarding the condition of the general fund. There is no logical reason, considering the enormous sums derived for highway purposes from the gas tax, the motor vehicle tax, the tax on highway transportation companies and federal aid, why the general fund should be called upon to continue to pay such a large annual amount for highway purposes."[111] Upon recommendation of the joint legislative committee, the legislature of 1933 passed a constitutional amendment providing that the interest and redemption charges on the highway bonds be met from the highway fund. The amendment was opposed by the automobile clubs and by a large section of the press, who argued that to take the highway bond charges away from the general fund was a diversion of the gasoline tax money from roads to general purposes. Their argument so far prevailed that the people rejected the measure at the referendum in June, 1933. Thereupon the legislature did the next best thing and assigned the receipts from the motor vehicle transportation license tax, which is not a special highway tax, but a general business tax, to pay the bond charges.

Another remedy, that of relieving the general property taxpayer, was one of the arguments for Governor Frank F. Merriam's plan of combining all the roads of the state into one system, to be managed by the State Department of Public Works, Division of Highways. The Governor introduced the plan in his budget message of 1935.[112] Arguments for the new state system centered around the greater economy with which the state can build highways. Of the roads in the state in 1934, 14,019 miles, or 14 per cent, were state roads; 17,222 miles, or 18 per cent, were city streets; and 65,130 miles, or 68 per cent, were county roads.[113] The state highways carried 47 per cent of the traffic, the county roads, 11 per cent; yet the the state spent $30,357,000 for construction and maintenance as compared with the $21,730,000 spent by the counties[114] for the same purpose. There were special reasons for this, such as lack of centralization or coöperation between the fifty-eight counties, and duplication in purchase of equipment.[115] To support so heavy a financial burden the counties are obliged to call upon the general property and rural road taxes for help. Although counties have decreased the percentage of road support that has come from general taxes and have increased their reliance on the subventions from the state funds, they still expect to meet 51 per cent of their road cost from these general taxes.[116] It was argued that the unified highway system, by doing away with county road taxes, would save the general property taxpayer $8,000,000 a year.[117] The Division of Highways and much of the press supported Governor Merriam's program.

The State Controller and the county supervisors led the opposition against it. The Controller feared the amount of state patronage inherent in such a plan. County supervisors did not like the surrender of local rights. Eventually, the State Chamber of Commerce, the Farm Bureau, and the California State Automobile Association joined the opposition, and the measure failed to pass.[118]

There is another remedy for the situation. If the special highway taxes are not to pay the full cost of highways, why should not they be reduced? After all, the Californian in his capacity as highway user is the same man who pays the sales tax and the other general taxes. The state is so thoroughly motorized that a reduction in the special highway taxes would reach nearly every family in the state. According to State Controller Ray L. Riley, a gasoline tax of two cents a gallon would provide $25,000,000 a biennium, a sum which he considered adequate.[119] The indications seem to be that with reviving prosperity a tax of two cents a gallon will bring even more. If that amount will provide an adequate highway program, why pay more? The argument against reduction is that the oil companies might raise the price and the public would have no reduction after all. How far this argument would hold true would depend upon the extent of competition between sellers of motor fuel. For a state with a deficit in the general fund to continue a surplus in the highway fund is pure folly. Both remedies could be adopted: the highway bonds could be paid from the highway fund and the fuel tax could be lowered. If both are not possible, one of the plans should be adopted. Either would afford a generally widespread relief to the taxpayer. The chief reason for diversion of the fuel tax in other states has been the realization of the anomaly of expanding the highway program while other services of the state were being curtailed severely.

The other taxes, the motor vehicle transportation license tax and the value tax, can be treated more briefly. The first is purely a business tax and should have no place in the expenditures for highways. There is no more reason for spending the returns on highways, or even on highway bond charges, than for spending the returns from the railroad franchise tax upon roadbeds, or those from the bank tax on bank buildings. Its proceeds belong in the general fund, to be used for general governmental purposes, like the proceeds from the tax on banks or railroads. Since, as a part of the costs of business, it is usually shifted in part, at least, to the customers of the business, the author believes that it should be only so high as is required of other businesses, and that no special charge in the nature of rent for the use of public property should be made against motor vehicle transportation companies. It is often argued that the tax on motor vehicle transportation companies should be levied to equalize competition between them and the railroads.[120] Should the state do so, it would be entering into a purely economic sphere of activity. The state should be reimbursed for that part of the cost of its highway construction that is due to commercial use, and it should levy impartially the same business tax on both motor companies and railroads. The use of highways by trucks and buses should be covered by the fuel tax and by the weight and tires tax, but in these no distinction should be made between vehicles for hire and vehicles hauling the goods of their owners. One may question whether the 3 per cent gross receipts tax on motor vehicle transportation companies should not be changed to a net income tax like that on other businesses.

The other general tax, that upon value, should be treated as an assessment and collection of taxes by the state as an agent for local units. Though the proceeds go into the general fund, this tax has been earmarked for state bond payments; it should go toward meeting the general expenses of the state. Viewed as a substitute for the property tax upon automobiles, the 1.75 per cent rate of the in lieu tax is probably too high.[121]

NOTES TO CHAPTER IV

[1] *California Constitution,* Art. IV, sec. 36, adopted November 4, 1902.

[2] William C. Fankhauser, *A Financial History of California* (*Univ. Calif. Publ. Econ.,* vol. 3 [Berkeley, 1913]), p. 347. The discussion in the text omits chauffeurs' and operators' licenses, which are regulatory, and have no significance for the study of revenue. See Motor Vehicle Act of 1905, *Cal. Stats.* (1905), ch. 612, p. 816.

[3] *Biennial Report of the State Controller* (1914), p. 50. For accounts of the development of registration fees in all the states, see National Industrial Conference Board, Inc., *Taxation of Motor Vehicle Transportation* (New York, National Industrial Conference Board, Inc., 1932); James W. Martin, "The Motor Vehicle Registration License," in National Tax Association, *Bulletin,* vol. XII, no. 7 (April, 1927), p. 193; no. 8 (May, 1927), p. 227; vol. XIII, no. 1 (October, 1927), p. 9.

[4] Motor Vehicle Act of 1913, sec. 5, *Cal. Stats.* (1913), ch. 326, p. 639.

[5] Motor Vehicle Act of 1915, *Cal. Stats.* (1915), ch. 188, p. 414.

[6] Motor Vehicle Act of 1913, sec. 7, *Cal. Stats.* (1913), ch. 326, p. 641.

[7] Means of determining horsepower is described, Motor Vehicle Act of 1915, sec. 3, *Cal. Stats.* (1915), ch. 188, p. 925.

[8] Motor Vehicle Act of 1923, sec. 77, *Cal. Stats.* (1923), ch. 266, p. 536.

[9] *Biennial Report of the State Controller* (1914), p. 50.

[10] State of California, Department of Public Works, Division of Highways, *California Highway Transportation Survey* (Sacramento: State Printing Office, 1934), p. 29.

[11] *Biennial Report of the State Controller* (1914), p. 50; (1916), p. 33; (1918), pp. 129, 137; (1920), pp. 79, 86; (1922), pp. 70, 76; (1924), pp. 77, 90; (1926), pp. 98, 107; (1928), pp. 67, 91; (1930), pp. 43, 155; (1932), p. 23; (1934), p. 44. Also State Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[12] California Taxpayers' Association, "Income and Expenditures of Government in California," in *Tax Digest,* vol. XIV, no. 4 (April, 1936), sec. 2, p. 34. Figures of the cost of collection of the registration fee in California, 1925–1931, are to be found in National Industrial Conference Board, Inc., *Taxation of Motor Vehicle Transportation* (1932), pp. 64, 65.

[13] *Final Report of the California Tax Commission* (1929), p. 104. For discussions of the questions of weight and highways, see Jacob Viner, "Problems of Highway Finance" (a report of a committee of the National Tax Association), in National Tax Association, *Proceedings* (1924), p. 411.

[14] *Cal. Stats.* (1923), ch. 266, sec. 77, p. 536; (1925), ch. 240, p. 404; (1927), ch. 844, p. 1708; (1929), ch. 253, p. 524.

[15] Federal Revenue Act of 1932, sec. 617.

[16] *Biennial Report of the State Controller* (1910), p. 32; (1916), p. 18; (1920), p. 32. Also *California Constitution,* Art. XVI, sec. 2.

[17] Motor Vehicle Fuel Tax Act of 1923, *Revenue Laws of California* (1924), p. 528; *Cal. Stats.* (1923), ch. 267, p. 751.

[18] *Report of the State Board of Equalization* (1928), p. 17. In their report for 1924 (p. 7) the board had written: "This source of revenue newly adopted in 1923 has, because of the obvious equity of its distribution, proven less objectionable than any of the other forms of taxation."

[19] *Revenue Laws of California* (1932), p. 354.

[20] *Ibid.,* p. 372; *Cal. Stats.* (1927), ch. 795, p. 1565. This one-cent tax was opposed by the State Controller, on the ground that two cents provided adequate revenue.

[21] Von T. Ellsworth, "Report of the Research Department, and Recommendations of

the California Farm Bureau Federation on the Proposed Increase in the Gasoline Tax," in California Farm Bureau Federation Publications, *Bulletin No. 14* (February 25, 1931). The Farm Bureau Research Department estimated that 50 per cent of the cost of county roads was paid from the general property tax. See also Ellsworth, "The Purposes and Provisions of the Tax Program of the California Farm Bureau Federation," in *Farm Bureau Monthly* (October, 1931), Art. XLVIII; "Reduction in Property Taxes through an Increase in the Gasoline Tax," in *ibid.* (May, 1931), Art. XLIII.

[22] Motor Vehicle Fuel Tax Act of 1933, *Supplement to Revenue Laws of California of 1932* (1934), p. 99.

[23] Motor Vehicle Fuel Tax Act of 1923, sec. 4, *Revenue Laws of California* (1924), p. 529.

[24] Motor Vehicle Fuel Tax Act of 1931, secs. 4, 6, *Revenue Laws of California* (1932), pp. 357, 359.

[25] Motor Vehicle Fuel Tax Act of 1931, sec. 1, *ibid.*, p. 355.

[26] Motor Vehicle Fuel Tax Act of 1923, secs. 4 and 6, *Revenue Laws of California* (1924), p. 529.

[27] *Ibid.*, p. 525; Motor Vehicle Fuel Tax Act of 1931, *Revenue Laws of California* (1932), pp. 356, 364, 367.

[28] *Biennial Report of the State Controller* (1924), p. 15.

[29] Motor Vehicle Fuel Tax Act of 1931, sec. 2, *Revenue Laws of California* (1932), p. 356. In the *Summary Report of the California Tax Research Bureau* (1932) the following statement appeared (p. 94): "Prior to April, 1931 . . . taxpayers were not required to post any security for the payment of the tax and delinquencies of alarming proportions resulted. . . . The provision for weekly payments and reduced security was made to meet the needs of 'independent' refiners whose finances apparently did not permit them to post bonds as large as twice their monthly taxes. As a practical matter, this arrangement has not proven satisfactory. Experience has indicated that if payments are to be made weekly more discretion should be given the State Board of Equalization as to the amount of bond to be filed covering the weekly payment."

[30] Motor Vehicle Fuel Tax Act of 1931, sec. 2, *Revenue Laws of California* (1932), p. 358.

[31] Motor Vehicle Fuel Tax Act of 1933, sec. 2, *Supplement to Revenue Laws of California of 1932* (1934), p. 104.

[32] Standard of California, Associated, Shell, Union of California, Richfield, General Petroleum, Texas, R. R. Bush Oil Co., Gilmore, and Signal are the ten highest. See *Los Angeles Herald and Express*, January 23, 1936; also *Report of the State Board of Equalization* (1924), p. 7; (1926), p. 14.

[33] For the definitions of motor vehicle fuel, cf. Act of 1923, *Revenue Laws of California* (1924), p. 528; Act of 1931, *Revenue Laws of California* (1932), p. 355; Act of 1933, *Supplement to Revenue Laws of California of 1932* (1934), p. 100; *Revenue Laws of California* (1936), p. 463.

[34] *Report of the State Board of Equalization* (1926), p. 8; (1928), p. 14.

"It is true that such a definition might include a number of products not commonly used as motor vehicle fuel, either alone or in blended form. Extension of the definition might involve taxation based on distributions of commodities which will never be consumed in motor vehicles. However, engineering developments have disclosed that such products as 'diesel oil' and 'casing head' for examples, not hitherto specifically defined in the act as motor vehicle fuel, are useable for that purpose. It is difficult to forecast the future use for similar products, and every precaution should be taken to safeguard the full effectiveness of the motor vehicle fuel tax."—*Summary Report of the California Tax Research Bureau* (1932), p. 95.

"The number of vehicles encountered (burning these new fuels) is too small to draw any definite conclusion as to the diesel oil or butane consumption per mile, and the average for both fuels of approximately 6 miles per gallon is without significance. The advantage in these fuels lies, not so much in the fact that they deliver more miles per gallon, but that they are cheaper than gasoline. Diesel oil, delivered, costs approximately four cents per gallon; and butane, at the refinery, approximately six cents per gallon."—Department of Public Works, Division of Highways, *California Highway Transportation Survey* (1934), p. 34.

The case of the state against the Sterling Refining Company, decided in favor of the state by the California Supreme Court, had to do with the sale of compounded fuel. See *Report of the State Board of Equalization* (1928), p. 8.

[35] Motor Vehicle Fuel Tax Act of 1923, sec. 4, *Revenue Laws of California* (1924), p. 529; Motor Vehicle Fuel Tax Act of 1933, sec. 3, *Supplement to Revenue Laws of California of 1932* (1934), p. 105; *Cal. Stats.* (1933), ch. 631, p. 1249.

[36] Motor Vehicle Fuel Tax Act of 1923, sec. 11, *Revenue Laws of California* (1924), p. 530; Act of 1933, sec. 11, *Supplement to Revenue Laws of California of 1932* (1934), p. 113.

[37] Motor Vehicle Fuel Tax Act of 1923, sec. 10, *Revenue Laws of California* (1924), p. 530; *People* v. *Standard Oil Co. of California*, 85 Cal. Dec. 599, *Supplement to Revenue Laws of California of 1932* (1934), p. 112.

[38] Motor Vehicle Fuel Tax Act of 1923, sec. 10, *Revenue Laws of California* (1924), p. 530. This clause was omitted from the law by an amendment of 1925. See also *People* v. *Ventura Refining Co.*, 204 Cal. 286, *Revenue Laws of California* (1932), p. 365.

[39] *Ibid.*, p. 365. Fuel imported and exported in the "original package," or tank car, and fuel sold to vessels clearing for ports outside the state are tax-free. Fuel carried into the state in the tank of a vehicle is not considered as imported.

[40] The table and quotation below are from the *Summary Report of the California Tax Research Bureau* (1932), p. 97.

Year	Amount of refund	Percentage	Year	Amount of refund	Percentage
1923–1924	$ 400,892.12	4.09	1928–1929	$3,061,996.26	8.88
1924–1925	1,147,830.89	7.67	1929–1930	3,549,157.29	9.19
1925–1926	1,391.958.27	8.18	1930–1931	4,498,697.19	10.67
1926–1927	1,450,413.37	7.57	1931–1932	3,966,116.23	9.69
1927–1928	2,262,433.49	7.37			

"In view of the great number of claims for refund it is practically impossible to check the validity of the claims. Completely to investigate these claims so as to assure their validity would involve a prohibitive expense. If fraud and evasion of taxes result from allowance of refunds, and that such is the result can scarcely be controverted, it would seem that the only feasible method for eliminating that fraud and evasion is to discontinue allowance of refunds."

[41] The penalty for selling without license was the tax plus 100 per cent, to be collected, if necessary, by sale of the culprit's property. The penalty for failure to file a report was fixed by the Act of 1923 at 25 per cent of the license tax; in the event of failure, neglect, or refusal to file reports the State Board of Equalization assesses the tax, adds the penalty, and turns the matter over to the Controller, who collects the tax, plus 25 per cent, plus 7 per cent per year from the date the tax was due. In 1931, the law was so amended as to call for a penalty of 15 per cent. The penalty for delinquency (failure to pay the tax) after the days of grace was 7 per cent by the Act of 1923; this was amended in 1925 to 10 per cent, at which figure it remains in 1936. Penalties are cumulative, and the infliction of one does not relieve the distributor from a previous lighter one.

[42] The whole controversy became amusing. State Finance Director Stockburger appointed five men as a sort of tax-collecting group, each man to retain 25 per cent of the first $200,000 and 20 per cent on the remainder. The whole scheme was really a revival of the obsolete system of farming out the taxes, and was opposed by State Controller Ray L. Riley, who refused to pay the commissions. The idea of the contract seems to have come from Louisiana. See *Los Angeles Times*, January 12, 1936; November 19, 1935; November 20, 1935; also *Santa Monica Outlook*, November 18, 1935; *Los Angeles Herald and Express*, November 16, 1935.

[43] *Los Angeles Times*, May 14, 1936.

[44] *Summary Report of the California Tax Research Bureau* (1932), p. 93.

[45] *Biennial Report of the State Controller* (1924), p. 89; (1926), pp. 97, 107; (1928), pp. 57, 79; (1930), pp. 43, 155; (1932), p. 23; (1934), p. 44. The returns for 1935 and 1936 are taken from State Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[46] Motor Vehicle Fuel Tax Act of 1923, sec. 13, *Revenue Laws of California* (1924), p. 531.

[47] The payments to the counties were made twice a year until 1931. References to these changes in the Motor Vehicle Fuel Tax Act, sec. 13, are: amendment of 1929, *Cal. Stats.* (1929), ch. 779, p. 1551; amendments of 1931 concerning quarterly payments and county use of funds, *Cal. Stats.* (1931), ch. 1081, p. 2285; *Revenue Laws of California* (1936), pp. 478–480.

[48] Motor Vehicle Fuel Tax Act of 1933, sec. 13½, *Supplement to Revenue Laws of California of 1932* (1934), p. 118.

[49] These figures include the sums distributed from the motor vehicle registration fee and the fuel tax. See California Taxpayers' Association, "Income and Expenditures of Government in California," in *Tax Digest*, vol. XIV, no. 4 (April, 1936), p. 11. The 1935 and 1936 figures are taken from State Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[50] Motor Vehicle Fuel Tax Act of 1923, sec. 13, *Revenue Laws of California* (1924), p. 531.

[51] *Cal. Stats.* (1927), ch. 795, p. 1565.

[52] *Revenue Laws of California* (1932), p. 368.

[53] State of California, Department of Public Works, Division of Highways, *California Highway Transportation Survey* (1934), p. 77.

[54] Division of Highways, *Statutes Relating to Division of Highways* (Sacramento, 1935), sec. 194, p. 37; sec. 203, p. 41.

[55] Senate Bill No. 561, *Cal. Stats.* (1935), ch. 29, p. 248; ch. 642, p. 1789.

[56] Von T. Ellsworth, "Annual Report of Research Department and Report on 1935 State Legislation to the California Farm Bureau Federation," in California Farm Bureau Federation Publications, *Bulletin No. 25* (Berkeley, 1935), p. 7.

[57] "The ratios of urban vehicles to total vehicles for the respective road systems are as follows:

State highways	78.7
Main county roads	66.3
Main city streets	89.1

"The ratios for both city and county systems require some qualification. The percentage for the county system would probably be lower if all roads, rather than only main roads, were included; and similarly, the percentage for city streets would be greater than indicated. Since the entire State system was covered, the ratio of 78.7 per cent is thoroughly representative and it agrees closely with the corresponding percentage distribution of 75.2 per cent for urban population.... Only in the more isolated sections do the urban owned vehicles drop below 60 per cent of all vehicles, and in all cases urban vehicles are over 40 per cent of the total even in some counties, such as Trinity, Plumas, and Alpine, which have no incorporated municipalities."—State of California, Department of Public Works, Division of Highways, *California Highway Transportation Survey* (1934), p. 53.

The half-cent is a minimum; the state may spend more on city streets.

[58] In *Report of the State Tax Commission* (1917) the following statement was made (pp. 62, 64): "A close estimate for the year 1915 places the losses of the electric lines as a result of the jitney and motor bus competition, in round numbers, at $3,150,000, and the losses of steam lines at $1,140,000, a total of $4,290,000; covering the first six months of 1916 the indications are that the losses this year directly attributable to this competition will exceed $5,000,000."

[59] The Pacific Electric Railway estimated the tax loss as $240,000. See *Report of the State Board of Equalization* (1914), p. 22.

[60] *Ibid.*, p. 29.

[61] *Ibid.*, p. 22.

[62] *Ibid.*, p. 23; *Biennial Report of the State Controller* (1914), p. 17.

[63] *Report of the State Tax Commission* (1917) reads (p. 60): "This Commission is disposed to look at the problem as being primarily a matter of regulation; that the security and service to the public is more vital than the matter of the taxation of the industry.... Purely from the standpoint of taxation, therefore, the jitney bus is a subject for local revenue. The state can come in and tax only for state purposes, on a basis of regulation. Localities are continually being deprived of property for local taxation by the extension and development of public utilities; therefore, to maintain that because the state is losing two hundred thousand dollars a year because of this new form of transportation it should levy a tax upon the jitney bus in order to recoup its losses is not logical or just.

"The suggestion that a state tax be levied against the jitney bus . . . to compensate the state for loss of revenue occasioned by the intrusion of this new form of transportation does not seem warranted, because the jitney bus unlike the railroads and street railways would not be exempted from local taxation."

[64] *Report of the State Board of Equalization* (1916), pp. 8–11; *Biennial Report of the State Controller* (1916), p. 39.

[65] How much more does the state spend for highways because they are used for commercial transportation? How much thicker and wider do the roads need to be? In the *Proceedings* (1929) of the National Tax Association (p. 521) C. J. Bullock of Harvard University, formerly chairman of the association's committee on motor vehicle taxation, estimates the comparative cost for a macadam road to be $6,000 or $7,000 per mile; for a road with improved surfaces for motor cars, $12,000 per mile; for a road wide enough and thick enough for the motor truck and motor bus, $50,000 to $70,000 per mile, practically a subsidy, "and yet these people want to be taxed like everybody else." For general discussions of the question of commercial motor vehicle taxation, cf. Merlin H. Hunter, "Report of the Committee on the Taxation of Commercial Motor Vehicle Transportation," in *ibid.* (1929), p. 468; (1930), p. 135.

[66] *Cal. Stats.* (1923), ch. 341; *Revenue Laws of California* (1924), p. 525.

[67] Sec. 6 of the 1923 act, *Revenue Laws of California* (1924), p. 526.

[68] Sec. 8 of the 1923 act, *ibid.*, p. 527.

[69] *Biennial Report of the State Controller* (1924), p. 14.

[70] *Report of the State Board of Equalization* (1924), p. 8.

[71] *Cal. Stats.* (1925), ch. 412, p. 833. The law of 1923 was repealed July 24, 1925.

[72] *Bacon Service Corporation* v. *Fred C. Huss as Captain of the Fresno County Traffic*

Squad, 199 Cal. 21; *Report of the State Board of Equalization* (1926), p. 9. In the board's report for 1928 (p. 13) appeared the following statement: "All litigation involving the constitutionality of the quarterly motor vehicle transportation license tax was determined in favor of the state in the latter part of 1926."

[73] *In re Paul Schmolke*, 199 Cal. 42; *Report of the State Board of Equalization* (1926), p. 9.

[74] *California Constitution*, Art XIII, sec. 15; *Revenue Laws of California* (1932), pp 50–52.

[75] *Ibid.* These rates were fixed by the Constitution, but the legislature was given power to change them.

[76] *Ibid.*

[77] *Political Code*, sec. 3664*a*; *Revenue Laws of California* (1932), p. 102. This amendment of 1929 came as a result of a California Supreme Court decision, *Alward* v. *Johnson*, 208 Cal. 359; affirmed by the United States Supreme Court, 282 U. S. 509.

"A stage line operated over the public highways, between fixed termini and over a regular route, and undertaking for hire or reward, to transport from place to place passengers and the goods of such as choose to employ it, is a common carrier within the meaning of this section, and is subject to the tax provided by this section, even though it is devoted chiefly to the carrying of the United States mails and parcel post."—*Revenue Laws of California* (1932), p. 51.

[78] Almost all municipalities in the state levy an operating or business tax for the operation of motor vehicles for the transportation of property for compensation. These levies approximate $1,000,000 per year.

[79] *Biennial Report of the State Controller* (1928), p. 76; (1930), p. 22; (1932), p. 8; (1934), p. 28.

[80] *California Constitution*, Art. XIII, sec. 15, *Revenue Laws of California* (1932), p. 50.

[81] *Biennial Report of the State Controller* (1926), p. 14. In his 1928 report the Controller wrote (p. 10): "It was impossible to carry into effect the old tax and its application has caused innumerable hardships to individual operators that will be augmented when this office begins the collection of judgments. Many truck owners will be forced out of business within the next few months."

[82] *Cal. Stats.* (1927), ch. 843, p. 1708.

[83] *Report of the State Board of Equalization* (1928), p. 18: "To equalize the tax burden between companies subject to gross receipts taxation and those who are not, we recommend that the California vehicle act be amended to require all those who operate for hire to secure special licenses at fees which will be materially greater than those now prescribed for commercial vehicles generally. It is submitted that persons so using the highways derive more than usual benefit and should pay accordingly."

[84] Proposition No. 8 at the election of 1928; *Cal. Stats.* (1929), ch. 780, p. 1553.

[85] *Cal. Stats.* (1927), ch. 844, p. 1708. The State Controller in his report for 1928 wrote (p. 10): "It is difficult to understand why any freight carrier continues to cling to the fiction of value in a franchise that will impose a gross tax upon the operation. Tax competition will ultimately force all taxing of freight motor transportation to a weight basis as a proper measure of highway use." The rates for 1929 have already been given in this chapter.

[86] *Final Report of the California Tax Commission* (1929), p. 106; *Summary Report of the California Tax Research Bureau* (1932), pp. 100–104.

[87] *Frost Trucking Company* v. *Railroad Commission*, 271 U. S. 563; *People* v. *Lang Transportation Co. et al.*, 217 Cal. 166; 17 Pac. (2d) 721; *People* v. *Duntley*, 217 Cal. 150; 17 Pac. (2d) 715. According to the 1932 *Report of the State Board of Equalization* (p. 16) the decisions just mentioned have "resulted in the elimination of some five

hundred carriers from the State tax roll and consequent shrinkage in revenue of more than $400,000."

[88] *Ibid.*, p. 17. "It is well established law that the highways of the state are public property; that their primary and preferred use is for private purposes; and that their use for purposes of gain is special and extraordinary, which, generally, at least the legislature may prohibit or condition as it sees fit."—*Stephenson* v. *Binford*, 287 U. S. 251, at p. 264. See also comment in National Tax Association, *Proceedings* (1934), p. 296.

[89] *Senate Journal* (1933), pp. 815, 1150, 2564, 2635. The law was Senate Bill No. 125. *Cal. Stats.* (1933), ch. 339, p. 928.

[90] Motor Vehicle Transportation License Tax Act of 1933, sec. 5, *Supplement to Revenue Laws of California of 1932* (1934), p. 213; *Cal. Stats.* (1933), ch. 339.

[91] Motor Vehicle Transportation License Tax Act of 1933, sec. 14, *Supplement to Revenue Laws of California of 1932* (1934), p. 220.

[92] Motor Vehicle Transportation License Tax Act of 1933, secs. 5, 8, 9, 10, 12.

[93] *Ibid.*, sec. 9.

[94] Motor Vehicle Transportation License Tax Act of 1933, sec. 13, as amended, *Cal. Stats.* (1935), ch. 780, p. 2176.

[95] *Biennial Report of the State Controller* (1934), p. 44. The 1936 figure is the estimate of the California Automobile Association.

[96] *Revenue Laws of California* (1936), p. 486; *Corporation Tax Service, State and Local, California* (New York, 1935), p. 499-5, sec. 4502.1.

[97] Motor Vehicle Transportation License Tax Act of 1923, sec. *1e*, *Revenue Laws of California* (1924), p. 525; *Political Code*, sec. 3665*a*, *Revenue Laws of California* (1932), p. 112; Motor Vehicle Transportation License Tax Act of 1933, sec. *1d*, *Supplement to Revenue Laws of California of 1932* (1934), p. 211; *Revenue Laws of California* (1936), p. 486.

[98] *Final Report of the California Tax Commission* (1929), p. 102.

[99] *Summary Report of the California Tax Research Bureau* (1932), p. 112.

[100] Von T. Ellsworth, "Report of the Research Department of the California Farm Bureau Federation on the Taxation of Automobiles," in California Farm Bureau Federation Publications (Berkeley, January 1, 1931), *Bulletin No. 12*, p. 2.

[101] *Ibid.*

[102] "The same amount of money as is now obtained from the personal property tax on automobiles could be obtained by an increase in the rate of the state motor vehicle license tax, with a relatively small addition to the state cost of administration. Of more importance than the reduced administrative cost, is the fact that the substitution of a heavier state license tax so designed as to yield the same amount as produced by the present license and personal property taxes would appreciably lower the tax burden for those automobile owners now paying the local personal property tax on their cars, since the burden would be spread over all of the cars in the state, including those now evading the local personal property tax."—*Final Report of the California Tax Commission* (1929), p. 103.

[103] Von T. Ellsworth, "Report of the Research Department of the California Farm Bureau Federation on the Taxation of Automobiles in California," in California Farm Bureau Federation Publications (1931), *Bulletin No. 12*.

[104] *Proposed Amendments to the Constitution and Proposed Laws to Be Submitted to the Electors of the State of California at the General Election to Be Held Tuesday, November 4, 1930* (Sacramento, 1930), p. 23.

[105] Frank F. Merriam, *Budget for the Biennium 1935 to 1937*, p. vi. Both Ray L. Riley, the State Controller, and Fred E. Stewart, of the State Board of Equalization, opposed this recommendation on the ground that the value tax belonged to the counties.

[106] *Cal. Stats.* (1935), ch. 362, p. 1312, approved June 25, 1935; effective September 16, 1935. The act was Senate Bill No. 1119. *California Corporation Tax Service*, II (1935), 895–134; *Revenue Laws of California* (1936), p. 402. The legislation was reenacted by the 1937 legislature. *Cal. Stats.* (1937), ch. 6, p. 62, and ch. 649, p. 1778.

[107] Practically, the decision was important to veterans, who are exempted from the property tax to an amount of $1,000 assessed valuation. See the *Santa Monica Outlook*, January 15, 1936.

[108] The case was the suit of Los Angeles County, brought by County Counsel E. W. Mattoon, against Ray L. Riley, State Controller, for $400,000 of the value tax. Riley maintained that the state cannot legally collect taxes for cities and counties, and doubted the constitutionality of the law. See the *Los Angeles Times*, June 30, 1936. The California Farm Bureau opposed the withdrawal of the personal property tax on automobiles from local tax rolls. See Von T. Ellsworth, "Pending Tax Legislation in California," in *Farm Bureau Monthly*, vol. VIII, no. 8 (June, 1935). "Attorney General Webb previously had ruled that the new automobile tax is a tax on property and, therefore, the veterans are entitled to exercise their $1000 exemption privilege. Riley contends it is not a property tax, but a privilege tax, and the exemption is illegal."—*Los Angeles Times*, January 1, 1931.

The receipts from the tax have been estimated at approximately $10,000,000 for 1936. Under the present system of distribution, the state would have more than $6,000,000 annually with which to met the interest and redemption charges on the state highway bonds, which cost $8,104,000 biennially, or $4,052,000 a year. There is a surplus of $2,000,000 for the general fund.

[109] "Considering the taxes from the point of view of their relation to highway expenditures, the California automobile taxes meet a larger share of state and local highway expenditures than in most states. In fact only three states in 1927 met a larger proportion of their highway expenditures from motor vehicle license and gasoline taxes. This is in part the result of the greater all-year-round use of cars which increases the yield of the gasoline tax, and in part the result of the relatively low highway expenditure per car. The average state and local highway expenditure per registered car in the United States was about double the expenditure per car in California in 1927. No other state had as low a cost per car in that year."—*Final Report of the California Tax Commission* (1929), p. 103. It is estimated that special highway taxes will bring in more than $50,000,000 in 1936.

[110] Cf. "An Act to Increase Employment by Authorizing an Appropriation to Provide for Emergency Construction of Public Highways and Related Projects," approved June 18, 1934, 48 *U. S. Stats. at Large* (1934), p. 995.

[111] This amount did not include special appropriations from the general fund for bridges, etc. Cf. Governor James Rolph, *Budget for 1933–1935* (Sacramento, 1933); *Assembly Journal* (1933), p. 47; *Senate Journal* (1933), p. 2115.

[112] Frank F. Merriam, *Budget of the State of California for the Biennium July 1, 1935, to June 30, 1937* (1935), p. xiv.

[113] Division of Highways, *California Highway Transportation Survey* (1934), p. 23.

[114] *Ibid.*, pp. 39, 75, 76.

[115] The state's road-construction equipment cost $3,000,000, that of the counties $12,000,000. See the *Los Angeles Times*, March 3, 1935.

[116] Division of Highways, *California Highway Transportation Survey* (1934), p. 72. "These two sources of revenue vary in relative importance from county to county. The former, or rural road tax, is the chief source of revenue derived from local taxation for county road purposes in most counties of the state. The counties, exclusive of the city and county of San Francisco, expended in 1929, $26,264,938.68 on county roads. The same

group of counties received from the motor vehicle and fuel taxes in 1929, $13,058,570.50. The difference between the above figures, $13,206,368.18, represents the amount to be raised by the counties from local taxation. Applying the usual rate of 40 cents per $100 of assessed valuation to $2,018,292,938, the total assessed value of outside property, it is found that the amount raised from the rural road tax is approximately $8,073,172. This leaves a balance of $5,133,196 to be raised chiefly by a general levy on all county property."—Von T. Ellsworth, "Report of the Research Department of the California Farm Bureau Federation, etc.," *Bulletin No. 14* (1931), p. 4.

[117] Statement of Governor Merriam, February 28, *Los Angeles Times*, March 1, 1935.

[118] *Los Angeles Herald and Express*, March 22, 1935.

[119] "A few years ago we had a two cent gas tax. At that time I argued to the legislature that two cents was adequate. It was only proposed to spend $25 million per biennium for roads, which was enough. The two cent tax would provide over $25 million, which it did. But the legislature increased the tax to three cents, and the state spends now $40,000,000 a biennium. Merely because we had the money, the amount spent was increased $15,000,000."—Ray L. Riley, in Commonwealth Club of California, *Transactions*, 29 (May 7, 1935), 326.

[120] Merlin H. Hunter, "Report of the Committee on the Taxation of Commercial Motor Vehicle Transportation," in National Tax Association, *Proceedings* (1929), p. 468.

[121] See the discussion upon this point in H. Dewey Anderson, *Our California State Taxes* (Stanford University Press, 1937), pp. 266–268.

V. THE TAXATION OF BUSINESS

THE HISTORY OF THE TAXATION OF BUSINESS in California from 1911 to the present time is replete with interesting developments. Part of this story has already been traced in a preceding chapter dealing with the separation of sources of revenue. It was there that the gross receipts tax upon public service corporations was discussed. It was this tax which, throughout the separation period, constituted the mainstay of revenue for the state government. The gross receipts levy as applied in California revealed certain advantages and certain disadvantages. In general it conformed to the canons of simplicity and adequacy, but it also displayed rigidity and inflexibility and failed to achieve equality in the distribution of the tax burden as between corporate and common property, as between classes of corporations, or as between individual corporations within the same class. The successive rate adjustments were painful evidence of the deficiencies of the gross receipts tax in these particulars. Yet it can be said that the gross receipts method of taxing the public utilities was a distinct improvement over the procedure which prevailed prior to 1911. As between local assessment and taxation of such property on an ad valorem basis and state taxation of it on a gross receipts basis, there could be little difficulty in making a choice.

It is not, however, the purpose of this chapter to delve further into the various phases of the gross receipts tax, particularly in view of the fact that that levy has recently been abandoned by the state in order that utility property, centrally assessed, might be available for taxation by the localities.[1] Since January 1, 1935, the state has been applying to the utilities the comparatively new franchise tax.[2] The history of business taxation in California, other than as it has related to the gross receipts tax formerly applicable to the utilities, has revolved around the old license and franchise taxes, the taxation of insurance companies, of banks, and of the general type of financial, manufacturing, mercantile, or business corporation. The discussion of these matters constitutes the scope of this chapter. Obviously within the confines of this one chapter no adequate consideration could be given all the many technical details necessarily involved in business taxation. The treatment, therefore, will be limited to what seem to be the essential aspects in the development of business taxes in California.

[1] For notes, see below, pp. 150–162.

Upon a fair appraisal of the circumstances, it can be said that California never had any really adequate system of business taxation up until at least the time of the enactment of the Bank and Corporation Franchise Tax Act of 1929. Such taxes as were employed—"camouflaged as property taxes or taxes in lieu of property taxes"—were not particularly well related one with another, a situation which impressed the 1929 tax commission if we may judge by reference to its proposal to set up a modern system of taxes on business alongside a modified property tax and a tax on persons.[3] But more will be said of these later developments in due course. We may well begin the outline of business tax development in California by brief reference to the old license tax.

This tax was first imposed in 1905,[4] with an annual levy of $10 upon every corporation for the privilege of doing business in the state. Its original purpose was to support the service of keeping an accurate record of existing corporations and of deleting from the records those which had ceased to exist. Revenue, however, came to be the primary consideration.[5] The tax evolved into a graduated levy based upon the amount of the par value of the authorized capital stock.[6] Partly because of the supposition that the tax was unconstitutional,[7] it was repealed by the 1913 legislature[8] but, after reversal by the State Supreme Court of its previous ruling,[9] was reënacted by the 1915 legislature[10] at appreciably higher rates than had formerly applied.[11] With the exception of the fiscal year 1914–1915, the tax was then in force from 1905 to 1927, in which year it was finally repealed[12] upon invalidation by the State Supreme Court.[13] The yield of the tax for the period of its existence was as follows:[14]

1905–1906	$139,000	1913–1914	$741,000	1921–1922	$ 991,000
1906–1907	304,000	1914–1915	9,000	1922–1923	1,118,000
1907–1908	663,000	1915–1916	774,000	1923–1924	1,263,000
1908–1909	664,000	1916–1917	784,000	1924–1925	1,316,000
1909–1910	746,000	1917–1918	758,000	1925–1926	1,357,000
1910–1911	872,000	1918–1919	757,000	1926–1927	1,375,000
1911–1912	844,000	1919–1920	847,000	1927–1928	24,000
1912–1913	799,000	1920–1921	937,000		

The corporation license tax, aside from meeting with constitutional difficulties, encountered various other obstacles which contributed to its final abandonment. It was reënacted in 1915 partly to make up for the loss of revenue—approximately $800,000 a year[15]—which had been incurred as a result of the repeal of the poll tax by initiative amendment voted upon at the November, 1914, election. The law was not restored, however, without opposition. The corporations complained of the combination of a license tax with a franchise tax[16] and insisted that unincorporated competitors would be given further advantages if the license tax were renewed.[17]

The 1917 California tax commission made certain observations upon the tax, directing attention to certain inequalities which arose under it and criticizing the administration of the law.[18] It pointed out first that the license tax was more burdensome upon the smaller companies in terms of gross or net receipts and reported full value of property, yet was not necessarily unjust because of that fact, for the reason that if overcapitalization existed the fault lay not with the tax or its method of application but rather with the financial structure of the corporation. Next the commission noted that inequality had arisen because of the nonapplicability of the tax to public service and other corporations taxed exclusively for state purposes. The utility taxes were presumably equated to the burden resting upon general corporations as a result of taxes on their franchise and property values. The commission suggested, as a remedy, the fixing of taxes upon the utilities at a rate high enough to cover the additional burden reflected by the license tax. Finally the commission drew attention to the inequality because of the franchise and license taxes as between incorporated and unincorporated enterprises. It proposed as a solution the application of an income tax to individuals and unincorporated concerns only.[19]

So far as the law's administration was concerned, the procedure of forfeiture of charters for nonpayment of the tax was held to be "unusual and extremely severe" and "the method of revivor under our statutory provision was questionable." Elsewhere the administration of the law by the Secretary of State had been held to be inadvisable, as involving duplication of tax administration and collection agencies, and the suggestion had been made that the State Controller might well have assumed responsibility for the collection.[20]

Aside from the old license tax a second type of corporation levy was the old franchise tax.[21] The story of this tax finds its beginnings in the observations of the 1906 commission on revenue and taxation upon the question of franchise taxation. This commission recognized several types of corporate franchises—to be, to do or to act, special, and general—that properly might be subject to taxation.[22] It found existing in California, as elsewhere, a strong demand for the taxation of these franchises. This demand it attributed to the sense of justice requiring a distribution of tax burdens in proportion to ability, to "popular discontent with the confessed failure of our present taxing system to reach the wealth invested in public and private securities," to the "recklessness and jobbery" which had characterized the granting of special franchises for the use of city streets, and to "the feeling that the granting of franchises makes private property out of what, in the nature of things, is public property, and that . . . private corporations are in such instances using public property."[23]

With respect to the general franchise, with which we are here concerned,[24] the commission remarked that its taxation was "a much vexed question in California at the present time. Corporations generally protest loudly that it forms an unjust discrimination against them, and the assessors are, for the most part, doggedly determined to put such property on the assessment rolls in accordance with a strict interpretation of the law and the Constitution, which has been made by the Supreme Court. The friction at this point is intense, and the feud between the corporations and the assessors over it is growing more bitter every year."[25] The view of the assessors was that there should be no neglect of the opportunity to make the corporations pay their fair share of the taxes; the view of the corporations was that the assessors enjoyed the exercise of an unjustifiable arbitrary power.[26] The commission also commented upon the likelihood of discrimination against the corporation. "It is a question," it said, "open for serious consideration, whether the taxation of such a franchise, tantamount to the taxation of the good will, against corporations, while similar items of property, if this be property, are not assessed against individuals and firms, does not constitute an unjust discrimination against corporations."[27]

It was in this atmosphere that the commission studied the taxation of the corporation franchise, which at that time was in the hands of local assessors and administered upon the familiar general theory of the corporate excess. The commission recognized that the "whole matter of the taxation of franchises is in an extremely unsatisfactory condition."[28] It expressed no doubt that there was "an element in the value of corporate property which is over and above the value of the tangible and physical property."[29] This element of value was attributable to the income or earning power of the corporation and if, as in Europe, corporations should be taxed upon such a basis the "vexed question" would disappear. The commission recommended a general franchise tax upon an authorized capital stock basis at a rate of one-twentieth of one per cent. Before it was submitted to the voters in 1908, however, the proposed rate was changed to a specific scale of moderate rates. As has been noted in the chapter on separation of sources, Amendment No. 1, containing this provision among others, failed of passage. When resubmitted in 1910 it called for a one per cent rate upon a value of the franchise to be fixed by the State Board of Equalization. This change seems to have been a concession to prevailing sentiment which apparently favored the continuation of a method of franchise taxation with which there was some familiarity.[30] The essential difference was that assessment was made a central rather than a local function. This obviated the difficulties with local assessment under the rule that the franchise was taxable at the principal place of business of the company. Naturally corporations had selected as their principal places of business the counties in which the assessors gave them favorable treatment. Said the 1910 commission on revenue and taxation, "The amendment makes no change except to transfer the administration of the law from the counties which have not succeeded in collecting these taxes to the state which can do so with certainty and uniformity."[31]

Having traced the origin of the old franchise tax which existed from 1911 to 1928, we may now turn to a consideration of certain matters concerning its administration during these years. One of the major problems related to the valuation of the franchise. This task of valuation, as just stated, by terms of the constitutional amendment, devolved upon the State Board of Equalization. This board continued in general the method of the corporate excess which had been followed by the local assessors.[32] That the procedure proved unsatisfactory seems evident from the frequent testimony to that effect and from the recurring litigation surrounding the valuation of these franchises.

The Board of Equalization in its 1913–1914 report seemed somewhat on the defensive, for it argued at some length against the adoption of any rigid rule of franchise assessment.[33] It considered that the Constitution, statutes, and decisions of the courts were "all the authority and law necessary for the equitable assessment of franchises."[34] It contended that no rigid rule could be devised which would apply alike to all the differing kinds and classes of corporations; that any such rule would deprive the board of power to follow the spirit where the letter of the law worked hardship; that since no strict rule of valuation was laid down for any other kind of property, there was no reason why such should be done for franchises; that there were many companies for which, although a valuation might properly be made, there would be lacking the necessary data to make them fit into any rule; and finally that a rigid rule would restrict the power of equalization between companies.

The board's comments upon some of these points, and certain of its ensuing remarks, are illuminating in that they reveal the factors which played a part in the determination of the franchise values. Such factors as amount and kind of property used, amount of profits, and stock values were of course significant. The board insisted that it did not act arbitrarily and without rules. "Quite the reverse is the case. Thus, we have classified the companies definitely into: (*a*) general franchises; (*b*) oil companies; (*c*) water companies; (*d*) mining companies, and require different reports from each. Thus, water companies are required to report mileage of pipe lines; oil companies, acreage, wells producing, gravity of oil, etc., and so on, a series of facts all throwing light in one way or another on values."[85] Later on in this same report the board comments upon a change made by the 1913 statute[86] which eliminated the alternative of presentation by a corporation to the board of, in effect, an asset or an income statement, thereafter requiring both to be made. "This was a very salutary provision. The board was enabled thereby to make comparison of the volume of business done by the different corporations. Moreover it enabled the board to compare the gross business done and the net results obtained by the many corporations engaged in identical business, and thereby establish a greater equality in fixing the tax. Again a showing of gross and net business done is often a fair index of stock values, which is a paramount feature in franchise ascertainment."[87]

The 1927 revision of the statute read: "All franchises, other than those of the companies mentioned in sections 3664*a*, 3664*b*, and 3664*c* of this code, shall be assessed at their actual cash value, after making due deduction for good will, in the manner hereinafter provided, and shall be taxed at the rate of one and eight-tenths per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the state."[88] This provision for "due deduction of good will" in corporation franchise assessment was declared unconstitutional.[89] In the same case it was ruled that since franchise meant "corporate excess" an assessment made upon this basis was a legal method of valuation, and the valuation so made, in the absence of fraud or mistake, was final. The board was not bound to accept the figures submitted by the corporation in its annual report, but might fix values entirely within "its best discretion."[40] The rule established for foreign corporations doing an interstate business was that assessment upon the basis of total worth—aggregate security values minus the value of tangible properties—might be made with subsequent apportionment upon the basis of a ratio between intrastate business in California and the total business of the corporation.[41]

The preceding discussion relative to the valuation problem has been selective and typical rather than exhaustive. But enough may have been said to emphasize the difficulties and dissatisfaction inherent in the method pursued. From 1912, when the Attorney General observed that many corporations, both foreign and domestic, were attacking the state assessment of the corporate franchise upon various grounds, down to the termination of the tax in 1928, the assessment of franchises was never carried through with complete satisfaction to all concerned.[42] The 1910 commission had expressed the hope that the transfer of the administration of the tax from local to central authority would result in "certainty and uniformity." Another commission, making inquiry after the lapse of twenty years, concluded that such hope had "not been completely fulfilled. The evidence before the Commission indicates that, from the point of view of the taxpayer, the present franchise tax is an arbitrary tax, the amount of which it is impossible to anticipate and accrue. The taxpayers complain that they are unable to secure any explanation as to the basis on which the assessments are made, although it is generally understood that the underlying procedure is primarily that of the old corporate-excess method. Gauged as a device in a general property tax system designed to supplement local assessments of tangible property, the present franchise tax appears to be open to criticism, both because, if it succeeds in attaining its object, it is unjust, and because it does not succeed in attaining its object."[43]

A second major problem in connection with the old franchise tax had to do with the inequality in distribution of tax burden which resulted under it. A brief presentation of this matter must suffice. Six years after the tax had become effective, the commission reporting in 1917 set forth the results of its extensive study of the working of the law.[44] It noted first of all that in the six years of operation of the law almost no attempt had been made to classify systematically the different corporations and to determine equity as among them. A study of some

18,000 corporations, based on 1915 records, was made. The study revealed, "almost without exception" on the basis of any standard available, whether gross or net receipts, assessed or true value, that the tax was extremely heavy upon the smaller companies. Likewise the commission found "striking" differences between the different classes of corporations, which was "both modified and intensified when the character of the business is known."

The study of the burden of the franchise tax made a decade later by the commission reporting in 1928[45] corroborated the conclusions reached in 1917. This commission viewed the franchise tax problem in its proper setting in a modified system of business taxation. More particularly it was concerned with the proposal for a new franchise tax as a means of validating the new method of bank taxation under consideration. In this connection it inquired into the burden of the existing franchise tax plus personal property taxes in terms of percentage of net income of concerns subject to it. It was these two taxes upon ordinary corporations that the commission considered comparable with the share tax upon banks. It found that there was wide variation among groups, the range being all the way from nine-tenths of one per cent for investment and finance companies, excluding banks, to 6.7 per cent for oil companies. Likewise marked variation of burden was found to exist within each group. Although extreme instances,[46] the commission said, were not especially significant, yet, with elimination of the 25 per cent paying the highest proportion and the 25 per cent paying the lowest proportion of income in taxes, there were still to be found, in the middle half of several groups, some corporations paying at least five times as much in terms of income as others. This was found to be true of oil, mining, agricultural, water, and miscellaneous corporations.[47] The commission also found that the burden of the existing franchise and personal property taxes varied with the amount of net income as well as with the kind of business. The average business corporation with an income under $25,000 paid "more than four times as much in taxes, in proportion to its income, as the corporation with an income of $1,000,000 or more."[48] The conclusions, of course, would be similar if merely the franchise tax itself in terms of ratio of net income were considered.[49]

The discussion of this tax may conclude[50] with a word of evaluation in addition to what has already been said on this subject. The tax never yielded substantial sums as compared with the total of state costs, and as time passed it provided a diminishing percentage of the total state revenues. In 1912 the yield was not far from 10 per cent of these revenues, whereas in 1926, for instance, the yield was less than 5 per cent of them. The financial results of the franchise tax, as summarized by the State Board of Equalization[51] are given in the table below.

TABLE 12

STATISTICAL HISTORY OF THE FRANCHISE TAX

Year of assessment	Rate of tax per $100	Number of franchises assessed	Total tax assessed	Average tax per corporation
1911	1.0	18,264	$1,667,970	$ 91.873
1912	1.0	18,109	1,630,898	90.060
1913	1.0	18,866	1,575,495	83.510
1914	1.0	19,322	1,761,946	91.188
1915	1.2	20,376	1,938,565	95.139
1916	1.2	18,098	1,957,797	108.177
1917	1.2	16,713	2,104,013	125.891
1918	1.2	17,083	1,972,425	115.462
1919	1.2	16,615	2,034,270	122.435
1920	1.2	18,568	2,321,805	125.044
1921	1.6	19,003	3,147,026	165.606
1922	1.6	19,116	3,179,052	166.303
1923	1.6	20,479	3,497,052	170.761
1924	1.6	22,473	3,931,996	174.965
1925	1.6	23,521	3,950,084	167.938
1926	1.6	24,578	4,057,026	165.067
1927	1.8	26,606	4,725,215	177.599
1928	1.8	28,304	4,691,340	165.748

The franchise tax had many critics and comparatively few defenders. Perhaps the substance of the criticism can be stated in the words of one of the members of the 1929 tax commission: "This is a tax which has never been understood, is arbitrary, and is subject to many variations and has never been a satisfactory form of exaction."[52] The commission in its preliminary report found a basic objection to lie in the fact that the franchise tax was essentially a property tax from the theory of which the trend in modern tax reform was distinctly departing. The franchise tax was lacking in adequacy as a modern business tax in that it failed to fit into a prospective system of business taxes imposed where the business activity was carried on and measured by the earnings of the business or by some approximation to those earnings.[53]

We may now continue the review of business taxation in California by turning to a consideration of the developments leading up to the new franchise tax which became operative in 1929 in pursuance of a constitutional amendment of November, 1928, and subsequent enabling legislation. This further discussion of business taxation is necessarily bound up with the interrelated questions of the taxation of banks and of intangibles. Hence all three of these matters will be considered together as component parts of a complete problem. No extended discussion, however, of the taxation of intangibles will be given because, until very recently, this constituted local taxation rather than state taxation with which this study is concerned.

The story begins with and in a sense ends in the procedure or method followed by the state in the taxation of banking and, particularly, of national banking institutions. Prior to 1910, at which time Constitutional Amendment No. 1 was adopted, providing, among other things, for a share tax upon banks, the taxation of banking institutions in California was in a very unsatisfactory state.[54] With this part of bank taxation history, however, we are not here primarily concerned. Suffice it to say that the revenue commission reporting in 1906 recommended the adoption of a share tax method, which would keep within the restrictions of the federal statute relating to taxation by the states of national banks and at the same time obtain a more adequate contribution from banking institutions. It should perhaps be stated at this point that states may not tax national banks except under conditions laid down by Congress.[55] Since this phase of the whole problem of bank taxation in the United States has been told often and well,[56] there exists no necessity here to delve deeply into the origin, evolution, and consequences of section 5219 of the *Revised Statutes of the United States* which governs the taxation by states of national banks.

At the time when Amendment No. 1 was adopted in California[57] there was available but one method, namely, the tax on shares, by which states could tax national banks. The language of section 5219 at that time read as follows:

"Nothing herein shall prevent all the shares in any association from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by the authority of the state within which the association is located; but the legislature of each state may determine and direct the manner and place of taxing all the shares of national banking associations located within the state subject only to the two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state and that the shares of any national banking association owned by non-residents of any state shall be taxed in the city or town where the bank is located, and not elsewhere. Nothing herein shall be construed to exempt the real property of associations from either state, county or municipal taxes, to the same extent, according to its value, as other real property is taxed."

In pursuance of this permissive authority and upon authority of the amendment to the California Constitution, the legislature provided for the new method of taxing banks.[58] Its essential features were (1) taxation of real estate of the bank (but not of its personal property) at the local property tax rate and (2) taxation by the state of the shares of stock upon the basis of the capital, surplus, and undivided profits, with a deduction for the assessed value of the bank real estate.[59] This was the method of bank taxation employed in the state from 1911 to 1928. Table 13 is reproduced from the special report of the tax commission and reveals the statistical history of the tax.[60]

In general, the method in California of taxing banks upon the share basis proved to be fairly satisfactory. The yield of the tax was substantial, even though as against this virtue there were occasional complaints of undue and unequal tax burdens. Perhaps in evaluating this tax it may be well to recall the words of the 1928 commission report: "In general, the experience under the present plan of taxing banks has been good. The method provided is definite, and there has been no complaint of discrimination as among banks. The rates have been changed on three occasions, and although these changes, and particularly the change made in 1921, provoked considerable controversy, and although some of the bankers now feel that they are heavily taxed, it may be said that the present method has given fair satisfaction both to the state and to the banks."[61]

But this plan of taxing the banks, however satisfactory, was not destined to continue, largely because of forces beyond the control of the state. States other than California were also affected. The story is familiar to students of tax problems and need not be repeated in detail. The whole difficult problem was precipitated by Supreme Court decisions interpreting the conditions under which the states were permitted to tax national banks. It has already been pointed out that the national banks, as creatures of the federal government, are taxable by the states only within the limitations set by federal law. The National Banking Act of 1864 authorized taxation of the shares of national banks to holders thereof subject to two conditions. The rate of tax was not to exceed the rate imposed on other moneyed capital in the hands of individual citizens coming into competition with national banks and the

TABLE 13

Taxes Levied on Banks and the Rates Applied, by Years, 1911–1928

Fiscal year	Period covered	Taxes levied (in thousands of dollars)			Rates applied (percentage)
		National banks	State banks	Total	
63	1911–1912	$ 835	$ 804	$1,639	1.0
64	1912–1913	873	828	1,701	1.0
65	1913–1914	915	864	1,778	1.0
66	1914–1915	946	886	1,831	1.0
67	1915–1916	1,153	1,075	2,228	1.2
68	1916–1917	1,170	1,066	2,236	1.2
69	1917–1918	1,152	1,063	2,215	1.16
70	1918–1919	1,161	1,097	2,258	1.16
71	1919–1920	1,192	1,150	2,342	1.16
72	1920–1921	1,282	1,337	2,619	1.16
73	1921–1922	1,653	1,995	3,649	1.45
74	1922–1923	1,647	2,109	3,757	1.45
75	1923–1924	1,600	2,257	3,857	1.45
76	1924–1925	1,484	2,652	4,136	1.45
77	1925–1926	1,536	2,794	4,330	1.45
78	1926–1927	1,514	2,834	4,348	1.45
79	1927–1928	1,933	2,525	4,458	1.45
80	1928–1929	2,549	2,236	4,785	1.45

shares were to be taxed at the domicile of the owner, but for purposes of taxation his domicile should be considered to be the place where the bank was located.[62] The former limitation was the significant one.

But here we must pause for a moment to consider what California had done with respect to the taxation of intangibles.[63] First of all, in 1910, by constitutional amendment, California had exempted mortgages from taxation.[64] Then in 1917, so-called foreign securities were distinguished from domestic securities.[65] This meant that shares of stock, so far as they represented tangible property located within and therefore presumably taxed within the state, were thereafter nontaxable.[66] In 1924 California, by virtue of constitutional amendment,[67] became one of the classification states in a position to extend preferential treatment to intangibles. In pursuance of this constitutional authorization the legislature of 1925 enacted the popularly known Solvent Credits Act, or 7 per cent law, providing that specified intangibles should be assessed at 7 per cent of the full cash value.[68] The local tax rates were to apply and the yield was to accrue to the localities.

At the time this law was enacted there was apparently no thought that it would invalidate or jeopardize the bank taxes. It will be recalled that section 5219 of the *Revised Statutes* permitted taxation of bank shares but at a rate no higher than that imposed upon "other moneyed capital" coming into competition with national banks. A long series of decisions by the United States Supreme Court had established the understanding that "other moneyed capital" included only the shares of other institutions doing a similar banking business, notably state commercial banks and trust companies and money of individuals employed in a manner similar to the employment of banking capital.[69] But in 1921 in the Richmond decision[70] the Supreme Court said in effect that individual investments in bonds, notes, and other evidences of indebtedness came into competition with national banks in the loan market.

This decision placed in an entirely new light the question of the state taxation of national bank shares, especially in those states which, like California, had classified intangibles for purposes of preferential treatment. National banks in those states were now able to claim discrimination in taxation which was contrary to federal law. In California, after the 7 per cent law previously mentioned had come into effect in the assessments of 1926, certain national banks paid their taxes on their stock at the 1.45 per cent rate (the rate which had been applicable since 1921) under protest[71] and brought suit to recover on the ground that other moneyed capital in competition with them was being taxed less heavily. This situation, fortified by subsequent decisions of the Supreme Court reaffirming the principles laid down in the Richmond case,[72] explains the enactment in 1927 of the law placing a rate of 1.45 per cent on full value of all intangibles.[73] The banks could not then claim discrimination and state revenues, it was contended, would be protected. This law was destined never to be enforced. The California Supreme Court, in a decision rendered March 8, 1928, declared invalid both the 7 per cent law of 1925 and the 1.45 per cent law of

1927.[74] Thus the situation with respect to the taxation of intangibles reverted to the status of 1917, namely, the assessment of all property, intangibles included, at full cash value,[75] with of course the application of the local rates.

Meanwhile, largely as a result of the Richmond decision and the consequent litigation in many states to test the validity of the share taxes on banks, the federal law concerning state taxation of national banks had been amended in 1923 and again in 1926,[76] so that section 5219 embodying the legislation on this subject provided four alternative methods of taxing national banks, in connection with each of which, however, certain restrictions were laid down. The four methods were as follows: (1) taxation of the shares (the only method from 1864 to 1923); (2) taxation of the dividends as part of the taxable income of the shareholder; (3) taxation of banks on their net income; and (4) taxation of banks according to or measured by their net income.

The employment of any one of these methods, with but a slight exception, excluded the employment of any of the others. The restrictions upon the share tax method have already been noted. The limitations on the second method were that dividends on national bank shares might be included in taxable income only if dividends upon shares of other corporations were likewise included; and that the tax should not be at a greater rate than was assessed upon the net income from other moneyed capital. Use of the third or fourth method was limited by the requirements that the rate must not be higher than that upon other financial corporations nor higher than the highest rate imposed upon mercantile, manufacturing, or business corporations.

These then, briefly, were the conditions which confronted the tax commission with respect to the taxation of banks and intangibles and with respect as well to the taxation of business in general, for the commission considered all of these as elements in a single comprehensive problem. The commission considered the situation sufficiently acute to call for a special report preceding its final and more complete one and for a recommendation of a special session of the legislature to deal with the emergency.[77] The immediate task in hand was determination upon a method of bank taxation which would meet the test of the federal requirements and limitations.

Through a process of elimination[78] the commission recommended for California the abandonment of the share tax method and the adoption of the fourth alternative for the taxation of national banks. The continuance of the share tax method, it reasoned, would probably be invalid unless the California Constitution were changed to remove the exemption from taxation of real estate mortgages, which it thought the Supreme Court would hold as "other moneyed capital in the hands of individual citizens of such state coming into competition with the business of national banks."[79] Likewise it concluded that a second possible ground for claiming discrimination might have been found in the provision permitting deduction of debts from solvent credits.[80] Throughout, too, the commission had been concerned with regard to the preferential treatment of intangibles as involving a discrimination against bank shares.[81] In fact, the commission recommended for California and included within its proposed constitutional amendment a provision calling for a low mill rate tax upon intangibles.[82] In view of decisions of the United States Supreme Court, already mentioned in the preceding discussion, on what constitutes "other moneyed" capital, the commission was undoubtedly justified in its position that a share tax upon banks which would have yielded any substantial revenue would have been incompatible with the proposed treatment of intangibles. So far as the second and third possible methods of taxation were concerned, inclusion of bank dividends in income under a personal income tax and taxation of banks on their net income, as practical propositions, these were dropped from consideration. The second method would have yielded inconsequential revenues and likewise would have required the enactment of a personal income tax which the commission was neither ready nor willing to urge as an emergency measure. The third method was discarded in favor of the fourth, "because under the fourth everything can be accomplished which may be gained by proceeding under the third, and presumably more besides, viz., the inclusion, if desired of tax-exempt interest in the base."[83]

Thus it came about that the commission recommended, the legislature voted, and the people approved the amendment to the California Constitution.[84] Subsequently the legislature enacted into law the Bank and Corporation Franchise Tax Act of 1929.[85] It is no part of the purpose of this presentation to trace in detail the provisions of this act and later amendments to it.[86] To do so would require a book, not a chapter.[87] The object rather, in the remaining discussion, will be to emphasize a few significant principles and to draw attention to some of the more important aspects of the new legislation. To this we shall come shortly.

Before we dismiss completely, however, the subject of taxation of banks prior to 1929, something in brief should be said concerning the often discussed matter of the burden of bank taxation. The general impression with which one is left after a survey of the history of bank taxation in California is that on the whole the banks have enjoyed a comparatively favored position in the matter of tax burdens. What has already been said about the views of the commissions of 1906 and 1917 need not be repeated here. The one considered the banks to be undertaxed. The other felt that at least they were not overtaxed. The original rate of one per cent upon bank shares seemed generally to be considered a moderate one.[88] The Board of Equalization in its 1913–1914 report, in commenting upon the change in tax rates made by the 1913 legislation, said: "With the relation to banks, however, from the data collected by the board, we were satisfied that they were not paying a just and equitable share of taxes and so recommended to the legislative committee. No attention, however, was given the recommendation; at least the ratio was not changed."[89]

By 1928, however, the situation with respect to relative burden had apparently changed. At any rate the commission from its studies determined that banks, state and national combined, were paying 11.8 per cent of their net income in taxes on bank stock.[90] It found the comparable burden (franchise plus personal property taxes) for general corporations to be 4.4 per cent.[91] Consequently the banks, in the commission's view, were relatively overtaxed.[92] However, the substitution of the franchise tax method for the tax upon bank shares greatly reduced the taxes the banks were required to pay.[93] The commission itself conceded that the proposed 4 per cent rate of the new franchise tax it was recommending was a "very moderate tax" on national banks and was low compared with rates in force in similar states.[94] It suggested the possibility of the elimination of personal property tax offsets and an accompanying increase of the rate from 4 to 5 per cent.[95]

The 1931 joint legislative committee on taxation, after reviewing the decline in yield of bank taxes consequent upon adoption of the new franchise tax method, attempted a comparison of relative burdens in terms of a property base. It found the 1929 taxes of the banks under the franchise method to constitute a burden relative to the taxable value of bank shares of but 8.3 per cent of the burden resting on common property in 1928, and in 1930 but 15 per cent of that burden.[96] It then pointed out the "position of unique advantage" enjoyed by the banks "where they are taxed only upon their real property and by an excise tax, while all other corporations are taxed either directly or by a commutated tax upon their real property, their tangible personal property, and upon their intangible assets (franchise) or by an excise measure."[97] Finally we may note that the Tax Research Bureau report of 1933 concluded that, despite property tax offsets which resulted in different effective rates as opposed to statutory rates upon banks and corporations, the total tax burden on corporations was heavier than that upon banks.[98] As a solution it recommended elimination of offset provisions and the determination of the rate to be applicable to banks partly in terms of the percentage of net income of general corporations consumed by personal property taxes.[99] The adoption of this suggestion in subsequent legislation was a concrete expression of an attempt to deal with this problem.

Having surveyed in certain of its aspects the question of bank tax burdens, we may now enter upon a brief consideration of some of the essential aspects and significant principles of the new legislation, begun in 1929, which changed the fiscal system of California. In their legal aspects the changes which occurred were, of course, designed mainly to alter the business tax structure of the state in order thereby to validate the proposed tax on banks according to the fourth alternative permitted by the federal statutes.[100] More fundamental, however, in the proposed new scheme of business taxation was the theoretical ground upon which it was urged. Probably the most significant circumstance in the developments as they transpired was the change from a property to an income basis in the system of business taxation in the state. The old franchise tax was conceived to be essentially a property tax. Likewise the gross receipts taxes upon the utilities were viewed as in lieu taxes and were related, as has been shown elsewhere in this volume, to the property taxes paid locally. The commission remarked that the trend in tax reform was distinctly away from the theory of the property tax. "In addition to such property taxation," it said, "there is rapidly being developed a system of business taxes imposed where the business activity is carried on, and measured by the earnings of the business or by some approximation thereto."[101] In the public hearings on the original bill prior to its enactment into law to carry into effect the provisions of the constitutional amendment, the tax was described by Professor Haig, adviser and director of research for the commission, as "a tax for the privilege of carrying on business in this state for a year in advance, the price for that privilege being determined by the earnings which were made during the period just closed. That is the theory of the law."[102]

Necessarily in the setting up of any method of business taxation upon the basis of net income, various technical and administrative matters will find embodiment in the statute. Among these will be provisions concerning corporations subject to the act, the definition or determination of net taxable income, rate or rates to be applied, allocation of income from interstate business, and so forth. In keeping with a previously stated purpose it is no part of the intention here to deal extensively with these matters, since the details are available to anyone who wishes to read the law itself. A few remarks, however, seem in order. We may first outline the essential provisions of the Bank and Corporation Franchise Tax Act of 1935.[103]

The act, in practical effect, is a net income tax levied upon all corporations except insurance companies[104] and certain holding[105] and nonprofit[106] corporations. Taxable organizations fall into two groups, namely, banks and financial corporations, and mercantile, manufacturing, and business corporations.[107] The latter are subject to a 4 per cent tax[108] upon their net income determined as specified in the act.[109] The rate applicable to the former class is determined by a formula which involves a determination of the percentage of net income paid in personal property taxes by the general corporations. The rate paid by banks and financial organizations is then the 4 per cent paid by these general concerns plus this determined percentage of their personal property taxes to their net income, with the provision that the combined rate may not exceed 8 per cent.[110] In view of the fact that banks and financial corporations either are not taxable upon their personal property or are entitled to certain offsets for such taxes,[111] this formula represents an attempt to equalize the tax burden as between the two groups of corporations.

The definition of net income, although broad enough to include interest from tax-exempt securities in the base of the tax,[112] still exemplifies, but with modifications from the original act, the announced policy in the early 1929 discussions of going "a long way to achieve equity, even at the cost of the sacrifice of a considerable amount of simplicity."[113] There was also, because of the liberal allowances and deductions, some loss of revenue, particularly in the early years of the new law, over what otherwise would have accrued to the state.[114]

Provision is made for the allocation of income from interstate business since, of course, the state seeks to tax only that part of the total income which is derived from business done within the state. Inasmuch as the equitable apportionment of corporate income among the states presents a difficult technical problem, and one of the most important with which the states have to deal, it may be singled out for brief comment as illustrative of the many other technical questions which arise in the field of business taxation.[115]

The law upon this point reads: "The portion of net income derived from business done within this State, shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the State the portion of net income reasonably attributable to the business done within this State and to avoid subjecting the taxpayer to double taxation."[116]

When the original bill was under discussion in January, 1929, Professor Haig, in public hearings before the Senate and the Assembly, dwelt upon the question of allocation. After pointing out the lack of uniformity obtaining in rules of apportionment used by the several states, he called attention to the decision which had been made by the commission to allow appreciable latitude to the administrator rather than to incorporate a specific formula into the statute. This decision, he said, had been made for a number of reasons. One of them was that from the standpoint of the taxpayer himself "it would be advantageous that the administrator's hands be not too tightly tied with respect to the amount of income that should be segregated to California, as compared with other states."[117] Again he urged that, even in those states which had adopted a statutory formula, it had been found necessary to accompany it with a blanket authorization to depart from the rule when circumstances seemed to require it.[118] Finally, he suggested that the administrator in California should be left "sufficient latitude to fit into the rules which have been established in a number of different states."[119] In accordance with this advice the legislature saw fit to state this section of the law in fairly broad terms. California may be said to follow what is known as the Massachusetts rule, which gives equal weight to three major factors—property (average monthly actual value of real and tangible personal property), pay rolls (wages, salaries, commissions, and other compensation of employees), and gross sales, less returns and allowances.[120] Professor Lutz remarked that "not only because of its inherent reasonableness, but also because of acceptance by other states, thus providing a good beginning of reciprocity," a committee of the National Tax Association in 1933 recommended the general adoption of the Massachusetts rule.[121]

Although the writer fully recognizes that there are many aspects of the franchise tax in California which have not been given consideration in this chapter, the discussion of these matters must be left to the special treatises.[122] There remains, however, one point to which some passing attention must be given. This is the matter of offsets against the franchise tax.

The commission reporting in 1929 recommended, as a temporary expedient, a limited personal property tax offset against the new franchise tax it was proposing. The privilege of the offset was contemplated not because banks did not pay personal property taxes[123] but rather because of the "solution it provided of the troublesome problem of safeguarding the local revenues during the period of transition."[124] The commission envisioned the ultimate abandonment of the personal property tax,[125] but it was seeking at the same time "to validate as adequately as possible the tax upon banks" and to avoid opening up the whole question of reimbursing the localities for the loss of revenue they would have incurred from the elimination of the personal property taxes upon the ordinary type of corporation.[126] The consequence of these deliberations was that the commission advised an offset against the new franchise tax for taxes paid on personal property up to 90 per cent of the franchise tax, with a minimum tax of $25 not "subject to offset." "This will operate," the report continued, "to prevent the disturbance of the revenues which the localities now receive from the personal property tax."[127]

But before the amendment was adopted by the people and the law enacted by the legislature, representations were made to the commission that there should also be an offset, albeit a limited one, for real estate taxes paid. The arguments advanced were that without it taxes of certain corporations would be greatly increased; that denial of such offset would constitute a discrimination against real estate as compared with other forms of property; and that lack of such an offset would discourage corporate organization for real estate enterprises. The commission made a thorough analysis of the case and the arguments stated for it. It is not necessary to review here the details of the commission's various views. On all counts it found the request an unwarranted one.[128]

Nevertheless as the law was enacted it included an offset for real estate as well as for personal property taxes paid to the localities. Personal property taxes and 10 per cent of real property taxes paid locally could be used as an offset with the proviso that the total offset could in no instance exceed more than 75 per cent of the franchise tax.[129]

These offset provisions were not, however, destined to remain in the law.[130] It has already been observed that the commission in recommending this provision had done so with the thought that it would be but a temporary expedient. The 1931 joint legislative committee said in its report: "The improvement of greatest merit that could be effected would be to have an established rate of tax for all corporations. This would necessitate the elimination of the offset for taxes on real and personal property paid to localities and a corresponding reduction in the amount of the tax rate."[131] About the same time the offset provisions were also criticized by the California Farm Bureau Federation. The personal property tax offset was said, for several reasons, to be both unnecessary and discriminatory; the real estate tax offset was said to make the franchise tax unequal and discriminatory in operation; and the offset feature which had been tried in other states had, in most of them, been abandoned in favor of a straight tax on or according to or measured by net income.[132]

Subsequent to these criticisms the attack was renewed in the *1933 Report* of the Tax Research Bureau of the State Board of Equalization. A number of things were pointed out there. The equality of the statutory rate was more apparent than real since the offset provisions resulted in an effective state rate upon banks of 3.37 per cent on net income as contrasted with 1.89 per cent on other corporations.[133] Yet by reason of personal property taxes paid, the total tax burden upon corporations was heavier than that on banks.[134] There was also inequity between corporations themselves as a result of the offset.[135] The solution suggested was the elimination of the offset with an accompanying adjustment of the bank tax rate to a higher figure than that paid by general corporations in recognition of the fact that banks do not pay personal property taxes which, however, do constitute a part of the total tax burden of other classes of corporations. This adjustment of the bank (and financial corporation) tax rate has already been discussed in describing some of the major provisions of the Act of 1935. Legislation of 1933 made effective the recommendations with respect to offsets. With the exception of the personal property tax offset for financial corporations, the provisions allowing personal property taxes and 10 per cent of real estate taxes as offsets up to 75 per cent of the franchise tax were eliminated from the law.[136]

With this modification, and others, in the new business tax and with changes likewise in other existing revenue laws and with the establishment of new sources of revenue far-reaching in scope and fundamental in effect, the California fiscal picture has been changed profoundly since 1929. Much, but not all, of this change, some of it with delay, has followed the outlines laid down by the commission which reported its findings in 1928 and 1929. This chapter may conclude with a brief discussion of the taxation of one class of business concern, namely, the insurance companies, which has not generally been patterned after the type of taxation which came to be adopted for banking, financial, and business corporations.

From 1911 to the present time California has employed a gross premiums levy in the taxation of insurance companies.[137] Provision was made in the constitutional amendment adopted November 8, 1910—known as Constitutional Amendment No. 1, which introduced separation of sources into California—for taxation annually of every insurance company or association doing business within the state at a rate of 1½ per cent upon gross premiums, less return premiums and reinsurance in companies or associations authorized to do business within the state. From this 1½ per cent upon gross premiums was to be deducted the amount of any county or municipal taxes on real estate owned in this state. The tax was to be in lieu of all other taxes and licenses, state, county, and municipal, upon the property of the companies, except local taxes upon real property and taxes that might be levied to meet a deficit in the state treasury. The amendment also carried retaliatory provisions[138] which authorized California to impose upon foreign insurance companies any disabilities imposed by other states upon California companies.

The 1906 commission had recommended a 2 per cent rate upon gross premiums. It offered the following explanation for suggesting that percentage: "The business of insurance is so peculiar that the rules developed for the determination of the tax rate upon corporations in general are not easy of application. But inasmuch as it is the consensus of opinion in so many other states that insurance companies ought to pay 2 per cent of their gross premiums as taxes, that is presumably a safe guide."[139] As previously stated, the tax on premiums inaugurated in 1911 has remained to the present time. Table 14 reveals the rates applied and the taxes assessed during the period involved.[140]

TABLE 14

TAXES ON INSURANCE COMPANIES, 1911–1935: RATES APPLIED AND TAXES ASSESSED

Period covered	Rate (percentage)	Taxes assessed (thousands of dollars)	Period covered	Rate (percentage)	Taxes assessed (thousands of dollars)
1911–1912.......	1.5	$ 520	1924–1925.......	2.6	$4,397
1912–1913.......	1.5	602	1925–1926.......	2.6	4,340
1913–1914.......	1.75	763	1926–1927.......	2.6	4,898
1914–1915.......	1.75	816	1927–1928.......	2.6	5,475
1915–1916.......	2.00	1,022	1928–1929.......	2.6	6,203
1916–1917.......	2.00	1,065	1929–1930.......	2.6	7,030
1917–1918.......	2.00	1,153	1930–1931.......	2.6	6,984
1918–1919.......	2.00	1,355	1931–1932.......	2.6	6,653
1919–1920.......	2.00	1,548	1932–1933.......	2.6	5,915
1920–1921.......	2.00	1,863	1933–1934.......	2.6	5,403
1921–1922.......	2.6	3,088	1934–1935.......	2.6	5,623
1922–1923.......	2.6	3,246	1935–1936.......	2.6	5,750
1923–1924.......	2.6	3,619			

With the exception of the rate adjustments at intervals[141] and the comments of the State Board of Equalization in succeeding biennial reports upon insurance tax litigation,[142] there was comparatively little attention given the subject of taxation of insurance companies until the time of the *1929 Report.* The commission reporting in that year, although recognizing that the tax on gross premiums had become "conventionalized" as well as somewhat standardized among the states, considered the matter from a number of points of view. The conclusions from its inquiry comprised the fifth of the ten major recommendations made by the commission for the reform of the tax system of the state. The commission recommended "that the taxes on insurance companies be modified (1) through the reduction of the rate of the gross premiums tax from 2.6 per cent to 2.25 per cent; (2) through the elimination of the privilege of offsetting real estate taxes against the gross premiums tax; and (3) through provisions designed to prevent evasion of the gross-premiums tax through reinsurance."[143]

The commission recognized that, because of the offset of real estate taxes paid locally, the actual rate paid by insurance companies was somewhat less than the 2.6 per cent statutory rate, namely, 2.4 per cent.[144] Yet, despite this fact, rates in California were found to be high rather than low when compared with those applicable in other states. The commission seemed inclined to accept an average rate for all the states of 2.25 per cent as against the rate of 2.6 per cent in California,[145] or 2.4 per cent with the offset included. The recommended rate for California coincided with the average rate throughout the country. The proposed rate reduction was further defended on the ground that it would make the burden on insurance companies correspond more closely to that on ordinary business.[146] Finally it was suggested that, because of the way in which the retaliatory clauses operated, a reduction in the rate would result in more favorable treatment of California companies operating in other states.[147]

With respect to the real estate tax offset against the gross premiums tax, the commission pointed out that this provision was "unduly liberal and has been subjected to considerable abuse."[148] It cited instances of nonpayment or payment of small amounts of insurance taxes as a result of this offset privilege.[149] To eliminate the offset, it further argued, would bring the taxation of insurance companies more in line with the general plan of business taxation that it was advocating for the state. Consequent upon elimination of the offset, suitable adjustment was to be made in the rate of the tax. The deduction for reinsurance, the commission stated, should be denied in the absence of affirmative showing that the reinsuring company had assumed liability for the tax upon premiums for insurance placed in California.[150]

The commission made some analysis of the feasibility of taxing insurance companies upon the basis of net income. It entertained some hope of this possibility because of the fact that it would further the progress toward uniform business taxation in the state and because this basis of taxation was urged by the marine insurance group.[151] From its examination of federal taxation of insurance companies upon a net income basis, the commission concluded that "it appears to be possible to evolve ways of taxing insurance companies on their net income, but their situation is clearly peculiar and requires special treatment."[152] Although it thought that taxation on the basis of net income might be the ultimate solution—as it has come to be for the marine insurers[153]—it hesitated to recommend that plan in view of the prevailing sentiment in the business against such a conception of insurance taxation and in view of the indeterminate status of insurance accounting.[154] Hence the commission finally urged the continuance of the tax upon gross premiums, although with the modifications which have already been noted. Except for marine insurers, this is the basis which California employs today, and has employed since 1911.[155] The modifications suggested by the commission were not acted upon.

In 1935, upon the recommendation of the administration, an attempt was made to change the rate of tax from 2.6 per cent to 4 per cent to raise an estimated $6,000,000 to help balance the state budget.[156] The proposal was vigorously assailed by the insurance companies, who contended that the increase, if made, would bring retaliatory increases in other states against California companies to such a degree that California companies would pay an additional $2.00 in taxes to other states for every additional $1.00 paid in California.[157] It was also asserted that the proposed increased taxes would be added costs which would have to be borne by the policy holders. These arguments, whether or not entirely valid, proved effective and the rate was left at the 2.6 per cent level.

A word in conclusion may be said concerning the taxation of marine insurers. It has already been noted that this group, appearing before the commission reporting in 1929, advocated their taxation upon the basis of net income.[158] This was urged as both equitable and administratively feasible. The plan had already been adopted in the District of Columbia, Pennsylvania, New Jersey, Oregon, and New York. The plan advanced by the marine insurance group proposed to "arrive at net income by approaching it from the underwriting income side, rather than from the investment income side."[159]

At the November, 1930, election there was proposed and adopted an amendment to the Constitution providing for this basis of taxation.[160] The amendment was urged largely upon the ground that the competitive situation made it desirable. Foreign insurers, it was said, taxed on net income could quote lower premiums than American insurers, and marine insurance companies of California transacting business in other states could not obtain the benefits of laws in those states until California passed similar laws.[161] "The question," said the commission in 1929, "is really whether the state desires to offer a subsidy of this character to foreign trade."[162]

The Constitution now provides for an annual tax of 5 per cent upon that proportion of underwriting profit from such insurance written in the United States "which the gross premiums of the insurer from such insurance written in this State bear to gross premiums of such insurer from such insurance written within the United States." This tax is in lieu of other taxes and licenses except taxes upon real estate and taxes which may be imposed because of any other class of insurance written by the company. The legislature is to define the terms "ocean marine insurance" and "underwriting profit."[163]

This chapter has outlined the story of the taxation of business in California from 1911 to the present time. The development runs through the old license and franchise taxes to the more modern franchise tax ushered in by the changes made in 1929. The most significant change during this period was that from essentially a property basis to an income basis in the taxation of business corporations. This development held true with respect to all classes of corporations except insurance companies, which continue to be taxed on a gross premiums basis. Ocean marine insurers are, of course, an exception here. Banking, financial, mercantile, manufacturing, and business corporations and public utilities come within the purview of the new franchise tax according to or measured by net income. In this respect, California during the last few years unquestionably has made distinctive fiscal progress. Net income is not a perfect measure of a tax, but it is a more satisfactory measure, even with respect to corporations, than any we have yet devised or are likely to devise in our further search for better standards and higher refinements in business taxation policy and procedure.[164]

NOTES TO CHAPTER V

[1] *California Constitution,* Art. XIII, sec. 14, as amended at the election of June 27, 1933. Also Art. XIII, sec. 14½.

[2] *Ibid.,* secs. 14 and 14½; *Cal. Stats.* (1929), ch. 13.

[3] *Final Report of the California Tax Commission* (1929), pp. 75–76 (hereafter referred to in this chapter as the *1929 Report*). The commission said with respect to its proposed plan (*ibid.,* p. 75): "The adoption of this proposal will result in equitable distribution of the tax burden in place of the present inequitable distribution. It will provide an elastic tax system in place of the present rigid mechanism. It will place all real estate on the same basis, with no artificially calculated rates. It will provide a uniform system of business taxes. It will make possible the ultimate solution of the personal tax problem."

[4] *Cal. Stats.* (1905), p. 493.

[5] *Preliminary Report of the Commission on Revenue and Taxation of the State of California* (Sacramento, 1906), p. 66 (hereafter referred to as the *1906 Preliminary Report*). For the early history of the license tax, see W. C. Fankhauser, *A Financial History of California* (*Univ. Calif. Publ. Econ.,* vol. 3 [1913]), pp. 347–349.

[6] *Cal. Stats.* (1907), p. 664. Under this law the tax ranged from $10 when the authorized capital stock did not exceed $10,000 to $250 when it exceeded $5,000,000.

[7] *K. K. Mulford Co.* v. *Curry, Secretary of State,* 163 Cal. 276. The State Supreme Court ruled in this case that the license tax, as well as the fees imposed for filing articles of incorporation with the Secretary of State, and graduated according to the amount of authorized capital stock, was unconstitutional and void with respect to foreign corporations engaged in carrying on an interstate as well as an intrastate business. The reasoning was that such exactions were a direct burden upon interstate commerce in violation of the commerce clause of the Federal Constitution and were also an illegal tax upon foreign corporations upon their property outside the state. The court also extended its ruling to domestic corporations doing an interstate as well as an intrastate business and having property situated without the state.

The State Board of Equalization in its report for 1913–1914 (p. 56), in commenting upon the decision, declared that it "appeared to take foreign corporations out from under this tax. As the constitution provided that foreign corporations should not be allowed to do business in California on any more favorable terms than domestic corporations, it seemed necessary to equalize the taxes by repealing the tax on domestic companies."

[8] *Cal. Stats.* (1913), ch. 336, p. 680.

[9] *Albert Pick Co.* v. *Jordan, Secretary of State,* 169 Cal. 1. The decision in this case, rendered December 15, 1914, enunciated principles which, since the Mulford ruling, had been laid down by a series of decisions in many states and finally by the Supreme Court of the United States in the Baltic Mining Co. cases and *S. S. White Dental Manufacturing Co.* v. *The Commonwealth of Massachusetts,* 231 U. S. 68. The California court ruled that henceforth both the filing fee and the license tax were to be construed as privilege or occupation taxes upon the right to do domestic business in California, that these were excise and not property taxes, that the levies were not on, nor based on, the capital stock but merely measured thereby, and that in every instance it was practicable to segregate strictly domestic or intrastate from interstate business.

[10] *Cal. Stats.* (1915), ch. 190, p. 422. The act was subsequently amended in particulars from time to time—in 1917, 1921, and 1923.

[11] The tax ranged from $10 on capital stock not exceeding $10,000 to $1,000 on capital stock exceeding $10,000,000.

[12] Coinciding with the repeal of the license tax, the rate of the franchise tax was in-

creased from 1.6 to 1.8 per cent, but this increase was insufficient to offset completely the loss of revenue involved. See *1929 Report*, p. 267.

[13] *Perkins Manufacturing Co.* v. *Jordan*, 200 Cal. 667. The court in this case decided that the tax was invalid as applied to a foreign corporation. "Because of the manifest inequity of continuing to exact these payments from domestic corporations, the 1927 legislature repealed the tax."—*Report of the State Board of Equalization* (1927–1928), p. 9.

[14] Figures are taken from the *1929 Report*, pp. 22 and 267.

[15] *Biennial Report of the State Controller* (1916), p. 16.

[16] *Biennial Report of the State Controller* (1914), p. 17. The complaint of double taxation had been raised before. The Controller in his report in 1912 had written (p. 31): "Again, even before the Mulford decision had been rendered there had been a good deal of opposition, as a mere matter of policy, to the continuance of the corporation license tax, because that and the franchise tax assessed by the State Board of Equalization are so much alike as to seem like two franchise taxes, and a great deal of confusion has arisen therefrom. Having the two taxes has appeared to most corporation taxpayers to be more obnoxious than a single tax would be even if it were double the amount of either one." And the State Board of Equalization in 1914 had said (*Report of the State Board of Equalization*, p. 56) that "there were so many different taxes on corporations that they were justly annoyed by the multiplicity of tax bills and reports."

[17] *Biennial Report of the State Controller* (1914), p. 17. The 1917 California tax commission touched upon this problem of the incorporated versus the unincorporated enterprise. See *Report of the State Tax Commission* (Sacramento, 1917), p. 58 (hereafter referred to in this chapter as the *1917 Report*).

[18] *1917 Report*, pp. 58–60.

[19] The 1929 commission dwelt upon this problem of the incorporated as against the unincorporated concern. Theoretically, it said, a system of business taxes should be as broad as business itself. It did not, however, at the time recommend an unincorporated business tax, even though it conceded such a tax should be envisioned as an ultimate possibility. Probably the best measure of such a tax, it argued, would be net income but with a rate of tax for certain reasons lower than that applicable to corporate business enterprises. In lieu of net income, certain external indicia such as rentals or floor space or gross sales (after the Connecticut plan) might be employed. The commission, however, objected to the gross sales basis, despite its simplicity and productivity, because of the difficulty of fixing a rate upon gross which would be comparable with the corporate rate on net, because of the burden upon the less prosperous concerns, and because, so far as the tax was shifted with respect to goods passing through many hands, of the cumulative burden upon the consumer. See *1929 Report*, pp. 79–80.

[20] *Biennial Report of the State Controller* (1914), p. 17. The tax throughout its existence was administered by the Secretary of State.

[21] These are referred to as "old" because neither is any longer employed. Art. XIII, sec. 16, of the Constitution, adopted November 6, 1928, provided for new methods of taxation of banks, franchises, and intangibles. In the *Revenue Laws of California* (1932) appears this editorial note (p. 53): "Since the adoption of this section there has been no further assessment of bank shares under section 14 (*c*), article XIII, nor, generally speaking, of corporate franchises under section 14 (*d*), article XIII. In March, 1929, the 'Bank and Corporation Franchise Tax Act' (chapter 13, Statutes of 1929, post, p. 375) was passed to carry into effect the new method of bank and corporation taxation provided by this constitutional amendment, and that act, in general, supersedes the provisions of the Political Code (sections 3664*b*, 3664*d*, etc., post, p. 104 et seq.) relating to bank share and corporate franchise taxes. However, none of the Political Code sections

has been repealed, and the law as it related to such taxation prior to 1929 is still retained in the constitution and Political Code."

[22] *1906 Preliminary Report*, pp. 66–69.

[23] *Ibid.*, p. 70.

[24] Special franchises, under the plan of the commission, were to be taken account of in the rate of the gross receipts utility taxes. Special franchises of such utilities as water companies, not included within the scope of the gross receipts tax, were to be assessed by the State Board of Equalization, and taxed at a one per cent rate. See *Final Report of the Commission on Revenue and Taxation* (Sacramento, 1906), pp. 12–13 (hereafter referred to as the *1906 Final Report*).

[25] *1906 Preliminary Report*, p. 69.

[26] *Ibid.*

[27] *1906 Final Report*, p. 269.

[28] *1906 Preliminary Report*, p. 69.

[29] *Ibid.*

[30] *Special Report of the California Tax Commission* (Sacramento, August, 1928), p. 30 (hereafter referred to as the *1928 Report*).

[31] *Report of the Commission on Revenue and Taxation* (Sacramento, 1910), pp. 28–29 (hereafter referred to as the *1910 Report*). The amendment, adopted in November, 1910, read as follows (Art. XIII, sec. 14[*d*]): "All franchises, other than those expressly provided for in this section, shall be assessed at their cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the state."

[32] "To determine the value of these franchises the assessor is supposed to ascertain the total value of all the outstanding securities, and to deduct from that the value of any visible or tangible property which he may find in the possession of the corporation, whether a public service corporation or not."—*1906 Preliminary Report*, p. 68.

Or again (*1910 Report*, pp. 28–29): "In the leading case of Spring Valley Water Works vs. Schottler, 62 Cal. 69, and other cases following it, the Supreme Court has repeatedly approved of the following method for making a valuation of the franchises of every class of corporation for purposes of taxation. This method consists in (1) ascertaining the total market value of all outstanding securities, and (2) deducting therefrom the assessed value of any visible or tangible property which belongs to the corporation."

[33] *Report of the State Board of Equalization* (1913–1914), pp. 16–17.

[34] *Ibid.*, p. 16.

[35] *Ibid.*, p. 17.

[36] *Cal. Stats.* (1913), ch. 20.

[37] *Report of the State Board of Equalization* (1913–1914), p. 21.

[38] *Cal. Stats.* (1927), p. 402.

[39] *Miller and Lux, Inc.* v. *Richardson*, 182 Cal. 115.

[40] *Ibid.*

[41] *People* v. *Ford Motor Co.*, 188 Cal. 8.

[42] "The franchise value . . . is an intangible value which has defied legislators definitely to define and courts closely to interpret. It can be approximated only by the comparison of detailed information laboriously and scientifically arranged and by the exercise of sound judgment. Without such information, so arranged, there can be no equitable assessment of the value."—*1917 Report*, p. 54.

[43] *1929 Report*, pp. 266–267.

[44] *1917 Report*, pp. 54–55 for text; for tables, pp. 56–67 and 188–241.

[45] *1928 Report*, pp. 34–40.

[46] "In one group, the oil companies, one corporation paid franchise and personal prop-

erty taxes which, combined, amounted to less than 1/100 of 1 per cent of the corporation's net income. Another company paid taxes amounting to more than fourteen times its net income."—*1928 Report*, pp. 36–37.

[47] *Ibid.*, p. 37.

[48] *Ibid.*, p. 38.

[49] *Ibid.*, p. 39. Here was presented a table "Relationship between Present Franchise Tax and Net Income." The range was from two-tenths of one per cent for investment and other finance companies to 5 per cent for building and loan companies.

[50] A further but incidental problem in connection with franchise taxation related to local assessments of the corporate franchise for the purpose of bond refunds. Since this matter has already been presented in the chapter dealing with separation of sources of revenue, no further reference is made to it here.

[51] *Report of the State Board of Equalization* (1927–1928), p. 16.

[52] From a paper "The Present System of Taxation in California," presented in 1928 by Mr. W. J. Carr.

[53] *1928 Report*, p. 31.

[54] The revenue and taxation commissions reporting in 1906 and 1910 described the conditions of bank taxation prior to 1910. The then existing tax system had broken down completely in its application to banks. National banks, because of conflict between federal and state statutes, largely escaped taxation; state banks were taxed "without uniformity, equality or regularity"; savings banks were discriminated against by the revenue laws, their taxes being half again as heavy as those of state commercial banks and five times as heavy as thoses of national banks, a policy the direct opposite of that in most other states.

[55] These restrictions undoubtedly were originally due to the apprehension felt at the time that in the absence of such limitations the states might burden national banks with unfair and discriminatory taxes.

[56] See, for instance, the following as typical of an extensive literature: Harley L. Lutz, "The Evolution of Section 5219, United States Revised Statutes," in National Tax Association, *Bulletin*, XIII (April, 1928), 205–212; and Roger J. Traynor, "National Bank Taxation in California," *California Law Review*, XVII (January, 1929), 83–119.

In the last-named article and in two others which followed in the same volume (March, 1929, pp. 232–257; and July, 1929, pp. 456–527) Professor Traynor traced exhaustively the legal complexities of bank taxation with especial but not exclusive reference to California.

[57] November, 1910. This amendment appears in Appendix A to this volume. Art. XIII, sec. 14, of the Constitution relates to taxation of banks by California.

[58] *Cal. Stats.* (1911), p. 530.

[59] The commission of 1906 had said that the shares of stock should be assessed or valued at their "book value," or at the amount paid in thereon plus the pro rata of the accumulated surplus and profit with deduction of the value of any real estate, other than mortgage interests therein, as assessed for county purposes and upon which the banks paid local taxes. The commission chose book rather than market values for a number of reasons, such as the greater certainty and definiteness of book values; the greater likelihood of their use resulting in equity as among banks, because high market value does not necessarily indicate proportionate ability to pay taxes; the abatement, comparable to that resulting from the nontaxation of the good will of mercantile or manufacturing concerns, which thus would be extended to the banks; and the increased cost of central administration if market values should be used. See the *1906 Preliminary Report*, pp. 63–64.

In 1922 an attempt was made (Senate Constitutional Amendment No. 35, a composite of six amendments relating to taxes for state purposes) to obtain the deduction of the book value of real estate rather than the assessed value. It was argued that the prevailing method caused a sort of double taxation on the difference between the assessed value and the book value of the real estate, which had been compensated for in the past by reducing the rate of the tax. (See table 13, p. 135.) The proposal was to allow the deduction of the book value and then, on the assumption that the assessed value was about 60 per cent of the book value involved, to raise the rate from 1.45 per cent to 1.63 per cent. This would have resulted in approximately the same revenue being derived from the banks as before. There was some fear, however, that the use of book value might be subject to abuse. At any rate, throughout the use of the share tax method, assessed value of real estate was employed as the permitted deduction. See Commonwealth Club of California, *Transactions*, 17 (1923), 305–306.

The 1917 tax commission had previously taken cognizance of this particular point. It printed a letter from the California Bankers' Association (*1917 Report*, pp. 42–48) purporting to show that the banks were carrying more than their fair share of the tax burden. The commission, however, although conceding that there was an element of inequality and double taxation, did not agree that such admission on its part should alter its view that the existing rate (1.2 per cent at that time) was "proper and just." The commission based its conclusion upon its finding that the burden of taxation inside incorporated cities was approximately $1.44 on the $100 of value, whereas the burden upon the banks, of taxes paid to the state, by their own figures, was $1.426. "This being the case, we cannot see where injury is being done to the banks by the present rate which is applied to their capital, surplus and undivided profits" (p. 42).

[60] *1928 Report*, p. 16. The commission's figures were gleaned from the reports of the State Board of Equalization.

[61] *1928 Report*, p. 15. In a footnote in the report, as evidence of bank attitude, is quoted a statement of Edward Elliott ("Bank Taxation in California," California Bankers' Association, *Bulletin* [July, 1928], p. 263) to the effect that "this method . . . has, on the whole, worked satisfactorily."

[62] *Revised Statutes of the United States*, sec. 5219.

[63] A more complete discussion than is presented here will be found in the *1928 Report* of the tax commission (pp. 43–53).

[64] Art. XIII, sec. 1. For a brief statement of arguments urged in behalf of this amendment, see Commonwealth Club of California, *Transactions*, 5 (1910), 394–395.

[65] *Political Code*, sec. 3608.

[66] "The term 'foreign securities' is somewhat misleading, for its use in this connection suggests that shares of corporations organized in other states are taxed, and that those of domestic corporations are exempt. The distinction between 'foreign' and 'domestic,' however, is not on the basis of the state of incorporation, but on the basis of the location of the property. A corporation, whose property is located in another state, is deemed to be 'foreign' for purposes of applying this tax on its securities; and a corporation, a part of whose property is situated without this state, is deemed to be 'foreign' to the extent of the ratio which its out-of-state property bears to its whole property."—*The New Tax Legislation in California* (a pamphlet published in March, 1929, by William Cavalier & Co.).

Although the administration of the law was somewhat lax, an attempt was nevertheless made in 1922 (Senate Constitutional Amendment No. 31) to empower the legislature to provide for the assessment of taxes on so-called "foreign" securities at rates different from those applied to other property. The presumption was that a rate lower than that upon property generally would be applied to them. For some discussion of the point, see Commonwealth Club of California, *Transactions*, 17 (1923), 309–310.

The commission report of 1928 points out that for various reasons the issue of the taxation of foreign securities assumed importance and that these reasons, combined with others, contributed to the agitation which resulted in the amendment of 1924. See the *1928 Report,* pp. 43–44.

[67] Art. XII, sec. 12½.

[68] *Cal. Stats.* (1925), ch. 12.

[69] F. R. Fairchild, "State and Local Taxation of Banks," *American Economic Review,* VI (December, 1916), 853.

[70] *Merchants' National Bank of Richmond* v. *City of Richmond,* 256 U. S. 635; 65 L. Ed. (decided June 6, 1921).

[71] About two-thirds of the national bank taxes for that year were involved. Several state banks also protested, basing their claim on the Fourteenth Amendment to the Federal Constitution guaranteeing equal protection. It was alleged that the Solvent Credits Act established an improper and arbitrary classification of intangible property. See the *1928 Report,* pp. 15–16.

[72] *First National Bank* v. *Hartford* (1927), 273 U. S. 548; 47 Sup. Ct. 462; and *Minnesota* v. *First National Bank of St. Paul* (1927), 273 U. S. 561; 47 Sup. Ct. 468. In both these cases discrimination was found to exist. For a critical evaluation of the Supreme Court interpretation of what constituted competing moneyed capital, see H. L. Lutz, "The Problem of National Bank Taxation, with Special Reference to California," National Tax Association, *Bulletin,* XIII (June, 1928), 265–267.

[73] *Cal. Stats.* (1927), ch. 223.

[74] *Arnold* v. *Hopkins,* 203 Cal. 553. The cases were decided largely upon the basis of legal technicalities. In the first instance the court said in effect that the legislature should have established a rate of taxation as well as a ratio or basis of assessment. In the other case the court argued that the legislature, in failing to provide for an equitable distribution of the revenues to the county, municipality, and district in which the property was located, had not framed the legislation in compliance with the requirements and limitations of the constitutional amendment.

[75] *Political Code* (1917), sec. 3627.

[76] Act of March 4, 1923, ch. 267, 42 *Stats.* 1499; Act of March 25, 1926, ch. 88, 44 *Stats.* 223.

[77] This session met in September, 1928. The legislature voted to submit to the electorate at the November election of that year Senate Constitutional Amendment No. 1, embodying the suggestions of the commission with respect to the taxation of banks, corporate franchises, and intangibles. The amendment, which became section 16 of Article XIII, appears as Appendix B to this volume.

[78] Professor Lutz has very aptly shown that, despite the four alternative methods of taxing national banks, there remained but one method by which the states logically could proceed. Taxation of shares was impossible in view of any attempt at scientific treatment of intangibles. No state by preference would employ the second method when it might better combine a franchise with a personal income tax. The third method was less attractive than the fourth, which permitted a broader base for the tax by the inclusion of income from all sources. See H. L. Lutz, *Public Finance* (2d ed.; Appleton, 1929), pp. 488–489.

[79] *1928 Report,* p. 25. Roger Traynor, in "National Bank Taxation in California" (*California Law Review,* XVII, 472–474), discusses this point further and concludes, "It is clear, then, that the exemption of mortgages rendered the tax on national bank shares contrary to the provisions of Section 5219."

[80] For a discussion of this point, see Roger Traynor, *op. cit.,* pp. 478–480. He expresses doubt that this matter would have been found to be embarrassing.

[81] Professor Traynor also comments upon this point (*op. cit.*, pp. 474–478) and concludes that, with the 1925 and 1927 laws made inoperative, the forms of intangible property governed by them "were still taxable at full cash value as determined by the county assessors and at rates fixed by the local taxing authorities. Thus it would seem that, unless the local authorities imposed discriminatory rates, the owners of national bank shares would have no complaint in so far as the effects of the invalidity of the 1925 and 1927 statutes are concerned." This point, however, does not take into consideration the desire of the commission for preferential treatment of intangibles, a proposition which was part of its proposed constitutional amendment.

[82] In pursuance of the constitutional authorization the legislature provided for the taxation of notes, debentures, shares of capital stock, bonds, deeds of trust, etc., at the rate of two mills on each dollar of actual value and for the taxation of solvent credits at the rate of one mill on each dollar of actual value (*Political Code*, sec. 3627*a*). The 1935 legislature amended this section of the Code to require, upon the adoption of a net income tax, the termination of the millage tax upon intangibles, except solvent credits, with the taxation thereafter of these intangibles by the state upon an income basis (*Cal. Stats.* [1935], ch. 834).

The counties and cities, particularly Los Angeles County and city, were opposed to this repeal because of the loss of revenue involved which, it was argued, would still more burden the property owner. But Governor Merriam, prior to signing the bill (Senate Bill No. 1112 or the Stow bill) on July 19 "pointed out that the State already has returned about $80,000,000 in tax relief to Los Angeles County and city through State assumption of school costs, the return of local property tax rolls of public utility properties, the allocation of an additional quarter-cent from the gasoline tax to the cities and about $11,000,000 biennially to counties and cities from the new automobile property tax."—*Oakland Tribune*, July 13, 1935.

The *Los Angeles Times* said editorially on July 10, 1935: "At the time the intangibles tax was adopted, it was agreed it should be repealed if the State ever adopted an income tax. S. B. 1112, which passed by a two-thirds vote and more in both houses, is an effort by the Legislature to keep that agreement; and it would be a breach of faith if it did not become law."

The law became effective September 15, 1935.

[83] *1928 Report*, p. 28. The commission's discussion of the power of the state to tax banks, the methods available, etc., covers pp. 18–28 of the report.

Professor Roger Traynor, in his article "National Bank Taxation in California," thus comments upon the selection of the fourth alternative (p. 490): "In view of the dangers and pitfalls in the use of the 'measured by theory' to reach income from exempt securities . . . and in view of the fact that it was by no means clear that the California bank share taxes were invalid . . . it would seem that a more uncertain and precarious system from the standpoint of the possible loss of revenue involved, was recommended for taxing banks than the one already existing."

There was some concern manifest when the commission made its report in 1928 over the question whether or not the states would be permitted to include tax-exempt interest in the base of the tax. A case was then pending in the Supreme Court of the United States (*Macallen Co.* v. *Massachusetts*) which on May 27, 1929, following, was decided adversely for the states on this particular point (279 U. S. 620). The court's decision was based fundamentally upon the motive of the legislature of Massachusetts in enacting the law to reach nontaxable property. For a discussion of the case, see Roger Traynor, *op. cit.*, pp. 456–462. Subsequently in *Pacific Co.* v. *Johnson*, 81 Cal. 519, on appeal to the United States Supreme Court, 52 Sup. Ct. Rep. 27, it was decided that in a franchise tax on corporations, "according to or measured by" net income, it is permissible to provide for inclusion within the tax base of interest from tax-exempt bonds, although such interest could not be taxed directly.

[84] Art. XIII, sec. 16. (See Appendix B.)

[85] *Cal. Stats.* (1929), ch. 13, approved March 1, 1929.

[86] *Cal. Stats.* (1929), ch. 781; (1931), chs. 64, 65, 1066; (1933), chs. 15, 209, 210, 303; (1935), chs. 275, 281, 353.

[87] The details are available to those who desire to read the statutes. In addition, one may refer to the observations on the Bank and Corporation Franchise Tax Act made by the 1931 joint legislative committee, in the *Assembly Daily Journal,* January 23, 1931 (pp. 27–35), where are briefly discussed for the most part various matters of administration and accounting, and to the discussion of the act in the *1933 Report* of the California Tax Research Bureau (pp. 73–91), which likewise is concerned primarily with various improvements in technical accounting and administrative procedure. Further, there will be found an extended discussion of various technical, legal, and administrative aspects of the act by Professor Roger Traynor in the *California Law Review* (XVII, 491–528).

For many other details of legal and constitutional provisions, rulings, court interpretations, and changes in the law, see *The Corporation Tax Service, California* (The Corporation Trust Co.), the section dealing with franchise and income taxes.

[88] When a committee of bankers appeared before the 1906 commission to urge that the proposed one per cent rate upon shares was too high, the commission replied (*1906 Preliminary Report,* p. 64) that it was "of the opinion that one per cent is a low tax on a business that is making over ten per cent per annum clear of all expenses."

Again it was said (statement by Joseph Hutchinson, chairman of the Taxation Section, Commonwealth Club of California, *Transactions,* 5 [1910], 340): "And as to one of the rates fixed in the new amendment, that to be charged banking corporations, it seems to be frankly admitted by the strongest partisans of the new proposed amendment that the rate is too small and was inserted in the proposed amendment under immense pressure from the combined banking corporations and upon log-rolling principles."

[89] *Report of the State Board of Equalization* (1913–1914), p. 25.

[90] *1929 Report,* p. 270.

[91] *Ibid.,* p. 271.

[92] The commission's calculations were criticized on the ground that real estate taxes paid should have been included in the comparison as well as franchise and personal property taxes. With the former included, "the percentage in the case of banks increases to 15.9% while for water companies it increases to 37.3%, for agricultural corporations to 33% and for real estate corporations to 16.3%. . . . If the tax commission had included real estate taxes it would have found that while banks paid taxes bearing a ratio of 15.9% to net income the average for all corporations was 16%."—California Farm Bureau Federation, Research Department, *Bulletin No. 13* (February 13, 1931), pp. 11–13.

[93] In 1928 the share tax produced $4,785,000 (see table 13, p. 135). In 1929 the new franchise tax on banks produced less than $550,000 and in 1930 less than $908,000. See *Assembly Daily Journal,* January 23, 1931, p. 30. The taxes paid in 1930 were less than one-fifth of the taxes paid in 1928 under the share tax method. It was said at this time (*Report of the State Board of Equalization* [1930], p. 11): "We do not believe that it is necessary for banks to be taxed so inadequately even under the law as it now exists."

[94] *1929 Report,* p. 78. Governor C. C. Young, in his *Second Biennial Message* (1931), stated (p. 48): "After a great deal of study this rate was finally fixed at 4 per cent as a fair figure, although it is lower than the rate in other states having the same system, such as New York with 4½ per cent, Massachusetts with 5 2/3 per cent, or Wisconsin with 6 per cent. Although the banks very properly might have paid more than a 4 per

cent rate, the law forbids them to pay more than other corporations, and it was determined that 4 per cent was as high as many of the smaller corporations could afford."

[95] *1929 Report,* p. xxii.

[96] *Assembly Daily Journal,* January 23, 1931, p. 31.

[97] *Ibid.* Since this was written, the franchise-tax principle has been extended, rate adjustments have been made, etc., which in large part meet the criticism made by the committee.

[98] *Report of the California Tax Research Bureau* (1933), pp. 78–79.

[99] *Ibid.,* pp. 79–82.

[100] "The Commission has a positive reason for suggesting a change in the form of the present franchise tax. It wishes to make it available for use as an element in the solution of the bank tax difficulty."—*1928 Report,* p. 32. Also see *ibid.,* p. 28.

[101] *Ibid.,* p. 31.

[102] *Public Hearing on Senate Bills Nos. 509–510* (Sacramento, 1929), p. 9. A complementary view of the theory involved has been expressed as follows (California Farm Bureau Federation, *Bulletin* [February 12, 1929], p. 8): "The franchise tax is commonly considered to be a benefit tax or a fee levied in payment for a special privilege granted by State. More correctly it should be considered to be a tax levied against certain favored classes because of the added taxable ability which they enjoy as a direct result of this special privilege of 'being' a corporation and of 'doing' business as such. California's new franchise tax is based upon the theory that the added ability spoken of can be measured best by net income."

[103] *Cal. Stats.* (1935), chs. 275, 281, 353. This is the latest revision of the original Act of 1929. See *supra,* footnote 86.

[104] Taxation of insurance companies is discussed at the end of this chapter.

[105] Sec. 4 (4).

[106] Sec. 4 (6).

[107] Secs. 1, 2, and 4.

[108] Sec. 4 (3).

[109] Secs. 6–10, which have to do with what constitutes gross income, deductions allowed from gross to arrive at net, allocation of income, etc.

[110] Sec. 4*a*.

[111] Secs. 3 and 4 (2), (7).

[112] Sec. 6.

[113] *Public Hearings on Senate Bills Nos. 509–510* (Sacramento, 1929), p. 9. It was to this end, for instance, that the original law of 1929 permitted deduction of federal income taxes in determining net income and provided for calculation of gain or loss from disposition of property upon the basis of January 1, 1928, rather than March 1, 1913, as under the federal law.

[114] Governor Young, *Second Biennial Message* (1931), p. 49.

[115] For a brief general discussion of this problem of allocation, see H. L. Lutz, *Public Finance,* 2d ed., pp. 497–499, and 3d ed., pp. 619–621. In the former edition Professor Lutz commented as follows upon the allocation provisions in the 1929 California franchise tax law (pp. 498–499):

"The new California franchise tax law invites dispute, if not disaster, by the indefinite language employed in its provision for allocation of net income to the state . . . As enacted, the law apparently provides that the initial allocation shall be made by the taxpayer . . . At the written request of the taxpayer the franchise tax commissioner is to disclose the basis of his own reallocation.

"This curious section contains the earmarks of a beautiful legal hornet's nest . . . Each taxpayer will naturally weight the enumerated factors in such manner as to show the smallest amount of net income arising from business done within the state, and if the tax commissioner reallocates he has every prospect of a fight on his hands, since the law scrupulously avoids stamping the tax commissioner's determinations as authoritative."

A more favorable view at the time was expressed by Professor Traynor ("National Bank Taxation in California," *California Law Review*, XVII [1928–1929], 516): "It seems safe to say . . . that the formula is at least as fair and equitable as others which have been examined and approved by the United States Supreme Court. In the situations where the general formula . . . is not found applicable . . . if the Commissioner carefully follows the directions of the statute . . . corporations will have no grounds for complaint because of improper allocation." His discussion, of which this was the conclusion, covers pp. 512–516.

[116] Sec. 10. This section also includes the following sentence: "If the commissioner reallocates net income upon his examination of any return, he shall, upon the written request of the taxpayer, disclose to him the basis upon which his reallocation has been made."

[117] *Public Hearings on Senate Bills Nos. 509–510* (Sacramento, 1929), p. 12.

[118] *Ibid.*

[119] *Ibid.*

[120] *1935 Bank and Corporation Franchise Tax Return*, schedule J.

[121] H. L. Lutz, *Public Finance* (3d ed.), p. 620. The report of the committee appeared in National Tax Association, *Proceedings* (1933), pp. 262–267. There had been earlier discussions by the association of the problem of allocation. See, for instance, National Tax Association, *Bulletin*, VI (January 1921), 113 ff. Also, National Tax Association, *Proceedings* (1922), p. 198.

[122] Some reference has already been made to places where discussion of these matters can be found (see *supra*, footnote 87). Mention may also be made of the *Revenue Laws of California:* annotated (1932), supplement (1934), and (1936). These volumes are serviceable to those who may desire to trace the changes and developments in the various sections of the statute.

[123] *1929 Report*, p. 298.

[124] *Ibid.*, p. 78.

[125] "To the Commission it seems an attractive prospect ultimately to resolve the property tax into a tax on real estate alone, gradually eliminating all personal property, both tangible and intangible, from the base as the proposed business and personal taxes may be developed and put into operation."—*1929 Report*, p. 89. Or, observe the statement of its fourth major recommendation, p. xxii.

[126] *Ibid.*, p. 302.

[127] *Ibid.*, p. 276. Art. XIII, sec. 16, 2 (*a*), of the proposed constitutional amendment read in part: "Such tax shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes, paid by such corporations to the state or political subdivisions thereof, but the offset shall not exceed ninety per cent of such state tax." A further section, 16 (3), gave the legislature the authority, by two-thirds vote, to change the amount or nature of the offset.

[128] The commission's analysis appears as part 4 of the *1929 Report* and covers pp. 297–305. The summarized statement of its conclusions follows (p. 305): "In brief, then, it is the conclusion of the Commission that an offset for real estate taxes against the new franchise tax should not be granted, first, because it would be so costly as to require an increase in the rate of the new franchise tax if the yield of the tax is to be adequate; second, because not only is it not necessary to grant it to avoid an unfair discrimination, but its introduction would bestow a positive and inequitable advantage to certain classes of corporations; third, because even without the offset the burden is not so onerous as to

warrant the apprehension that wholesale abandonment of charters will result; fourth, because the offset is out of harmony with the general program which the Commission is formulating; fifth, because the ends which its proponents hope to achieve by it can be better achieved by other and more direct methods; and, sixth, because the true interests of real estate owners as a whole will ultimately be best served by the establishment of this new business tax on corporations as a tax in addition to, rather than in substitution for, the real estate taxes of these corporations."

[129] *Cal. Stats.* (1929), p. 20, sec. 4, of the Bank and Corporation Franchise Tax Act.

[130] The act as it read after the 1935 revision still retained for financial corporations an offset for personal property taxes paid with the limitation that the franchise tax, after allowance of the offset, should not be less than 4 per cent on the net income or less than $25. See sec. 4 (2).

[131] *Assembly Daily Journal,* January 23, 1931, p. 33. Among other things the committee pointed out (p. 34) that, "from the best evidence available, it seems that the offset provisions work to the advantage of the large corporations possessing large property holdings to the disadvantage of the small corporations that own little, or lease, business property."

[132] These were main headings in an outline presentation of the case against the offsets. The discussion will be found in California Farm Bureau Federation, Research Department, *Bulletin No. 13* (February 13, 1931), "Recommendations of the California Farm Bureau Federation on the Proposed Amendments to the Bank and Corporation Franchise Tax Act of 1929 as Embodied in Senate Bills 325 and 326 and Assembly Bill 1472," pp. 6–10. On pp. 1 and 2 of the same bulletin appeared the statement that the offset provisions had resulted in: (1) gross inequalities in percentage of state tax paid to net income as between different classes of corporations and as between corporations of the same class; (2) discrimination against agricultural, real estate, and other corporations owning a large amount of real estate but little personal property; (3) discrimination in favor of urban corporations at the expense of rural corporations.

[133] *1933 Report,* p. 78. It was observed in this connection (pp. 78–79) that "no objection to this result has been made by the banks, and it is reasonable to assume that they recognize the soundness of the view that personal property taxes paid by corporations may be considered in determining whether a discriminatory burden has been imposed upon banks within the meaning of the federal statute." For a discussion of legal and constitutional aspects involved, see Professor Traynor, "National Bank Taxation in California," in *California Law Review,* XVII (1928–1929), 500–507. Here Professor Traynor discusses the question whether the offset provisions invalidated the new franchise tax.

[134] *1933 Report,* p. 79.

[135] *Ibid.,* pp. 79–81. Of the 34,682 corporations taxable under the act in 1931, 27,279 were subject to the minimum, arbitrary assessment of $25 not subject to offset. Hence the provision availed them nothing. Further, the offsets allowable resulted in different effective tax rates which varied quite widely for the different classes of corporations.

[136] *Cal. Stats.* (1933), p. 870.

[137] An exception, to be noted presently, appears for ocean marine insurers. The gross premiums tax was employed prior to 1911 but was confined to foreign insurance companies. For the earlier history of insurance company taxation, see W. C. Fankhauser, *op. cit.,* pp. 168, 201–202, 354–355.

[138] Art. XIII, sec. 14 (*b*). The language of this retaliatory part of the section is not given here. It will be found in Appendix A to this volume, which reproduces Constitutional Amendment No. 1.

In *Revenue Laws of California* (Sacramento, 1932), p. 104, appears this comment: "The so-called retaliatory laws are also reciprocal in nature, since their ultimate object is to secure reciprocity and do away with discrimination. Thus, if a foreign insurance company, when taxed here at the usual rate, pays an amount actually greater than a California company would have been required to pay on the same business in the home state of the foreign company, no retaliatory tax is to be exacted, notwithstanding the fact that the California rate on some of the business may be less than the corresponding rate in the other state. Retaliatory laws are to be strictly construed, and the ultimate effect of the tax is determinative." (*Bankers Life Co.* v. *Richardson*, 192 Cal. 113.)

[139] *1906 Report*, p. 259.

[140] Source of data: *1929 Report*, pp. 28–30; *Reports of the State Board of Equalization;* and *Budget of the State of California, 1935–1937.*

[141] See table 14.

[142] The details of this litigation are not presented here. In large part they involved in one respect or another the definition of gross premiums subject to tax. In its report for 1926 the board stated (p. 6):

"There is no pending insurance company tax litigation. As stated in our last biennial report, the Supreme Court decided adversely to the state on the taxability of the item of dividends applied to reduce insurance premiums, by holding that such an item did not constitute 'receipts' accruing to the companies, and was, therefore, not taxable.

"By reason of the settlement between the Attorney General and the insurance companies of the remaining questions involved in this litigation, the legal controversy was brought to a close. The adverse judgment and the settlement have necessitated the return by the state to the insurance companies of the sum of $1,022,703.04, on account of taxes previously collected on the items affected.

"These refunded taxes represent claims which have been accruing against the state since 1912 and owing to the large amount involved, the legislature in 1925 made provision for the return to the companies of the over-collection in three installments, to be allowed as credits against their taxes for the years 1925, 1926 and 1927."

See also the following reports of the board: (1916), pp. 20–22; (1918), pp. 11–12; (1920), p. 7; (1922), pp. 6–7; (1924), p. 7.

[143] *1929 Report*, p. xxiii.

[144] *Ibid.*, p. 81.

[145] *Ibid.*, pp. 81, 87.

[146] *Ibid.*, p. 87.

[147] *Ibid.*, pp. 87–88.

[148] *Ibid.*, p. 87.

[149] *Ibid.*, pp. 80–81.

[150] *Ibid.*, p. 88.

[151] *Ibid.*, p. 82.

[152] *Ibid.*, p. 85. See the commission's analysis of the difficulties of net income determination for insurance companies (pp. 82–85).

[153] But even here the commission, despite the fact that the marine insurers urged they be taxed on a net income basis, advocated the continuance of the gross premiums method because of the greater simplicity of administration, the absence of uniformly favorable reports from states which had adopted the net income measure, and the lack of a workable definition of net income by insurance companies generally. See *1929 Report*, p. 88.

[154] *Ibid.*, p. 87.

[155] The authority for the taxation of insurance companies is to be found in the *Constitution*, Art. XIII, sec. 14 (*b*), and in the *Political Code*, sec. 3664*b*. This latter section was legislation of 1917. See *Cal. Stats.* (1917), p. 338. Legislation of 1921 changed the rate to 2.6 per cent. See *Cal. Stats.* (1921), p. 21.

[156] *Budget of the State of California for the Biennium 1935 to 1937*, p. vi.

[157] "Eighteen California companies doing business outside California would, the companies estimate, pay an additional tax of $1,030,835 under the proposed 4 per cent rate. Of this amount California would receive only $380,333 and other states, under retaliatory laws would collect $650,512."—"Higher Insurance Tax Elicits Strong Protest," *Los Angeles Times*, February 23, 1935.

[158] *1929 Report*, p. 88.

[159] *Ibid.*, p. 85.

[160] Senate Constitutional Amendment No. 17, unanimously passed by the 1929 legislature, which became section 18 of Article XIII, and subsequently section 14 with changes specifying a 5 per cent rate and assessment by the State Board of Equalization.

[161] *Proposed Amendments to the Constitution* (Sacramento, November 4, 1930), p. 22.

[162] *1929 Report*, p. 88.

[163] The legislature in 1931 enacted the legislation to make the amendment effective. *Cal. Stats.* (1931), pp. 56–58; *Political Code*, sec. 3664*b*-1, providing for the tax; sec. 3664*b*-2, defining ocean marine insurance; sec. 3664*b*-3, defining underwriting profit; and sec. 3664*b*-4, prescribing the method of computing the tax.

[164] See J. W. Mudge, "How Business Corporations Should Be Taxed," National Tax Association, *Bulletin*, XVI, 105–114.

VI. THE RILEY-STEWART ACT

THE ENACTMENT by the 1933 legislature of the so-called Riley-Stewart act[1] introduced fundamental changes into the tax system of the state. The purpose of this chapter will be to trace the background and history of this legislation, to outline its provisions, to summarize the arguments for and against it, to describe somewhat its practical working, and otherwise to attempt an evaluation of this most recent development in California fiscal history. The discussion may begin with a brief statement of provisions of the law in order that the events or forces leading up to it may be more clearly understood. Subsequent discussion will amplify and clarify the essential aspects that are merely mentioned in the following paragraph.

The provisions of the act may be conveniently summarized under the headings of revenue, relief, and expenditure control. Fundamentally, the act involves abandonment of the plan of separation of sources of revenue employed in the state since 1911. Public utility property is returned to the local tax rolls there to be taxed as other property is taxed. The local property tax base is thus broadened by approximately one-sixth. The utility property is to be centrally assessed by the State Board of Equalization. The state relinquishes the gross receipts tax upon public service corporations amounting to some $60,000,000 per biennium. Attempted relief to real property is another aspect of this legislation. This is presumed to result from the facts that, first, as just noted, the local property tax base is broadened and, second, the state takes over a substantial part of the burden of educational support formerly borne by the localities. This additional financial responsibility of the state, amounting to about $80,000,000 per biennium, is taken care of by the proceeds from the sales tax. Finally the Riley-Stewart act attempts to limit the increase in expenditures of both the state and local governments.

Senate Constitutional Amendment No. 30 at the June 27, 1933, special election "was carried by a majority approximating three hundred thousand, every county but three in the state voting favorably for its adoption."[2] To appreciate and understand the Riley-Stewart act, it is necessary to know something of the antecedents, something of the reasons for the aspects or provisions, of No. 30.

[1] For notes, see below, pp. 189–200.

It was in the midst of much financial confusion that the 1933 legislature began its work. The Governor's budget with its tax recommendations failed of approval by the legislative body and consequently there devolved upon it the task of undertaking to meet the fiscal emergency. It was fortunate that the 1933 legislature functioned with a reasonable degree of harmony, although certain of the state's interests, notably those of labor, were weakly represented and although the legislature might be accused of mistaking the insistent voice of the real estate combinations for that of the less articulate elements of the state as a whole.

Various aspects of Constitutional Amendment No. 30 mentioned above had been debated both in legislative halls and in the press for some time. For some time longer the question of the greater efficiency of state support and control of schools had been discussed in educational circles. The California County Supervisors' Association had proposed in 1931 that the state assume the entire support of schools and provide the revenue from a sales tax. The California Farm Bureau Federation favored state assumption of school costs but believed that an income tax should supply the revenue. At the same time a joint committee of the California Real Estate Association, the State Land Title Association, and the State Building Owners' and Managers' Association recommended that ad valorem taxes be limited to 50 per cent of state and local expenditures, hoping by this device to relieve real estate of some of its tax burden. All these proposals coalesced in a constitutional amendment known as Proposition No. 9 which, as an initiated measure, came before the electorate in November, 1932.

Proposition No. 9 provided in substance for assumption by the state of the county's share of school costs, the revenue to be provided by an income tax and a selective sales tax.[8] The arguments in favor of the proposal stressed the relief from the real property tax burden which would result from the transfer to the state of some $50,000,000 in annual school costs. It was contended that property contributed less than 25 per cent of the peoples' income and yet was required to pay more than three-fourths of all governmental costs and more than 85 per cent of all school costs. It was argued that the amendment in no way affected the local control of the schools nor in any way increased teachers' salaries or total school costs. Something, too, was said about equalizing educational opportunity throughout the state and also about recognizing the principle that education was the most essential function of the state, that is, was properly a function of the state government rather than of the local. The amendment should be approved by the voters, it was urged, because it had the sponsorship of some nine state-wide organizations[4] and had been placed upon the ballot through the signatures of nearly 160,000 voters in fifty-six counties. Arguments such as the foregoing were presented by such individuals as the president of the Union Title Insurance Company, the State Superintendent of Public Instruction, and others.

Proposition No. 9 was branded by its opponents as an "amateurish, impractical attempt at tax relief"; was criticized on the ground that the proposed new taxes would yield inadequate revenues, thereby throwing the burden back on property; was condemned for proposing to increase the fixed charges in support of the schools and for preventing retrenchment in school costs, even granting that these costs would not be increased; and was opposed because it carried provisions to confer on local school boards the constitutional power to fix taxes without revisionary control, because it contained no limiting provisions with respect to taxes or expenditures for either state or local governments, and finally because it took "no account of the problem that would arise as regards the gross receipts taxes on public utilities which must, in effect, be on a parity with taxes on common property."[5] These arguments against the measure were presented by the president of the Los Angeles City Board of Education, by the chairman of the property owners' division of the San Francisco Real Estate Board, and by others.

Proposition No. 9 was rejected by a two-to-one vote, "partly because of general opposition to the sales tax which it proposed to write into the constitution, and partly because it was opposed by the public utilities and the San Francisco real estate men, but chiefly because it was popularly interpreted (its proponents say misinterpreted) as providing for a substantial increase in school revenue at a time when voters were feeling the pinch of hard times."[6]

The significance of Proposition No. 9 as a forerunner of Constitutional Amendment No. 30 and of the Riley-Stewart act merits more attention. At the time the measure was under discussion the author of the present volume prepared a paper setting forth especially the financial or taxation aspects of the proposal. The paper as then given, without amendment or deletion, is reproduced in the extended footnote below. A perusal of this presentation will reveal perhaps some of the essentials of the problem as it was viewed at that particular time.[7]

A final observation may here be made with respect to Proposition No. 9. The matter was referred to in the January 23, 1933, report of the California Tax Research Bureau. The bureau's statement was to the effect that the defeated amendment was "indicative of the trend of thought and future possibilities of shifting to the State, obligations now financed by the local governments." The bureau's report also observed that the measure had contained no tax limitation clause and then inquired whether the growing responsibility of the central government in raising revenue for local expenditure should be accompanied by greater state responsibility and control.[8]

Further details of the background of the fiscal adjustments made by the 1933 legislature may now be traced. From Proposition No. 9 and other proposals was evolved the "Riley plan" for the use of the legislature of that year. In time it came to be known as the "Riley-Stewart plan," named after Mr. Ray L. Riley, State Controller, and Mr. Fred E. Stewart, Director of the Tax Research Bureau and member of the State Board of Equalization, each of whom was prominent in working with and advising legislators relative to the state's fiscal problems. The Riley-Stewart plan called for an amendment to the State Constitution. Accordingly, Senate Constitutional Amendment No. 30 sponsored by nineteen Senators and Assembly Constitutional Amendment No. 68 sponsored by thirty-four Assemblymen were introduced on January 26.[9] Very soon the Assembly amendment, and other less important measures intended to remedy the fiscal situation, dropped behind, and Senate Constitutional Amendment No. 30 became the successful measure for reform. During this stage of the development the State Board of Equalization had given its support to the program.[10]

At the first opportunity after the legislative recess, on March 3, the Senate voted to withdraw the measure from the committee on constitutional amendments and refer it to the committee on revenue and taxation. The members of this committee had already given the amendment attention, for on the day it was received it was reported out with twenty-seven amendments, all of which were adopted. The committee and the Senate repeated this action on three other occasions until almost all the amendment had been written by the Senate's committee on revenue and taxation. The amending paragraphs included the title, the paragraphs concerning limitation of state expenditures, much of the sections on limitation of local expenditures, and taxation of corporations. Only two unimportant amendments had been proposed from the floor. The members of the committee on revenue and taxation wrote the law and the Senate accepted their work. On March 24 Senate Constitutional Amendment No. 30 passed the Senate without a dissenting vote. When it left the Senate it contained provisions concerning the return of utility property to the local tax rolls, limitations of state and local expenditures, assumption of school costs by the state, and a state gross receipts or transactions tax to be assessed by the State Board of Equalization.[11]

The Assembly, by no means so unanimous as the Senate, gave to the amendment a determined opposition and would not permit its passage despite the exigencies of the state treasury until satisfied with the changes made. In the Assembly the committee on revenue and taxation played the same rôle as the corresponding committee had performed in the Senate. The amendment remained in committee from March 24 until April 6. Twice the committee presented the Assembly with lists of amendments, all of which were adopted,[12] before April 20, when the first vote was taken. The Assembly rejected the Riley-Stewart plan by a vote of 41 to 36,[13] not because the members did not appreciate the need for some change, but because the representatives of labor and of the farm groups objected to the gross transactions tax and the representatives of the metropolitan areas did not like the curtailment of the financial powers of local units inherent in the plan. The Assembly moved to reconsider and the committee on revenue and taxation set itself so to amend the measure that it would be acceptable. It could almost be said that the committee wrote whatever parts of the bill the Senate committee had left unwritten.[14] The results of the first vote were repeated April 26 and May 1 before the measure passed. During these days the State Controller, members of the State Board of Equalization, and the State Franchise Tax Commissioner were in touch with the committee. They were present to answer questions when, on April 20, the Assembly sat as a committee of the whole for consideration of the amendment.[15] On May 2, Senate Constitutional Amendment No. 30 passed the Assembly by a vote of 67 to 10. The farm and labor representatives had been satisfied by the deletion of the gross transactions tax and the legalization of "new taxes" which could be construed to mean the income tax as well as a sales tax, and most of the metropolitan representatives had been reconciled by an amendment to the county tax limitation clause. Analysis of the ten recalcitrant votes shows that all of them represented metropolitan areas.

Eight came from Los Angeles and one each from Alameda and San Francisco.[16]

On May 4 the Senate accepted all the amendments made in the Assembly and the legislature finished its share in the financial reform of the state.[17] The Riley-Stewart plan went to the people on June 27, 1933. Between the adjournment of the legislature and this date, members of both houses and the fiscal officers already mentioned, Riley and Stewart in particular, diligently campaigned for its adoption by the electorate. As has already been pointed out, the amendment carried by a very substantial majority.[18] The plan was supported by the Governor, legislators, the State Board of Equalization, those organizations which had backed Proposition No. 9, real estate interests, public utility groups, farmers, and manufacturers.[19] It was opposed by labor leaders, retail merchants, and a few individuals, among whom was former Governor C. C. Young, concerning whose objections something is said later on in this chapter.

A few additional comments are necessary by way of describing the background of Constitutional Amendment No. 30. The fiscal problems, when the 1933 legislature met, were to balance the state budget, relieve real estate from some of its tax burden, avoid an ad valorem levy, and at the same time maintain essential governmental services. Public expenditures in California, as elsewhere, both state and local, had been increasing over a long period of years. A fairly full program of social legislation involving old age pensions, pensions for the blind, orphan aid, teachers' and Civil Service employees' retirement, tuberculosis hospitalization, and so forth, expenditures for capital outlay due to population growth, the expensive highway system, as well as other items, were primarily responsible for this increase in expenditures.[20] Expenditures from the state general fund for the 1931–1933 biennium were nearly 10 per cent above those for 1929–1931, which in turn had been almost 15 per cent above those for 1927–1929.[21] Then there had been sharp declines in yield from some of the principal sources of revenue accruing to the general fund of the state.[22]

So far as the local governments were concerned in this period immediately preceding the fiscal adjustments made in 1933, they were plagued by rapidly mounting tax delinquencies and by decreases in property valuations which approximated 20 per cent in the two-year period 1930–1932, "the decrease being especially notable as to intangibles."[23] In California prior to 1933 approximately 75 per cent of total state and local revenues came from local levies upon property. The rapid increase in local expenditures in the decade preceding 1931, together with a similar increase in local indebtedness along with inordinately high special assessment levies (particularly in some localities), combined with decreased property values and falling income from property to bring into still bolder relief the already heavy burden of the property tax. "Local revenue demands could not be satisfied by a tax levied upon the capitalized value of *expected future earnings* or upon 'fair market value' when neither of these bases was related to the current annual income, in many cases the lack of income, of property subject to taxation."[34]

In the campaign pamphlet *A Plan for Tax Relief*, compiled under the supervision of Senator Swing and Assemblyman Lyon, the assertion was made that:

"Despite the utmost economy, present State taxes providing general fund revenues are inadequate to meet the minimum requirements of government. Under the Constitution, provision is made for a general State property tax to meet whatever deficit occurs. However, the property tax already imposed by counties, districts and cities is proving burdensome to an extreme degree and deficiencies are increasing at an alarming rate. Especially in the case of farm property is the tax approaching the point of confiscation.

"Addition of a State tax rate to the local taxes already imposed on property would be an unfortunate development fraught with sinister consequences to well-ordered government in California. That it would retard economic recovery seems inevitable."[35]

Such then in substance was the background of the fundamental fiscal changes which took place in California in 1933. Although a summary statement has already been given of the essential aspects of the new legislation, those provisions may now be set forth more explicitly, albeit somewhat briefly inasmuch as the details will be apparent from a perusal of the text of Constitutional Amendment No. 30, reproduced in Appendix C to this volume.

Amendment No. 30 then did the following things:[36]

1. It provided relief for the burden imposed upon property by transferring to the state, to be raised from sources other than the property tax, the nearly $76,000,000 per biennium at that time required for school purposes, an expenditure which had been met by the county tax on common property. In other words the state assumed the counties'

fixed charges of $30 for each elementary school pupil and $60 for each high school pupil in average daily attendance, amounting to $38,000,000 annually. It was estimated that this transfer would lower the county tax rate an average of 71 cents, a reduction of about 20 per cent.[27]

2. It limited county, city, and school district expenditures to an amount exceeding by not more than 5 per cent the expenditures of the preceding year "thus assuring that local taxpayers will get full benefit from the transfer of educational expense from the counties to the State."[28]

3. It limited state expenditures for each biennial period to an amount exceeding by not more than 5 per cent those of the preceding biennium and accompanied this requirement by a stipulation to the effect that "not more then twenty-five per cent of the total appropriations from all funds of the State shall be raised by means of taxes on real and personal property according to the value thereof." This, again, was done in the effort to assure the relief aimed at in the plan.

4. It abandoned, effective January 1, 1935, the plan of separation of sources of revenue which, under Constitutional Amendment No. 1, had obtained in the state since 1911. Public utility property, theretofore taxed on the gross receipts basis by the state, was returned to the local tax rolls, to be taxed as other property was taxed, thereby broadening by approximately one-sixth, or to the amount of $1,300,000,000 of assessed value, the local tax base "with corresponding tax reduction for the common property owner, and consolidating all taxpayers into a cohesive group whose interests are identical."[29]

5. It provided for central assessment of public utility property by the State Board of Equalization with full apportionment thereof back to the several counties where this property was situated.

6. Finally it authorized the legislature to provide the necessary funds for meeting the state expenditures, to raise the money required to meet the additional educational costs assumed by the state, and to provide for any further relief to property as might be feasible by means of any form of taxation not prohibited by the Constitution.

Having traced thus far the background and the provisions of the Riley-Stewart plan, we are now in a position to inquire into the actual working of the program. This inquiry in turn necessarily leads finally to some attempt at evaluation of this legislation.

The problem which at first arose was an old one in a new guise, namely, that of equalizing tax burdens as between public utility and common property. That is, this was the first question if we except the debate which occurred prior to January 1, 1935, the effective date of transfer of utility property to local rolls, on whether the state should retain or relinquish as scheduled the public utilities as a source of state revenue. Assemblymen Cronin and Williamson of San Francisco had introduced a measure designed to delay for a period of two years the transfer of the utility property. In view of the unbalanced state budget this postponement was urged as one alternative to the levy of an ad valorem tax or of nuisance taxes. The property owners' division of the Los Angeles Realty Board, in a suggested state budget balancing program, urged retention on this score and also on the score that the local tax burden would not be lessened by the transfer, that there was evident an intent on the part of the local governments to use the revenue from public utility taxation not to reduce local tax burdens, but to enlarge local expenditures.[30] In favor of transferring the utility property as scheduled, it was argued that local governments had set up their budgets in the expectation of receiving this additional revenue of some $33,000,000 annually and that to deprive them of it would unbalance nearly every county budget, thus compelling adjustments which might take the form of further property tax burdens.[31] To have delayed the transfer would have necessitated submission of the question to a vote of the people. The Governor was quoted as having said, "It has been my opinion that the people would not vote favorably on the proposition and that it would be useless to present it to the people."[32] A joint legislative tax committee expressed opposition to the proposed delay. The vote was 9 to 3.[33] Finally, a statement of the State Finance Director may not have been without its influence. He remarked that if the utilities were kept on the state rolls another two years, he would favor increasing state gross receipts tax rates on these corporations to such a degree as would provide the estimated $8,000,000 additional per biennium which these utilities would pay when returned to the local tax rolls.[34]

But to come back to the original question. The statement was made that the first question to arise was that of equalizing tax burdens as between public utility and common property. This was the problem which all during the separation period from 1911 to 1935 arose to plague tax officials and legislators. The problem now presented itself in a new form. Since public utility property was to be taxed at the same rate as other property, it was necessary to equalize assessment ratios in the counties throughout the state in order that the application of uniform rates to all property would result in equal tax burdens. There was need "for a thorough analysis of local assessment ratios in order that there may be no disparity between the assessments made by the State Board of Equalization and those made by local assessors upon property which will appear on the same assessment rolls and be subjected to like tax rates."[35] This task of equalizing assessment ratios devolved upon the State Board of Equalization. A valuation division of the board was created in November, 1933, to deal with the problem.[36] To describe fully the principles involved, the procedure followed, and the varying views expressed would require a separate treatment. But a few observations may be made to indicate the nature of the problem.

There was first of all the fact to be dealt with that assessment ratios upon common property varied markedly throughout the state.[37] The range was found to run all the way from 26.24 per cent in Modoc County to 58.69 per cent in Mono County.[38] This constituted a difference of more than 30 per cent between the low and the high. The average was found to be 46.66 per cent.[39] Some 65 per cent of local property in the state was found to be taxed on this approximately 50 per cent basis.[40] Consequently the board accepted an approximately 50 per cent basis upon which to equalize assessment ratios. This obviously necessitated raising the ratios of some counties and lowering those of others. The net result was an estimated increase of more than $200,000,000 in assessed values throughout the state.[41] It also meant the addition of utility property to the local rolls at approximately 50 per cent of the appraised value.

In the second place the board was under the necessity of valuing the properties of the utilities for tax purposes. This task involved all the familiar problems relating to the making of valuations, especially with respect to the particular basis or principle, or combination of bases and principles and relative weight of them, which were to be dominant in the determination of the tax base. The State Board of Equalization, through its valuation division under the directorship of Mr. A. G. Mott, during the summer of 1935 completed the drawing up of a schedule of public utility values. These schedules placed total values at almost $2,000,000,000 (full value) or, to be more precise, $889,655,760 of assessed values on a 50 per cent assessment ratio.

The utilities were offered opportunity to protest these assessments. This, with considerable alacrity and with little bashfulness, they proceeded to do. For instance, the total of these proposed assessments on tangible utility property in the city of Los Angeles was approximately $132,000,000, of which no less than $107,000,000 represented properties of utilities which petitioned for reassessment.[42] The petitions for reassessment were based upon a number of grounds.[43] Inability of the Pacific Electric Company to earn an operating profit was made the basis of the contention that its property had merely a salvage or junk value for taxation purposes. The company also protested the values placed upon right-of-way lands, alleging that such lands would have little if any value if rail service were discontinued. A number of utilities, among them the Southern California Edison Company, the Southern California Gas Company, the Los Angeles Gas and Electric Corporation, the Southern Counties Gas Company, and the Associated Telephone Company, complained that failure of the board to follow the assessment methods of local assessors had resulted in the establishment of higher values for public utility property than for other property. This "equalization" contention is of course based upon the conception that, unless public utility values are equalized with values placed upon common property by using the local assessor's methods, public utility property will bear a disproportionate share of the tax burden.[44] Other utilities, notably the Southern California Telephone Company, contended that there was no relationship between fair value as a rate base and a valuation for taxation purposes,[45] inasmuch as the local assessors were following methods quite different from those of the State Board of Equalization. This was a phase of the "equalization" contention. Other complaints, for instance from the Santa Fe Railway Company, were that too little weight was given to the element of stock and bond value, a view directly opposed to that of certain other companies such as the gas, electric, and telephone utilities; and, from the Pullman Company, that too little regard was given the element of depreciation. In general it may be said, as has been true elsewhere and at other times, that each utility tended to favor that particular method of valuation or urge that particular item or point which would result in placing the lowest possible value upon its property for taxation purposes. Not the least illuminating circumstance in the proceedings, therefore, was the divergent and opposing positions taken by the protestants before the Board of Equalization.

Other questions respecting values have also arisen.[46] It can be said, then, that in the practical working out of the Riley-Stewart plan this task of valuation was one of the major problems with which the administrators were called upon to deal. A further inquiry into practical aspects of the new fiscal arrangements of 1933 brings one to the heart and intent of the entire plan, namely, relief for real estate. This was sought, as has been pointed out, through transfer of county mandatory school costs to the state to be financed by means other than property taxes, through return of utility property to local rolls thus broadening the local tax base, and through expenditure limitations imposed upon both state and local governments, particularly the local units. We may now discuss more particularly this matter of relief from property taxes.

Extensive claims were made for the Riley-Stewart plan as a means of relieving the burden of the property tax. It was pointed out, for instance, that assumption by the state of the county mandatory educational costs[47] would result in an average tax saving to every county of the state of $0.71 per $100 of the assessed value of property.[48] The maximum saving of $1.63 occurred in Nevada County and the minimum of $0.27 in Mono County.[49] These savings were stated to approximate a 20 per cent reduction in county and district tax rates.[50] This percentage was computed on the basis of a total of county and district taxes in 1932, exclusive of special assessments, of some $200,000,000 taken in conjunction with the total mandatory school costs of something less than $40,000,000 annually proposed to be transferred to the state to be financed from revenues other than property taxes. Furthermore, by the repeal of Amendment No. 1, which had provided for separation of sources of state and local revenue since 1911, the authors of the Riley-Stewart plan hoped to extend additional relief to property. This would result, it was said, from the broadening of the local tax base by about one-sixth through the return of utility property to local rolls to the extent of some $1,300,000,000 of the then existing assessed values of utility property. "The benefit of this change to localities where there are large public utility holdings will be an important factor in tax relief for the farmer, home owner and business man."[51]

Since these early statements appeared, reaffirmation has been made of the savings presumably effected through the provisions of the Riley-Stewart amendment. The State Board of Equalization, in its 1933–1934 report, remarks that the elimination of the sum of $40,000,000 annually in county school costs "reduced by an average of 20% county taxes on homes, farms and business holdings generally," although it at once notices that in some localities "these property tax reductions have not been realized, due to off-setting expenditures made by local taxing authorities."[52] The board further observed that the total county, city, and district taxes for 1934–1935 of $205,348,025 were $55,704,137, or 21.34 per cent, under the $261,052,162 total of the same items for 1932–1933, the last year before the 1933 amendment became effective, and attributes a major part of this decrease to the transfer of school costs to the state.[53] Put in another way, taking into account a decrease of 16.02 per cent between 1932 and 1934 in the true value of property taxed, the tax burden upon each $100 of true value had decreased, according to the board's figures, from $1.90 to $1.78 during the two-year period.[54] Finally, in this same report, the board points out that, consequent upon the extension of local taxes to utility properties, property owners would experience in 1935–1936 a further tax reduction of approximately $30,000,000.[55] The board then concludes that "*taxes on common property owners in California will be reduced in the period from 1932 to 1935 by more than $85,000,000, or almost one-third*. More than eighty per cent of this reduction is directly attributable to the constitutional amendment suggested by this board in 1933."[56]

The projected relief from the burden of the property tax was, then, the basic argument offered in behalf of the Riley-Stewart plan as embodied in Constitutional Amendment No. 30. But there were also other corollary and supplementary advantages urged in support of the program. These may briefly be set forth at this juncture before we proceed to a consideration of some of the opposing arguments presented at the time and finally, in the light of this delineation of the pros and cons, to an evaluation or appraisal of the act in its broader aspects.

Closely related to the claim of relief to real estate was what might be called the agricultural argument. It said in substance that agriculture was a basic industry, that California was still largely an agricultural empire, that its prosperity and resources were largely in land, that the depression fell heavily upon the rural communities, and that until rehabilitation of the farmer was effected through relief from oppressive taxes there could be no lasting improvement in general economic conditions either rural or urban.[57] Then, although overlapping is here apparent, there were what might be designated general economic arguments to the effect that the prosperity of the state depended upon the ability of California to interest prospective residents in the ownership of homes and farms and that the entire credit structure of the state rested upon its land values, which presumptively were being impaired by excessive taxation[58] and which presumptively, too, would be improved and stabilized by adoption of the plan under consideration. Next there was the social aspect of the whole question, which emphasized the desirability of an assured minimum educational program and equality of educational opportunity. Fiscal considerations suggested the advisability of relatively less reliance upon property taxes. Finally, there was the argument that the separation of sources plan in operation since 1911 had outlived its usefulness and should be replaced by a tax system conforming more closely to the current economic and fiscal conditions of the state and its political subdivisions. The 1929 California tax commission had criticized very severely the old separation of sources arrangement and had advocated its replacement, suggesting among other things the return of utility property to local tax rolls.[59] Since the separation of sources plan has been discussed earlier in this volume, no further reference is made to it here.

We come now to a consideration of some of the arguments advanced in opposition to the Riley-Stewart plan. Keeping in mind the intent of the amendment as it has already been described, we find that a survey of the opposing views, interspersed with comments relative to such virtues as the plan may possess, becomes an evaluation of the measure as a whole.

One of the objections to the plan at the time of its proposal was the lack of any very definite information concerning its essentials. The broad, general program was there, but just how it would work out both in its details and with respect to its consequences in the fiscal affairs of the state remained largely unanswered questions. To some, acceptance of the plan seemed to be leaping before looking, if, indeed, not perhaps jumping from the proverbial frying pan into the equally proverbial fire.[60] In view of the attendant uncertainty, it was argued that, imperfect as the prevailing system of taxation was, the state should not abandon it and incur the risk of having it replaced by a system which in all likelihood would be no improvement over the old.[61] Subsequent events have justified to an appreciable degree these doubts concerning the proposal adopted at the summer election of 1933.

Furthermore the plan was viewed as a "jumble of disconnected measures, an agenda rather than a finished program."[62] The transfer of school costs from counties to the state and relinquishment of utility taxes to the localities were considered two separate and distinct measures which should have been separately submitted.[63] The only unifying force in the measure revolved around its fundamental intent, namely, to relieve the real estate tax burden. To that end it was proposed to transfer school costs, return utility property to local rolls, and limit expenditures. Certainly, however, these proposals were quite unrelated except in the respect stated. Probably the voters should have been given an opportunity to express themselves upon each item taken by itself. The proposed transfer of school costs was substantially a political matter, the abandonment of the fundamental aspect of the state's tax system mainly a fiscal question, and the limitation of expenditures principally a social and economic problem.

The Municipal League of Los Angeles opposed Senate Constitutional Amendment No. 30 partly because in its judgment the amendment favored the public utilities.[64] Picturing a deficit in state finances of some $60,000,000 for the years 1931–1935, it estimated that under the existing tax arrangements the utilities would pay $10,800,000 toward this deficit, whereas under the proposed change they would pay but $2,700,000 toward it.[65]

The charge was made that the Riley-Stewart plan was objectionable because it divorced collection of public funds from their expenditure and because it left intact without modification the existing number and organization of political subdivisions of government. Certainly, even in the presence of any plan of expenditure limitation, there was reason to believe that collection by one agency, the state, and spending by another, the locality, would not be conducive to economy in educational expenditure, particularly should the attitude develop that concern need not be manifested since the state was footing the bill. In California under the new arrangement the decision whether the funds would be used to provide relief or merely to give greater leeway for additional expenditures was left, except so far as the expenditure limitation aspect intervened, in the hands not of the state, nor of the 58 counties, but of the 3,200-odd school districts throughout the commonwealth. Then, too, with respect to the aggregate of expenditures, and hence the relief to property, it was properly argued that the amendment did not reach the problem at its source. It operated upon the basis of preserving the status quo by saying that the state should serve each district as it then stood rather than to begin with and carry out a program of consolidation. Certainly an early step in the reduction of property taxes should be a decrease in the large number of independent tax-levying units.

It was said that the Riley-Stewart plan would not equalize educational opportunity if the richer districts exceeded the minimum standards provided by state support of the school system. The uncertainty of revenues from taxes on utilities on a property basis was compared with the assured yield from the existing levy on gross receipts.[66] It was thought, even with well-intentioned boards administering the law, that property tax revenues would be much below what was then being paid automatically to the state on a gross receipts basis. The dangers from the political factor were not unforeseen. That the utilities would be forced into future politics to control boards was considered a very likely development. If so, California would experience again the evils of political influence which characterized the operation prior to 1911 of the old system of local taxation of the utilities upon a property basis.[67]

An argument advanced by many was that the Riley-Stewart plan was in essentials merely a tax shifting and not a tax reducing proposal.[68] Although transfer of school costs would relieve the local rolls, it obviously would not reduce total educational costs. The contemplated and understood enactment of a sales tax was, of course, painful evidence of tax shifting or at best tax adjustment, rather than reduction. Especially, too, was it urged along this line that the owners of the larger and more valuable properties would receive the major benefits from the new taxation arrangements; that, so far as the small home owner, farmer, and merchant were concerned, the Riley-Stewart plan was not for them an unmixed blessing. As a matter of fact, it is not particularly difficult to prove that a sales tax, such as California adopted, burdens rather than relieves the small property owner. Furthermore, the amendment failed to withdraw, as certain interests in the state on occasion had advocated, the constitutional right of the state to impose an ad valorem tax to make up any deficiency in revenue. It is true that a 25 per cent limitation on property taxes relative to total state expenditures was provided for, but there remained the possibility, aside from the sales tax burden, of still further reneging, so to speak, on the relief to property ostensibly offered by Amendment No. 30, through imposition by the state, to the limit permitted, of a property tax which had not been employed since 1911.

Still other objections to the Riley-Stewart plan cropped up, such as that it paved the way for the taxation of publicly owned public utilities,[69] that it constituted a violation of the principle of home rule in government and taxation,[70] and that it presented no adequate solution of the problem of expenditure control. No such solution was forthcoming, partly because of the difficulty of finding any adequate means of control; partly because educational costs, with contributions upon an average daily attendance basis, would continue to increase with the increase in the number of pupils; and partly because gasoline tax money, untouched by any provision of the amendment, would still automatically go to the highway fund. Without dwelling upon these matters, however, we may now supplement and conclude this review of the various objections to the Riley-Stewart plan with a brief appraisal of it in its broader aspects. The discussion will relate to (1) the fiscal position of the state, (2) the sales tax, (3) the subsidy principle, (4) methods of utility taxation, and (5) property tax relief and expenditure limitation. It is apparent that each of these items could be treated at some length.

The proponents of the Riley-Stewart act probably did not give due regard to its effect upon the state finances. Granted that the plan may have relieved the local fiscal situation somewhat, it certainly made a difficult problem of adjustment so far as the state treasury was concerned. It requires in perspective no particular mathematical imagination to appreciate the financial embarrassment involved, when the state, already with a deficit of $10,000,000 in its general fund surplus, surrendered $60,000,000 in revenue biennially and at the same time assumed $80,000,000 of additional financial responsibility for a similar period. That was why the state, if it wished to balance its budget for the 1935–1937 biennium, was compelled almost to double its income from current sources. The 1929–1931 biennium ended with a surplus of some $31,029,000 in the general fund. The 1935–1937 biennium, it was estimated on one occasion, would end with expenditures, including a carry-over deficit of $32,000,000, exceeding normal revenues by some $140,000,000.[72] Although all this financial embarrassment was not due to the Riley-Stewart act, a substantial part of it was traceable to the fiscal adjustments which marked this legislation.

Any evaluation of the 1933 measure would be incomplete without mention of the sales tax which it was generally understood would follow upon the adoption of Constitutional Amendment No. 30. Since this tax is dealt with elsewhere in this volume, but brief reference need be made to it here, and that merely to express a point of view. It is regrettable that within the last few years so much of American tax legislation has been based upon grounds of expediency.[73] The California sales tax is no exception to this generalization. The judgment of the writer may perhaps aptly be summarized by saying that the Riley-Stewart act fastened the sales tax upon the state. The implications of objection to the principles of the tax and of the likelihood of its permanence are apparent. Sales taxes in general possess the virtue of productivity[73] but the defect of inequality. If equality in the distribution of the tax burden is the objective, sales taxes should be used with moderation.

Another basis of evaluation, developed fully, would lead to a thorough inquiry into the merits of the subsidy principle. This, too, must be given no more than passing comment, since it constitutes a subject in itself. But clearly to pass final judgment upon the Riley-Stewart act is necessarily to weigh in the light of experience the advisability of state aid in its specific application to conditions in California and as particularly related to state contributions in support of the public schools. With a very substantial part of the local tax rate on property traceable to educational costs,[74] the transfer of these costs to the state to be financed from sources other than a property tax was defensible, assuming the need for property tax relief and assuming further that the adoption of the sales tax, and other devices, afforded that relief in the degree anticipated. This latter assumption is a doubtful one. Perhaps, as Professor Plehn remarked, "the transfer of school costs from the county to the state will be approved by those who favor local centralized schools and opposed by those who favor local control. It's a matter of political theory."[75] But the transfer presents also certain questions relating to the fundamentals of state aid.

Although the subsidy principle has certain serious shortcomings,[76] the time probably has come when we must reckon with its larger application in the field of practical fiscal affairs.[77] The strain upon local tax resources, made increasingly severe by the continued demand for more and better governmental services, apparently must be eased by some dependence upon the wider and richer tax resources of the state. In California the subvention program was based primarily upon the objective of reduction of local taxes and secondarily upon that of equalization of educational opportunity. Each of these objectives was laudable.[78] The questions remain, however, whether the expected relief has materialized and whether the granting of further state aid in support of the schools in California should not have been accompanied by some degree of central supervision over the funds thus distributed.[79]

Another respect in which one may seek to evaluate the Riley-Stewart act relates to the relative merits of the two different methods of taxing public utilities. Should these enterprises be taxed upon a gross receipts basis by the state or upon an ad valorem basis by the local governments? To discuss at any length this particular matter would be to digress from the main theme of the chapter. And yet this aspect of the whole picture is necessary to proper perspective. Either method of taxation has its advantages and its disadvantages. Perhaps these are of such a nature as to lead one to the general conclusion that either method may be employed without undue concern over the opportunity cost of foregoing the other.[80] Yet one may question the effectiveness of administration of an ad valorem tax in the absence of a permanent and professional tax commission to supervise the assessment of public utility property.[81] Likewise inquiry may be made concerning equality or inequality of tax burdens under the old method as compared with the new. Again one may conclude that merit in this respect is about equal.[82] Finally, without presuming to complete treatment of this phase of the subject, one may question the theory implicit in the existing ad valorem method of utility taxation in California, that the location of such property should determine its situs for taxation purposes. There is always here a problem of the relationship between the location of property and proper government needs. Again reference may be made to Professor Plehn's pertinent inquiry, "Why should San Bernardino County, for example, tax upwards of 800 miles of railroads in sparsely populated districts when San Francisco can tax only 16 miles?"[83]

We now come to the final aspect of the appraisal of the Riley-Stewart act. Has it given relief to real estate and has expenditure limitation proved sound in theory and practicable in application?

These two phases of the property tax problem are inseparably related, but for the sake of clarity in the discussion we may consider them in order. The promised relief to real estate, a topic already discussed in part of this chapter, was to be assured through transfer of school costs to the state, through return of utility property to local rolls, thus widening by approximately one-sixth the local property base, and through expenditure limitation. What further may be said concerning the present and prospective achievements in this direction?

The first recommendation of the Martin tax commission of 1929 called for the abandonment of separation of sources of revenue in California and the return of utility property to local rolls.[84] In commenting later on in its report upon this proposal in its bearing upon real property taxes, the commission observed that at least in certain counties this return of utility property would offer opportunity of substantial relief to real estate.[85] The commission at once noted, however, that whether the relief materialized or not would depend largely upon the vigilance of the local taxpayers. "If they permit the advantage of the expanded local tax base to be absorbed by an increase in local expenditures, obviously no relief will result."[86]

There is evidence and testimony, past and current, as well as general reasoning, to support the view that tax leeway is likely to be taken up in additional levies for other purposes. In California in 1912, one year after separation of sources had been effected by Amendment No. 1, the local taxpayer discovered that the "local tax rates absorbed all of the savings brought about by the deduction of the state tax from his tax bill."[87] Mr. J. W. Hartman, chief deputy county assessor of Los Angeles County, recently released figures revealing the situation between 1932 and 1934 in Los Angeles County. He pointed out that the increase in city, county, school, and other district taxes during that period had nullified the saving made by the sales tax. That saving was some $0.652 per $100 of assessed valuation, due to transfer of school costs to the state. Taking Los Angeles city tax district number one as typical, increases in tax rates for various purposes, such as general county, municipal, flood control, water district, and schools, totaled $0.622, thus almost wiping out the saving made by the sales tax. "This is just one district," Mr. Hartman remarked. "The amount of increase varies throughout the county, but this example shows why the expected reduction in taxes as a result of the sales tax has not materialized."[88]

On top of the situation just described rests the further consideration that property owners, who in many instances have not benefited in an absolute sense at least in the reduction of property tax rates, are also payers of the sales tax which was, so to say, to double for the property tax. Unfortunately, it appears to have doubled in more ways than one. As a matter of fact, it is difficult to give adequate reasons for the faith that was in us with respect to the sales tax as a means of easing the property tax burden. The prospect of permanent relief, if the problem is viewed in its broader aspects, is dubious. Granted that temporary relief may be apparent because of slight rate reductions or postponement of advances in rates, the facts still remain that property taxes will probably continue to constitute the mainstay of local government revenues and that sales tax revenues will probably be used to support heavier expenditures rather than substantially to reduce property tax burdens. In view of the ever increasing demand for governmental services, it would be a remarkable government indeed that would resist such demands, particularly if it had at its command a well-developed and productive source of revenue.[89]

Permanent relief to property, clearly, was the objective of the Riley-Stewart act. But long since, despite favorable testimony here and there,[90] serious doubt of realization of this end has arisen. Indeed with many the doubt has become a conviction. Haig and Shoup have pointed out that by September, 1933, "more than 800 school districts had asked that the board of equalization exercise its power to permit them to exceed the limitations on expenditures imposed by the Riley-Stewart amendments."[91] After noting that the board permitted excesses in but seventeen districts (and these mainly because of earthquake damage), they then suggest that "only time will tell whether the board will continue to hold the localities in check."[92] The board itself, in its 1933–1934 report, stated that during the preceding two years more than 1,150 taxing units in California had applied for permission to exceed the constitutional limit upon the increase of expenditures.[93] The board then further stated that it "denied authorization to expend a total of more than $7,500,000 with a direct saving to local taxpayers to that extent. The indirect saving, due to the fact that local taxing authorities, aware of the constitutional limitation, prepared their budgets accordingly, is undoubtedly much greater."[94]

The problem, however, of permanent relief to property involves something far more than, or perhaps one might better say other than, the imposition of sales taxes and the resort to expenditure limitation devices. Fundamentally it is a problem of proper assessment procedure, proper classification of property, reorganization of governmental units, greater emphasis upon tax sources which represent ability to pay, and other thoroughgoing tax reform measures long advocated by students. Only in consideration of these broader principles can there be found any satisfactory and lasting solution of the property tax burden.[95]

In concluding this chapter there may be presented a comparatively brief treatment of the expenditure limitations which constituted an important aspect of the Riley-Stewart act. Here and there, particularly in footnote 7 to this chapter, reference has been made to this aspect of the recent fiscal developments in California. To date, expenditure limitation has been more pertinent with respect to local finances than with respect to state finances, with which this volume is primarily concerned. For this reason, as for the further ones that expenditures and the limitation of them constitute large questions in themselves, the treatment here is restricted.

The problem of the limitation of expenditures is not new to California nor is it related solely to depression years. In 1916, for instance, in its *Foreword on Taxation in California,* a California tax commission remarked, "This Commission would suggest that the only effective way of placing a restriction would be to place a limit upon the total amount of taxes that could be raised yearly in a given county. For instance, in Arizona the state constitution has taken care of that by prescribing that in any one year no more than five per cent increase in the total amount of tax raised can be levied over the preceding year in any county or other political subdivision. Along with this is a provision providing for an emergency allowance, good for only one year, upon a presentation of the necessity therefor to the state tax body, which, after public hearing, grants or refuses the increase. Such a measure we advocate for California as being one of the most effective means of producing economy in governmental affairs."[96] In 1918, again, there was approved an amendment known as Assembly Bill No. 1013 designed to limit the increase in the tax burden of the counties to not more than 5 per cent in excess of the tax burden of the preceding fiscal period.[97] The procedure involved in administration of this limitation provision was very similar to that embodied in the present California legislation. It was argued that the bill would limit increases in tax levies reasonably without jeopardizing essential services, would set up a reviewed budget for every county in the state, and would result in a valuable body of comparative statistical data by years and by counties.[98] The bill was in operation for several months but was opposed by the school forces of the state, who resorted to the referendum, suspended its operation, and substituted in its place a measure designed to protect school levies from the limitation.[99]

The present limitation of expenditures in California, however, probably traces its origin to the latter part of the decade of the twenties. This was a relatively prosperous period although accompanied by rising expenditures which inevitably meant increased real estate taxes. The 1929 California tax commission commented upon the problem of relief to real estate and among other things said in this connection, "The Commission has considered the various efforts made in other states to control local expenditures through arbitrary percentage limitations and has found the record a discouraging one. Such limitations often work real hardships because of their inelasticity, they are often bitterly resented as interferences with local self-government, and usually they are easily circumvented when the will to do so is present. There is no satisfactory substitute for eternal vigilance on the part of the local community in controlling expenditures."[100]

The problem of limitation was further considered by the joint legislative committee on taxation in 1931 and by the California Tax Research Bureau in its report of January 23, 1933. The former body considered a number of possible limitation methods but concluded that each was impracticable and inapplicable to conditions in California. It passed the responsibility to the Tax Research Bureau, the creation of which it recommended, and agreed in effect with the 1929 commission that "only through rigid economy, careful scrutiny of proposed bond issues and restriction of special assessments and tax levies, coupled with the courage to admit that many desirable things can not be afforded, can any appreciable reduction in local taxes be secured."[101] The research bureau made a study of "proper tax limitation methods" as directed in section 4, chapter 623, *Statutes of 1931*.[102] After commenting upon the need for limitation as evidenced by growing delinquent tax lists and after reviewing limitation methods tried elsewhere, as in Colorado, New Mexico, Indiana, Ohio, and Oregon, the bureau came to certain obvious general conclusions, such as the desirability of uniform and adequate accounting, the need for simplicity in any plan that might be adopted, the inclusion of both tax and debt limitations, jurisdiction by the state over all local taxing districts, some recognition of home-rule sentiment, realization that limitation was no panacea, and the need for a specific limitation on governmental expenditures.

Such in brief is the background of existing limitation provisions in California. Although this is not the place to set forth the general theory and principles of limitation, it may be here remarked that the verdict of students is generally adverse with respect to the efficacy or desirability of tax and expenditure limitation devices. The fact that the depression evoked a great mass of tax limiting legislation[103] is in no wise assurance of the advisability of such action as has been taken. Such limitation devices have been criticized and condemned on many grounds. They fail, it is said, to accomplish their ends; they are likely rather to be the cause, directly or indirectly, of certain grave abuses in local financial administration, such as unjustified borrowing, defaulting and juggling of assessment values; they possess certain inherent weaknesses and at the same time lack constructive elements of any kind; they force the adoption of new and hastily devised taxes; they weaken local initiative in budget making.[104] More particularly with reference to California, Professor Plehn remarked somewhat reservedly, "Its best feature [the Riley-Stewart plan] is the attempted limitation of expenditures, state and local."[105] Professor Haig, who served as the tax expert for the 1929 California tax commission, said: "There are elements in the amendment concerning the effects of which I am dubious. I refer particularly to the percentage limitations on increase in expenditures and the 25 per cent property tax limitation. Experience elsewhere affords little grounds for optimism with respect to the efficiency and workability of such limitations. I can, however, recognize the political considerations which undoubtedly influenced the decision to include them."[106]

Coming now more particularly to the provisions of the California law, we may notice first of all the limitations placed upon the expenditures of the state. The first part of Constitutional Amendment No. 30[107] provided that the state could not increase its appropriations from the general fund for any biennium by more than 5 per cent over the appropriations for the preceding biennium unless two-thirds of the members of each house voted so to do. This provision was written by the Senate and unchanged by the Assembly.[108] It had been backed by the California Real Estate Association and the taxpayers' organizations. It was generally popular throughout the state because of its relation to economy programs. School appropriations, automatically regulated by the number of pupils in average daily attendance, were excluded from the limitation (as were also interest and redemption charges on state bonds). Otherwise the limitation extended to all types of expenditures and could not exceed 5 per cent unless two-thirds of all the members of each house of the legislature voted in favor thereof, provided, however, that no amount in excess of 5 per cent could be considered as a part of the base for determining the maximum expenditure for a succeeding biennium. If the appropriations in the budget act exceeded the limitation, and the budget had not been passed with two-thirds vote, the several items in the budget were automatically and proportionately to be reduced by the percentage of the excess of the budget as a whole. Items in which the excess was due to extra appropriations were to be reduced first, or made void. The amendment also provided that "not more than 25% of the total appropriations from all funds of the state shall be raised by means of taxes on real and personal property according to the value thereof."

Another part of Constitutional Amendment No. 30[109] provided for the limitation of local expenditures. With intent to obtain for the taxpayer the full benefit of the transfer of school costs to the state, the law provided that the expenditures of local units, namely, any county, city and county, municipality, district, or other political subdivision of the state, might not be increased by more than 5 per cent a year except in those cases where the excess was authorized by a two-thirds vote of the electors (a majority vote for the municipalities) or a favorable decision of the State Board of Equalization. The increase so obtained, however, could not be used as a base for determining the maximum expenditure for a subsequent year. Three types of expenditures were excluded from the limitation: (1) expenditures to pay interest and redemption charges on bonds, heretofore issued or hereafter to be issued, of any local unit; (2) expenditures by or on behalf of publicly owned facilities operated for the promotion and accommodation of commerce and navigation, irrigation districts, municipal utility districts, or metropolitan water districts organized or existing under the laws of the state; and (3) expenditures arising out of any gift, bequest, or donation. The 5 per cent limitation was made mandatory until June 30, 1935. Subsequently the legislature, by a two-thirds vote of each house, could limit both local expenditures and the amount of taxes which might be imposed upon real and personal property for local purposes.

Expenditure limitation upon local governments, thus introduced for an initial period of two years, was thought to be necessary as a means of dealing with an emergency situation. High hopes were held for it. In fact, it was stressed in the campaign for the adoption of Amendment No. 30 as being one of the most important of the advantages of the new plan. It is undoubtedly true that many of those who voted for No. 30 did so because they were convinced it would bring relief from property tax burdens, to which they thought the 5 per cent limitation on state and local expenditures would make a substantial contribution. The limitation, with the accompanying provisions for some flexibility, was believed to be necessary not only because of the large amount of property tax delinquencies, but also because of the tax adjustments made by the act. That is, the state's assumption of the mandatory school costs and its return of utility properties to local tax rolls opened the way for expanded local levies without any increase in tax rates. It was deemed advisable, through expenditure limitation, to guard against such an eventuality. The real objective was, of course, reduced tax rates.

The 1935 legislature through the so-called Wright act[110] extended the limitation provisions applicable to local governmental units for a further two-year period ending on June 30, 1937. The amendment had specified no definite date of expiration for the provisions relating to limitation of expenditures by the state government. In thus extending these provisions the legislative body generously liberalized the original limitations in various ways. Through these changes the legislature in effect: "(1) permitted the 5% allowable increase to be cumulative instead of being based on previous year's expenditures; (2) gave the Board of Equalization discretionary powers to include allowances in excess of the limitation in the base for determining the limitation of future years; (3) defined expenditures subject to limitation to be those made from tax monies only, except State school apportionments; and (4) exempted from the limitation any expenditures made necessary by legislative action."[111] The legislature, indeed, went so far as to raise questions of the effectiveness of any such liberalized provisions in controlling expenditures in any adequate degree and questions of the validity or constitutionality of the whole expenditure limitation program.

Aside from these uncertainties, there are other counts upon which expenditure limitation in California must be viewed with reserve. There have developed, for one thing, many practical difficulties in the administration of the law, a number of them involving court tests and interpretation. Among these difficulties has been particularly that of determining the base upon which the limitation should be computed,[112] as well as the problem of determining just what the expenditures of a given local unit are. When to these various administrative difficulties is added the certainty that expenditure limitation is not a fundamental solution of a difficult problem, one is all the more justified in concluding with a recent observer that limitation "is an expedient rather than a cure," that "taxpayers cannot depend upon mechanical contrivances alone to keep down the rising costs of local government, much less effect substantial reductions," and that the "solution lies in men and not in methods."[113]

NOTES TO CHAPTER VI

[1] Senate Constitutional Amendment No. 30, submitted to and approved by the electorate, June 27, 1933 (see Appendix C to this volume). See *Senate Journal*, I (1933), 992–994, 2453; also *Proposed Amendments to the Constitution* (California State Printing Office, Sacramento, June 27, 1933), pp. 1–8; also *Cal. Stats.* (1933), ch. 63, p. 3072.

[2] Statement by State Controller Riley, in National Tax Association, *Proceedings* (1933), p. 132. One of the counties in which the measure failed to pass was San Francisco. Haig and Shoup attribute the negative vote in this county to the better organization in this area of the opponents of No. 30 and to the influence particularly of the Retail Dry Goods Association. See R. M. Haig and Carl Shoup, *The Sales Tax in the American States* (Columbia University Press, 1934), p. 293.

[3] Proposition No. 9 was described on the ballot as follows: "School funds. Income, Sales Tax. Initiative constitutional amendment. Provides for income tax on individuals, estates and trusts, and selective sales tax. Provides for state public school equalization fund, requiring therefor annual minimum appropriation of forty dollars per elementary pupil and seventy dollars per high school pupil. Permits county and district school taxes. Requires school district taxes to meet district budget. Requires district apply to teachers' salaries seventy-five per cent of state moneys received for elementary schools and seventy per cent of that received for secondary schools, unless it expends therefor seventy per cent of maintenance budget less auxiliary expenses."

[4] These organizations were: the California Farm Bureau Federation, the State Grange, the County Supervisors' Association, the State Department of Education, the California Teachers' Association, the County Auditors' Association, the California Real Estate Association, the Property Owners' Division, and the so-called State Tax Equalization Association.

[5] These arguments, summarized pro and con, were set forth in the voters' handbook describing the various propositions upon the November 8, 1932, ballot. The material with reference to Proposition No. 9 is to be found on pp. 14 and 15 of Part I. The text of the amendment appears upon pp. 14 and 15 of Part II. See *Proposed Amendments to the Constitution and Proposed Laws* (Sacramento, November 8, 1932).

[6] Haig and Shoup, *op. cit.*, p. 291.

[7] The author's paper entitled "Possible Tax Situation Arising from Passage of Proposed Constitutional Amendment" follows:

"Any attempt to evaluate the possible tax situation arising from the passage of the proposed constitutional amendment to transfer a larger share of the cost of education to the state necessarily involves consideration of at least three problems, as follows:

1. The possible effect upon the aggregate of public expenditures.
2. The desirability or undesirability of the proposed new sources of revenue.
3. The financial outlook for the state.

These may be considered in order.

"One of the most frequent criticisms of this proposed amendment is that no provision has been made for limitation of the amount of taxes that local taxing districts may impose in event of the alleged relief to common property. There are good grounds for considering this omission a valid criticism of the measure.

"In the first place, testimony, experience and general reasoning support this conclusion. A recent report of the California State Board of Equalization points out that unless adequate means of limitation are coincident with tax reduction, any leeway is usually taken up in new tax levies for other purposes. The New York State Commission for the Revision of the Tax Laws, to assure the use of new money for relief instead of for increased expenditure, recommends the creation of a state-operated local government board to deal with the problem. Reductions in federal taxes in the post war years were followed by increases in state and local taxes. In California in 1912, one year after separation of sources of revenue had been effected by amendment no. 1, the local taxpayer discovered that the 'local tax rates absorbed all of the savings brought about by the deduction of the state tax from his tax bill.'

"Again, even in the presence of any plan of limitation there is reason to believe that collection by one agency and spending by another will not be conducive to economy in education expenditure, particularly if the attitude develops that concern need not be manifest since the state is footing the bill. A comparable situation may be said to have existed in California in some degree since 1911 with regard to state expenditures in general on the theory that the corporations were paying the bill. In California under the proposed arrangement, the decision as to whether the funds will be used for relief or otherwise expended will be left in the hands not of the state, nor of the 58 counties, but of some 3200-odd school districts throughout the commonwealth.

"Then, too, from the standpoint of the aggregate of public expenditures, and hence of relief to property, it can be argued that this amendment does not reach the problem at its source. It operates on the basis of the status quo by saying we ought to serve each district as it now stands rather than to begin with a program of consolidation. It is probably true that 'the first step in the reduction of taxes on the farmer as well as the merchant and the home owner must be the elimination of the greater part of this host of tax-levying units.'

"Finally it may be pointed out that the problem of finding effective limitation methods is an extremely difficult one. The 1927 California Tax Commission found the record of efforts in other states to control local expenditures through arbitrary percentage limitations a discouraging one. The 1929 Joint Legislative Committee on Taxation discovered no satisfactory method of tax limitation which it felt warranted in recommending to the legislature. Constructively, it may be pointed out that the groups supporting this proposed amendment are now engaged in trying to find some means of controlling local expenditure. Further it may be said that their proposal for an income tax, a direct personal obligation, is an essential part of any effective, long-time program for economy in state and local expenditures. People watch public expenditures when they realize the cost of government. Certainly, however, the proposed amendment is objectionable without at least some sort of provision for budgetary control such as was recommended by the 1929 Joint Legislative Committee which proposed to give boards of supervisors the power to review and revise budgets of school districts. But whatever the method of control, some central financial responsibility would seem to be desirable even at the expense of a measure of local political autonomy, if the new taxes proposed are to be replacement or substitute taxes rather than additional ones.

"The second general problem to be considered relates to the desirability or undesirability of the proposed new sources of revenue, namely, income and selective sales taxes. Some of the most important aspects of each of these two revenue possibilities may be very briefly discussed.

"It was the considered judgment of the 1927 California Tax Commission reporting to the 1929 legislature that the establishment of a personal income tax would probably ultimately be recognized as essential to a satisfactory solution of the problem of taxation in California. The personal income tax is being widely adopted. It exists today in 20 states, no less than 8 of the 20 having adopted it since 1929. Net income is generally considered today as being the best measure of ability to pay. It is quite clear that the income tax has many positive advantages among which is the fact that it 'would tax important economic resources which can never be reached by taxation of property.' The cost of administering such a tax is comparatively small, the yield under normal conditions relatively substantial. The more widespread the use of this tax, the less significant becomes the argument that its adoption in California is objectionable because it would repel wealthy residents. Furthermore it is the total tax differential which is the important thing and the income tax is only one factor in this. The tax differential, too, is only one factor entering into the determination of residence or location of industry. Probably as specifically related to the proposed constitutional amendment the problem of the income tax, and also the sales tax, is twofold: (1) Will it be a replacement or merely an additional tax? and (2) will it provide, along with the sales tax, sufficient sums to meet the cost of the enlarged financial obligations of the state?

"With regard to the first of these questions no satisfactory data are available, and no arbitrary answer can be given. Relief to the property owner would depend, as already indicated, upon the extent to which the new tax leeway would be used for tax relief rather than for more government expenditure. Also it must be remembered that property owners will be income tax payers. Finally it may here be noted that if the legislature fails to enact income or sales tax laws or if having enacted such laws the new sources of revenue do not yield sufficient sums, the state under existing constitutional authorization, is empowered to levy an ad valorem tax upon property, operative and non-operative, throughout the state. In this case the degree of benefit to real estate would be materially lessened. As to the second of these questions, comment will be made shortly.

"Sales taxes are vigorously defended and as vigorously opposed. They are held to be productive; to be in conformity with the principle of ability to pay; to be elastic in yield; to be fairly easily and inexpensively administered; to be paid unconsciously by the taxpayer. They are opposed because they are regressive; because they are pyramided; because the consumer who presumably pays them also pays shifted property and business taxes as well as the federal excises; because they decrease sales, and lead to out of state purchases and to 'bootlegging' of the article; because effective administration may be unduly expensive and unduly regulatory of the industry; because they are paid unconsciously by the consumer; because the success of the gasoline tax is in no sense a criterion of the possible success of other selective sales taxes which are new and in the experimental stage, etc.

"The third general problem of the proposed amendment revolves around the financial outlook for the state. This in turn is a problem of present and prospective expenditures and present and prospective revenues. A few facts with regard to the current fiscal position of the state are here in order. During the eight years since 1924 that cost of government statements have been prepared in California by the Controller's office, the total annual net costs have almost doubled, increasing from $63,784,350.87 in 1924 to $124,153,145.60 in 1931. According to a statement of the Department of Finance about the middle of March, state general fund revenues fell 20% below normal from 1929 to 1931 and will decline to 45% below normal by 1933. A statement released by State Controller Riley on March 20th revealed that new revenue requirements for the biennium 1933–35 without any reference to additional educational costs proposed to be assumed by the state ranged between eleven million and fifty million dollars, depending upon various assumptions. The assuming of further education burdens by the state under this amendment would, according to the State Department of Finance, increase state expenses by $44,352,000 a year or $88,704,000 a biennium; and if elementary and high school attendance increased during the forthcoming biennium to 3% and 7.6% respectively the added cost to the state for the biennium would be $99,823,000.

"To meet these additional expenditures reliance is placed upon the proposed income and selective sales tax. While fiscal difficulties would very likely be encountered because of the newness of these taxes and because of the abnormal business conditions, it is not impossible that eventually sufficient sums could be found to meet the additional expenditure. Much would depend upon the broadness of the base of the tax and the rates employed. The State Board of Equalization sometime ago estimated that California could raise $18,000,000 per year from a selective sales tax such as that in force in South Carolina. According to a recent federal census of retail distribution California ranks fourth among the states in total net sales and in net sales per capita is exceeded only by the District of Columbia. The 1929 Commission concluded that the yield of a personal income tax in California would be substantial, that with the New York scale the tax would yield in excess of $10,000,000 and at the Wisconsin scale at least $25,000,000. However, with regard to this whole fiscal problem, it is very important that various factors be kept in mind to guard against financial optimism. Among these factors are the constant tendency to shift more burdens to the state; the marked decline in yields of both income and sales taxes, especially income taxes, together with the variability of income tax yields; the employment by the federal government of similar taxes which necessarily limits their use by the states; the fixed charge upon the state retained and increased by this amendment, determined at a high level of expenditure and increasing as school attendance increases; and finally again, in case of a deficiency in revenue, the imposition of a state ad valorem tax on property.

"In conclusion it may be said that no one measure will solve California's tax problem as it relates to the financing of education and the relief of common property. The solution will necessitate a well coördinated plan involving among other things strict budgetary control extending down to the smallest political subdivision. If it is conceded that real estate taxes must be reduced, this may possibly be considered an argument for reduced taxes in general through economy and retrenchment, rather than that we should at this time ask the state to assume the burden of the present county mandatory requirement in the hope of encouraging home ownership, assisting the farmer, and preserving the integrity of real estate values in view of their importance in the larger financial realm as security for bonds and mortgages. We may well agree with the 1929 Joint Legislative Committee on Taxation that ultimate reliance for reduced local taxes must be placed on rigid economy, careful scrutiny of bond issues, restriction of special assessments and tax levies, and the courage to admit that many desirable things cannot be afforded."

[8] *Report of the California Tax Research Bureau of the State Board of Equalization* (Sacramento, January 23, 1933), p. 144 (hereafter referred to as the *1933 Report*).

[9] *Senate Journal* (1933), p. 367; *Assembly Journal* (1933), p. 674. The session of 1933 saw many amendments to the tax code submitted in both houses of the legislature. Usually these dealt with one phase of the subject. Several had tax limitation provisions. Most of these were swallowed up in Senate Constitutional Amendment No. 30 and Assembly Constitutional Amendment No. 68.

[10] Haig and Shoup, *op. cit.*, p. 291. These writers comment upon the position of the board as follows (pp. 291–292): "This body had lost most of its power in 1929 when collection of the state franchise tax was transferred to a newly created franchise tax commissioner. Being a constitutionally established body, however, the board had remained in existence. Casting about for ways to restore itself to power, it found its opportunity in the desires of the various organizations which had backed Proposition No. 9, combined with the situation that confronted the legislature in January, 1933."

[11] Senate committee on revenue and taxation, *Senate Journal* (1933), p. 6; for Senate action on the amendment, see *ibid.*, pp. 657, 662, 772, 808, 935; for the form in which the amendment left the Senate, see *ibid.*, p. 992.

[12] Assembly committee on revenue and taxation, *Assembly Journal* (1933), p. 347; for amendments adopted April 7 and April 19, see *ibid.*, pp. 1973, 2392.

[13] *Ibid.*, p. 2509.

[14] For amendments adopted by the Assembly on April 22, April 26, and May 1, see *ibid.*, pp. 2612, 2757, 3060. No amendments were adopted except those proposed by Assemblyman Lyon, who had the steering of the measure through the Assembly. Two interesting amendments were proposed. One by Assemblyman King would have exempted the dwelling house in which the owner resides, together with the necessary outbuildings and land to the extent of one acre, to the assessed value of $2,500, this exemption not to apply to any person who owned property assessed at $5,000 or more. The other, proposed by Assemblymen McCarthy and Knowland, would have prohibited the state from taxing the receipts or the services of any publicly owned utility. See *Assembly Journal* (1933), pp. 2760, 3060, 3108.

[15] *Ibid.*, p. 2025.

[16] *Ibid.*, pp. 5, 3110.

[17] *Senate Journal* (1933), pp. 2306–2308.

[18] *Supra*, p. 163.

[19] It has been said that "most of the school teachers as individuals probably favored the plan, but they were not active in the campaign either as individuals or as an organization because of the hostility they had incurred in their fight for Proposition No. 9."—Haig and Shoup, *op. cit.*, p. 293.

[20] For a brief discussion of this background see comments by Ray L. Riley, "California's Tax Problem," in National Tax Association, *Proceedings* (1933), pp. 130–131.

[21] Haig and Shoup, *op. cit.*, p. 290.

[22] *Ibid.*, pp. 289–290.

[23] *Ibid.*, p. 290.

[24] Professor Elmer D. Fagan, "Fiscal Policy in California during the Depression," Tax Policy League, *Taxbits*, vol. II, no. 3 (January, 1935), p. 6.

[25] *A Plan for Tax Relief* (California State Printing Office, Sacramento, 1933), p. 7.

[26] *A Plan for Tax Relief.* Restated here substantially as given in this pamphlet.

[27] *Ibid.*, pp. 9, 15.

[28] Provision was made for flexibility in some exceptions to the limitation clauses. Permission to exceed the limitation could be given by the State Board of Equalization or by a two-thirds vote of the electorate, except with respect to municipalities, where a majority vote was ruled sufficient. The limitation of local expenditures was made terminable in January, 1935, although the legislature was given power to extend the restriction. For further details respecting local limitations see the text of Amendment No. 30 in Appendix C.

[29] It is interesting to observe here that the 1929 California tax commission had recommended abandonment of separation of sources and return of utility property to the local tax rolls. This was the first of ten distinct recommendations made by the commission. The summarized statement of this first recommendation follows: "That the operative real estate of all public utilities be valued by the state and then returned to the counties to be added to the local tax rolls and subjected to the same tax rates as are imposed upon the real estate of corporations and individuals. This step will eliminate the necessity of computing a rate to be imposed on public utilities because the rate will be determined automatically when the local property rates are struck. It will remove the cause for complaint arising from the counties which now suffer from the withdrawal of the operative property of the public utilities. It will almost completely solve the problem of the exemption of publicly-owned public utilities. These advantages will be gained at the cost of a considerable but not unreasonable increase in administrative difficulty. There must be a state assessment of the utility property returned, a state determination of the percentage of full value at which the utility property shall be added to the local rolls, and a distribution of the utility property to the various taxing districts of the state."—

Final Report of the California Tax Commission (Sacramento, 1929), p. xxii (hereafter referred to as the *1929 Report*).

[30] "Realty Men Plan Budget," *Los Angeles Times*, March 14, 1935; also an editorial, "State Financing," *ibid.*, March 16, 1935.

[31] See the editorial referred to in the preceding note; also "Utility Tax Starts Row," *Los Angeles Times*, March 6, 1935.

[32] *Ibid.*

[33] *Los Angeles Herald and Express*, April 30, 1935.

[34] *Los Angeles Times*, December 26, 1934, "State Seeks to Keep Tax on Utilities"; and December 27, 1934, "Seek Financial Relief on Big California Budget."

[35] *Report of the California State Board of Equalization* (1933–1934), p. 28.

[36] *Ibid.* For a description of the procedure employed by the division, see *ibid.*, pp. 29–32.

[37] *Ibid.*, p. 33, where a table is presented of assessment ratios and actual tax burdens for all counties of the state.

[38] *Ibid.*

[39] *Ibid.*

[40] "State Tax Plan Given," *Los Angeles Times*, February 23, 1935.

[41] "Uniform Tax Basis Looms," *Los Angeles Times*, February 16, 1935.

[42] *Public Utility Reassessment Proceedings before the State Board of Equalization. Memorandum from Carl I. Wheat, Public Utilities Counsel, to City Attorney Ray L. Chesebro* (August 19, 1935), p. 1. This document has been reproduced as Appendix D to this volume. A perusal of it will reveal interesting details of assessment procedure and views of both utilities and public officials. It particularly emphasizes the divergent views of various utilities concerning the basis or method by which their properties should be valued for taxation purposes. This entire valuation problem might well be made a separate and extended study.

[43] *Ibid.* The statements made in the next few sentences are gleaned from this document.

[44] There is undoubtedly some danger from this source. However, the already mentioned adjustment by the board of common property assessment ratios throughout the state will help to meet the problem in part. Furthermore, as Mr. Wheat points out, it is not impossible that this alleged inequality of assessment between public utility and common property may lead in the future to a greater degree of centralized control over local assessment procedure.

The problem is not a purely local one. Professor Lutz remarks with respect to it in general (*Public Finance* [2d ed.; Appleton, 1929], p. 480): "The danger of discrimination against the properties centrally assessed is real, and the courts have been appealed to on more than one occasion to afford relief. But the difficulty is one which goes back to the inadequate operation of the whole system of property assessment."

[45] To this view on the part of certain utilities Mr. Wheat takes vigorous exception (*op. cit.*, p. 6): "The efforts of certain utility representatives to divorce values in taxation wholly and completely from values on which consumers are asked to pay a return in rates appear to be ill-advised, to say the least. The contention . . . that the two are wholly unrelated is as fallacious as it is unjust to the public. . . . Somewhere there is a proper and just mean, and certainly the contention of the local telephone company that it should be allowed to earn a return in rates on an alleged 'value' of $175,000,000, and at the same time be taxed on a basis of only $46,000,000 (twice its claimed assessment) on the same properties is absurd. Indeed, it is so absurd that the very fact that this contention has been made (with a straight face) by this concern should have a salutary effect."

The California tax commission of 1929 commented upon this problem. Perhaps its two-paragraph discussion should be reproduced here, but the substance of the view expressed is set forth in the following statement (*1929 Report*, p. 57): "The fact is, of course, that the two so-called values are fundamentally different things, and although with perfect judgment on the part of the public utilities in making their decisions regarding their investment in plant and with perfect regulation on the part of the state the two may closely approximate each other, there are many circumstances in this imperfect world in which they will necessarily be far apart."

[46] For instance, Mr. Hopkins, Los Angeles county assessor, sought to assess street franchises, or the "franchises to do," to the amount of $23,400,910, claiming that the State Board of Equalization had not taken these into account in assessments placed upon utility properties. Mr. LeRoy Edwards, general counsel for the Los Angeles Gas and Electric Company, countered by saying that the board had taken into consideration all intangible values, and that furthermore these values were also taxed under the State Bank and Corporation Franchise Tax Act. Hence he contended that franchises received a double assessment; he also argued that the so-called "franchises to do" had merely a nominal value determined by the cost of acquiring them. These matters are discussed in two numbers of the *Los Angeles Times:* "Heavy Tax Loss Faced by County," December 14, 1935; and "Tax Error Disputed," December 19, 1935.

[47] In 1932–1933 the amount required to be raised by the counties was: for elementary schools, $21,284,658.91; for high schools, $16,326,776.36, making a total of $37,611,-435.27. See *A Plan for Tax Relief,* p. 9.

[48] *Ibid.,* pp. 9, 15.

[49] *Ibid.,* p. 15.

[50] *Ibid.,* p. 9.

[51] *Ibid.,* p. 12.

[52] *Report of the California State Board of Equalization* (1933–1934), p. 10.

[53] *Ibid.;* also p. 32.

[54] *Ibid.,* p. 32.

[55] *Ibid.*

[56] *Ibid.*

[57] See National Tax Association, *Proceedings* (1933), p. 131, and *A Plan for Tax Relief,* pp. 9–10.

[58] See *Proposed Amendments to the Constitution* (Sacramento, June 27, 1933), p. 3.

[59] See especially the commission's evaluation of the separation of sources plan in the *1929 Report,* p. 73.

[60] "I am very much at sea as to what to say about the Riley-Stewart plan. Although I have had conferences with its sponsors, I am still unable to visualize just how it will work. . . . So very little information is available on the essentials that it seems very much a leap in the dark."—From a communication to the author from Professor Carl C. Plehn, dated June 13, 1933. Further on in his letter Professor Plehn remarks that the state's deficit, all of which was in the general fund, could be met without amending the Constitution. Hence he suggested at the time that the state should do by statutory enactment what was necessary to meet the emergency and thus "give Mr. Riley and Mr. Stewart two years to perfect their plan and show how it will work in dollars and cents."

[61] View emphasized by former Governor C. C. Young, in California League of Women Voters, *Bulletin,* vol. 8, no. 9 (June, 1933).

[62] Letter from Professor Plehn.

[63] Former Governor C. C. Young, *op. cit.*

[64] In this connection refer to the comment on p. 171 of this work and to footnote 34. A short campaign dodger of the league urged, for various reasons, a negative vote on No. 30. No date appears upon the dodger but it was circulated some days prior to the election on June 27, 1933.

[65] This conclusion was based upon a public utility assessment in 1933 of $1,100,000,000,

out of a total property assessment in the state of $6,000,000,000, or approximately 18 per cent. Eighteen per cent of $60,000,000 would be $10,800,000. But under the 25 per cent limitation with respect to levy by the state upon real and personal property, but $15,000,000 of the deficit could be met from property taxes, and the utilities' 18 per cent share of this would be $2,700,000.

[66] Former Governor C. C. Young, *op. cit.*

[67] *Ibid.* Also from Professor Plehn's communication previously referred to: "The old 1906 system to which this will be a return, in part, provided the funds (out of taxes saved) to support the old Southern Pacific political machine. Possibly we can avoid a return of such conditions. I don't know."

[68] Illustrative of this view is the following statement in the dodger already mentioned, from the Municipal League of Los Angeles: "In a sentence, we condemn this amendment because it completely fails to solve the real tax problems of the state and shifts the burden of government from privilege to the shoulders of the small home and farm owner and the propertyless. And yet this proposal is advocated as 'A Plan for Tax Relief.' "

[69] See the dodger of the Municipal League of Los Angeles. Interestingly enough, the 1929 California tax commission (*1929 Report*, pp. xxii, 67–68) suggested that the return of utility property to the local rolls would "almost completely solve the problem of the exemption of publicly-owned public utilities."

[70] The 1931 joint legislative committee on taxation rejected certain suggested means of controlling expenditures on the ground that they ran counter to the strong home rule sentiment in the state. See *Assembly Daily Journal*, January 23, 1931, pp. 26–27.

[71] The general picture as it related to the general fund of the state was described by Mr. A. E. Stockburger, State Director of Finance, in a paper "Balancing the Next State Budget," presented to the State Chamber of Commerce Taxation Conference, October 25, 1934. See also the comments in *Report of the State Board of Equalization* (1933–1934), p. 11.

[72] "In this emergency we need new taxes and a general retail sales tax is perhaps the best bet."—Letter from Professor Plehn.

[73] "The only commendable feature of California's retail sales tax is its productivity."—Professor Fagan, *op. cit.*, p. 10 (see footnote 24).

[74] "The average rate necessary for the counties to levy on common property in order to raise this minimum amount required by the Constitution during 1932–33 was $0.71 per $100 of assessed value. There were, in addition, numerous special district taxes for school purposes with the result that practically half of the local tax rate was imposed for educational expense."—Statement made in the campaign pamphlet *A Plan for Tax Relief*, p. 9.

[75] Letter from Professor Plehn.

[76] See, for instance, H. L. Lutz, *op. cit.*, pp. 124–125.

[77] For a summary discussion of current aspects of this problem see "Principles of State Aid," in Tax Policy League, *Taxbits*, vol. II, no. 10 (August, 1935).

[78] Equalization of educational opportunity has been much emphasized in extending state aid in support of education.

[79] This question was raised in the *1933 Report of the Tax Research Bureau*, p. 144.

[80] "Neither method of railroad taxation has decisive advantages over the other, much depends on precedent and on administrative conditions." This was the conclusion of Professor Lutz (*op. cit.*, p. 481).

[81] This question was raised by Professor Fagan (*op. cit.*, p. 8). Under Mr. A. G. Mott, the valuation division of the State Board of Equalization, however, seems to have done a conscientious piece of work in making the original utility valuations. This was the testimony, for instance, of Mr. Carl I. Wheat, public utilities counsel for the city of Los

Angeles. In his memorandum on *Public Utility Reassessment Proceedings before the State Board of Equalization,* dated August 19, 1935, he wrote: "Considering the fact that this was the first assessment of its kind in California; that fully 19,000 separate and distinct taxing areas or units were involved (in each of which a separate assessment of utility properties had to be made for each utility therein operating); that an appropriation of but $150,000 and only a year and a half of time were available, and that the value of the properties to be assessed amounted, in total to approximately two billion dollars, it seems proper to state that the work of the State Board of Equalization and of its valuation staff, under the direction of Mr. A. G. Mott, has been a remarkable illustration of efficient and, as far as we can ascertain, wholly nonpolitical government effort. The fact that, out of over 500 utilities whose properties were assessed, only about a dozen filed protests is remarkable, to say the least. On the whole, while there are a few companies and a few items as to which we feel the assessments are somewhat low, we are convinced that an honest and determined effort was made to arrive at fair and reasonable values." Also it should be noticed that the state board has recently envisioned its metamorphosis into a professional tax commission giving all its time to tax problems.

[62] Professor Fagan (*op. cit.,* p. 9) summarizes the situation in this respect as follows: "The new as compared with the old method of taxing public utilities in California shows little, if any, superiority in the matter of equalizing burdens except with regard to discriminations between different classes of utilities and their customers and between customers of utilities and of other business in municipalities of different size. Under the new plan the same ad valorem rate wll be applied to the property of all classes of utilities in the same locality. This method will also correct a condition produced by the uniform state rate on utilities of the same class. Under the flat rate, the same class of utility paid the same rate of taxation regardless of the size of the municipality in which it was operating. This meant, of course, that if the state rate were high enough to equalize utility taxes with taxes on other property in the large cities where governmental cost and property taxes were high, it would discriminate against the customers of utilities in the smaller places where governmental costs and property taxes were low, and conversely." This conclusion, he points out, was based on the assumption that taxes on utilities would be shifted to consumers.

[63] Letter from Professor Plehn.

[64] *1929 Report,* p. xxii.

[65] *Ibid.,* p. 91.

[66] *Ibid.*

[67] Controller Ray L. Riley, "The California Tax Problem," in National Tax Association, *Proceedings* (1928), p. 57. Mr. Riley had given similar testimony two years previously when he said (*ibid.* [1926], p. 289): "Within one year after the adoption of the new plan, county rates were as high, or higher, than before separation. It afforded an opportunity to advance rates without protest from the taxpayers, who were not aware of the true situation."

See also the testimony of the 1929 commission (*1929 Report,* p. 47) to the effect that "the relief which was expected to be given to the owners of real estate as the result of separation has not developed." The commission attempted no definite answer to the question whether real estate had been less burdened than it would have been if Amendment No. 1 had not been adopted.

[68] "Tax Increases Nullify Sales Levy Benefit," *Los Angeles Times,* November 21, 1934. Mr. Hartman made his statement in response to inquiries from taxpayers asking why the tax reduction made possible by the sales tax had not been passed on to the property owners.

[89] Along these lines see Alfred G. Buehler, "An Appraisal of General Sales Tax Experience in the United States," in Tax Policy League, *Taxbits*, vol. III, no. 5 (March, 1936), p. 4.

[90] For instance, the San Bernardino County grand jury in a report filed March 12, 1935, said: "Particularly do we stress the manner in which the savings in taxes made possible through the passage of the Riley-Stewart bill have been passed on to the taxpayers in this county. Here we did get a direct benefit in the way of an appreciable reduction, while in many other counties the saving was nullified by other things which were allowed to creep into the budgets." See California Taxpayers' Association, *Tax Digest*, XIII (June, 1935), 192–193.

In this same article Mr. Grier, chairman of the board of supervisors of San Bernardino County, comments favorably (p. 193) upon certain of the benefits of the Riley-Stewart act but then goes on to state (p. 213): "During the past few months our Chambers of Commerce and various other organizations are again becoming active and the requests being made to our board of supervisors for additional governmental expenditures would far exceed a 5 per cent limitation."

State Controller Riley stated on one occasion that the total general county tax levy for 1932–1933 was $132,778,463, as against $86,740,704 for 1933–1934. This indicated, he said, that No. 30 had resulted in total tax savings of $39,000,000 plus a reduction in county governmental costs of $7,000,000, or a total of $46,000,000.

At another and later time, however, he was less optimistic. Speaking to the tax reduction group of the California State Chamber of Commerce on November 7, 1935 (as reported in the *Los Angeles Times*, November 8, 1935), he said: "We may expect that the taxpayers of California will in the aggregate be compelled to pay in the neighborhood of $15,000,000 for the year 1935–1936 in excess of the year 1934–1935. In other words, about one-half of the relief afforded by the return of the utility property to county taxes will have been absorbed during the first year of its return through increased governmental levies. With this record before us it would appear that limitations alone will not and can not afford adequate protection."

[91] Haig and Shoup, *op. cit.*, p. 294. Further data relative to school district applications were given by Vierling Kersey, State Superintendent of Public Instruction, for the year 1933–1934. Of the total excess expenditures authorized by special elections and by the board, $194,119.47, or 6 per cent, was required for current maintenance expense; $560,693.24, or 17 per cent, for normal repairs, replacements, and construction of new buildings; and $2,353,354.66, or 77 per cent, for strengthening or reconstructing buildings damaged by earthquake shock.

[92] *Ibid.*, p. 295.

[93] *Report of the California State Board of Equalization* (1933–1934), p. 12.

[94] *Ibid.*

[95] Professor Plehn, in the following words, refers to one of the possible complications mentioned above, and then suggests an interesting new possibility (the italics are mine): "If the limitation of expenditures works and if the county supervisors and city fathers do not discover some way to continue the old tax rates and use the money in addition to the state's increased contributions to schools and local streets and highways, then and then only will the prayer for reduction be realized. *For a short time real estate taxes may go down. But will they stay down?* Be it remembered that if the government takes less of joint revenue of owner and government, the value to the owner goes up. This at once brings higher assessments and even at the lowered tax rates yields more money."—Letter from Professor Plehn.

[96] *Foreword on Taxation in California* (August, 1916), p. 11.

[97] The discussion with reference to this 1918 measure is based upon the material to be found in Commonwealth Club of California, *Transactions*, 13 (1918–1919), 233–237.

[98] The objections to the measure, akin to those urged against similar legislation in recent years, were summarized by one Mr. Dolge as follows (*ibid.*, p. 236): "My objections to the proposed measure are that it will promote bond issues and license taxes, compel county officials and interested citizens to attend meetings of the Board of Authorization in Sacramento; that it undermines home rule; that it seeks to amend county and city charters by legislation outside of the charters; that it puts a community which dares to differ with the State Board of Authorization to the expense of an election, at which election not a majority, but only 2/5 of the voters are necessary for an adverse decision. It may be questioned if a board consisting of five specialists in government administration and finance are really capable of passing judgment upon the financial requirements of 57 counties of this state, the problems of no two of which are alike. The appointment of five state officials as members of the proposed board will merely have a tendency to centralize political power in Sacramento."

[99] As will be noted later, appropriations from the general fund of the state for the support of the public school system are exempted from the present limitations applicable to the state government.

[100] *1929 Report*, p. 91.

[101] *Assembly Daily Journal*, January 23, 1931, p. 27.

[102] The bureau's study occupies pp. 140–159 of its *Report*.

[103] "At least fourteen states have enacted laws during the last two years setting limits of one kind or another upon the tax raising powers of state and local governments, and in seven of these states such provisions have been embedded in the state constitutions."—"Overhauling State Revenue Systems," Tax Policy League, *Taxbits*, vol. I, no. 10 (August, 1934), p. 2.

[104] The literature upon limitation is extensive. For a concise statement of some of the arguments pro and con, see the *Taxpayers' Business* (September, 1934), published by the Taxpayers' League of St. Louis County, Minnesota. Herbert U. Nelson presents the case for limitation and Arthur Eugene Buck the case against limitation. A reply to Mr. Nelson appears in Jens P. Jensen, "Property Tax Limitations," Tax Policy League, *Taxbits*, vol. II, no. 4 (February, 1935), pp. 2–9. It is here that Professor Jensen particularly argues that tax limitation is not a door to tax reform, as contended by Mr. Nelson. Further discussion of the limitation movement will be found in Tax Policy League, *Taxbits*, vol. I, no. 10 (August, 1934), and in "Preliminary Report of the Committee of the National Tax Association on Expenditure Control," H. L. Lutz, chairman, National Tax Association, *Proceedings* (1933), pp. 200 ff. Although much of what is said in these references relates to tax rather than expenditure limitation, the general principles seem applicable to both.

[105] Letter from Professor Plehn.

[106] Letter of Robert M. Haig, Columbia University, to State Senator Herbert C. Jones, July 11, 1933, in *Senate Journal* (1933), p. 3200.

[107] Now *California Constitution*, Art. IV, sec. 34*a*.

[108] *Senate Journal* (1933), pp. 662, 992. The facts which follow were gleaned from the amendment to the Constitution.

[109] Now *California Constitution*, Art. XI, sec. 20. The discussion following summarizes the provisions of this part of the Constitution.

[110] *Cal. Stats.* (1935), ch. 356.

[111] Quoted from Harry H. Baskerville, "Control of Local Expenditures," California Taxpayers' Association, *Tax Digest*, vol. XIV, no. 4 (April, 1936), p. 126. The order of his points follows the order in the act. This article by Mr. Baskerville presents a concise, critical, and constructive summary of the recent local expenditure limitation movement in California. For reasons already given, no attempt is made here to deal in detail with

the subject. Three other articles which discuss the problem are: "Expenditure Control," *Tax Digest*, vol. XIII, no. 4 (April, 1935), pp. 120–121; "Local Costs Reduced," *ibid.*, no. 6 (June, 1935), pp. 192 ff. (by Hon. C. C. Grier, chairman, Board of Supervisors, San Bernardino County, California); and "How Local Expenditure Limitation Works," *ibid.*, no. 12 (December, 1935), pp. 409 ff. (by A. H. Campion).

[112] Should, for instance, unused contracted school expenditures be included in the base? The Attorney General so ruled, but County Auditor Payne of Los Angeles County argued that "to include unused contracted expenditures in the base for estimating the annual 5% increase would be an evasion of the Riley-Stewart Act." Or again, since the state assumed school costs for 1933–1934, should county tax rates be based upon expenditures of 1932–1933 without the inclusion of school costs? The Attorney General so ruled, but was overruled by the District Court of Appeal. Some twenty-three counties, including Los Angeles County, were involved because in these counties the boards of supervisors had computed the allowable increase in their budgets on the basis of expenditures of 1932–1933, including school expenditures. Certain further aspects of the problem of the base are mentioned briefly in the *Report of the State Board of Equalization* (1933–1934), pp. 21–22.

[113] Comments of Mr. Harry H. Baskerville, former president of the Los Angeles City School Board, in California Taxpayers' Association, *Tax Digest*, vol. XIV, no. 4 (April, 1936), pp. 127–128.

VII. THE SALES TAX

UNLIKE THE INCOME TAX, which was the outcome of many years' reflection on matters of taxation, the sales tax[1] developed suddenly in the period of the deficit. In 1933, when the California tax was first enacted, there was little precedent in other states for retail sales taxes, since no state had operated one long enough to reach any conclusive results. The idea of sales taxes had not permeated even to those who might be expected to give special attention to matters of revenue. California owes her retail sales tax to the deficit of 1932 and the consequent reorganization of her financial system. Though she was not a pioneer, and though her story is not very different from that of other states, her experience is worth reviewing.

When the evolution of the Riley-Stewart plan revealed that the thinning state revenues were to be stretched not only over a deficit but over school costs too, the legislature of 1933 found itself compelled to consider new sources of funds. Two facts were plain: increased taxation was necessary, and this taxation could not fall upon land. Thus forced to a reorganization of the state revenue system, the legislature expressed its attitude in a report of a joint committee which had been appointed to study the situation:

"We are of the opinion that it is not advisable at the present moment to make any more radical changes in the system of State taxation than are absolutely necessary. Any such proposed changes have necessarily had combined with them the levying of transactions, turnover, gross sales, gross income, or other broad-base taxes.... In this way we will have preserved for the relief of real estate all new fields of taxation as yet not used in California, until we can obtain some definite results from the administration of a sales tax in California."[2]

From this confusion the retail sales tax slowly emerged. The California state tax commission in 1929 had said that "the existence of heavy taxes on the privilege of doing business, even though they be of a type which are presumably easy to shift, such as taxes on sales or 'turnover,' for example, often give the appearance of imposing a heavier burden upon business than is actually imposed, and thus may operate to discourage prospective development."[3] The Board of Equalization had recommended a transactions tax.[4] Attracted by the success of the gasoline tax, the legislature first considered broadening the state excise

[1] For notes, see below, pp. 222–228.

taxes, a possibility which had been reported upon by the Tax Research Bureau in 1932.[5] In January, 1933, the bureau submitted full estimates concerning the rate and yield of a selective sales tax on articles such as tobacco, beverages, confectionery, ice cream, patent and proprietary medicines, cosmetics, furs, sporting goods, musical instruments, radios, and cameras.[6] Subsequently both houses of the legislature introduced bills calling for a selective sales tax based upon the bureau's report, and for gross sales taxes something like transactions taxes.[7]

Though the California public had had a previous acquaintance with excises, it was largely ignorant of the workings of gross and retail sales taxes and had not considered them when it elected the legislature; thus there was no popular discussion of them until the Riley-Stewart plan came to referendum. During the discussion of this plan in the Senate, a majority of the legislators became convinced that a selective sales tax would not yield the required revenues,[8] and that a gross sales tax would result in an undesirable pyramiding of the tax. Influenced by the fact that many European countries and eight American states were already using the sales tax, and that other states were considering it, the California legislature stood ready to join the stampede toward the new fashion.[9] Although action was deferred, awaiting the people's vote upon Senate Constitutional Amendment No. 30, the joint legislative committee proposed a 2 per cent retail sales tax in its report of April 29.[10]

During the campaign waged for the passage of the Riley-Stewart plan, the State Controller and members of the legislature, speaking for it in localities throughout the state, argued for the retail sales tax as the most desirable of the new methods of raising revenue. In answer to the criticism that it would tax according to needs and not according to tax-paying capacity, State Controller Ray Riley evoked the benefit principle as being fully as applicable as the orthodox ability canon, especially when the proceeds of the tax were to be used for schools.[11] Since the Riley-Stewart plan also included the income tax as a possible new source, the popular vote must not be interpreted unreservedly as an endorsement of the sales tax.

After the adoption of the Riley-Stewart plan, a retail sales tax was expected from the reconvened legislature.[12] Those groups which normally might be expected to oppose such a measure did not make an effective attempt to do so. Consumers generally were apathetic, unorganized, or expecting more relief from the lessening of the general property tax than burden from the sales tax. The Grange and the Farm

Bureau, both of whom on July 3 declared themselves in favor of an income tax and opposed to any but a selective sales tax, finally consented to a retail sales tax provided it was accompanied by a tax on incomes. Those who in most states were the effective opposition, the retail merchants, whose organization in California was only a year old, were apparently reconciled by the provisions for passing the tax on to the consumer, and by the fact that no one type of business was more favored than another. The very speed with which the law was passed disarmed its natural opponents. On July 18, the State Controller sent to the legislature communications stating that at a meeting held in the Controller's office the retail merchants' organizations had given their approval to a 3 per cent sales tax.[13] The most powerful factor in disarming opposition was the general conviction that the sales tax was less of an evil than the ad valorem tax on property, the lack of revenue for schools, or the further increase in the deficit.

Believing that public opinion acquiesced, if it did not actively approve, the legislature proceeded to enact the tax. Expert legal advisers had drawn up a bill modeled on the law of New York State[14] and providing for a 2 per cent tax on all retail sales. This law was introduced into the Senate July 18 and progressed rapidly through all the stages. At the second reading its rate of 2 per cent was raised to 3 per cent; provisions were added for shifting the burden to the consumer, for dropping the rate, in the event that the receipts for the first six months should be more than $25,000,000, to a rate that would produce $50,000,000 a year, and for exempting purchase of gold bullion. As an urgency measure, the bill was read the third time on the day after its introduction, and after the easy defeat of an attempt to exempt foodstuffs the sales tax passed the Senate by a vote of 26 to 10. Though the Assembly lowered the rate to the original 2 per cent, a compromise at 2½ per cent was finally reached, when the bill passed the Assembly 43 to 21, and was approved by the Governor on July 25.[15]

The new law provided for a tax of 2½ per cent upon the gross receipts from sales by all retailers. Neither house of the legislature made any effort to exempt food. There were, however, four exemptions: the gross receipts from sales which the Federal Constitution forbids the states to tax; from sales of gas, electricity, and water, when delivered to consumers through mains, lines, or pipes; from the sale of gold bullion or gold concentrates and precipitates; and from sales of personal property to be used in public works contracts. Sales of food to the state or other government units for use in relief were taxed, but were subject to refund.[16] The 2½ per cent rate was to remain effective until July 1, 1935, after which date it was to be lowered to 2 per cent unless the legislature of 1935 should otherwise decide.

After the retail sales tax had begun to operate, opposition to it developed, as was to be expected for any unfamiliar tax. The hostility, however, did not lessen with time. Probably the most important factors in the growing discontent were the Governor's veto of an income tax and the failure of the general property tax rate to decline during 1933 and 1934. Labor and consumers seemed to be willing to pay the tax if incomes also carried a share of the general tax burden. Though not entirely reconciled, retailers' organizations were not active agents in the discontent once they learned to shift the tax, but the general public grew more displeased. The general property tax rate, moreover, did not go down; after a slight decrease in 1933, the counties took up the slack; by the end of 1934 most of them had as high a rate as before they shifted the school costs to the state. The small property owner and renter found that they had merely burdened themselves with another regressive tax. The growth of this voiceless hostility is difficult to trace, because the press of the state, generally conservative and favorable to large real estate organizations, was loud in its praise of a "new, rich, just, and sane" tax. Upton Sinclair's denunciation of the sales tax was probably one of the most potent factors in the large vote he polled as candidate for governor. His vote, however, must not be taken as a measure of the strength of the opposition to the tax situation, for, although a large part of his poll can probably be counted as a protest against the sales tax, many votes which on this score might have gone to him were probably freightened away by other aspects of Sinclair's program.[17]

Meanwhile the hard-pressed makers of the budget had decided to ask for an extension of the sales tax. Although the returns from it had bettered expectation, both the State Board of Equalization and Controller Riley, apprehensive of the decrease in state revenues that was to come with the return of utility property to the local rolls in January, 1935, and fearing that a 2 per cent sales tax would not provide sufficient revenue, recommended an increase in the rate to 3 per cent, without any exemptions.[18] The Governor's budget called for a 3 per cent rate in order to provide for the state school contribution of $142,500,000 for the biennium 1935–1937: "I am convinced that during a continuance of our present emergency conditions this type of tax can carry, without severe hardship to our people, an even greater share of the school costs. Such a tax reaches a large group which otherwise makes a relatively small contribution toward the support of government; and that is the group which derives the most benefit from the public schools. The increased revenues from a 3% tax will produce approximately \$126,000,000—still short of the total required for public schools and exclusive of the appropriations needed for the operation of the State university, the teachers' colleges, and other educational institutions of the State."[19]

Governor Merriam stated further: "I would like to present the necessity for an increase of 1 per cent in the sales tax, making it a ½ per cent increase over what it is at the present time. The school bill of the State is \$143,000,000 . . . I would like to call this a 'school tax' for it is dedicated to the payment of the expenses of the schools of California. I know there is opposition to it. I know it is a nuisance and that it puts a tax on some of the poorer people and small taxpayers, because it is on the amounts that are purchased. But I am convinced also that everyone, no matter how poor he may be, should make some little contribution to education in the State."[20]

Though in both houses the worst storms of the session raged around the budget and the income tax, the administrative sales tax proposal had a difficult voyage through the legislature of 1935. The attack which the "Epic" group launched aggressively early in the session was not, however, so bitter as the denunciations of the campaign had led the public to expect. So richly had the tax demonstrated its productivity that efforts for its repeal or replacement by a selective sales tax had no effect, and even the "Epic" bill confined its attack to a demand for a lower rate and for the exemption of cheap clothes and food for human use.[21] For these two changes the opponents of the tax fought hard. No less than ten bills of this nature were introduced, including bills for exempting food, for exempting clothes priced at \$25 or less (except sporting goods and furs), for exempting medicines sold to hospitals, and for exempting spray oil for citrus or deciduous fruit trees.[22] To these were opposed such bills as the Swing bill, which provided for the continuation of the tax at 3 per cent on all retail sales except those exempted under the law of 1933. This bill gained powerful support because of the necessities of the budget, which made members doubt whether a 2 per cent tax, or even a 3 per cent tax with foodstuffs exempted, would take care of the state's needs after the loss of utility property in January, 1935. Foodstuffs had provided about a quarter of the receipts during the twenty-three months' life of the law of 1933. As the argument continued, it took on the aspects of a struggle between the two houses by reason of the "Epic" strength in the Assembly. In May the joint legislative committee on revenue and taxation recommended the exemption of foodstuffs, a sales tax of 3 per cent on all other sales, a use and storage tax, and the inclusion of rentals and leases as taxable. Said the report:

"The committee has studied the operation of the sales tax and the yield from it over the past two years and has tried to make a reasonable estimate of what may be expected in the next biennium. There is a definite upswing in prospect, both in volume and in price. The receipts from the first of this year are about 15% above those in the first quarter of last year. Indications are that the increase will continue for the next two years. Considering governmental and trade reports, and the present trend, the committee feels justified in counting upon at least a ten per cent increase over present levels for the next two years.

"The deduction in revenue on account of the exemption of foods has been liberally estimated. Any steps that may be taken by the Legislature in restricting the exemption of foodstuffs that may properly be called essential, will be reflected in a corresponding increase in revenue.

"The budget estimate of the sales tax at 2 per cent, with no exemptions, for the coming biennium was $84,000,000. The committee's estimate for the 3 per cent rate with food exempt is $119,500,000. The net additional revenue from this source is therefore $35,000,000. [The minority report estimated the revenues with food exempt as $25,000,000.]

"The estimate of the yield under Assembly Bills Nos. 1271 and 1273 is an additional $4,800,000. . . . The committee has taken an amount which is well under the first estimate made by the sponsors of the bill."[23]

After this report, the legislature amended the retail sales tax by the passage of three bills: the Hunt bill, as amended, exempting foodstuffs and raising the rate on the sale of other commodities to 3 per cent; a bill which included leases and rentals among taxable transactions; the use tax bill, which attempted to extend the tax to purchases made outside the state. The exemption of foodstuffs passed the Assembly 54 to 25 and the Senate 34 to 3. The vagueness of the law with respect to the exemption of essential foodstuffs evoked a decision of the State Board of Equalization exempting almost everything sold in grocery stores.[24]

These laws went into effect July 1, 1935. So far as consumption with food exempted is a better index of ability to pay than consumption with food included, the California sales tax became less regressive under the new law.

In the early months of administration the returns showed that the sales tax was going to raise more than the estimated $4,000,000 monthly.[25] Between August 1, 1933, and June 30, 1934, the receipts were $46,180,388.63 exclusive of the fees for retailers' licenses. During the year the tax averaged about $4,200,000 per month, and between twelve and thirteen million dollars a quarter.[26] Either improved administration or improved business conditions resulted in a steadily rising volume of receipts each quarter of its operation. The tendency of the tax to bear harder upon urban than upon rural districts was shown in the fact that Los Angeles County paid $19,000,000, or 41 per cent, and San Francisco County paid $7,650,000, or 15 per cent, of the tax.[27] Food stores, including groceries, meat markets, bakeries, vendors of dairy products, fruit, and vegetables, but excluding general stores that sell food incidentally, paid a little more than 23 per cent of the entire tax; dry goods and department stores were second, motor vehicle dealers third, and restaurants fourth.[28] Exclusive of retailers' license fees,[29] returns from the retail sales tax were:[30]

1934 (11 months)	$46,180,388
1935	55,162,463
1936	68,520,644*

* Includes the returns from the use tax.

Since the California courts have generally construed the state's taxing powers liberally, the legislature probably would have been upheld in the passage either of an income or of a sales tax; the Riley-Stewart amendment left no doubt about the state's power to levy either. During the campaign for the amendment, the tax was certainly understood to be the outgrowth of a favorable referendum. Fearful lest a decree of unconstitutionality directed at a part of the act would invalidate the whole, resulting in loss for the state of the much-needed revenue, the legislature inserted in the sales tax act after the most debatable sections (those dealing with motor fuel, with shifting) the provision that the fate of these sections in the courts was not to affect the validity of the rest of the act.[31] Court tests of the act came early. In November, 1933, within fifty days from its effective date, five hundred Los Angeles merchants filed suit and demanded the return of the taxes so far paid. These merchants contended that the law was irregularly introduced in the legislature, that it violated the uniformity clause of the Fourteenth Amendment to the Federal Constitution, and that as an urgency measure it was not properly passed[82] and therefore should not have become effective until ninety days after the Governor had signed it. In the case of N. H. Schur of Santa Monica, who complicated the matter by being a tango operator, the Sacramento Superior Court in December, 1933, upheld the constitutionality of the sales tax. With respect to the charge that the sales tax was not uniform in its application, the court said:

"It is well settled that in order to meet the requirements of uniformity it is not necessary that a general law have a universal operation. It may properly exempt from the operation a class founded upon some natural, intrinsic or constitutional distinction. The determination of the propriety of the exemption is primarily for the legislative power, to be determined in the light of its knowledge of all the circumstances and requirements.

"Certainly the exemption of property which this State is prohibited from taxing is proper."

Concerning the charge that the act was not in valid effect until ninety days after the Governor's signature, the court remarked:

"The power to levy taxes for governmental support is such an inherently necessary governmental activity, vital to the performance of the functions for which the government exists, that this court cannot be led to place a restriction upon that legislative power which does not necessarily follow the language of the section of the Constitution referred to.

"Surely the people did not intend that every appropriation and every tax levy might be delayed and subject to possible defeat through referendum. The common insistence upon stability and certainty in government refutes such an intent."[83]

The attack on the law of 1935 was made by the restaurant proprietors, who believed that food sold in restaurants should be included in the provision exempting food for human consumption. Since restaurants were fourth in the percentage of revenues in the classification of forms of business by amount of tax receipts, the legislature had not relinquished so important a source of revenue, and food sold in restaurants had remained taxable when food sold in stores was exempted. In the test case, wherein Dan Dicktakes of Sacramento asked for a writ of review of the decision of the State Board of Equalization in revoking his permit as a retailer, the California Supreme Court upheld the constitutionality of the 1935 law in exempting food.[34]

Contrary to the opinion of classical economists such as Adam Smith, administration of the sales tax has proved quite possible. California's history has been like that of other states in this respect. Agreeably surprised at the ease of collection, fiscal officials have perhaps been led to underestimate the problems which need to be solved when the tax is applied.[35] The next section of this chapter will analyze these problems, which are four: the construction of administrative machinery; the definitions of retailer and of retail sale; the shifting or incidence of the burden; and the question of interstate commerce.

The first problem, that of administrative machinery, was apparently easy to solve with machinery already in existence. By the Act of 1933, administration was confided to the State Board of Equalization, which was authorized to make such rules and appoint such accountants, auditors, investigators, and assistants as it might deem necessary to collect the tax.[36] There were two checks on the possible arbitrary conduct of the board: it was ordered to report annually to the State Controller, and its every official act was made subject to judicial review if the suit was brought within sixty days after service of notice.[37] Efficient administrative machinery is essential to the success of a tax not hard to administer, but hard to administer well. The very number of taxpayers creates the necessity for a large and competent staff, especially for the State Board of Equalization in its work of auditing. The board has organized a sales tax division with a chief thereof whose staff is of two sorts, legal and accounting. The legal staff is concentrated in Sacramento, since it can be most effective there. For auditing and inspecting, the state is divided into thirteen administrative units, each with its sales tax accounting staff.

Upon the retailer rests the burden of collection.[38] He is made directly responsible for the payment of the tax, which is assessed at 2½ per cent (to June 30, 1935) and 3 per cent (after July 1, 1935) of his gross receipts from all sales. The tax is due quarterly, an arrangement which suits the convenience of state and retailer better than the annual plan, which does not ensure a steady return to the state, or than the monthly report, which is extra work for the retailer. On the fifteenth day of the month following the close of each quarter, the retailer must fill out and file with the State Board of Equalization a complete statement of his gross receipts, and must send with this report the amount of the tax and any other information the board requires.[39] His books are open to inspection by the board or its authorized agents, who are penalized for divulging any information thus acquired. One of the most difficult problems of administration arose in connection with the small shopkeepers who do not keep books systematically. Errors were innocently made many times, especially in differentiating between exempt and taxable transactions.[40] Retailers have objected, also, to being made bookkeepers gratis for the state.

It would be strange if evasions were not frequent under a system in which the taxpayer assesses himself. If the retailer fails to file a return on the day appointed, he is penalized 10 per cent of the amount of his tax plus interest at ½ per cent a month from the date the tax was due. The board may require the retailer to deposit security with it, and may even sell such security at auction for the payment of the tax. The board may, at any time within three years, make additional assessments if it believes that the retailer has not reported correctly; it may make arbitrary assessments for failure to make a return, or jeopardy assessments if it believes that the collection of the tax will be endangered by delay; all these bear the same 10 per cent penalties with ½ per cent interest as does neglect to file return. If the board believes that the neglect or understatement was due to fraud or wilful evasion, the penalty becomes 25 per cent. Moreover, any retailer refusing to make a return or filing a fraudulent return is subject to certain penalties. These penalties enable the board to enforce collection, though since it is obviously impossible to make a careful check on the books of the 200,000 California retailers the board has concentrated upon a few well-advertised examples.[41] The taxpayer's protection against unjust treatment in assessments is to petition the board within fifteen days after receipt of notice for a reassessment; if then he is not satisfied, he must file suit in any court of Sacramento County within sixty days after the tax is due.

Under this machinery the costs of collection have been comparable to the costs in other states, which average between 2 and 3 per cent of the returns. In California under the 1933 law the cost of the collection of the sales tax was about 2.5 per cent of the total returns, which included the collections from the tax and the retailers' permit fees. By section 29 of the law, the total receipts from the retailers' permit fees were assigned to care for costs of collection; when these fees were subtracted from the total, the remainder of the cost was much less, being approximately 1.7 per cent for the first year, 1933–1934. By reason of the subtraction of the fees, the public has come to underestimate the cost of collection. The State Board of Equalization spent during 1933–1934 the sum of $840,000, of which $586,000 went for wages.[42]

Though problems of evasion and fraud present themselves in the administration of every tax, the sales tax has peculiar problems of its own. Chief among these, if one may judge from the number of rulings the State Board of Equalization has made on the subject, is the question, Who is a retailer? By definition and by the requirement of a license for all retailers, the law of 1933 sought to answer the question. "Retailer" was defined as "every person engaged in the business of making sales at retail." All retailers were required to obtain from the State Board of Equalization a permit to do business in the state; they must apply within thirty days after July 1, 1933; the fee was $1.00 for each permit, and each place of business required a permit. Failure to comply with the law or the rules of the Board of Equalization was reason for revocation of the permit. The law of 1935 required that these permits be renewed before August 1, 1935. California was rather more efficient than most states in finding the number and location of the taxpayers.[43]

These provisions, however, did not solve the problem, which is so intricate that many of the board's decisions seem hairsplitting. Agents, peddlers, canvassers, for instance, are left to the board's determination of whether they are retailers or retailers' employees.[44] Just as truly as is the corner grocer a retailer when he sells to the housewife, so manufacturers or wholesalers become retailers when they sell machinery or supplies directly to another factory or wholesale house for consumption there; many of those firms that had advocated the passage of the sales tax were disagreeably surprised at this development.[45] Vendors of those goods that enter both into consumption and into manufacture present especially troublesome problems. Hatcheries, for instance, are retailers when they sell eggs for consumption, wholesalers when they sell to poultry farms or grocery stores; plant nurseries are retailers when they sell seeds to gardeners, wholesalers when they sell to farmers if the products raised from them are to be sold.[46] Careful bookkeeping is necessary to distinguish between wholesale and retail sales. The vendor can save himself the tax by requiring the purchaser to give a certificate stating that the goods are for sale.[47] The certificate does not always solve the problem, because the destination of the goods cannot always be known at the time of purchase; under such circumstances the vendor may estimate the percentage his retail sales bear to his total volume of sales, unless the board has make a working estimate that applies to his particular type of business.[48] Charitable organizations, unless their goods are sold directly to the needy, are retailers;[49] auctioneers and tango operators are so classified also.[50]

The connection between retailers and vendors of services which are not taxed is particularly close in urban life. The businesses involved are of three types: those the services of which are given as an incident in the sale, as in the installation of heating plants or the alteration of clothes;[51] those which are frequently half service and half retail, as are the businesses of garage men and plumbers, electricians and contractors;[52] those which give services primarily and sell articles but incidentally, as do barbers, operators of beauty parlors, repairmen, bookbinders, dentists, oculists, painters, bootblacks, photographers, and morticians.[53] The chief problem here is to prevent the tax from falling upon the service. In many of these businesses it is next to impossible to distinguish between the man as retailer and the man as contractor. If separate accounts for services and sales cannot be kept, the general character of the business is taken into account.

Retail sales are as difficult to define as retailers. Here also the law attempts to help by declaring that a "retail sale" or "sale at retail" means a sale to a consumer or to any person for any purpose other than for resale in the form of tangible personal property. "Retail sales" were to include credit sales, and leases and rentals. "Sale" means "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property, for a consideration, and includes the fabrication of tangible personal property, for consumers who furnish either directly or indirectly the materials used in the fabrication work and the furnishing, preparing or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing or serving such tangible personal property. A transaction whereby the possession of property is transferred but the seller retains title as security for the payment of the price shall be deemed a sale."[54] These definitions, however, settled the question only for regularly licensed retailers.

There also arose the questions of sales by persons not retailers, sales of goods which might either be consumed or resold, sales connected with services; in addition, there were questions of credit sales, sales of feed and fertilizer, sales of containers, tags, labels, name plates.[55] The intent of the legislature and the ruling of the State Board of Equalization were: "Gross receipts from sales to manufacturers, producers, or processors of tangible personal property which enters into and becomes an ingredient or component part of the tangible personal property which they manufacture, produce or process, are not taxable. The fact that the article manufactured, produced, or processed is in a different form or of a different character is immaterial."[56]

Gross receipts from leases and rentals became taxable under the Act of 1935.[57] Credit sales, the gross receipts of which were taxable under the Act of 1933, but with a provision that enabled the retailer to pay the tax when he collected the amount from the purchaser, are taxed in full since 1935 at the time or during the quarter of the purchase.[58]

Viewed from the social aspect, the most important sales tax problem and the one most difficult of just solution is that of incidence. Although the responsibility of the state administration ends when the tax has been collected from the retailer, the intent of the law of 1933 was that the tax should be passed to the consumer "in so far as the same can be done."[59] Beyond setting the tax at a high rate (high rates have generally made shifting easier) and making it illegal for anyone to advertise that he was absorbing the tax, the legislature did not explain how shifting was to be done. In the belief that people should be made tax conscious, the State Board of Equalization ruled that the tax was not to be hidden in the price, but invoiced separately through to the consumer.[60] Otherwise, the state left the retailers to work out their own means for making the consumer pay the tax.

The retailers lost no time in devising an appropriate machinery. Though the law permits the use of revenue stamps and tokens, the use of these had not become familiar in the various states in 1933, when retail sales taxes were comparatively new. After the feasibility of stamps and tokens had been discussed for about a month, the merchants fell back upon a device already in use among some of them—the schedule, or "breakdown." In the first month the tax was in operation and before the courts had passed on its constitutionality, the general confusion had forced the retailer to absorb most of the tax he had saved himself by developing the breakdown, by which he charged the customer the price of the article plus a certain percentage for tax. Obviously, the exact amount of the tax could not be charged to the customer, since 2½ per cent of the amount of the purchase would usually come out at a fraction of a cent. Collection of a tax upon small purchases would also be troublesome. The breakdown was devised to collect the tax to the nearest fraction of a cent, so that the result would approximate 2½ per cent of gross sales during the quarter. Accordingly, some consumers would pay a high rate, even 6 per cent, on a sixteen-cent article, whereas others would pay a low rate, as on a fifty-nine-cent purchase; those whose purchases were less than fifteen cents paid no tax at all. The breakdown clearly discriminates against ten-cent stores and groceries, for purchases of their wares could often be kept under the fifteen-cent line. On the whole, however, the breakdown was a rough approximation of justice. At first the State Board of Equalization was skeptical about its use; but when the retailers generally protested that the use of slugs, stamps, or tokens would be troublesome, the board prescribed the schedule, in September, 1933, for general use. The breakdown under the law of 1933 was as follows:[61]

Sales	Tax	Sales	Tax
$0.01 to $0.14	No tax	$1.06 to $1.49	$0.03
0.15 to 0.59	$0.01	1.50 to 1.90	0.04
0.60 to 1.05	0.02	1.91 to 2.30	0.05

Over $2.30, additional cent for each 40 cents of sale price

The Act of 1935, by raising the rate to 3 per cent and exempting foodstuffs, made a new breakdown necessary. The schedule adopted was more elaborate than the previous one:[62]

Sales	Tax	Sales	Tax
$0.01 to $0.14	None	$2.17 to $2.49	$0.07
0.15 to 0.49	$0.01	2.50 to 2.83	0.08
0.50 to 0.83	0.02	2.84 to 3.16	0.09
0.84 to 1.16	0.03	3.17 to 3.49	0.10
1.17 to 1.49	0.04	3.50 to 3.83	0.11
1.50 to 1.83	0.05	3.84 to 4.16	0.12
1.84 to 2.16	0.06		

This sort of ascent continued, each dollar of price adding three cents more to the sales tax. The schedule of 1935 is in use at the time this chapter is being written.

The legality of this breakdown was tested in the courts of San Diego County by a suit brought in August, 1935; it was declared illegal, on the ground that the one-cent tax on a fifteen-cent article is a 6 per cent, not a 3 per cent tax. When the state appealed the decision, the Supreme Court upheld the lower court's verdict and likewise declared the breakdown illegal.[63] The court's pronouncement was unsettling to the administration of the tax. The State Board of Equalization announced that it would demand the use of tokens; a token of ⅛ cent would be the sales tax on a five-cent purchase. The tokens were neither to carry the state seal, nor to be backed by the state credit, but were to be "merchant money," to be used only in payment of the tax.[64]

Most states have been faced with the problem of legal avoidance because sales made in interstate commerce are not subject to state taxation. Because of this fact, state retail sales taxes really act as subsidies to interstate at the expense of intrastate commerce. California is more fortunately situated than other states in this respect, in that she has no large shopping or commercial center near her borders, and thus avoids the sort of situation found in the Rock Island, Moline, and Davenport area, and in New York City.[65] For most articles, mail-order houses are the only competitors of California firms, although this was not true with certain high-priced articles such as automobiles, whose purchasers often saved the tax by sending or going East for them. The State Board of Equalization ruled that when goods were sent from outside directly to the consumer they could not be taxed, as being in interstate commerce, but that when they came to rest inside the state in a warehouse or storage room before delivery they were in intrastate trade. Although it is difficult to obtain figures, this avoidance of taxes reached proportions sufficient to induce representatives of the State Board of Equalization to propose that Congress be petitioned for the right to collect a sales tax on interstate commerce. They later joined representatives of Indiana in a delegation to Washington for laying the idea before the proper congressional committee.[66]

The outcome was the passage of the Use Tax Act by the legislature of 1935.[67] Because of certain decisions made by the United States Supreme Court in connection with the sale of gasoline and alcoholic beverages, some students of taxation conceived the idea that a use tax would not be pronounced unconstitutional. According to this act, all tangible personal property purchased from firms outside California, brought or sent to this state, is taxed to the user, at the same rate and with the same penalties and procedure as are applied to goods sold within the state. If the vendor maintains an agency in California, he may pay the tax as retailers in the state do, and may receive a certificate of payment;

if the vendor has not received authority from the board to pay the tax, the purchaser must do so.[68] The constitutionality of the use tax is being tested in the courts at the time this chapter is being written. By the passage of the act the legislature believed that it had solved the problems arising from the competition of state firms with the attendant paralyzing of intrastate trade.

There remains the minor question of the taxability of sales to ships plying the high seas. Sales to a ship's commissary are not taxable, because they are judged to be sales for resale.[69] Sales of fuel oil are taxable, because in these sales the vessel is regarded as the final consumer.[70]

He who would prophesy about the future of the sales tax in California would be venturesome indeed. Its existence is a presumption in favor of its continuance, because emergency taxes often find permanent places in fiscal systems. In California the position of the tax is strengthened by the fact that it was not a mere stopgap, but part of a fundamental reorganization of the state's revenue structure.[71] A few months ago the tax appeared more likely to last than seems now to be true. In the last two months of 1935, opposition to it took clearer form. In view of its present equivocal status, we are justified in attempting analyses of the attack upon it and the defense of it.

Besides those economists who disagree in principle, the opponents of the sales tax naturally are people who believe it to be detrimental to their interests: retailers, consumers, members of labor unions and the state farm organizations. In California, as elsewhere, the general effect of the tax has been deterrent to business. Although a few retailers may have made money from it, most of them have barely recouped the amount of the tax, or have suffered losses. By allowing a fifteen-cent exemption, the breakdown has been weighted against businesses of low-cost articles, such as grocery stores and ten-cent stores, since the retailer must pay the tax on his gross sales, whether he is able to shift it or not. It is doubtful also whether retailers were really able to shift the whole of the tax, because the buying power of the individual consumer did not rise. There must have been many choices in favor of cheaper goods, and many curtailments of nonessentials; sales of food were little affected either before or after the exemption of 1935, since people must eat; and this inflexibility of an essential must have affected luxuries.[72] An absolute determination of the effect of the tax is impossible because the tax was after all a minor factor in the 20 per cent rise since 1932 in the cost of living and because this rise has been accompanied by an increase in public expenditures and in reëmployment which has modified whatever effect advances of prices have had upon business. We may say that purchasing would have been greater without the tax. At any rate, retailers feel themselves not only annoyed, but hampered by the tax and its attendant bookkeeping. During the winter of 1935–1936, they have made an effort to influence public opinion against the tax by attacking it in the advertising circulars which they are in the habit of distributing to customers.

Consumers as a class remain as voiceless as when the tax was first enacted. They cannot assume the whole burden of the tax unless they have an unspent surplus or increased wages. So far as these factors and increased employment have given them more to spend, the individual has been able to assume the tax and maintain his standard of purchasing. Where income has not been increased, a situation true for the majority, he has had to curtail his savings, his purchases, or his other expenditures such as rent. With respect to the last two, he has passed the tax in part at least back to the producer or to the landlord. The sales tax falls with exceptional weight on people of lower incomes because so much larger a share of their expenditures goes for taxable necessities. Moreover these are the same people who through home ownership or rent of small overvalued properties pay an undue proportion of the general property tax. Consumers, however, have no general combination of their own and are inarticulate except as they can express themselves in other organizations such as the Federation of Labor and the Grange, or by their votes as they may have opportunity.

From the first, the California Federation of Labor has preferred a selective sales tax to one on retail sales. This organization was somewhat satisfied, but not entirely so, by the exemption of food. It has reaffirmed its original position often since the tax laws of 1933, and in its statement on the subject in November, 1935, at a state convention, announced that it was initiating the repeal of the tax by referendum in the general election of 1936.[78]

Farmers' organizations have come to support the sales tax. The Grange gave its official though reluctant consent to the enactment of the tax in 1933. Naturally, the argument that the tax would reduce the burden on land was attractive to farmers and ranchers. Since that time they seem to have discovered that the sales tax hurts the farmer as consumer more than it helps him as landowner, for in November, 1935, at a meeting of the Grange in Sacramento, the members passed resolutions favoring income and inheritance taxes and opposing general and retail sales taxes, "as foisted upon the masses by corporations and large property holders seeking to unload their taxes, and not as based upon ability to pay."[74] The California Farm Bureau Federation favored the selective sales tax in 1933, and in 1935 supported a sales tax continuing the 2½ per cent rate, the inclusion of leasings, rentals, and interstate sales, and the exemption of spray oils. It opposed the amendments of 1935 as finally passed. As is to be expected, the Farm Bureau is actively opposing the repeal of the sales tax in 1936, because it believes that the state deficit makes the money necessary, and because it fears adoption of the single tax.[75] With adoption of the income tax, the hope that these two new taxes will bring relief from the general property tax has brought the farmers of the state to look on the sales tax with favor.

The opposition to the sales tax has coalesced in the Sales Tax Repeal Association, with headquarters both in northern and in southern California. This association has obtained the necessary number of signatures to a petition for submitting to referendum at the general election of 1936 a constitutional amendment for the repeal of the sales tax and a prohibition of all such taxes in the future. But alas for the student of finance who would desire a clear-cut expression of opinion upon this question alone, this same amendment proposes to substitute for the sales tax a tax on land values, especially unimproved land, and natural resources. In addition to the provision for the repeal of the sales tax and a prohibition of such taxes in the future, the amendment provides for the repeal of that part of Senate Constitutional Amendment No. 30 which provides for a 25 per cent tax limitation on real estate; and for the substitution of a tax on land values, the exemption of homestead improvements to the value of $1,000, and of improvements for five years at the rate of 20 per cent per annum, thus paving the way for the complete exemption of tangible personal property and improvements.[76] This proposition for the repeal of the sales tax is being opposed by the State Tax Equalization League, which consists of representatives from the Farm Bureau Federation, the California County Tax Equalization Association, the Economic Council of Southern California, the California Teachers' Association, the State Supervisors' Association, the State Department of Education, Alta California, and the State Association of County Auditors. To this list must be added the actively opposed real estate associations and the State Chamber of Commerce.

Opponents of the sales tax can base their reasoning on the orthodox economic theories of the last two hundred years. During most of the modern period, ability to pay has been the accepted principle concerning the incidence of the tax burden. Economists have regarded sales taxes as survivors of the medieval system, and have believed that they retarded the natural flow of commodities and were an unwarranted interference with business. Economists especially have opposed the practice of hiding the tax in the price so that the final taxpayer did not know how much he was paying. They have looked with disfavor on a tax that does not stay where it is put. Their reasonings have by no means lost their cogency. The sales tax is "based not on ability to pay but on necessity to consume, bearing with greater weight on persons with small incomes and large families than it does on those with large incomes and small families."[77] The former generally pay a larger percentage of their incomes in taxes than do people of larger incomes.

Support of the sales tax comes from many quarters. The California Real Estate Association has been a power in its behalf since the beginning. Those who believe that they will suffer more from other taxes if the sales tax is repealed are naturally in favor of it. The state council of the California Teachers' Association, at a meeting in Los Angeles in December, 1935, although it conceded the regressive character of the tax, pronounced itself in favor of it and opposed repeal until some equally productive substitute is found for the support of the schools.[78] This attitude will make a deep appeal to parents who are interested in their children's education. The state fiscal administration, the Governor, the Controller, the Board of Equalization, and the legislature are in favor of the sales tax. There has been organized the Economic Council of Southern California to fight for its retention.[79] The press, although not so loud in its praise as in 1934, is still pleased with the sales tax. The arguments, of varying degrees of validity, which are advanced by these friends of the tax are that it will relieve the burden upon real estate; that it is a just and little felt tax; that it is in conformity with the benefit principle; that it is easy to collect; that it is productive; and that it is better than any possible alternatives.

The promise of 1933 that the decline in the county general property tax rate would offset the burden of the sales tax has not been kept. The average taxpayer would need to own real property valued at $25,000 before his general property tax would equal the amount the average family pays in sales tax.[80] He does not always realize this fact, for he pays his general property tax at once, his sales taxes in penny driblets. Though the county tax rate in California was lowered during 1933, it has since been increased, until for most counties it was almost as high in 1935 as when the schools derived their support from the property tax. Relieved of the support of schools, the counties have taken up the slack and spent the money elsewhere. Unless the county rate is lowered permanently, the people of California will only have saddled themselves with another tax.[31]

The argument based on the justice of the tax has various forms. Some friends of the sales tax take ability to pay as their principle, and say that it taxes all alike, since everyone pays the same amount on the same purchase. We have seen that a tax which exacts an equal tribute from every income irrespective of its size does not result in an equality of tax burden. Friends of the tax also fall back upon the principle of benefit as being equally just, if not more so, than that of ability to pay; regression, they say, is defensible, especially when the revenue obtained is used for schools, since the people who pay the largest share are those whose children receive the benefit from public education. However valid this argument may be, it certainly seems lacking in its appreciation of the fact that the community as a whole is the better for an educated citizenry, and that therefore a larger regard might be given to ability to pay and somewhat less significance attached to the outworn doctrine of individual benefit. It is further argued in the name of justice that the sales tax reaches people who otherwise would not contribute substantially if hardly at all to the support of government. Yet property taxes and other levies of federal, state, and local governments bear heavily upon the very same people who carry the sales tax.

Some importance, but clearly not too much, may be attached to the view that the sales tax by bringing home to everyone the cost of government thereby contributes to economy in the conduct of the public business. Productive the sales tax surely is, and adequacy as a fiscal canon must be given its due weight. That there may be no alternative to the sales tax except closing schools or lowering the quality of education will cause the people of the state to hesitate before they surrender its rich returns. At the Governor's conference on taxation, February 3 and 4, 1936, Governor Merriam told the representatives of all classes of business in the state that he could see no other means of providing the money which the state returns to the counties for schools. The money collected has been returned to the counties in proportion to the school population so that counties poor in finances but rich in school children have received more money than under the former system. The sales tax will in all probability remain unless some other method of financing the schools can be found or unless recovery from business recession greatly increases the state's revenue from other sources.

The sales tax need not stay at its present high rate of 3 per cent. Even with food exempted, the returns have risen because of the upswing in business. If $50,000,000 a year is adequate, why place the rate where the returns will be $67,000,000? Either exemption of low-cost articles, or preferably a lowering of the rate, would be the next logical step. California has one of the highest rates in the United States. Why not as a minimum program, lower it when the state deficit has been reduced?[53]

NOTES TO CHAPTER VII

[1] Although the material for this chapter has been drawn from the official sources which have been cited previously in other chapters, there are interesting accounts which proved helpful here: Robert M. Haig and Carl Shoup, *The Sales Tax in the American States* (New York: Columbia University Press, 1934), pp. 288–298; Elmer D. Fagan, "Fiscal Policy in California during the Depression," in *Taxbits*, vol. II, no. 3 (January, 1935); two articles by Fred D. Bullock: "California's Retail Sales Tax Act of 1933," in *Tax Digest*, vol. XI, no. 9 (September, 1933), p. 296, and "California's Sales and Use Taxes," in *ibid.*, vol. XIII, no. 9 (September, 1935), p. 295. Helpful also, though in a more general way, were Beulah Bailey, "Sales Taxes in the States," in *ibid.*, p. 304; Alfred G. Buehler, *General Sales Taxation* (New York: The Business Bourse, 1932); and National Industrial Conference Board, Inc., *Sales Taxes, General, Selective, and Retail* (New York: National Industrial Conference Board, Inc., 1932).

[2] Report of the Joint Legislative Tax Committee, *Senate Journal* (1933), pp. 2113–2117.

[3] *Final Report of the California Tax Commission* (Sacramento, 1929), p. 7.

[4] *Report of the State Board of Equalization* (1932), p. 11.

[5] *Summary Report of the California Tax Research Bureau* (Sacramento, 1932), p. 11.

[6] *Report of the California Tax Research Bureau* (Sacramento, 1933), pp. 129–137.

[7] *Senate Journal* (1933), pp. 509, 512, 693, 1054.

[8] *Senate Journal* (1933), p. 581; *Assembly Journal* (1933), p. 3057. In 1928 the joint committee of the California Real Estate Association, the State Land Title Association, and the State Building Owners' and Managers' Association proposed a sales tax for the support of schools. See Robert M. Haig and Carl Shoup, *The Sales Tax in the American States*, p. 291.

[9] The states having gross sales taxes in 1932 were: Connecticut (1921), Delaware (1906), Georgia (1929), Mississippi (1930), Pennsylvania (1821), and West Virginia (1921). Pennsylvania's tax was very low; three of the others had high exemptions; Missouri (1909) had a local turnover tax; Kentucky (1930) had a tax on the gross sales of retailers. In 1933 Arizona, California, Illinois, Indiana, Michigan, New York, North Carolina, Oklahoma, South Dakota, Utah, and Washington passed sales taxes, most of them retail sales taxes. For the situation at the present time (July, 1936), see "The Decline of the Sales Tax," in Tax Policy League, *Taxbits*, vol. III, no. 8 (June, 1936).

[10] *Senate Journal* (1933), p. 2113.

[11] See *infra*, p. 220, for comment on this argument.

[12] "Whether the financial condition of the state and localities would have forced passage of a sales tax in the absence of that plan must remain an open question. Certainly there would have been an insistent demand for new revenue, and the example of other states would have been sufficient to draw the attention of legislators to the sales tax. Furthermore, many of the interests responsible for the passage of the Riley-Stewart plan would doubtless have advocated the sales tax as a method of redistributing the burden of taxation, if their broader program had failed."—Haig and Shoup, *op. cit.*, p. 290. For the attitude of the Federation of Labor, see *Senate Journal* (1933), p. 3379. For the attitude of the Grange, see *ibid.*, p. 3465.

[13] The organizations consenting were the California Retail Merchants' Association, the California Merchants' Association, The San Francisco Merchants' Association, the Alliance of Retail Trade Associations of Northern California, the California Retail Grocers' and Merchants' Association, California Retail Lumbermen's Associations, the California Real Estate Association, the California Manufacturers' Association, and the Progressive Merchants' Association, which last represented the chain stores. See *Senate Journal* (1933), p. 3342.

[14] Haig and Shoup, *op. cit.*, p. 293. Ray L. Riley, in "Sales Taxes as a Supplemental Source of Revenue Administration," National Tax Association, *Proceedings* (1934), stated (p. 111): "We of California who are charged with the responsibility of administering the sales tax were privileged to write the legislation, with Dr. Traynor as the chief draftsman in charge."

[15] *Senate Journal* (1933), p. 3398; *Assembly Journal*, II (1933), 3057.

[16] *Cal. Stats.* (1933), ch. 1020, p. 2601.

[17] Elmer D. Fagan, "Fiscal Policy in California during the Depression," Tax Policy League, *Taxbits* (January, 1935).

[18] *Report of the State Board of Equalization* (1934), p. 11; *Biennial Report of the State Controller* (1934), p. 10.

[19] *Budget of the State of California for the Biennium 1935–1937*, sec. VII.

[20] Frank F. Merriam, "The State Budget," *Tax Digest* (March, 1935), p. 89. This article is Governor Merriam's address before the ninth annual meeting of the California Taxpayers' Association, held in Los Angeles, February 15, 1935.

[21] Senator Schottky introduced virtually the same selective sales tax that had been considered in the legislature of 1933. See Senate Bill No. 929, *Senate Bills and Resolutions* (1935); *Final Calendar of Legislative Business* (1935), p. 307.

Assembly Bill No. 122, introduced by twenty-eight members, was the essence of the "Epic" program in the Assembly. See *Assembly Bills and Resolutions* (1935); *Final Calendar of Legislative Business* (1935), pp. 94, 157. Senator Olson's bill, Senate Bill No. 39, was the "Epic" bill in the Senate. See *Senate Bills and Resolutions* (1935).

[22] Senate Bill No. 80 called for the continuation of the 2½ per cent rate; Senate Bill No. 928 would extend the sales tax to gasoline; Senate Bill No. 551 was very like Assembly Bill No. 1208 and would extend the tax to leases and rentals of tangible personal property; Senate Bill No. 710 would exempt the gross receipts of sales of medicines to hospitals. Assembly bills to exempt food were Nos. 122, 761, 862, 1208, 1225, 1565, 1858; Assembly Bill No. 1845 called for the exemption of sales of spray for citrus and deciduous fruit trees; Assembly Bill No. 1871 would legalize the use of tokens; No. 2276 would permit the tax to be collected either hidden in the price or separately from it. See *Final Calendar of Legislative Business* (1935), *passim; Senate Bills and Resolutions* (1935); *Assembly Bills and Resolutions* (1935).

Most of these bills never went beyond committee, but they are mentioned here to show the divergence of interest and of opinion over the sales tax in the legislature of 1935.

[23] Report of the Special Joint Legislative Committee on Revenue and Taxation, *Senate Daily Journal* (May 15, 1935); *Tax Digest*, XIII (June, 1935), 188. For the minority report signed by Senator Jespersen, see *Senate Daily Journal* (May 17, 1935), p. 204. See also C. C. Cottrell, "California's Finances," in *Tax Digest*, XIII (March, 1935), 82.

[24] The 1935 amendments to the Retail Sales Tax Act of 1933 were four, of which the first was concerned with unimportant administrative detail (*Cal. Stats.* [1935], ch. 351, p. 1226); the second was the exemption of food (*ibid.* [1935], ch. 355, p. 1252); the third amended the bill generally and added the provisions regarding leases and rentals (*ibid.* [1935], ch. 357, p. 1256); the fourth was the use tax (*ibid.* [1935], ch. 361, p. 1297), discussed later in this chapter. For the ruling mentioned see State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 231.

[25] *Report of the State Board of Equalization* (1934), p. 167.

[26] A. E. Stockburger, State Director of Finance, "Report to Governor Merriam," as quoted in the *Los Angeles Times*, November 2, 1934.

[27] *Report of the State Board of Equalization* (1934), p. 167.

[28] Sales collections according to classification of retailers for the fiscal year ended June 30, 1934 (*Report of the State Board of Equalization* [1934], p. 174):

Classification	Tax collected	Percentage
Bakeries and caterers	$ 503,366.24	1.09
Beer parlors	198,575.67	.43
Bookstores	133,923.13	.29
Cigar stores	424,859.58	.92
Clothing stores	2,489,122.95	5.39
Concessions and tango games	60,034.51	.13
Confectionery	277,082.33	.60
Dairy products	1,126,801.48	2.44
Department, dry goods, and general stores	5,476,994.09	11.86
Fruit and vegetable stores	632,671.32	1.37
Drugstores	2,115,061.80	4.58
Furniture and floor coverings	1,930.340.24	4.18
Garage, accessories, etc.	3,043,287.61	6.59
Grocery stores	7,301,119.44	15.81
Hardware and farm implements	1,048,294.82	2.27
Heating and plumbing	355,588.99	.77
Jewelry	309,408.60	.67
Lumber and building material	1,916,486.78	4.15
Meat markets	1,228,389.34	2.66
Motor vehicle dealers	3,657,486.78	7.92
Office, school, and store supplies	341,734.88	.74
Radio and music stores	253,992.14	.55
Restaurants	3,634,396.59	7.87
Secondhand stores	230,901.94	.50
Shoe stores	729,650.14	1.58
Stationers and printers	1,057,530.90	2.29
Variety (5 and 10, etc.)	997,496.38	2.16
Vending machines	60,034.51	.13
All other retailers	4,645,747.10	10.06
	$46,180,388.63	100.00

[29] $210,981 for the fiscal year 1933–1934. See *Biennial Report of the State Controller* (1934), p. 47.

[30] *Report of the State Board of Equalization* (1934), p. 167; Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[31] If the exemptions of the Act of 1935 are declared unconstitutional, the rate of the tax becomes 2 per cent, as under the Act of 1933. See Retail Sales Tax Act of 1935, sec. 5, note, *Revenue Laws of California* (1936), p. 502.

"Where a liberal view of the uniformity provision has been held by the courts of a state the sales tax is likely to be declared constitutional."—National Industrial Conference Board, *General Sales and Turnover Taxation* (New York, 1929), p. 73.

[32] See *California Constitution*, Art. IV, sec. 1.

[33] These quotations are taken from the *Los Angeles Times*, December 11, 1933. Schur's appeal was denied by the District Court of Appeals, which in thus upholding Judge Lemmon's decision did not discuss the constitutionality of the sales tax. See *Schur* v. *Johnson*, 2 Cal. App. (2d) 680.

[34] *Los Angeles Times*, September 11 and 17, 1935.

[35] "Although our Commission has had a rather wide experience in administering a variety of tax laws, we have found our retail sales tax the most difficult and perplexing statute which we have ever tried to administer."—Mark Graves, New York State tax commissioner, as quoted by Mabel Walker, "The Sales Tax on Trial," *National Municipal Review*, XXIV (May, 1933), 258.

[36] *Cal. Stats.* (1933), ch. 1020, pp. 2607, 2611.

"The mechanical equipment and details required to carry on a business of some two hundred thousand accounts is an interesting story in itself. Suffice it to say that every problem of accounting must be met in such an organization."—Ray L. Riley, "Sales

Taxes as a Supplemental Source of Revenue—Administration," in National Tax Association. *Proceedings* (1934), p. 112.

[37] *Cal. Stats.* (1933), ch. 1020, secs. 25 and 33; *Supplement to Revenue Laws of California of 1932* (1934), p. 165.

[38] "The California Retail Sales Tax of 1933 . . . imposes a charge upon the retailer and not upon the consumer. This was held by the United States Circuit Court of Appeals in the case of Meyer Construction Company v. Corbett (1934) 7 Fed. Supp. 616. . . . The court ruled that this issue (constitutionality) could be raised only by the person upon whom the tax is levied, i.e., the retailer, and that the tax was not on the consumer, although it might be passed on to him."—*Report of the State Board of Equalization* (1934), p. 19; *Revenue Laws of California* (1936), p. 501. See also *People* v. *Herberts of Los Angeles*, 3 Cal. App. (2d) 482.

[39] Retail Sales Tax Act of 1933, sec. 9.

[40] State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 49, March 1, 1934; Ruling No. 49, October 1, 1935.

[41] For penalties, overpayments, and refunds, see the Act of 1935, secs. 9½, 20, 23, 24; also State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 65, July 1, 1935.

[42] Following is the explanation of the newspapers' statement that the cost of collection was 1.7 per cent (*Biennial Report of the State Controller* [1934], p. 16): "The cost of administering and collecting the retail sales tax is limited to the revenue derived from permit fees plus 2 per cent of the tax received. The 2½ per cent cost noted above is arrived at by adding the revenue derived from permit fees to that derived from the tax and applying costs against this total. If the amount of the permit fees is subtracted from the cost figure, and the balance of the cost applied against the tax only, the percentage arrived at is less than 2 per cent." For the expenses of the sales tax division of the State Board of Equalization, see *ibid.*, p. 23; *Report of the State Board of Equalization* (1934), p. 26; *Cal. Stats.* (1935), ch. 341, p. 1179 (the Budget Act, which appropriated $3,000,000 for the sales tax division for the biennium 1935–1937).

[43] Act of 1933, secs. 2, 12; State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 42, April 15, 1934. Some of the states attempt to find the retailers by a sort of town-to-town canvass; in others, telephone and street directories have been used. See Haig and Shoup, *op. cit.*, pp. 129, 138.

[44] State Board of Equalization, *Sales Tax Rules and Regulations*, Rulings Nos. 18, 29.

[45] Haig and Shoup, *op. cit.*, p. 581.

[46] State Board of Equalization, *Sales Tax Rules and Regulations*, Rulings Nos. 3, 22, 22½, 56, 121, March 1, 1934.

[47] *Ibid.*, Ruling No. 52, March 1, 1934.

[48] *Ibid.*, Rulings Nos. 17, 41.

[49] *Ibid.*, Ruling No. 8.

[50] *Ibid.*, Ruling No. 62.

[51] ". . . Nor shall 'gross receipts' include the price received for labor or services used in installing, applying, remodeling, or repairing the property sold."—Retail Sales Tax Act, sec. 2 (*f*).

[52] State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 11, April 1, 1934; Nos. 45, 47, March 1, 1934.

[53] *Ibid.*, Rulings Nos. 4, 6, 7, 16, 37, 51, March 1, 1934; Ruling No. 33, January 1, 1935.

[54] *Cal. Stats.* (1933), p. 2599. The part about leases was added by the law of 1935, *Cal. Stats.* (1935), ch. 357, p. 1256.

[55] State Board of Equalization, *Sales Tax Rules and Regulations*, Rulings Nos. 10, 12, 27.

[56] "It is the sense of this committee that . . . receipts from sales of tangible personal property to manufacturers, producers or processors, which enter into and become an ingredient or component of the tangible personal property which they manufacture, produce or process for resale, are not taxable, and that the fact that the article manufactured, produced or processed is in a different form or of a different character is immaterial, and that poultry, dairy and other livestock feeds are deemed to become component parts of the eggs, milk, meat and other livestock products produced for resale."—Senator Swing's resolution, introduced into the legislature as the resolution of the joint legislative committee on revenue and taxation, and adopted unanimously July 17, 1933. See *Senate Journal* (1933), p. 3327.

State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 30. The rest of the ruling reads: "Gross receipts from sales to manufacturers, producers or processors of tangible personal property which is consumed by them in manufacturing, producing or processing and does not become an ingredient or component part of the tangible personal property manufactured, produced or processed, are taxable. The manufacturer, producer or processor is the final buyer or ultimate consumer of such tangible personal property and does not purchase it for resale."

Other rules of the State Board of Equalization which deal with specific decisions upon this point are Nos. 20, 21, 22½.

[57] *Cal. Stats.* (1935), ch. 357, p. 1256.

[58] State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 12, July 12, 1935.

[59] Retail Sales Tax Act of 1933, sec. 8½.

[60] "Fortunately, the board determined to assume the attitude that the tax applied to gross sales and that it was in no way concerned as to the methods adopted by the trade in recouping the tax. This position was somewhat complicated by a provision in the statute which endeavored in so far as possible to set forth the tax as a separate transaction."—Ray L. Riley, "Sales Taxes as a Supplemental Source of Revenue—Administration," National Tax Association, *Proceedings* (1934), p. 113.

[61] Fred D. Bullock, "California's Retail Sales Tax Act of 1933," *Tax Digest*, XIII (September, 1933), 300; Retail Sales Tax Act of 1933, sec. 8.

[62] Fred D. Bullock, "California's Sales and Use Taxes," *Tax Digest*, XIII (September, 1935), 319.

[63] *Los Angeles Times*, August 28, 1935. The case was *C. Leon de Aryan* v. *Woolworth Company*, before Justice Shell. For the California Supreme Court's decision see *Los Angeles Times*, October 9, 1935.

[64] These tokens, however, never came into use and the breakdown is still in operation.

[65] Haig and Shoup, *The Sales Tax in the American States*, pp. 62–76, 321, 424, 729.

[66] State Board of Equalization, *Sales Tax Rules and Regulations*, Ruling No. 26; *Los Angeles Times*, February 21, 1935.

[67] This law is *Cal. Stats.* (1935), ch. 361, p. 1297. Interesting discussions on the constitutionality of a use tax were presented to the National Tax Association in 1934. See Charles L. B. Lowndes, "State Taxation of Interstate Sales," National Tax Association, *Proceedings* (1934), p. 139, and Henry Rottschaefer, "State Taxation of Interstate Sales," *ibid.*, p. 149.

[68] State Board of Equalization, *Rules and Regulations under the Use Tax Act of 1935*, Ruling No. 11.

[69] *Sales Tax Rules and Regulations*, Ruling No. 59.

[70] *Ibid.*

[71] "Now that the sales tax is on the books, the prevailing opinion seems to be that it will remain in the California tax system for a long time to come. In this state the sales

tax is not, strictly speaking, an emergency measure designed to provide for the relief of distress. It is rather part of a general revision of the state's fiscal system. Careful reading of the Riley-Stewart plan suggests that the voters did not fully appreciate what they were approving and may discover in the course of time that they have imposed upon themselves a new type of tax without providing permanent relief for property."—Haig and Shoup, *op. cit.*, p. 294.

"I am of the opinion that the sales tax with the necessarily high rates that must be employed to supply adequate revenue, is unlikely to remain in its present form beyond the emergency period. Personally, I favor a low rate and a broad base which would include services and all types of transactions, with few exceptions."—Ray L. Riley, "Sales Taxes as a Supplemental Source of Revenue—Administration," in National Tax Association, *Proceedings* (1934), p. 115.

[72] Alfred G. Buehler, "An Appraisal of General Sales Tax Experience," *Taxbits*, vol. III, no. 6 (March, 1936), p. 5. Also Harcourt L. Calverly, "Scope and Problems of State Sales Taxes," National Tax Association, *Proceedings* (1935), p. 159: "The price of a 5c cup of coffee did not increase in Michigan, on July 1, 1933, to 5 15/100 cents. It hasn't reached that figure even yet, though I sometimes suspect that perhaps the coffee is not quite the same. But the shifting of taxes takes place in many and sometimes devious ways. Changes in size of packages, qualities of merchandise, extent or quality of service and so on, accomplish shifting, just as much as direct price increases."

[73] The names of many California labor leaders are signed to the petition for repeal of the sales tax.

[74] These expressions of opinion took place at the meeting of the National Grange at Sacramento, November 19, 1935. See *Los Angeles Times*, November 20, 1935.

[75] The attitude of the California Farm Bureau Federation may be seen in the following publications by Von T. Ellsworth, Farm Bureau Federation, Research Department: "Annual Report and Report on 1935 State Legislation," *Bulletin No. 25* (1935), pp. 6–11; "Anti-Tax Repeal," in *Farm Bureau Monthly*, vol. IX, no. 3 (February, 1936); "The Governor's Tax Conference and Its Results," in *ibid.*, no. 4 (March, 1936); "A Threatened Tax Dilemma," in *ibid.*, no. 5 (April, 1936); "Farm Bureau Opposes Initiative Repeal of the Sales Tax, etc.," in *ibid.* (July, 1936), Art. LXXVII; radio address, June 30, 1934, published in pamphlet form, as *Bulletin No. 40*.

[76] This information is condensed from a reading of the amendment and from the literature of the Sales Tax Repeal Association. The proposed amendment has been ruled off the November ballot. See footnote 11 in chapter ix.

[77] National Industrial Conference Board, *Sales Taxes, General, Selective, Retail* (New York, 1932), p. 45.

[78] Report of the committee on public relations of the California Teachers' Association, adopted at the meeting of the state council of the C. T. A., held in Los Angeles, December 7, 1935.

[79] The Economic Council of Southern California announced its policy at its meeting in Riverside, California, December 15, 1935.

[80] Mabel Walker, in Tax Policy League pamphlet, *The Home Owner and the Sales Tax* (New York, April, 1935).

[81] See two articles by A. H. Campion, "A Balanced County Budget," in *Tax Digest*, XIII (August, 1935), 264; "Tax Levies Increase," in *ibid.* (October, 1935), p. 329.

[82] "With the passing of the depression, sales taxes in the United States are on the decline. Of the 28 states which adopted them, seven have abandoned their laws, and the sales tax acts of 10 expire in 1937. Only 11 have sales taxes as permanent features of their systems.

"The sales tax is the child of panic and unpreparedness. It thrives in the more backward states that have failed to reform their tax systems to keep pace with modern conditions. It strikes where there exist confusion, panic, and inelasticiy of revenue sources. States can get along without it even during a depression . . . as has been demonstrated in recent years by a number of states. . . . Now that recovery becomes more and more pronounced it appears that the much vaunted sales tax is on its way out, albeit the exit may be a lingering one in some sections."—Tax Policy League, *Taxbits,* vol. III, no. 8 (June, 1936).

VIII. THE CALIFORNIA PERSONAL INCOME TAX

THE STORY OF THE INCOME TAX is one of the most interesting in California fiscal history. Despite original constitutional authorization for such a measure,[1] discussion persisted for many years before its final adoption in 1935.[2] After enactment of the law, strong agitation arose for its repeal.[3] The purpose of this chapter is in part to trace the development of the income tax concept in California and in part to relate that development to a consideration of the principles of income taxation in general. In this way, perhaps, some contribution can be made to the discussion of a current issue in California fiscal affairs. The purpose in view can best be achieved by reviewing and attempting an evaluation of the various arguments pro and con that have enlivened the struggle in the state. This survey of opposing views will be followed by a summary analysis of the principal features of the Personal Income Tax Act of 1935. The technical details are available to those who wish to read the law itself. The chapter will close with some brief observations upon state income taxes in general.

The modern state income tax movement began with the Wisconsin law of 1911.[4] At the present time some thirty-three states have personal income tax laws upon their statute books. We need go back no farther than 1914 to observe California's interest in this direction. In its report for that year the State Board of Equalization, after commenting upon certain difficulties of double taxation of income and property and effective enforcement of an income tax law, remarked that it "remained for Wisconsin to discover the solution of both these difficulties."[5] The board quoted extensively from the 1911–1912 report of the Wisconsin tax commission,[6] which outlined the salient features of the Wisconsin measure that marked it as different from any other law up to that time adopted in this country. Our own board then concluded that "the tax conditions in Wisconsin are very similar to those in California ... the inauguration of an income tax might be regarded as an important step forward in the direction of a sounder system of taxation. ..."

Especially noteworthy as among the earlier references to the income tax was that section of the report of the 1917 tax commission dealing with the subject.[7] The commission commented upon the change in

[1] For notes, see below, pp. 252–257.

public attitude toward the tax. "During the last few years there has grown up all over the country a strong sentiment in favor of the income tax. Its popularity was demonstrated by the zeal with which the various states ratified the income tax amendment to the federal constitution. Several states already have adopted it for state purposes, and many others are considering taking over the income tax as a part of their local revenue systems."[8] The commission went on to point out that certain tax authorities such as Professors Seligman and Plehn, who formerly opposed the tax, had come to favor it.[9] The latter was quoted as urging the adoption by California of such a measure as "necessary to round out the tax system of this state."[10] The commission itself favored the tax as a partial substitution for the personal property tax and as a means of reducing and better distributing the tax burden.[11] Finally the commission outlined the provisions of an ideal income tax for state purposes.[12]

Subsequent interest in the income tax was revealed in the statement made on January 26, 1932, by Mr. Francis P. Farquhar before the Commonwealth Club of San Francisco. He said, "At that time [about 1922] we [tax section of the Club] rather reluctantly gave up the idea of recommending a State income tax. From such information as we had, we believed the farmers were opposed to it, and that it would work an injustice. It is rather interesting to find tonight that the farmers, or their representatives at least, consider it a possibility."[13] Meanwhile a special tax commission reporting in 1929 and a joint legislative committee reporting in 1931 had considered aspects of the income tax for California. The former had said, "The Commission believes that the establishment of a personal income tax in California will probably ultimately be recognized as essential to a satisfactory solution of the problem of taxation in California."[14] The latter was less positive, feeling that too little was known of the effects of an income tax in relation to the burden upon real estate to justify recommending the tax at that time.[15] Further attention will be given to these reports later in this discussion. These brief references may serve here as an indication of the reflection upon the income tax over a considerable period of time. They at least show that the Act of 1935 had as a background something more than the necessity for revenue engendered by the depression years since 1929.

To carry out, however, the main intent of this chapter to dwell not particularly upon historical detail but rather upon the principles of income taxation as applicable in California, let us turn to a review and appraisal of the arguments in opposition to and in favor of the income tax as they have been urged in this state.

First of all it was argued that the income tax law should not be passed because it would very likely become permanent. "An income tax once set up, would be very hard to get rid of; it is almost impossible to pry politicians loose from any established source of added revenues."[16] Fortunately or unfortunately, the objection is undoubtedly a valid one. Whether, however, it perforce condemns the tax in question is another matter. To the advocates of the income tax, its permanence, if that should prove to be one of its aspects, is an outcome much to be desired. Upon analysis, the objection does not seem particularly serious. Necessary public revenues must be raised in some way. If they are not to be obtained through an income levy, they must be obtained through other taxes. It might well be that it would be more desirable permanently to raise a given sum by means of an income tax as a part of the tax system than by some alternative means. The decision upon a particular source of revenue ought to rest not upon whether the particular tax would be a permanent part of the tax structure but upon whether, all things considered, it would be a better way to raise the revenue than by resort to other types of tax. With equal or greater force the objection being considered could be urged against a sales tax. He would be a bold prophet indeed who would predict that the sales taxes now being widely used in the American commonwealths, or a large remnant of them, would not become a permanent part of their tax systems.[17]

In the second place it was contended that the state's use of the income tax would constitute an invasion of the federal field since the federal government derives a large part of its revenue from the income tax. From this it was deduced that the state tax would be a failure as a revenue producer, and especially so when such sums as might be derived from it were compared with the total revenue requirements of the state. The argument became economic in character as it proceeded. "The Federal income tax is jacked up to the last inch of production already; in fact, it is generally considered by tax experts to be well beyond the point of maximum production.[18] When a state tax is imposed on top of it, the flight of capital into nontaxable investment is accelerated, and this flight is already sufficient to make recovery difficult or impossible."[19]

This assertion was followed by the familiar but somewhat uncertain contention that investment in tax-exempt securities, to the degree that it takes place, constitutes a proportionate limitation of investment in productive enterprise which otherwise would serve to increase wealth and pay rolls of the community.[20] More will be said later concerning various economic aspects of the income tax. Here it may simply be conceded that the adoption by California of an income tax has helped that much more to complicate the whole difficult problem of coördination of federal and state finance.[21] At the same time, however, it must be remembered that two-thirds of the American states already use this tax, that the states were early in the field, Wisconsin leading the way in 1911 two years prior to the 1913 federal tax. In one sense, therefore, it would be as proper to say that the federal government was invading a state field as to say that the states were invading a federal field.

As a phase of this second argument it was contended that a state income tax superimposed upon the federal levy would constitute an excessive burden. Even those sympathetic to state income taxation expressed concern on this score. The argument merits consideration since a major objective in any revenue system is a just distribution of burden. The problem would arise quite aside from any additional income available for state taxation which is not reported to the Federal Internal Revenue Department.[22] A study based upon the assumption of replacing by income taxes one-half—about $1,500,000,000—of the general property taxes in the American commonwealths developed the conclusion that this given amount of revenue "would rest more easily when cushioned on the income structure of the nation than when resting on a rigid property base, and could be carried with less distress to taxpayers and less repressive effects upon business and industrial recovery."[23] If we apply such a general conclusion to the specific situation locally and assume the necessity of finding a given amount of revenue, it would seem reasonable to conclude that it would be better for California to raise the estimated sum of $17,500,000 biennially from an income tax than from an equivalent ad valorem tax on property. If the California revenue system is viewed as a whole with its present distribution of tax burden, it is very doubtful if the present income tax at one-fourth the federal rates can be considered excessive or unjust. On the contrary the rate structure constitutes a quite modest program. There is little doubt that it is possible and within the bounds of justice for those in the higher-income brackets to make this substantial contribution to the support of the state government. The possibility of such a contribution is apparent in the light of figures for income even in a depression year, as given farther on in the discussion. Furthermore it must be remembered that there is a difference between apparent and effective rates. The former are the rates stipulated in the law. They appear much higher than they really are. The latter are the ratios of taxes to total net income and are of course better measures of actual burdens than are the rates specified in the statute itself. The difference arises because of exemptions and deductions and adjustments permitted by the law.[24]

A third argument in opposition to the income tax for California was that such a levy would discourage investment in the state, that California would no longer be an attractive place of residence for people of wealth. Those setting forth this view insisted that industry would languish, that unemployment would grow apace, that the sources of taxable wealth would be dried up and hence the burden of taxation increased upon remaining property, and that in general dire economic consequences would be the result. The argument appeared again and again in the opposition press of the state, mostly, it must be said, in the form of assertion and reiteration of assertion without the support of many sustaining facts or much convincing analysis. Frequently, too, it must regretfully be admitted, the statements made along this line were unduly extreme. Happily they were not accepted at their face value.

It is probable, other things being equal, that a substantial income tax would cause some removals to other states imposing no such tax. At once, however, the question arises whether an income tax is the only consideration. The question, of course, must be answered in the negative. The National Industrial Conference Board, surely not enthusiastic about income taxes, in a study of state income taxes completed in 1930 said: "It should not be overlooked that the total tax differential is the important consideration and that the income tax is only one factor in this. Moreover, it should be kept constantly in mind that the tax differential is only one of the factors entering into the determination of the location of industry."[25]

Writing along the same line, Professor Roy G. Blakey of the University of Minnesota in a study published in 1930 said: "The charge that the income tax is bad for business and drives industries from a state, does not seem convincing except to those who want to be convinced. Other factors than taxes are often more important in determining the location of industries. Furthermore, if a state has a certain amount of funds to raise, an industry might just as soon pay a part of its share in income taxes as to pay equal or greater aggregates in heavier property or franchise taxes. Net income taxes, rather than property taxes, should be particularly attractive to new industries. While they are getting on their feet, they will have little or no income tax to pay; when they later become prosperous, the wherewithal to pay these taxes will be available. Such taxes are quite different from property and gross sales taxes which have to be paid for years of heavy losses as well as for years resulting in profits."[26]

In the discussion of this matter of capital investment within the state, it is particularly pertinent, in view of the sales tax now operative in California, to recall the comments of the great English economist, Alfred Marshall, made in 1917. He wrote at that time: "Finally, a remark may be made, somewhat dogmatically, on a rather abstruse point... It is, that if a great part of the Revenue is derived from taxes on commodities consumed by the people, then either the standard of living of the people must be lowered, or the taxes must ultimately be paid by the employers; therefore it must in the main fall on the income obtained from the use of capital in business. So far as it does this, it will tend to drive capital away nearly as much as a tax on income derived from capital would, and even more than a tax on all considerable incomes, including those that are earned by professional men and salaried business officials. All taxes, unless they are so spent as directly to increase efficiency, tend in the same direction."[27]

It is apparent that impartial authority remains unconvinced of any very great harmful effects of income taxation upon capital investment within a given jurisdiction. As a matter of fact, the argument has been overworked. It is a stock defense on the part of those individuals and groups who dislike a program which will cost something. As Professor Davisson of the University of California has pointed out, it is the same sort of argument that was urged when workmen's compensation legislation was proposed in California.[28] Yet California has prospered despite, and may it not perchance be in some measure because of, workmen's compensation. Further, if Wisconsin's experience is any guide, the tax in that state does not hamper the business and industrial development of the state.[29]

Finally, it may be pointed out that as more and more states adopt the income tax the argument being considered here becomes less and less significant. If other states have an income tax, where will people and capital go from California to escape her tax? Personal income tax laws were in force in nineteen states on January 1, 1933. Six more states passed income tax laws during 1933 and one more in 1934. California's tax in 1935, along with those of certain other commonwealths, made her the thirty-third state to pass such a law. In the light of facts such as these, it is difficult to maintain seriously that the present California income tax will materially jeopardize investment in this state.

The California income tax law must be looked upon in part as a product of the depression. The increasing need for revenues finally compelled recourse to various new levies of which the income tax was one. At once it was attacked on the ground that such a tax would retard recovery and would have generally adverse economic consequences. As illustrative of this line of argument, reference may be made to the statement of a representative of California Citizens, a group working for the repeal of the income tax law and prevention of its reënactment except by majority vote of the people. "An income tax takes spending power away from the individual and places it in the hands of the politician. The individual spends his money normally; it goes through the normal channels of trade, benefits industry and creates jobs. The politician does not spend it normally and only too frequently government funds are expended in channels detrimental to business, even though it is generally recognized that the ultimate solution of the unemployment problem is a successful industry."[30] Or again, we may notice the editorial statement in the Hearst *Los Angeles Herald and Express:* "A state income tax would reduce purchasing power in California and would prevent additional purchasing power from coming to this state.

"Such taxation would, therefore, reduce present employment in the state of California and interfere with the process of recovery by making it impossible to create additional employment in this state."[31]

These statements are typical of those which were repeatedly made attacking the income tax on the ground that it would interfere with recovery. Various economic aspects of the income tax, already slightly touched upon, will be considered more fully in outlining the case in favor of income taxation. Here we may merely observe that undue significance has been ascribed to the income tax as a recovery deterrent. The prominence given to the argument by the opposition is reminiscent of the relating of high prices of the war years to the income levies of the federal government. As a matter of fact, prosperity versus depression, high prices versus low prices, can be explained only in the light of many complex and interacting factors. Ascription of California's economic weal or woe to such an income levy as now obtains in the state raises questions of intellectual integrity and the bending of arguments to suit personal ends.

It is, of course, regrettable that taxes have had to be increased in a time of depression.[38] The problem becomes one of relative depressing or retarding effect in connection with various taxes that may be used. In this respect it is very likely that income taxes present the most satisfactory approach. If maldistribution of purchasing power contributes to adverse business conditions, and if by imposing an income tax we can help correct such maldistribution, then we shall have done something to help restore prosperity.

The case for the income tax as a depression tax has been vigorously put by Professor Simpson. Writing in the September, 1934, number of the *Survey Graphic* he contends that a "broad line of policy which sound principles of government finance would suggest is that to whatever extent public expenditure during depression must be financed through taxation, this should take as far as possible the form of income taxes, taxes on luxuries, or taxation on the basis of something that represents a surplus of income and resources above the necessities of life. And this policy does not rest on any impulse to 'soak the rich' or other radical philosophy; it rests only on the most obvious and common sense principles in the distribution of tax burdens....

"The fact that incomes decline during a depression has nothing to do with it, as long as there are substantial numbers of people with substantial incomes, on the one hand, compared with those who have no income, on the other... [and] a nation which, according to estimate of the National Bureau of Economic Research, produced $38,350,000,000 of new net wealth in 1932, at the bottom of perhaps the severest depression in our national history, is not yet at a point where it is obliged to levy destructive capital and business taxes. And a nation which in the same year paid out $2,600,000,000 in dividends, $5,500,000,000 in interest, $1,700,000,000 in rents and royalties, and $7,200,000,000 in pure profits; a nation that even in 1933 was still buying 1,493,000 new passenger cars and 1,139,000 new radios—a nation whose income and expenditures run into these figures at the bottom of depression may be suffering from many maladjustments but is obviously not suffering from any actual poverty of economic resources."[33] One may add by way of conclusion that, after all, prosperity did occur along with high income tax rates in the United States.

This discussion of the depression aspect of the income tax may conclude with reference to the summary view of the committee organized to consider the place of state income taxation in the revenue systems of the states. Having set forth various grounds in support of its position in favor of a larger use of income taxes in the several states, the committee said: "In the fourth place, income taxation is free from many of the harmful effects traceable to property taxation. An income tax does not penalize savings and investment; does not fall with regressive weight upon the poorer classes; does not produce the appalling tax delinquency that has characterized property tax collections for years past; and does not aggravate the processes of deflation in recurring periods of depression. In fact, the transfer of a larger portion of tax burdens to income should have the effect of retarding the deflation of property values in times of depression."[34]

A word may here be said concerning a related objection, namely, that an income tax is uncertain as a revenue producer and particularly likely to decline drastically in a time of depression. Federal experience can be cited to substantiate the argument.[35] We are likely to forget, however, that instances of elasticity can also be given.[36] There is danger, too, of forgetting, because of the experience of depression years, the large sums yielded by an income tax when times are prosperous. Furthermore, there are not lacking ways in which to adjust income tax yields to the exigencies of depression years.[37] Again the California tax is but one element in a revenue structure to yield for 1935–1937 about $17,500,000 out of a total of some $228,000,000 accruing to the general fund of the state. Finally, it would seem pertinent to point out in this connection that we should manifest concern over the qualitative as well as over the quantitative aspect of our revenue system.

The objection that the income tax is difficult and costly to administer would not be a vital one even if the charge were entirely true. Criticism of the income tax in California on this score ranged from moderate to extreme. That there are difficulties of administration no person would deny. Net income under modern conditions is a complex concept and the tax can be no more simple than the economic facts to which it applies. The objection to the income tax on administrative grounds was expressed on one occasion as follows by Mr. Ray L.

Riley, California State Controller: "I recognize that we are going to have an income tax, but, as a practical individual, I do not like it from the standpoint of the State. The moment you attempt to make a workable income tax to prevent injustices, so many refinements are necessary that they in themselves create loop-holes to permit tax evasions. The fellow with the smartest tax attorney gets off with the least tax. I have seen it stated that it costs the taxpayer about 10% of the tax to find out how much he owes."[38]

As far back as 1917 when there had been comparatively little experience in income tax administration, the California tax commission said: "The cost of administering the state income tax is surprisingly low. In Wisconsin, the average cost of administration is about 1.6% of the amount assessed—making it one of the most cheaply administered taxes known."[39] Twelve years later the 1929 commission said: "The record of the personal income tax in other states since 1910 establishes the fact beyond all question that such a tax can be satisfactorily administered. A state tax on personal income is undoubtedly a feasible and workable plan."[40] The commission further observed that the cost of administration was comparatively small, being somewhat less than 2 per cent in New York, where generous provision had been made for administration expenses.[41] The commission estimated the cost of administering personal property taxes in California to be about double the cost of administering an income tax.[42] The testimony of the National Industrial Conference Board was in similar vein. The board concluded that the "available evidence indicates that the income tax is not an expensive tax to administer, compared with other forms of taxation requiring a technically trained personnel."[43] In general it may be said that the cost of administration ranges between 2½ and 3 per cent and shows a tendency to decline as experience is gained and administration is improved.

Obviously the effectiveness of a state personal income tax with respect to administration depends essentially upon centralized rather than local administration. That was demonstrated as far back as 1911 with the Wisconsin act of that year. American experience further dictates a plan of self-assessment by the taxpayer but subject to check by the government, particularly through a plan of information at the source requiring those who pay wages, interest, rent, and dividends to give information concerning these payments to the tax administrators. Finally, there should be some correlation between the federal and state taxes the better to serve the convenience of the taxpayer as well as to facilitate administration by the tax officials. If these conditions are observed, administratively there should be comparatively little objection to a state income tax. But even if there were, should we not be willing to pay some price for a measure of equity and justice in the revenue system, assuming that these ends were attainable through an income tax?

Various other but more or less minor corollary objections to the income tax for California were urged. Among them were the arguments that the income tax was easy to impose and increase because it appears to follow the political fashion of the time of sharing the wealth;[44] that it was a tax on surplus needed for lean years;[45] that those who earn by work or skill cannot escape the tax, whereas the speculators and those who live on tax-exempt income would pay very little proportionately;[46] that a state constitutional convention should so revise the Constitution as to give the legislature control of the budget, thus removing the need for income tax legislation;[47] and that the tax as enacted failed "to allow as credit for purposes of the normal State tax the amount of dividends received by California residents as part of their income."[48] On the whole, careful analysis leads to the conclusion that most, if not all, of the objections to the income tax for California were overdrawn. The arguments reviewed would have been more convincing had they been made by their proponents less sweeping and in some instances less impassioned in character.[49] Moderation is a virtue to either side in a controversy.

A delineation of income tax development in California would be incomplete without a study of the forces which led finally to the adoption of the Act of 1935. These forces, if we may judge by the tangible outcome, were more potent than those which have just been reviewed in outlining the arguments against the income tax.

The discussion may well begin with the very practical consideration that California needed the revenue. The facts in this connection were given wide publicity and were all too familiar to the legislators grappling with the problem of balancing a budget. Suffice it to say that from a $31,000,000 surplus in the state treasury at the end of the 1931 biennium California had moved toward a prospective deficit of more than $100,000,000 at the end of the 1935–1937 biennium. Even had California raised the maximum sum possible under constitutional limits by means of an ad valorem tax on all property[50]—some $66,000,000—it still would have been necessary almost to double the general fund revenues then in sight from existing revenue sources in order to meet deficits previously incurred and requirements for the 1935–1937 biennium. Without any question California needed the estimated $17,500,000 biennially the income tax was designed to yield. This fact was a compelling one in the minds of the legislators.

This is not the place to engage in an extended analysis of the incidence of an income tax. Yet considerations of incidence played their part in the California discussions. An income tax is likely to rest where it is put. A realization of this fact was undoubtedly the foundation of much of the opposition to the legislation. To argue, or merely to assert, as frequently was done, that such a tax should not be imposed because it would be passed on to the consumer is to argue contrary to generally accepted conclusions.[51] Such statements are made either because of failure to determine or admit the facts or because of intent to mislead. The National Industrial Conference Board from an extensive study made of the shifting and effects of the federal corporation income tax concluded that the taxes on corporation profits are seldom if ever shifted.[52] And if corporations producing things for sale cannot shift such a tax, on what basis can it be argued that an individual could shift a tax on his net income? There is nothing inherent in a tax on individual net income that gives the individual any more power over his income than he had prior to the imposition of the tax. Since, then, such a tax cannot be shifted, there would tend to be fewer adverse repercussions due to tax policy than if almost any other tax were employed. This being true, to enact an income tax law seemed to many as happy an arrangement as any California could adopt in order to minimize consequences of increased taxation as well as at the same time to counteract the adverse effect of other taxes, existing and proposed, in the tax system.

Still another factor playing an important part in the ultimate enactment of income tax legislation in California was the growing appreciation that an income tax conforms to the widely recognized principle of modern taxation—taxation according to ability to pay.[53] The adoption of the state income tax in California extended the application of this principle and therefore was a step in the direction of the trend of modern fiscal policy. The mere amount of one's net income is not in itself an adequate index of one's ability to contribute to the support of government. But given reasonable interpretation and sufficient flexibility in defining net income, it is probably the best index we can devise. If one has no net income, he pays no tax. If he does have net income, he surrenders a modest percentage of it to help support essential services of government from which he and others derive benefits of a general and highly important, even if not of a specific and definitely ascertainable, character. Does this not appeal to the impartial observer as a fair basis of taxation, particularly when viewed, as intimated above, in conjunction with other types of taxes which make up the state tax system?

This thought leads to a further related point in the case for the income tax in California. No tax can be completely adjudged upon its own merits alone. It must be viewed in its place in the whole tax structure. This was the considered judgment of the 1929 tax commission. Discussing the nature and advantage of a proposed system of taxation for California, the commission said: "This plan . . . should ultimately consist of three distinct but complementary elements: First, a property tax of reduced scope; second, a business tax upon all business activities carried on within the borders of the state; and, third, a personal tax levied upon all residents of the state. . . .

"The great positive advantage which would accrue from the establishment of a personal income tax would lie in this: that it would supply the missing third leg of the tax stool and provide a logical unity to the system. This personal tax, measured by ability to pay, would tax important economic resources which can never be reached by taxation of property."[54]

In other words an income tax alone might be undesirable. Other taxes alone might also be objectionable. But with the attempt to establish in the state something approaching a system of taxation, the case for the income tax appreciably strengthened. The California sales tax, for instance, is regressive, that is, it takes a larger part of the small income than of the large income. If two men receive incomes of $2,000 and $5,000 respectively and each spend $1,000 for taxed commodities at 2½ per cent rate of sales tax, the tax of $25 is one-eightieth of the $2,000 income but only one two-hundredth of the $5,000 income. This is not equitable taxation with respect to ability to pay. Nor would the finding in this respect be different if each spent his entire income for taxed commodities and thus was taxed at the rate of 2½ per cent on $2,000 and $5,000. It is generally recognized that the principle of ability to pay in taxation requires that the tax rate on the larger income be higher than the tax rate on the smaller income. The conclusion was inescapable that California needed a progressive income tax to counterbalance the regressive effect of such taxes as those on sales and property, in order that the state might have a better balanced and more equitable tax structure. A proper recognition of this ideal in a fiscal system unfortunately was lacking when in 1933 Governor Rolph signed the sales tax bill but vetoed the moderate income tax measure which also had been passed by the legislature.

The reference to property taxes just made suggests still another phase of the income tax chapter in California fiscal history. No one can study the development of income taxation sentiment in the state without relating it to the general problem of property taxation. As far back in time as the report of the 1917 commission, it was recognized that only an income tax could reach wealthy California residents whose property was situated in eastern states.[55] The commission also suggested that "if the income tax should be adopted it ought not to be made an additional tax, but rather a partial substitute for the personal property tax."[56] The 1929 commission, after noting that "California has clung to the taxation of personalty more tenaciously than most states,"[57] observed that the attractions of a personal income tax were to be found in the "opportunity it offers to eliminate the personal property tax and in the positive merits it possesses as a method of achieving a more satisfactory and equitable distribution."[58] The commission, in effect then, described various unsatisfactory aspects of personal property taxes in California and suggested the possibility of an income tax as at least a partial solution of some of these difficulties.[59]

Certainly the income tax offered some opportunity to equalize the tax burden between property-owning and nonproperty-owning classes having taxpaying ability and some opportunity to reach income from intangibles escaping property taxes. Furthermore the revenue obtainable from an income tax, although it might not ultimately prevent, would yet help to minimize, the possibility of a state ad valorem levy, a tax which, if not politically expedient and economically unwise, would nevertheless be inconsistent with the program the state had recently introduced under the Riley-Stewart act.[60] Whether an income tax would provide any substantial relief from the heavy burden of property taxes, however, is another question. Conclusions in this respect must be based on considerations of the scale of public expenditures and the scope of income taxation. If public expenditures continue their increase, as seems probable, then property taxes will not necessarily decrease nor even remain where they have been even if other forms of revenue are adopted. The best that could be said under such a circumstance would be that the property tax burden, because of income or other levies, would be less than it otherwise would have been. That the representatives of real estate believe the California tax on incomes serves their interest is apparent in the position the California Real Estate Association took at its thirty-second annual meeting, January 3, 1936, in opposition to the proposed repeal of the income tax to be voted upon at the November, 1936, election.[61] Evidently the real estate people of California feel as those of other states have felt that some relief from the tax burden upon real estate is to be found through the income tax. The nature of this relief is described by the committee on the place of income taxation in the revenue systems of the states when it says that "income taxation is free from many of the harmful effects traceable to property taxation."[62] The same committee, in discussing the degree rather than the nature of the relief that might be expected from an income tax, makes a plea for a much wider scope of income taxation than any heretofore adopted by the American states in saying that "the demoralizing effects of extreme dependence on property taxation have been sufficiently obvious and have been fully recognized by tax students for years past. We need only point out here that income taxes of the scope of present statutes will make no material impress upon state revenue systems and can scarcely in any perceptible degree mitigate the effects of heavy dependence on property taxation."[63]

As a further phase of the relation between income and property taxation, the influence of the California farmer must not be forgotten. The California Farm Bureau Federation drew up the Chatters bill which, with some modifications, became the legislation of 1935. The interest of the farmer in income taxation is readily understandable. The Bureau of Agricultural Economics of the United States Department of Agriculture completed in 1930 a study of the farm tax situation in fourteen states. The report pointed out that "farm property is heavily taxed and along with other real estate and certain other classes of tangible property it is bearing more than its reasonable share of the cost of local government."[64] A typical state income tax, however, is primarily an urban levy since "the per capita current income of farmers is relatively low; a substantial portion of farmers' income is received in home produce and other non-cash items which are consumed by farmers' families and therefore never reported as income; and farming is usually carried on in small units as compared to manufacturing and commerce. As a result there are many small incomes most of which are under the personal exemption allowed."[65] Although there may be some question whether, from his point of view, the farmer is fully justified in his faith in the income tax, the fact is that the California farmer has been one of the staunch supporters of such a program. The degree to which the farmer will benefit will depend in general upon the trend in the volume of public expenditures and in particular upon the disposition made of the proceeds from the income tax. In California the avoidance of a frequently suggested ad valorem levy on all property or the apportionment of proceeds in such a manner as to equalize tax resources would redound to the benefit of the rural communities.

Finally in recounting the development of income taxation in California, a word may be said about one of the factors which, although difficult to measure in that it is somewhat intangible, played its part in the story. The remarkable strength revealed by the Epic Democratic forces in the state elections of 1934, with their advocacy of various programs foreign to California's traditional sentiments, undoubtedly suggested to the conservative elements in the state the advisability of supporting some form of income tax legislation. Can the income tax make any contribution toward the stability of a disordered economic system? Some believe that it can. Taxation, and particularly income taxation, is "one of the few agencies of the capitalistic economy which without serious modification of the system as a whole can be deliberately used to stabilize that economy whenever it fails to achieve stability."[66] Inequalities of wealth and income create social disorders. Inequality of capital accumulation leads to overinvestment and cyclical depression. Perhaps in both of such situations the income tax might be helpful through mitigation of the causes for social disorder or overinvestment. In any event the critics of income taxation must reckon with growing social forces which, fortunately or unfortunately, are not content to stop with the purely fiscal aspects of the taxing power.[67]

The preceding discussion of the broad general principles of income taxation as applicable in California leads logically to a delineation of the provisions of the Personal Income Tax Act of 1935. As indicated at the outset of this chapter, the purpose here is not to deal especially or extensively with technical details. To do so would be merely to restate the law itself, as well as rulings with respect to it, which would take us much beyond the scope of intended treatment and would require a separate chapter. It must suffice here to outline in summary fashion the essential aspects of the new legislation.

The law[68] was described as "an act to provide for the levy and collection of a tax upon the incomes of individuals, estates and trusts, and to provide for the disposition of the revenues therefrom, and to provide that this act shall take effect immediately." It was approved by Governor Merriam on June 13, 1935. It was enacted substantially as sponsored by the administration, although, as will be noted shortly, attempts were made to modify its original provisions in certain particulars. In general the measure was patterned after the federal law even to the extent of incorporating within the law various provisions of the federal statute,[69] providing for the same personal exemptions and deductions for dependents, and so forth. There are, however, some notable differences between the two statutes, such as those with respect to the treatment of dividends, salaries of employees of the state and its political subdivisions, and earned income. The state law subjects to taxation dividends from stock in the same measure as other income, whereas the federal law exempts dividends from the normal tax. The salaries referred to are subject to the state tax but are exempt from the federal levy. The state law grants no credit for earned income. These, as well as other differences based upon the different treatment of residents and nonresidents of the state, distinguish the state from the federal law. The authority for the state legislation is to be found in an early provision of the California Constitution[70] and in a subsequent fortifying amendment voted by the people at the June 27, 1933, election.[71] The revenue accrues to the state and is credited to the "personal income tax fund" of the state treasury.[72]

The principal aspects of the Personal Income Tax Act of 1935 may be summarized under four main headings: persons subject to the act, determination or definition of net income, rate structure, and administrative provisions.

The law provides that the tax "shall be levied, collected and paid for each taxable year upon the entire net income of every resident of this State and upon the net income of every non-resident which is derived from sources within this State."[73] The word resident is defined as including "every natural person domiciled in the State of California and every other natural person who maintains a permanent place of abode within this State or spends in the aggregate more than six months of the taxable year within this State. The word non-resident includes every natural person other than a resident."[74] The law further provides that the taxes imposed by the act upon individuals "shall apply to, and be imposed upon, the income of estates or of any kind of property held in trust (other than so-called Massachusetts trusts)."[75]

Questions have already arisen in the effort to define a resident of California. The wording of the statute raises significant problems of interpretation. The Franchise Tax Commissioner, who administers the income tax law, has said with respect to those who visit California for indeterminate periods: "The new tax act will not cost them one cent unless they derive taxable income from sources within this State.

"Nor will their sojourn in this State for more than six months during the taxable year, or the maintenance of a permanent place of abode within this State give rise to income tax liability unless they are actually and legally domiciled within this State or receive income from sources within this State."[76] Attorney General Webb has remarked that "a presumptive residence may be rebutted by competent and satisfactory proof of actual domicile elsewhere."[77] Undoubtedly there will be court tests over this aspect of the law.

The tax is, of course, one upon net income, which is described as gross income (the items of which are specified) minus the various deductions allowed by the act.[78] Gross income is defined broadly,[79] and includes among many income sources "any salary, wages or compensation of any officer or employee of this State, or any political subdivision, district or municipality thereof."[80] Certain items are not included in gross income, such as amounts received under life insurance contracts; the value of property acquired by gift, bequest, devise, or inheritance; amounts received as compensation for personal injuries or sickness; and income which the state cannot tax under the Federal Constitution or laws of the federal government or the Constitution of the state.[81]

If it is necessary clearly to determine gross income, the Commissioner may require the taking of inventories; capital gains or loss provisions follow those of the Federal Revenue Act of 1934, as already indicated; with respect to nonresident taxpayers, gross income includes only that from within the state, and gross income from within and without the state must be allocated and apportioned under rules and regulations prescribed by the Commissioner. There are detailed provisions with regard to the inclusion of dividends in gross income, with a specific exclusion of stock dividends as subject to taxation.[82]

To arrive at net income certain deductions are permitted from gross income, such as ordinary expenses; interest on indebtedness with certain restrictions; certain taxes; losses sustained during the taxable year and not compensated for by insurance; bad debts; losses from sales or exchanges of capital assets under definite limitations; reasonable allowances for exhaustion, wear and tear, obsolescence and depletion; and contributions or gifts for various purposes—all under stipulated conditions.[83] Certain items are not deductible, such as personal, living, or family expenses; amounts paid out for permanent improvements made to increase the value of property; premiums on certain life insurance policies; losses from sales or exchanges of property under certain conditions; and so forth.[84]

Finally it is worth while to note that the statute permits of flexibility in the determination of net income and thus facilitates administration of the law in so far as it makes provision for the computation of net income "upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer."[85]

After providing for exemptions similar to those in the federal law ($1,000 for a single person and $2,500 for the head of a family or a married person living with husband or wife) and for a $400 credit for each dependent,[86] the statute sets up a scale of rates ranging from 1 to 15 per cent, popularly described as a schedule equal to one-fourth of the federal rates.[87] Table 15 shows the rate structure.[88] One of the interesting things revealed by it is that the actual tax burden, through almost all the brackets until the largest incomes are reached, is significantly lower than the apparent tax burden indicated in the statutory schedule of rates. This situation emphasizes what was said earlier in this chapter concerning the difference between actual and apparent tax burdens resulting from a given rate schedule. Mr. Myrick in commenting upon his figures observes that, "while the rate of tax runs up to a fairly high figure, the actual tax burden in most cases should not prove excessive. ... but very large incomes appear to be rather heavily penalized, the State income tax absorbing nearly 50% of the balance remaining after payment of the Federal taxes."[89]

Much has been said and inevitably much more will yet be said concerning oppressive California income tax rates. At the time the measure was under consideration in the legislature there were demands for rates much higher than those finally adopted. It is probable that the Chatters bill received some support from those who wished to head off elements seeking a still higher rate.[90] Assemblyman Chatters defended his bill, low in comparison with Democratic demands for a biennial return of $50,000,000, on the ground that "incomes of $1,000,000 will pay a total of $761,800 in taxes to the federal and state governments. We cannot risk driving capital, business and investment out of California

TABLE 15

RATE STRUCTURE OF CALIFORNIA PERSONAL INCOME TAX ACT

Blocks of net income	Tax rate (percentage)	Total income	Total tax	Percentage actual tax on total income
$ 5,000	1	$ 5,000	$ 50	1
5,000	2	10,000	150	1.5
5,000	3	15,000	300	2
5,000	4	20,000	500	2.5
5,000	5	25,000	750	3
5,000	6	30,000	1,050	3.5
10,000	7	40,000	1,750	4.38
10,000	8	50,000	2,550	5.1
10,000	9	60,000	3,450	5.75
10,000	10	70,000	4,450	6.36
10,000	11	80,000	5,550	6.94
20,000	12	100,000	7,950	7.95
50,000	13	150,000	14,450	9.63
100,000	14	250,000	28,450	11.38
250,000	15	500,000	65,950	13.19
500,000	15	1,000,000	140,950	14.09

by levying a higher rate."[91] State Controller Riley called such a prospective exaction "confiscation." Assemblyman Chatters also defended his proposals against those of the Olson bill. The latter had a rate schedule imposing heavier taxes in the higher brackets but also one which did the same thing in the lower brackets. Although the Assembly voted overwhelmingly for a schedule approximating one-third the federal rates,[92] there were not a few who wished to go higher than that. Senate sentiment was, however, in favor of a lower level of rates not to exceed an approximation of one-fourth the federal rates. Hence the rate schedule finally imposed represented a concession on the part of the liberal advocates of income tax legislation.

The contention that the California income tax is unduly burdensome is not entirely convincing for a number of reasons. The progression in the statutory schedule of rates is quite moderate. The actual as contrasted with the apparent burden, as has already been pointed out, is another circumstance to remember. The repeal of the two-mill tax upon intangibles is a still further alleviating factor.[93] In a similar light are to be considered the deductions from gross income, the various exemptions and credits, and in California, along with seven other states, the privilege enjoyed by married taxpayers of dividing between them their income for taxation purposes so that they are enabled to avoid the higher rates otherwise applicable in the upper brackets of large incomes.[94] And finally, as Mr. Myrick has demonstrated by reference to facts in the situation, "in comparison with the tax burden on incomes and securities in other States, the new California tax is relatively favorable up to even good-sized incomes and on larger amounts the difference is usually not great enough to be an important factor. Income taxes of other leading States and the mill tax on intangibles in those States will prove to be higher in a great many instances when a comparative study of individual situations is made."[95]

Having considered thus far, in outlining the main aspects of the California Personal Income Tax Act, the persons subject to the act, the determination or definition of net income, and the rate structure, we may turn finally to a brief reference to certain administrative provisions of the law.

It is encouraging to know that the law as drawn up provides for most of the essentials of effective administrative procedure as they have been demonstrated by the experience in other states. These essentials have been outlined by the committee of the Tax Policy League on the place of state income taxation in the revenue systems of the states as follows: "The success of a state income tax depends to a very large extent upon the vigor and honesty of its administration. The two most essential requisites for such administration are central responsibility and a non-political civil service. Without both of these features competent administration is very unlikely, and without either, it is quite impossible. Central administration should be either by a State Tax Commission or a Commissioner, plus a Board of Tax Appeals. The administration should be given adequate financial support for the audit of returns and books, both in the office and in the field. It should be given adequate legal authority to compel co-operation on the part of taxpayers in furnishing necessary information.

"The law should require those who pay out wages, interest, rent and dividends to give 'information at the source' concerning such payments. Free examination of income tax returns by the public will further facilitate honest administration and make available to the public information which it is entitled to have."[96]

The administration of the California act is placed in the hands of the Bank and Corporation Franchise Tax Commissioner. The State Board of Equalization acts as a board of appeal.[97] An attempt was made in the Assembly to place the administration with the State Board of Equalization, but the proposal was defeated by a vote of 27 to 48.[98] It was argued that the board members are elected, whereas the Franchise Tax Commissioner is appointed by the Governor "and therefore subject to political control."[99] The Commissioner may divide the state into "a reasonable number of districts," may examine books, papers, and records, and may appoint and remove officers, agents, and deputies. Provision is made for information at the source, and, if deemed necessary in certain instances, collection at the source.[100] Administration of the act, as already pointed out, is facilitated by provision for acceptance of the taxpayer's annual accounting period and regularly employed method of accounting as bases for computation of income subject to the tax.[101] Provision is also made for installment payment of the tax.[102] Furthermore, the fact that in various provisions the state act follows the federal law with which the taxpayer is already familiar should help both officials and taxpayers in the everyday application of the law. Finally, aside from various detailed provisions with respect to procedure which need not here be recounted, the act endeavors to meet the problem of double taxation of interstate income through provision for credit for taxes paid other states by resident or nonresident taxpayers.[103] This is a provision in the direction of equity which should contribute to the more effective administration of the California income tax law.

The Personal Income Tax Act of 1935 marks a definite development and departure in California fiscal policy. Many have misgivings. But many others, for reasons which have been stated and explained in this chapter, feel that the adoption of the income tax was a distinct forward step for the state to take. It would be unfortunate, indeed, should misunderstanding on a disputed matter mar the orderly progress of the state. The issue is more than the income tax versus other taxes; it is income and other taxes versus the extent of public expenditures. If, to meet these expenditures which are likely to increase with growing emphasis upon social services, we must have sales taxes and property taxes, it would seem just to employ, as well, moderate income taxes in order to establish and maintain a proper balance in the fiscal structure of the state. One in any event may hope that California has moved intelligently and surely to serve the ultimate good of the commonwealth.

NOTES TO CHAPTER VIII

[1] "Income taxes may be assessed to and collected from persons, corporations, joint-stock associations or companies resident or doing business in this state, or any one or more of them in such cases and amounts, and in such manner, as shall be prescribed by law."—*California Constitution*, Art. XIII, sec. 11 (original section, Constitution of 1879). California has been in a favored position in this respect. The uniformity clauses of various state constitutions have made the adoption of income taxes difficult. See Tax Policy League, *Taxbits*, vol. II, no. 7 (May, 1935), p. 9.

[2] *Cal. Stats.* (1935), ch. 329. Approved by the Governor, June 13, 1935.

[3] The proposed initiative measure would amend the State Constitution so that hereafter no law imposing a personal income tax could become valid except upon a majority vote of the people. The state law requires 187,000 signatures to the petition. At the present writing (December, 1935) apparently some 300,000 signatures have been obtained and certified to the Secretary of State. Consequently the proposition will appear upon the 1936 November ballot.

[4] For a brief outline presentation of the growth of state income tax legislation see *Taxbits*, as cited in footnote 1. Or consult recent standard texts on public finance.

[5] *Report of the State Board of Equalization* (1913–1914), p. 50.

[6] *Ibid.*, pp. 50–54.

[7] *Report of the State Tax Commission of the State of California* (Sacramento, 1917), pp. 110–120 (hereafter referred to in this chapter as the *1917 Report*).

[8] *Ibid.*, p. 111.

[9] *Ibid.*, pp. 112–113.

[10] *Ibid.*, p. 113.

[11] *Ibid.*, pp. 112–113.

[12] *Ibid.*, pp. 118–119.

[13] Commonwealth Club of California, *Transactions*, 26 (1932), 505.

[14] *Final Report of the California Tax Commission* (Sacramento, 1929), p. 94 (hereafter referred to in this chapter as the *1929 Report*).

[15] "Nor has the committee had the means, time, nor opportunity to consider intensively the effect of the income tax, or sales tax or other forms of taxation upon our system. The experience of other states furnishes slight assistance. Those states that have the income tax now in effect are seriously studying and have commissions at work on the problems; whether such tax is in fact a substitute tax, resulting in a lessening of the tax burden upon real estate, or is simply an additional tax giving greater opportunity for increased expenditures with no benefit to real estate; whether new taxpayers are reached by the introduction of a personal income tax or taxpayers already paying heavy taxes upon their real property furnish the bulk of the income tax."—From Report of the Joint Legislative Tax Committee, *Assembly Daily Journal*, January 23, 1931, p. 22.

[16] "A State Income Tax?" (editorial), *Los Angeles Times*, November 23, 1934. In the same editorial the further comment was made that "a State income tax should be the last resort; even an ad valorem levy would be preferable, since that is not likely to become a permanent tax feature."

[17] The observation seems particularly applicable to conditions in California. This is true for a number of reasons, one of which is the larger measure of financial responsibility recently assumed by the state for the support of education. The sales tax is looked upon as a "school tax."

[18] This is, however, a debatable point. See the argument by Professor E. M. Patterson, "Sales Tax or Income Tax," *The Nation*, January 18, 1933. "For years we have been told

that high rates mean a low yield although returns and the practice in Europe regularly show the opposite and our own common sense reinforces this evidence."—*Ibid.*

[19] "State Income Taxes" (editorial), *Los Angeles Times*, January 8, 1934. The *Times* is an outspoken opponent of the state income tax.

[20] *Ibid.* The degree to which evasion of income taxes is accomplished by investment in tax-exempt securities has undoubtedly been exaggerated. In this connection refer to the study made by Dr. C. O. Hardy, *Tax-Exempt Securities and the Surtax* (New York: Macmillan, 1926), 216 pp. A summary statement of some of Dr. Hardy's conclusions appears in Lutz, *Public Finance* (2d ed.; New York: Appleton, 1929), pp. 581–582.

[21] The problem has been fully recognized. The Roosevelt administration is contemplating a Washington conference in 1936 to deal with it.

[22] Such as income from California state and municipal securities, salaries of state employees, etc.

[23] Herbert D. Simpson, "Borrow—Don't Tax," *Survey Graphic*, XXIII (September, 1934), 448.

[24] For a discussion of the point involved with accompanying graphs see *Taxbits*, as cited in footnote 1. Professor James W. Martin, research director of the interstate Committee on Conflicting Taxation, points out as an illustration apropos the federal income tax that "an individual with a net income of $55,000, for example, might point to a tax under the 1934 federal rates of 34%; but the effective rate on his entire income would be actually 10%."

[25] National Industrial Conference Board, *State Income Taxes* (New York, 1930), vol. II, ch. xiv; quoted in Elmer D. Fagan and C. Ward Macy, *Public Finance* (New York: Longmans, Green, 1934), p. 428.

[26] Quoted from Professor Roy G. Blakey, *Report on Taxation in West Virginia* (Charleston: Jarrett Printing Co., December 27, 1930), p. 266.

[27] Quoted in Fagan and Macy, *op. cit.*, pp. 187–188, from "National Taxation after the War," by Alfred Marshall, in *After-War Problems* (London: George Allen & Unwin, Ltd., 1917), ch. xviii, secs. 2, 3, 4.

[28] Professor Malcolm Davisson in Commonwealth Club of California, *Transactions*, 29 (May 7, 1935), 321.

[29] See the study by G. L. Leffler, "Wisconsin Industry and the Wisconsin Tax System," *University of Wisconsin Bulletin* (Madison, 1930).

[30] David R. Faries, as quoted in the *Los Angeles Times*, September 23, 1935.

[31] *Los Angeles Herald and Express* (editorial), January 7, 1935.

[32] For a scholarly appraisal of California fiscal policy during the depression see a paper by Professor Elmer D. Fagan of Stanford University in Tax Policy League, *Taxbits*, vol. II, no. 3 (January, 1935), pp. 2–15.

[33] Herbert D. Simpson, *op. cit.*, p. 434.

[34] *The Place of State Income Taxation in the Revenue Systems of the States* (May, 1935), p. 7 (published by the Tax Policy League). Members of the committee were Professors Herbert D. Simpson, Northwestern University, chairman; Roy G. Blakey, University of Minnesota; Harold M. Groves, University of Wisconsin; Jens P. Jensen, University of Kansas; and James W. Martin, University of Kentucky.

[35] The decline of the federal income tax yield during the depression years is common knowledge and requires no particular comment.

[36] "From a fiscal point of view income taxes possess distinct advantages. No other tax can be made to yield as much revenue or to yield it so dependably. . . . Great Britain has long used this tax as an elastic emergency source by the simple device of raising or lowering the rate according to the varying needs for revenue. . . . Several instances of marked reliance on the income tax for elasticity may be mentioned. Wisconsin and Massachusetts

met the demand for the soldiers' bonuses, and for educational funds by imposing state income taxes at higher rates."—Jens P. Jensen, *Problems of Public Finance* (New York: Crowell, 1924), p. 362. It should be said, however, that this was written before the experience of the years of depression.

[37] Professor Harold M. Groves, in "Recent State Income Taxation in the United States," *Tax Magazine* (March, 1934), points out that this adjustment has taken place through supplementary gross income tax laws, increase of income tax rates, and "classified income so that capital losses can be offset only against similar gains and in no case against other income." Reserves against lean years might also be set up, but this policy would require high-quality fiscal administration and control of political spending.

[38] Commonwealth Club of California, *Transactions*, 29 (May 7, 1935), 325.

[39] *1917 Report*, p. 116.

[40] *1929 Report*, p. 95.

[41] *Ibid.*, p. 98.

[42] *Ibid.*

[43] National Industrial Conference Board, *State Income Taxes*, II (New York, 1930), 139.

[44] *Los Angeles Times*, September 23, 1935, in an item "Tax Repeal to Be Asked."

[45] *Los Angeles Herald and Express*, February 6, 1935, in article "Arnold Points State Income Tax Evil."

[46] *Los Angeles Times*, January 8, 1934, "State Income Taxes" (editorial).

[47] *Ibid.*, November 23, 1934, "A State Income Tax?" (editorial).

[48] *Ibid.*, May 9, 1935, in article "Joker Found in Tax Bill Raises Rate." After the legislature decided to include dividends as subject to the income tax, it subsequently passed the Stow bill repealing the county tax on intangibles, thus substantially meeting the objection here mentioned. See the *Oakland Tribune*, July 14, 1935, "Rich to Flee Income Tax in State, Is Claim."

[49] "Every legislator who voted for California income taxes is public enemy No. 1. Their flippant, asinine reasons and excuses expose both their mentality and their prejudices."—Frank A. Garbutt, *Los Angeles Times*, December 8, 1935. Or recall the remarks of Assemblyman Ford Chatters, author of the bill which became the law, on the floor of the Assembly on April 19, 1935: "I wonder if Mr. Hearst or Mr. Norris believe, as they editorialize, that the Chatters bill is an extortionate and 'confiscatory' income tax—or that it will mean 'devastation of business, paralysis of industry, stagnation of trade and, in its ramifications, destitution for those now employed in shop, store, and factory.' "—*Santa Monica Outlook*, April 19, 1935.

[50] See footnote 60 below.

[51] For a concise discussion of the incidence of income taxes see H. L. Lutz, *op. cit.*, pp. 336–339. Also M. S. Kendrick, *Taxation Issues* (New York: Harpers, 1933), pp. 114–119. Professor Kendrick concludes (p. 119): "For these reasons, the writer believes that an income tax on personal earnings can be shifted neither at once nor ultimately, and that its incidence is finally on those who pay it. They suggest to him that the rates of this tax could be made much higher than at present with precisely the same incidence."

[52] "The researches of the National Industrial Conference Board embodied in this study indicate that in general the federal corporation income tax is not shifted to consumers but remains a burden upon the taxpaying corporations and hence upon their stockholders."—The National Industrial Conference Board, *The Shifting and Effects of the Federal Corporation Income Tax*, II (New York, 1930), 160.

[53] There are those who believe that we must eventually go beyond the ability theory to a newer conception of taxation. "A new theory of taxation is therefore necessary in the new state—that of state partnership. Together with the older theory of ability to pay, it

must form the main foundation of the new tax system."—Professor Paul Studenski in *The Nation*, 139 (October 17, 1934), 430.

[54] *1929 Report*, pp. 75, 99. The commission report outlined other circumstances which in its judgment supported the income tax proposal (pp. 99–100): "The ability of the property owner to pay taxes depends, then, on the ultimate realization of income from that property more than on the current value of that property. Further, earned income, which the property tax fails to reach, clearly represents some ability to pay taxes. There is a considerable class of professional and business men earning high salaries or making large business profits, whose taxable property is very small in comparison with their income. Many of them do not own the homes in which they live, and the amount of the tax shifted to them in form of rentals is no adequate measure of ability. These men receive material benefits from state and local expenditure, and are in a position to contribute directly to these governmental costs far more than the small tax on their automobiles, their household furnishings, and such securities as they may choose to reveal to the tax assessor.

"Finally, it may be noted that, if a personal income tax were established, it would be possible, under the provisions of section 5219 of the Revised Statutes of the United States, to include dividends from national banks in the income base subjected to the tax, even if it is impossible to tax either the personal property of the banks or their shares of stock. This would mean a more adequate revenue from bank sources and an improvement in the equity of the distribution of the tax burden generally."

[55] *1917 Report*, p. 113.

[56] *Ibid.*, pp. 114–115.

[57] *1929 Report*, p. 98.

[58] *Ibid.*

[59] *Ibid.*, pp. 98–99. The commission commented particularly upon difficulties of administration, inequalities of assessment, underassessment, evasion, etc.

[60] In event of a deficiency in revenue the state may impose an ad valorem tax upon all property in the state (*California Constitution*, Art. XIII, sec. 14). However, the sum raised from this source cannot exceed 25 per cent of the total appropriations from all funds of the state (Art. IV, sec. 34*a*).

[61] "They also expressed a strong sentiment in favor of continuing the state income tax and the five per cent limitation of public expenditures."—*Los Angeles Times*, January 4, 1936, "Realty Men in Favor of Sales Tax."

[62] Report of a committee of the Tax Policy League, *The Place of State Income Taxation in the Revenue Systems of the States* (May, 1935), p. 7. The remaining part of the comment of the committee along this line was quoted above in the discussion of the depression aspects of income taxation.

[63] *Ibid.*, p. 6.

[64] Whitney Coombs, "The Taxation of Farm Property," *United States Department of Agriculture, Technical Bulletin, No. 172* (February, 1930), p. 67.

[65] "The Personal Income Tax and School Support," *Research Division, National Education Association, Study No. 8* (February, 1931), p. 13.

[66] Professor Paul Studenski, "Public Finance in the World Crisis," *The Nation*, 139 (October 17, 1934), 430.

[67] "Instead of merely conforming with the changes occurring in the social order, taxation should induce them. Of all the peaceful means of bringing about a new social state, taxation is the most potent one. It should be used not merely as an expedient to raise revenue, but as a positive force for social reconstruction."—Professor Paul Studenski, "A Tax Program for the Future," *The Nation*, 140 (March 6, 1935), 276.

[68] *Cal. Stats.* (1935), ch. 329. The published regulations with respect to the law will be found in *Regulations relating to the Personal Income Tax Act of 1935 of the State of*

California (Supervisor of Documents, 214 State Capitol, Sacramento, California, 1936), 207 pp.

[69] For instance, incorporated in the state law were sections 111, 112, and 113 of the Federal Revenue Act of 1934 relating to the computation of gain or loss resulting from sale or other disposition of property; section 117 of the same act, and other sections therein referred to, dealing with the determination of gain or loss on sales or exchanges of capital assets; and section 114 of the 1934 act, and sections therein referred to, relating to the basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed. Compare section 7, subsections *d* and *e;* and section 8, subsection *k* of the state act.

[70] See footnote 1 to this chapter.

[71] Senate Constitutional Amendment No. 30, adopted June 27, 1933. Also *California Constitution,* Art. XIII, sec. 15: "The Legislature shall provide for the raising of revenue by any form of taxation not prohibited by this Constitution in amounts sufficient to meet the expenditures of this State not otherwise provided for...."

[72] *Cal. Stats.* (1935), ch. 329, sec. 31.

[73] *Ibid.,* sec. 5.

[74] *Ibid.,* sec. 2, subsec. *k.*

[75] *Ibid.,* sec. 12, subsec. *a.*

[76] "Income Tax Rules Given," article in *Los Angeles Times,* November 17, 1935.

[77] "Income Tax Scope Told," article in *Los Angeles Times,* September 13, 1935.

[78] *Cal. Stats.* (1935), ch. 329, sec. 6.

[79] *Ibid.,* sec. 7.

[80] *Ibid.*

[81] *Ibid.,* subsec. *b.*

[82] For particulars with respect to the preceding statements, see sec. 7 of the act.

[83] For the details of these deductible items, see sec. 8 of the act.

[84] The nondeductible items are specified in sec. 9 of the act.

[85] Sec. 16, subsec. *a.*

[86] Sec. 10, subsecs. *a* and *b.*

[87] The rate schedule is set forth in sec. 5.

[88] This table is adopted from Donald Myrick, "New California Income Tax," in the *Los Angeles Times,* July 30, 1935. It is based upon section 5 of the act which provides that "there shall be levied, collected and paid for each taxable year upon the entire net income of every resident of this State and upon the net income of every nonresident which is derived from sources within this State, taxes in the following amounts and at the following rates upon the amount of net income in excess of credits against net income provided in section 10:

"Upon net incomes not in excess of $5,000, 1 per centum of such net incomes.

"$50 upon net incomes of $5,000; and upon net incomes in excess of $5,000 and not in excess of $10,000, 2 per centum in addition of such excess.

"$150 upon net incomes of $10,000; and upon net incomes in excess of $10,000 and not in excess of $15,000, 3 per centum in addition of such excess.

"$300 upon net incomes of $15,000; and upon net incomes in excess of $15,000 and not in excess of $20,000, 4 per centum in addition of such excess.

"$500 upon net incomes of $20,000; and upon net incomes in excess of $20,000 and not in excess of $25,000, 5 per centum in addition of such excess.

"$750 upon net incomes of $25,000; and upon net incomes in excess of $25,000 and not in excess of $30,000, 6 per centum in addition of such excess.

"$1,050 upon net incomes of $30,000; and upon net incomes in excess of $30,000 and not in excess of $40,000, 7 per centum in addition of such excess.

"$1,750 upon net incomes of $40,000; and upon net incomes in excess of $40,000 and not in excess of $50,000, 8 per centum in addition of such excess.

"$2,550 upon net incomes of $50,000; and upon net incomes in excess of $50,000 and not in excess of $60,000, 9 per centum in addition of such excess.

"$3,450 upon net incomes of $60,000; and upon net incomes in excess of $60,000 and not in excess of $70,000, 10 per centum in addition of such excess.

"$4,450 upon net incomes of $70,000; and upon net incomes in excess of $70,000 and not in excess of $80,000, 11 per centum in addition of such excess.

"$5,550 upon net incomes of $80,000; and upon net incomes in excess of $80,000 and not in excess of $100,000, 12 per centum in addition of such excess.

"$7,950 upon net incomes of $100,000; and upon net incomes in excess of $100,000 and not in excess of $150,000, 13 per centum in addition of such excess.

"$14,450 upon net incomes of $150,000; and upon net incomes in excess of $150,000 and not in excess of $250,000, 14 per centum in addition of such excess.

"$28,450 upon net incomes of $250,000; and upon net incomes in excess of $250,000, 15 per centum in addition of such excess."

[89] *Ibid.*

[90] At least this was the explanation of Assemblyman Redwine of Los Angeles for his vote for the Chatters bill.

[91] *Oakland Tribune* (California), March 20, 1935.

[92] The vote was 70 to 5.

[93] *Cal. Stats.* (1935), ch. 834.

[94] Assemblyman Chatters, discussing on one occasion the tax liability of husband and wife with a joint income of $200,000, said: "In California the same taxpayers, permitted to make separate returns, would pay $30,594 each, or $61,188, and one-third for the proposed state tax would yield $20,396 or a total of $81,584—both state and federal—as against $87,019 for federal income tax alone in any state not having a community property law."—*Santa Monica Outlook*, April 19, 1935.

[95] He then outlines the comparative tax situations in Arizona, Connecticut, Florida, Illinois, Massachusetts, Missouri, New York, Ohio, Pennsylvania, and Wisconsin. His contribution to the thought on the subject seems particularly significant in that it was published in an opposition paper. But with the income tax established, former opposition was converted into comparative justification. See Donald Myrick, *op. cit.*

[96] Tax Policy League, 309 East Thirty-fourth Street, New York City, *Report of the Committee* (May, 1935), p. 15.

[97] *Cal. Stats.* (1935), ch. 329, secs. 32 and 20.

[98] *Los Angeles Times*, April 12, 1935, "Income Tax Bill Passed in Assembly."

[99] *Los Angeles Herald and Express*, April 11, 1935, "California Income Tax Bill Passes in Assembly." Another factor in the attempt, made by Epic-leader Assemblyman Jones, to place the administration with the board, may have been the circumstance that the board included in its membership Epic-supported Orfa Jean Shontz.

[100] *Cal. Stats.* (1935), ch. 329, sec. 23.

[101] *Ibid.*, sec. 16.

[102] *Ibid.*, sec. 14, subsec. *b*.

[103] *Ibid.*, sec. 25.

IX. MISCELLANEOUS TAXES

To trace the main outlines of fiscal history in California for the quarter-century since 1911 has been the main purpose of this work. Developments of the period were destined, as has been seen, fundamentally to change the tax system of the state from that with which it began twenty-five years earlier. The complexion of the tax structure has not been particularly affected by certain miscellaneous taxes which have been employed, or by the familiar single tax which was attempted, and yet a summary presentation of them seems desirable in order to round out in reasonably satisfactory fashion our story of California fiscal affairs. Attention will be directed first to the poll tax, which was repealed, and then to the single tax, the proposed adoption of which has been of recurrent interest in California. Reference will next be made to two taxes—chain store and oleomargarine—which at the present time are awaiting submission to the electorate in November, 1936. Finally, in the order of their fiscal importance, certain other miscellaneous levies will be briefly discussed.

The Poll Tax

The California Constitution originally provided for the levy of an annual poll tax, of not less than two dollars, on every male inhabitant of the state over twenty-one and under sixty years of age, with the exception of certain specified classes. The proceeds were to go into the state school fund.[1] This tax was in force from 1880 until 1914, when by virtue of initiative constitutional amendment of that year the levy and collection of a poll tax in the state were prohibited.[2]

There was considerable discussion at the time concerning the merits of the repeal proposal.[3] The proponents of repeal argued that the poll tax was "an antiquated excrescence upon our revenue system," and was primitive, archaic, and unrighteous; that the tax could not be uniformly collected; that continuance of the poll tax was not necessary for the support of the schools;[4] that other revenues were or would be readily available; that the existence of the state tax was seized upon as a pretext or precedent by boards of supervisors to levy additional head taxes for hospitals, roads, sanitation, and so forth; that the practice of compelling employers to deduct the tax from the wages of employees

[1] For notes, see below, pp. 272–275.

tended to create discord and ill feeling between them;[5] and that the poll tax was class legislation of the worst kind. Those who opposed the repeal measure were concerned with the danger to state finances resulting from the loss of the substantial revenues yielded by the tax, argued for its retention on the basis of governmental benefits for which all should pay something, and maintained that the tax was quite light and that when considered as part of a tax system its inequality as an objection disappeared.[6]

Although the Constitution was thus amended to prohibit the use of poll taxes, an amendment of 1920[7] stated that the legislature should provide a poll tax of not less than four dollars on every alien male inhabitant over twenty-one and under sixty, to be paid into the county school fund. But the alien poll tax law of 1921, comprising sections 3839 to 3856 inclusive of the Political Code, was held to contravene the Fourteenth Amendment to the Federal Constitution as denying to persons within the state's jurisdiction the equal protection of the laws.[8] Again, in 1924, the adoption of a further amendment called for the levy and collection of an annual educational poll tax of not less than five dollars on every male inhabitant over twenty-one and under fifty years of age, with the exception of those honorably discharged from Army, Navy, or Marine Corps; persons who paid a real or personal property tax amounting to at least five dollars; and paupers, idiots, insane persons, and imbeciles. The money was assigned to the state school fund. This is the provision as it reads today. Seemingly no subsequent legislature has been unenlightened enough to enact the necessary enabling legislation.

The Single Tax

The telling of California's fiscal story during the quarter-century under consideration would not be complete without at least a passing reference to the single tax. Although the movement seemed to become thoroughly acclimated to the land of its birth, it has never been quite able to add the vital cubit to its stature, a fact that has been due to no lack of effort and conviction on the part of those whose hearts and minds have warmed to the doctrines of Henry George.

This is no place to launch into a prolonged description and evaluation of single tax principles as they have been and are being argued and pleaded for in California. Each side has invoked all the arguments, theoretical, philosophical, economic, or social—valid or not—with which students of tax problems are familiar. Regularly every two years between 1912 and 1922, in one form or another, the electorate was called upon to record its determination of this issue. Every time the question was answered in the negative. The recorded vote in these past elections[9] was as follows:

Year	Yes	No	Loss margin	Year	Yes	No	Loss margin
1912	169,321	243,959	74,638	1918	118,088	360,334	242,246
1914	267,618	375,634	108,016	1920	196,694	563,503	366,809
1916	260,332	576,533	316,201	1922	124,403	515,590	391,187

In 1936, for the seventh time, the question comes before the voters for their judgment. Probably in no previous election have the lines been so sharply drawn. For this time the principle of the single tax is bound up with the repeal of the sales tax. Whereas heretofore the proposition has been ordinary home rule in taxation or just plain single tax, it is now in the guise of a program launched by groups calling themselves the Sales Tax Repeal Association and the Tax Relief Campaign Committee. Perhaps all too well the Board of Equalization in 1916 recognized the possibilities of initiative amendment to the Constitution, for, having observed that three attempts already had been made by the single tax advocates "to insidiously overthrow our tax system and inject their noxious creed," it went on to urge the adoption of a constitutional amendment which would prohibit the initiative being employed to invoke the single tax.[10]

The initiative constitutional amendment which will be submitted to the voters in November, 1936, provides for the abolition of the present sales tax and prohibits the imposition of any new sales tax, rescinds the present 25 per cent limitation of total appropriations from all funds of the state which may be raised by taxes on real and personal property, establishes immediately a reduction of $1,000 in the assessed value of improvements, and requires the gradual abolition, over a period of five years, of taxes on improvements and personal property, with the substitution therefor of land value taxation.[11] With trepidation on one side and hope on the other, the people of the state will anxiously await the result with an interest not for some time vouchsafed a major tax question.

The Tax on Chain Stores

Fanned by much fervid oratory, the movement against chain stores flamed into discriminatory laws in twenty-two states of the South and West, California being one. Undeterred by the attitude of the courts toward the constitutionality of such measures,[12] the proponents have vigorously supported their program in this state as in others. The Cronin-Murray bill, passed by the legislature of 1935 and approved by the Governor on July 21, 1935,[13] is designed primarily to "eliminate the menace which is forcing the displacement of the independent merchants who built up the California of today," and only incidentally to provide revenue for the state.[14]

The tax is in the form of an annual license fee. Under the provisions of the Chain Store Tax Act of 1935, anyone desiring to operate a store in this state must apply to the State Board of Equalization for a license to operate. Each store must have a separate license. Besides the filing fee of fifty cents which must accompany the application, the fees[15] are as follows:

Store no. 1......	$ 1.00	Store no. 5.....	$ 16.00	Store no. 9....	$256.00
Store no. 2......	2.00	Store no. 6.....	32.00	Store no. 10...	500.00
Store no. 3......	4.00	Store no. 7.....	64.00	Every store	
Store no. 4......	8.00	Store no. 8.....	128.00	over ten....	500.00

Returns were estimated at $3,000,000,[16] and were assigned without earmarking to the general fund. These fees are not all-inclusive. Those associations of independent merchants which maintain coöperative buying and price-fixing arrangements—voluntary chains—are not included. Neither are "filling stations" or gasoline bulk plants, ice plants, warehouses or stores, agricultural coöperatives, newspapers, theaters or cinemas.[17]

The chain stores waged a vigorous fight against the measure. They asserted that they saved the consumers about $48,000,000 a year, or 10 per cent of the state's marketing bill. California, they argued, was more vulnerable to a law against chain stores than any other state in the Union, because the chains bought $229,141,000 of California goods, mostly agricultural products, and sold $139,565,000, a 64 per cent balance of trade in favor of California.[18] They protested that the tax would mean the dismissal of their employees. In the fight against the tax, the chain stores were assisted by farm organizations.[19] In their advertising sheets they published pictures of their smaller security holders. Though during the public hearing in Sacramento they were unable to convince Governor Merriam that he should not sign the bill, their petitions for referendum, circulated the day after signature, and filed in September, delayed the effective date of the act. Originally designed to go into operation on October 1, it now awaits the result of the general election in November, 1936, along with the oleomargarine tax.[20]

Two general principles would seem to be involved with this act. One, whether the state should intervene in an economic question, was answered in the discussion of commercial motor transportation. The other quesion is whether the state should use its taxing power to achieve a social end. Usually, students of public finance have answered "No," and have believed that direct legislation, not taxing power, should be the method used.

The Oleomargarine Tax

So humble a product as oleomargarine does not seem logically to fall in the same category as alcoholic beverages and race tracks, but the California law has ordered that oleomargarine should be subject to an excise tax. In an effort to help the dairy industry, the California Farm Bureau has worked many years to obtain a tax that will raise the price of butter substitutes. Its first success came in 1925, when a tax of two cents a pound was laid on oleomargarine and other butter substitutes not containing milk products. Distributors of oleomargarine; manufacturers who used it in their products; retailers, hotels, and restaurants who sold or served it, were to be licensed by the State Director of Agriculture; the fees were $100 for manufacturers, $50 for wholesalers or distributors, $5 for retailers, and $2 for hotels and restaurants. Exported oleomargarine was exempt. All license fees collected and the excise tax as well were assigned to the oleomargarine enforcement and dairy control fund, created by the Act of 1925, and used by the Department of Agriculture.[21] The tax never became effective because an initiative petition calling for a referendum was filed, and the tax was rejected at the general election on November 2, 1926, by a vote of 749,640 to 287,703.

This decisive vote quieted proponents for the time. Between 1926 and 1935, there was no further tax in spite of the Farm Bureau's activity. In 1933 the legislature passed a bill levying a tax of eight cents a pound on oleomargarine and butter substitutes.[22] The bill was vetoed by Governor Rolph in a lengthy message in which he gave the following reasons for his action: the bill was so worded that all margarine products except those made from cocoanut oil would escape the tax, and since a tax on cocoanut oil was really a tariff on Philippine commerce it would both injure California exports to the Philippines and conflict with the federal power to regulate commerce; even if the tax applied to all oleomargarine, that article could still be sold cheaper than butter, for the price of butter regulates the price of oleomargarine, and not vice versa; the dairy industry was not threatened by butter substitutes so long as California imported butter; finally a tax on oleomargarine would cause hardship to many families, would "single out the poor man's table for a selective sales tax on a solitary food product."[23] The bill did not pass over the Governor's veto.

However, the proponents of the oleomargarine tax were not vanquished; the tax was proposed again in the legislature of 1935, passed each house by a large vote, and was approved by Governor Merriam.[24] It has not become effective, and probably will not, for no sooner was it passed than initiative petitions originating in the urban counties were filed asking for a referendum at the general election in November, 1936; until that date, the tax is being held in abeyance.[25]

By the Act of 1935,[26] there is imposed, in addition to the retail sales tax, a tax of ten cents a pound upon oleomargarine, which is defined as (1) all substances heretofore known as oleomargarine, oleo, oleomargarine oil, butterine, lardine, suine, and neutral; and (2) all mixtures and compounds containing any edible oils or fats other than milk fat made in imitation of butter, or when so made, intended to be sold as butter or for butter or as butter substitutes. The tax is administered by the Director of Agriculture. Collection is by means of stamps which the director sells to the distributor (i.e., the producer, manufacturer, wholesaler) of oleomargarine. The proceeds go to the general fund.

This tax is an example of the use of the state's revenue powers by an organized group in an attempt to effect an end important to themselves—in this instance, to drive oleomargarine from the market and increase the sale of butter. The excise is not intended to raise revenue for the state. Since the greater part of the population is urban and has no interest in raising the price of oleomargarine, the tax will probably be rejected next November.

Liquor Taxes

Usually the first excise to be considered by a taxing power has been that on intoxicating beverages. Perhaps because viticulture and the manufacture of wine are so important among the state's industries, California had no such excise until the deficit of 1933 and the necessity for finding new revenue sources forced consideration of a liquor tax. Previous to the adoption of the federal amendment prohibiting the sale of intoxicating beverages, this state had left the licensing, controlling, and taxing of their sale entirely to local jurisdictions. After the separation of sources in 1911, the State Controller suggested that one way to overcome the deficit then anticipated was to levy a state tax upon dealers in liquor; since there were 16,000 of them, "a straight tax of $100 a year would bring in a revenue of $1,600,000; a tax of $125, a revenue of $2,000,000, and a tax of $150, a revenue of $2,400,000." He admitted that a graduated tax would be fairer, but thought that a classification of dealers would be impossible. The plan was not intended to interfere with local methods of control. He thought less opposition would come from dealers than from people who thought that "a tax would be the equivalent of placing the seal of the state's approval" upon an evil, but since the federal government was not signifying approval by its excise, this opposition might be met.[27] The Controller's suggestion did not receive legislative enactment. In 1918 the federal amendment precluded state excises upon alcoholic beverages.

When the federal government began to permit the sale of beer and light wines in 1933, and the repeal of the prohibition amendment impended, the idea of an excise upon these beverages was revived in California. First regarded as part of the selective sales tax, beer and wine were singled out for special attention early in the legislative session of 1933. Of many bills which were bruited, three succeeded in becoming law:[28] two Alcoholic Beverages Excise acts, imposing taxes effective immediately upon the sale of beer and wine, and the Liquor Control Act, which was to go into effect when repeal of the federal amendment should become a reality.[29] These three acts are the foundation of the state policy toward special taxes upon alcoholic beverages. They are also police measures, but with that feature we are not here concerned.

Repeal of the federal amendment brought with it the question whether the state or the local units should control the sale of beverages. Since the duty of enforcing the federal measures had fallen to the state, it was natural that the initiative constitutional amendment adopted at the general election of 1934 should give to the state the exclusive powers to control, license, and tax sales of liquor. On the basis of this amendment, court decision also gave such taxing powers to the state.[30] The legislature of 1935 acted upon this provision by enacting a liquor control and excise law more comprehensive than the laws of 1933 and including all forms of transaction in alcoholic beverages in the jurisdiction of the state.

Under the laws of 1933 and 1935, the state collects from dealers two kinds of taxes: license fees and an excise on volume manufactured or sold. License fees are designed to control the traffic and to protect the state's revenue interest by determining who is the taxpayer. The fees may be divided into three general classifications: those upon sales by manufacturers, importers, and wholesalers; those upon sales by common carriers; and those upon retailers with stationary places of business. Under the law of 1933, the state licensed and controlled sales under the first two of these classifications, but the retail sale of wine and beer was controlled by licensing boards of counties and municipalities. Under the law of 1935[31] the state grants and controls all types of licenses.

Types of licenses issued under the law of 1933, and the fees therefor,[32] are set forth in the following tabulation:

License	Annual fee in 1933
"On sale" beer and wine	$ 50.00
"Off sale" beer and wine	10.00
"Off sale" for other liquor	100.00
Industrial alcohol	
Under 5 gallons	5.00
Over 5 gallons	50.00
Medical alcohol	1.00
Wholesalers	
Liquor other than beer or wine	100.00
Beer and wine	10.00
Winery	100.00
Brewery	100.00
Distillery	50.00
Importers	100.00
Trains "on sale" beer and wine, per train	12.00
Boats "on sale" beer and wine, per boat	50.00

Types of license and fees therefor under the law of 1935[33] are as follows:

License	Annual fee in 1935
Beer manufacturer	$750.00
Wine manufacturer	
1,000 gallons or less	5.00
1,000 to 2,500 gallons	10.00

License	Annual fee in 1935
2,500 to 5,000 gallons	$ 20.00
5,000 to 20,000 gallons	40.00
20,000 to 100,000 gallons	75.00
100,000 to 200,000 gallons	100.00
200,000 to 1,000,000 gallons	150.00
For each 1,000,000 gallons over	100.00
Distilled spirits manufacturer	250.00
Still	10.00
Rectifier	250.00
Fruit brandy manufacturer	150.00
Distilled spirits and wine importer	100.00
Beer importer	500.00
Wine bottling or packaging	10.00
Distilled spirits bottling or packaging	250.00
Beer bottler or packager	500.00
Beer and wine wholesaler	50.00
Distilled spirits wholesaler	250.00
Retail package "off sale" beer and wine	10.00
Retail package "off sale" distilled spirits	
First $10,000 sales per year	100.00
Each $10,000 sales per year after the first	10.00
Industrial alcohol dealer	50.00
"On sale" beer license (retail)	25.00
"On sale" beer and wine license	
For trains, per train	15.00
For boats, per boat	50.00
Retail	75.00
"On sale" distilled spirits	
Cities over 40,000 population	450.00
Cities from 20,000 to 40,000 population	300.00
Remainder of state	250.00
Trains, per train	100.00
Sleeping cars	200.00
Boats	250.00

An excise tax is imposed on the manufacturer, importer, and wholesaler of all beverages containing one-half of one per cent or more of alcohol by volume, and manufactured in or imported into California. The excise on beer (62 cents a barrel of 31 gallons) and on wine (2 cents a wine gallon) was levied by the Act of 1933. These rates were retained in the Act of 1935, and to them have been added excises on other liquors. At present, the scale of the excise[34] is as follows:

Beer	per barrel	$0.62
Wine	per gallon	.02
Sparkling wine or champagne	per pint	.03
Distilled spirits of proof strength:		
2-ounce bottle		.02
8-ounce bottle		.05
1 pint, or over ½ pint		.10
⅕ gallon, or fraction over a pint		.16
1 quart		.20
½ gallon		.40
1 gallon		.80
Distilled spirits of more than proof strength, double the rates given above		

Exemptions from this excise have grown in number. The law of 1933 exempted sales made by one manufacturer or importer to another with a valid license, and sales for export, whether beverages manufactured in or those imported into California, the fact of export to be proved by the filing of an export certificate containing necessary details. To these exemptions the law of 1935 added beverages consumed by the employees of a licensee, as well as sales of denatured alcohol and sales made for governmental or scientific use, when the object was not the manufacture of beverages.[35]

Under the laws of 1933, retailers of wine and beer paid to the county or municipality that issued their licenses a maximum tax of fifty cents a barrel on beverages sold to the consumer,[36] but this provision was eliminated from the law of 1935. Retailers and common carriers pay no state excise taxes.

Administration of these taxes is confided to the State Board of Equalization as assessor and enforcer, and to the State Controller as collector. Especially inclusive are the powers of the State Board of Equalization, by reason of its authority to grant, deny, suspend, and revoke licenses whenever it believes that the revenue and welfare provisions of the statute have been violated. Since 1935, when retail wine and beer sales,[37] formerly licensed by local boards (county or municipal), were included within its jurisdiction, its power has been well-nigh absolute. Anyone wishing to manufacture, import, blend for sale, serve, or sell at retail any beverage containing one-half of one per cent or more alcohol must apply for a license to the State Board of Equalization. The license cannot be transferred and must be issued to a specific person for specific premises. It expires each year on December 31. The applicant must supply a bond equal to one and three-fourths times the amount of his license.[38]

The law of 1933 contained provisions authorizing the use of stamps for collecting the excise tax upon wine and beer. These provisions were repeated in the law of 1935 for collecting the tax upon distilled spirits, but stamps are no longer used for beer and wine. The board may sell stamps to manufacturers and importers, only occasionally to retailers.[39]

Returns from the taxes on liquor[40] have been as follows:

1933	Alcoholic beverages	$ 76,170
1934	Alcoholic beverages	1,028,822
1935	Alcoholic beverages	1,617,423
1936	Spirituous liquor excise	7,181,273
	Alcoholic beverages	1,813,929

Even in the short time the tax has been in existence, the disposition of the receipts has been changed. Under the laws of 1933, all the license fees except the "on sale" and "off sale" licences for retail establishments, and all of the volume excise tax on beverages sold by manufacturers and importers, went into the license tax fund created by the laws. After expenses of administration were deducted, 60 per cent of the balance was appropriated semiannually to the counties, and cities and counties, in proportion to the amount of fees collected from each county. Any surplus was to go to the state's general fund. Fees from "on sale" and "off sale" wine and beer licenses to retail establishments, and the 50 cents a barrel tax on the retail sale of wine and beer, went to the counties, and cities and counties. The counties were at liberty to dispose of this money as they desired.[41] The penalties on manufacturers and wholesalers for violation of the beverage tax act were paid to the county treasuries.

By the Act of 1935, all license fees, including those on retail licenses for the sale of wine and beer, and all receipts from the excise tax on volume, are paid into the alcoholic beverage control fund, created by the Act of 1935. Fifty per cent of the money collected from fees is to be distributed to the counties, and cities and counties, in the proportion which the fees collected from each county bear to the whole amount of fees collected. The remaining license fees and the volume tax are to bear the following expenses, which are in nowise to fall upon the counties' share: $600,000 goes to the Board of Equalization for its expenses in administering the act; $12,000 (or so much as is necessary) goes to the State Controller for collection costs; $60,000 goes to the State Department of Health for preventing the manufacture, sale, or transportation of adulterated, misbranded, or mislabeled alcoholic beverages; $1,400,000 goes to pay auditors and clerks; $10,000 goes to the State Department of Finance for its expenses in the enforcement of the act; an unspecified amount is allowed for refunds; and the balance goes to the general fund without restrictions on use.[42]

OTHER MISCELLANEOUS TAXES

Taxes on horse racing.—After having been forbidden since 1909, horse races at which betting is allowed were permitted in California by a constitutional amendment adopted at the special election on June 3, 1933. The legislature of 1933 immediately passed a statute making this constitutional provision effective.[43]

Under the law of 1933,[44] three kinds of fees are levied upon horse races. All persons wishing to conduct horse races at which wagers are made must apply annually to the horse-racing board for a license to do so. This board, created by the act, is composed of three members appointed by the Governor. The application for a license must be accompanied by a fee: for counties of 1,000,000 population or over, $10,000; for counties of from 600,000 to 1,000,000, $10,000; for counties under 600,000, $50 per racing day. These fees are paid by check to the State Treasurer. In addition, annual registration fees in amounts fixed by the horse-racing board are collected from all horse owners, riders, agents, trainers, stewards, starters, timers, judges, and other officials. A license tax of 4 per cent of all money handled in pari-mutuel pools must be paid to the state treasury daily for each racing day.

The statute of 1933,[45] enacted before an estimate of returns could be made, provided that all the money collected from races should be paid into a fund called the fair and exposition fund. This fund was to be distributed thus: $20,000 was to go for the expenses of the horse-racing board; the balance was to be spent for agricultural fairs—$100,000 for the California State Fair; 5 per cent of the remainder for citrus fairs and expositions, apportioned on the basis of the population of the counties that hold citrus fairs; 40 per cent for encouragement of county or district fairs other than citrus fairs; and the rest to state institutions of learning, for vocational training in agriculture and animal husbandry, or for relief of unemployment in California. The legislature was to allocate these sums biennially.

The statute of 1935[46] could be more definite. After the $20,000 for the expenses of the board are deducted, the disposition is: $125,000 to the California State Fair; $125,000 to the Los Angeles County Fair; $15,000 to the Sixth District Association for citrus fairs; 5 per cent of the balance for county citrus fairs, 40 per cent for agricultural fairs other than citrus fairs, but no county or district to receive more than $40,000; and of the balance, one-third to the State Emergency Relief Administration, one-third to California Polytechnic School, and one-third to the University of California.

The fish canners' tax.—Another miscellaneous tax of some interest may be described as the fish canners' tax.[47] It became operative in 1917 and was amended slightly in 1935.[48] The original act was described in substance as an act to license canners, curers, preservers and packers of fish, and handlers of crustaceans and mollusks, and to provide a revenue therefrom for the conservation, propagation, and restoration of fish in the state of California. In addition to certain license fees, the act imposed, with certain limitations, a privilege tax of two and one-half cents for each one hundred pounds, or fraction thereof, of fish purchased or received by licensees, or fish caught or taken by licensees with their own equipment. All moneys from the license fees and privilege tax were required to be credited to the fish and game preservation fund "and shall be expended on conservation work for the benefit of the commercial fishing industries within the districts from which the revenues are derived." The amendment of 1935 placed salmon in a special class and imposed a privilege tax of one-half cent per pound the proceeds of which were to be used only for the purpose of propagating salmon.

The athletic admission tax.—This act was adopted as an initiative measure at the general November election of 1924. It became effective December 17, 1924. Aside from establishing various license fees, it provides for a 5 per cent tax upon the gross receipts from boxing and wrestling exhibitions, exclusive of any federal taxes paid thereon. Exhibitions held for the sole benefit of veterans' organizations are exempt from the provisions of the act. All moneys except those appropriated annually by the legislature to defray the expenses of the State Athletic Commission are given over to the purpose of maintaining such homes for the care of veterans of any war of the United States as were in existence at the time the amendment became effective or that might thereafter be established by the laws of the state.[49] The yield from license fees and the 5 per cent tax on gross receipts averages more than $80,000 per year.

Fertilizer taxes.—Two legislative enactments provide for these taxes. An act of 1903[50] to regulate the sale of agricultural minerals imposes a tax of twenty-five cents for every ton of fertilizer sold, the selling price of which to the consumer is $8 or more per ton. An act of 1923[51] imposes a tax of ten cents per ton for every ton of agricultural minerals sold, such as lime, marl, gypsum, and phosphate rock intended for use on land. The proceeds of these taxes are used for the enforcement of laws governing the fertilizer industry.

The kelp tax.—The harvesting of kelp is subject to a $10 annual license fee and a privilege tax of one and one-half cents per ton of wet kelp harvested. Leases granting the exclusive privilege of harvesting kelp in specified areas must require the payment of a three-cent tax per ton with a minimum of $40 per year per square mile area of such beds, which tax is in lieu of the privilege tax of one and one-half cents per ton otherwise required to be paid.[52]

It seems unnecessary to carry further this discussion of miscellaneous revenues. The purpose in view has been subserved if some indication has been given of the nature and general significance of these items, which, as noted at the beginning of the chapter, have had no very important bearing upon the essential character of the revenue system of the state. We may now turn to a few summarizing and concluding remarks with respect to the quarter-century of California finance which has been reviewed in the preceding pages.

NOTES TO CHAPTER IX

[1] Art. XIII, sec. 12.

[2] The amendment as adopted read: "No poll tax or head tax for any purpose whatsoever shall be levied or collected in the State of California."—Art. XIII, sec. 12. The amendment was adopted by a vote of 405,375 to 374,487. See *Report of the State Board of Equalization* (1914), p. 59. For the early history of the poll tax in California see W. C. Fankhauser, *A Financial History of California* (*Univ. Calif. Pub. Econ.*, vol. 3 [1913]). Or see the extracts from this work in Commonwealth Club of California, *Transactions*, 9 (1914), 255–258.

[3] For a presentation of the arguments pro and con, see *Report of the State Board of Equalization* (1912), pp. 98–105, and Commonwealth Club of California, *Transactions*, 9 (1914), 231, 251–255.

[4] This seemed to be a matter of major concern on the part of those who expressed opposition to the repeal. At the time of repeal, the poll tax was yielding more than $800,000 annually, all of which went into the school fund of the state. Fankhauser wrote in 1913 (*op. cit.*, p. 344) before the repeal measure was adopted: "Suggestions and attempts to repeal the provisions of the constitution requiring the collection of a poll tax have been frequently made, but thus far have failed, largely because no other source of revenue has been found to serve as a satisfactory substitute."

[5] "Unharvested crops have been left to rot in the fields, buildings in course of construction have been abandoned and prolonged and costly strikes have had their inception through the enforcement of this practice."—Statement by Ed. J. Kay, Sacramento county assessor, in *Report of the State Board of Equalization* (1912), p. 100.

[6] These were the arguments presented by Professor Carl C. Plehn. See Commonwealth Club of California, *Transactions*, 9 (1914), 254–255.

[7] The amendment was opposed upon various grounds, such as the inquisitorial methods which would be involved in determining who were aliens and the objection of compelling those eligible for citizenship to become citizens merely to escape the tax. See Commonwealth Club of California, *Transactions*, 15 (1920), 228–229.

[8] *In re Kotta*, 187 Cal. 27; *In re Terui*, 187 Cal. 20.

[9] California Taxpayers' Association, *Tax Digest* (March, 1936), p. 92.

[10] *Report of the State Board of Equalization* (1916), p. 30.

[11] The initiative measure qualified for the ballot and was certified by the Secretary of State on September 8, 1934. As titled, it reads as follows: "Taxation Initiative. Adds Sections 112 and 2*a* to Article XIII, and amends Section 34*a* of Article IV, of Constitution. Abolishes all sales taxes imposed since January 1, 1933; and prohibits any sales tax. Repeals tax limitations in said Section 34*a* and declares taxation shall be limited only as provided in Section 2*a*. Requires deduction of one thousand dollars from assessed value of homestead improvements. Reduces taxation on tangible personal property and improvements over period of five years and prohibits taxation thereof thereafter. Increases land taxes proportionately. Defines improvements."

Since the comments upon the single tax in this chapter were written, the State Supreme Court on August 27, 1936, in a split decision, issued a writ of mandate ordering the Secretary of State not to place the proposed initiative on the November ballot. Opponents of the repeal amendment objected to the "misleading and deceptive" title.

"The title is carefully worded," said the majority opinion, "to indicate to a prospective signer that sales taxes are forbidden, that progressively taxes on personal property and improvements are abolished and that certain tax limits are removed, but it totally fails to indicate that the proposal is also a taxing measure.

"Everything that possibly could induce electors to sign the proposal is carefully included in the short title, but the one thing that would cause them to hesitate—the imposition of new taxes on real property—was certainly excluded. Such a title is clearly misleading and does not substantially comply with the Political Code. . . .'

The dissenting opinion of Justice Seawell was in effect that "hypertechnical and captious reasons should not be regarded as affording sufficient grounds for obstructing the electorate in putting into practical use the simple and direct method of legislation which the system was intended to afford. . . . Proposed legislation should not be denied a place on the ballot unless it clearly and unmistakably fails to comply with the substantial and important requirements of law."—"State High Court Bans Ballot on Sales Tax Repeal," *Los Angeles Times,* August 28, 1936.

[12] The chain store taxes of Kentucky, Iowa, and Wisconsin have all been declared unconstitutional.—*Literary Digest,* vol. CXXI, no. 10 (March 7, 1936), p. 43.

[13] *San Francisco Examiner,* July 21, 1935; *Los Angeles Times,* July 22, 1935; *Final Calendar of Legislative Business (Assembly Weekly History)* (1935), p. 654.

[14] Statement of Assemblyman Cronin of San Francisco, *Los Angeles Herald and Express,* May 3, 1935.

[15] Chain Store Tax Act, sec. 6, *Cal. Stats.* (1935), p. 2273; *Revenue Laws of California* (1936), p. 715.

[16] *Santa Monica Outlook,* May 3, 1935; *Los Angeles Times,* September 7, 1935.

[17] Chain Store Tax Act, sec. 1*b*, *Revenue Laws of California* (1936), p. 711; *Los Angeles Times,* May 3, 1935.

[18] *Los Angeles Times,* July 11, 1935; July 17, 1935; July 22, 1935. Also *Oakland Tribune,* July 22, 1935.

[19] *Los Angeles Herald and Express,* May 9, 1935; Von T. Ellsworth, *Annual Report of Research Department and Report on 1935 State Legislation to the California Farm Bureau Federation* (1935), p. 11.

[20] *Los Angeles Times,* July 21, 1935; September 23, 1935. Also *Los Angeles Herald and Express,* September 7, 1935. Both of these propositions were rejected by the electorate.

[21] *Cal. Stats.* (1925), ch. 329, p. 550. The law of 1925 was aimed to prevent the sale of butter substitutes under the name of butter.

[22] Assembly Bill No. 2352, *Assembly Journal* (1933), pp. 3527, 4048.

[23] *Assembly Journal* (1933), p. 4270.

[24] Approved April 17, 1935. The Farm Bureau bill had asked for a 12-cent tax.

[25] *Los Angeles Times,* August 14, 1935.

[26] *Cal. Stats.* (1935), ch. 51, p. 384; *Revenue Laws of California* (1936), p. 716. Twenty-three states tax oleomargarine.

[27] *Biennial Report of the State Controller* (1914), p. 15. For a general study of state liquor taxes since 1933 see Abraham Efros and Max Ziefert, "State Taxation of Alcoholic Beverages," Tax Policy League, *Taxbits,* vol. III, no. 6 (April, 1936), 14 pp.

[28] Assembly Bills Nos. 1527 and 2336, which together are the Alcoholic Beverage Tax Act of 1933; Assembly Bill No. 1528, the State Liquor Control Act of 1933. See *Assembly Journal* (1933), index; *Senate Journal* (1933), index.

[29] Alcoholic Beverage Tax Act (excise on wine and beer), *Cal. Stats.* (1933), ch. 51, p. 340, approved April 6, 1933; Alcoholic Beverages Act (excise on beer and wine), *ibid.,* ch. 178, p. 625, approved April 27, 1933; State Liquor Control Act, *ibid.,* ch. 658, p. 1697, approved June 3, 1933; *Supplement to Revenue Laws of California of 1932* (1934), pp. 180, 194.

[30] "The State of California, subject to the Internal Revenue Laws of the United States, shall have the exclusive right and power to license and regulate the manufacture, sale, purchase, possession and transportation of intoxicating liquor within the State, and subject to the laws of the United States regulating commerce between foreign nations and among the States shall have the exclusive right and power to regulate the importation into and

exportation from the State, of intoxicating liquor. Intoxicating liquors, other than beers, shall not be consumed, bought, sold, or otherwise disposed of for consumption on the premises, in any public saloon, public bar or public barroom within the State; provided, however, that subject to the aforesaid restriction, all intoxicating liquors may be kept and may be bought, sold, served, consumed, and otherwise disposed of in any bona fide hotel, restaurant, cafe, cafeteria, railroad dining or club car, passenger ship, or other public eating place or in any bona fide club after such club has been lawfully operated for not less than one year. The State Board of Equalization shall have the exclusive power to license the manufacture, importation and sale of intoxicating liquors in this State, and to collect license fees or occupation taxes on account thereof and shall have the power, in its discretion, to deny or revoke any specific liquor license if it shall determine for good cause that the granting or continuance of such a license would be contrary to public welfare or morals."—*California Constitution*, Art. XX, sec. 22, adopted November 6, 1934.

See also *Los Angeles Brewing Company* v. *City of Los Angeles et al.*, California District Court of Appeals, Fourth Appellate District, July 15, 1935; and *California Corporation Tax Service* (1935), pp. 515–516.

[31] *Final Calendar of Legislative Business* (1935), p. 305; *Tax Digest*, XIII (August, 1935), 268; *Cal. Stats.* (1935), ch. 330, p. 1123; *Revenue Laws of California* (1936), p. 425.

[32] Figures are taken from *Cal. Stats.* (1933), ch. 658, secs. 11 and 15, p. 1697 (Liquor Control Act); ch. 178, sec. 2 (Beverage Tax Act). The Liquor Control Act gives the figures for winery and brewery licenses at $10 and $1. An "on sale" license permits the holder to sell for consumption with meals on the premises. An "off sale" license permits sale but not consumption on the premises.

[33] Figures are taken from *Cal. Stats.* (1935), ch. 330, secs. 4, 5, p. 1123. Cities of more than 40,000 population are Berkeley, Fresno, Glendale, Long Beach, Los Angeles, Pasadena, Oakland, Sacramento, San Diego, San Francisco, San Jose, and Stockton. Cities of from 20,000 to 40,000 population are listed as Alameda, Alhambra, Bakersfield, Huntington Park, Pomona, Richmond, Riverside, San Bernardino, Santa Ana, Santa Barbara, and Santa Monica.

The beer importer's license fee was declared void September 20, 1935, by the United States District Court, in the case of *Young's Market Co.* v. *State Board of Equalization.* See *Revenue Laws of California* (1936), p. 430.

[34] *Cal. Stats.* (1935), ch. 330, secs. 23, 24; *ibid.* (1933), ch. 178, sec. 5.

[35] *Cal. Stats.* (1933), ch. 178, sec. 11; *ibid.* (1935), secs. 29, 30; *Revenue Laws of California* (1936), p. 440.

[36] *Cal. Stats.* (1933), ch. 178, sec. 17.

[37] *Ibid.*, sec. 20.

[38] *Cal. Stats.* (1935), ch. 330, secs. 6–22.

[39] *Ibid.* (1933), ch. 178, sec. 6; *Supplement to Revenue Laws of California of 1932* (1934), p. 198; *Cal. Stats.* (1935), ch. 330, sec. 34; *Revenue Laws of California* (1936), p. 446.

[40] *Biennial Report of the State Controller* (1934), p. 29; California State Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (June, 1936).

[41] Liquor Control Act of 1933, secs. 30–33, *Supplement to Revenue Laws of California of 1932* (1934), pp. 191–193; Alcoholic Beverage Tax Act of 1933, sec. 14, *ibid.*, pp. 191, 201, 205.

[42] Alcoholic Beverage Control Act of 1935, sec. 37, *Revenue Laws of California* (1936), p. 447.

[43] *Cal. Stats.* (1909), ch. 28, p. 21; *Penal Code*, sec. 377*a*; *Cal. Stats.* (1911), ch. 7, p. 4;

California Constitution, Art. IV, sec. 25*a*; *Assembly Amendment* (1933), No. 119. An initiative amendment to legalize such horse races was defeated by referendum at the general election of 1926. See *Cal. Stats.* (1927), p. lxxxvi. The successful bill in 1933 was Assembly Bill No. 2412. See *Assembly Journal* (1933), index.

[44] *Cal. Stats.* (1933), ch. 769, p. 2046.

[45] *Ibid.*, sec. 13.

[46] *Cal. Stats.* (1935), ch. 515, sec. 13, p. 1587.

[47] *Cal Stats.* (1917), ch. 687, p. 1275. Approved May 28, 1917. In effect July 27, 1917.

[48] *Cal. Stats.* (1935), ch. 456. Approved July 11, 1935. In effect September 15, 1935.

[49] *California Constitution,* Art. IV, sec. 25¾. New section adopted November 8, 1932.

[50] *Cal. Stats.* (1903), ch. 225, p. 259.

[51] *Cal. Stats.* (1923), ch. 349, p. 721.

[52] Fish and Game Code, Art. IV, secs. 580–596; *Cal. Stats.* (1933), ch. 73, pp. 448–450.

X. CONCLUSION

THE STATE OF MIND in which one concludes a work of this kind may best be indicated by mentioning a few of the more general and important of the impressions gained from the study made. In the first place one feels and appreciates the changing character of tax problems. California saw fit fundamentally to modify its revenue system in 1911 by introducing the separation of sources plan whereunder certain taxes were assigned to the state, whereas the property tax was reserved for the local governments. This system, designed to eliminate the evils of the preëxisting order of things, was undoubtedly a step forward in taxing theory and practice. Yet hardly had it been introduced when difficulties arose. Separation, once heralded as a sort of panacea, became disillusioning. This did not mean that the framers of the plan lacked wisdom and foresight. It simply meant that economic development and change necessitated new adjustments. Whether these new adjustments need have been of the fundamental character that they proved eventually to be, may be an open question. But at any rate the separation of sources plan was finally abandoned, as recommended by the tax commission which reported in 1929. It is interesting to note that this commission found as many if not more reasons for condemning separation than had the earlier commission for advocating it. Thus were developing circumstances in social and economic life responsible for basic reform in the tax system of the state. If any further fact were necessary to impress upon one the changing character of fiscal problems in California, it could be found in the mere recalling of the recurrent studies of and reports upon revenue and taxation in this state which have persisted down to the present time.

A second impression with which one is left from a study of California's fiscal history is that of the unusual variety and extent of the problems with which the state has had to deal. A state originally and still largely agricultural in its nature has yet in time become more and more urbanized and industrialized. These changes, together with the remarkable growth in population and the increasing social activities of government, both of which contributed to increased public expenditures with the consequent need for expanded revenues, have brought with them questions to which ready answers have not always been available. The various commission surveys fairly bristle with pointed paragraphs on this problem and on that. What is the relative burden of taxation as between public utility and common property, as between classes of utilities, and as between individual utilities? If tax rates should be adjusted, how far and in what direction? Upon what basis should business concerns be taxed? Particularly how should the state tax the banking institutions and insurance companies? What new types of taxes should be employed? What changes should be made in the old ones? What will be the incidence and effects of the taxes used? Can there be found for all of them a logical and defensible place in the tax system as a whole? How broad should the tax base be? In what measure should the state subsidize local governments? These are illustrative basic questions, to say nothing of the manifold administrative complexities which like barnacles attach themselves to every tax employed.

Other impressions crowd upon one, but perhaps most significant of all is the feeling that the state, despite difficulty and obstacle, has made definite advance in its fiscal affairs. Perhaps this progress has been halting rather than regular, perhaps too much tinged at times with expediency rather than happily colored by conscious forethought and plan, or perhaps too often retarded by the influence of minority groups. But progress nevertheless there has been in such directions as better tax administration, in the adoption of the net income basis in the taxation of persons and of business, and in general in the achievement of some semblance of a system of taxation. It is only regrettable that economic and legal necessity forced the adoption of the regressive sales tax, which now provides some 55 per cent of the general fund revenues of the state.

California, like other states, has supplemented its revenues by borrowing. The biennial budget for 1935–1937 summarized the facts with respect to the state debt.[1] This debt is of interest for a number of reasons. Most of it has been incurred during the period which has been under review in these pages. Of the total outstanding bonded indebtedness of $155,966,500 reported as of December 31, 1934, $133,885,000 of it has been incurred since 1913. The general government bonds, chargeable to the general fund and totaling $93,738,500, were issued for such major purposes as state buildings and parks, state university buildings, highway construction, and unemployment relief. The total debt service, interest and redemption, for general government bonds for 1935–1937 was stated to be $16,472,074.64. Self-liquidating bonds totaling

[1] For notes, see below, p. 282.

$62,228,000 were issued mainly for San Francisco harbor improvement and for veterans' farm and home-building purposes.

Another item which should be recalled at least to the extent of mention was the provision in 1922 for the executive form of state budget.[2] The governor is required to submit to the legislature, with an explanatory message, a budget containing an itemized statement of all proposed expenditures and estimated revenues for the ensuing biennium, together with a comparison thereof with expenditures and revenues of the existing biennial period. If the proposed expenditures for the ensuing period shall exceed the estimated revenues, the governor shall recommend the sources from which the additional revenue shall be obtained. The governor may at any time amend or supplement the budget and may reduce or eliminate items of appropriation without approving others, subject to a two-thirds vote of both houses of the legislature. No bill, other than the budget bill, may contain more than one item of appropriation and with certain exceptions no appropriation bill may be passed prior to the adoption of the budget. Although budgetary procedure in California may be lacking in some of the standards which could be set up for such a program, in general it can be said that satisfaction has attended the administration of the budget in the state.

Still another aspect of California state finances that merits attention is the growth of state aid to local governments. So significant has this development become that in the 1935–1937 budget a special point was made of setting out in clear relief the extent of the state's subventions to counties.[3] These subventions, for schools, social welfare and public health, highways, and other purposes, reached an estimated total for the 1935–1937 biennium of $193,951,489.64. Of the total, $158,433,892.82 was payable from the general fund and the remainder from special funds. Thus it is that a very large share of the state's expenditures ($193,951,489.64 out of a total of $347,313,074.59)[4] is for aid in one form or another to local governments. This fact, although largely one with respect to expenditures, which this volume has not undertaken to discuss, helps to explain in substantial measure the distinctive development of the revenue system of the state particularly within the last three or four years. Taxation has taken on relatively less of a local and more of a state character. This circumstance, with its accompanying implications and possibilities, opens up a whole vista of principles and problems upon the discussion of which we cannot enter here.[5]

The current financial position of the state is at present (July, 1936) more encouraging than for some time past. Although it is true that in order to finance the deficit in the general fund the state has been registering warrants,[6] the deficit for the 1935–1937 biennium, originally estimated at nearly $100,000,000, will now apparently be less than half that sum.[7] With continuing improvement in the yield of state taxes and with no adverse vote on pending propositions to repeal the sales and income taxes, the state should, without the levy of new taxes, be much nearer a balancing of its budget. If that be true, then there is likely to be heard much less in the future of the pros and cons of prospective new levies such as severance, gross receipts, real estate transfer, nuisance, and other sorts of taxes.

That the problem of taxation in the state is definitely a live issue, however, admits of no question. Evidences of that are to be found in the recent joint legislative committee report on revenue and taxation,[8] the Governor's conference on taxation held in early February, 1936, and the activities of the interim committee which is to report probably to the 1937 legislature or to another tax conference. No attempt is made here to abstract the substance of the joint legislative committee report which, according to the committee's statement, was concerned with a balanced budget for 1935–1937, adequate provision for unemployment relief, and the present deficit. At the Governor's taxation conference, held at Sacramento on February 3 and 4, 1936, there were adopted a number of resolutions among which were those opposing repeal of the sales and income taxes, selecting a committee of three to appoint an interim committee of twenty-five to study questions of governmental revenues and costs, instructing responsible state officials to take immediately all necessary steps to accomplish reductions in expenditures, declaring against the levy of any additional taxes for the time, requesting amendment of the national security act so that individual residence requirements of the states would prevail for old age security benefits, and calling for discontinuance of the SERA and assignment of direct relief administration to the state board of social welfare to eliminate duplicating costs.[9] The interim committee of twenty-five, duly appointed, is now functioning, and presumably will present its findings in season.

Thus the picture presented is one of continued inquiry into the working of the revenue laws of the state. In the process of their application, much attention necessarily must be given to administration, for, as has often been stated, effective administration is a highly important thing. The commission reporting in 1929 gave a section of its report to this matter.[10] Its observations made in 1929 are still pertinent in 1936. The commission criticized the lack of centralization in the state's tax administrative machinery, with the corporation taxes under the jurisdiction of the State Board of Equalization, the inheritance tax in the Controller's office, the motor vehicle license tax in the Department of Finance, and so forth. It objected to the elective State Board of Equalization and suggested in its place the establishment of an appointive permanent professional tax commission, going so far, indeed, in this respect as to condition its other recommendations upon the acceptance of its proposals for changes in the state administrative machinery. Although many other changes recommended in this 1929 report have been by now adopted, there has been little if any change in the direction of the administrative reform suggested by the commission. Decentralization still exists. The Board of Equalization administers the alcoholic beverage, insurance company, motor vehicle transportation, sales, and use taxes, as well as assesses public utility property for purposes of local taxation; the Franchise Tax Commissioner has charge of the bank, corporation, and personal income taxes; the Controller still administers the inheritance tax; and the Department of Motor Vehicles takes care of the state tax upon motor vehicles. Likewise no substitution of an appointive commission for an elective board has been made, or apparently is likely to be made.[11] Obviously there is still room for improvement in California along the lines generally recognized as desirable for, if indeed not essential to, the most satisfactory state tax administration. A properly constituted commission assigned proper functions would be a constructive improvement.

If there is one thing which a survey of twenty-five years of fiscal history in California should teach, it is a recognition of the need for progressive change. Peradventure it is for others, coming later, to say whether in California, as elsewhere, public finance shall adhere to the classical and conservative standards of the past, sufficient for that day, or shall be so constructed that it will harmonize with the social needs of a different age. Heretofore we have undertaken to make the revenue system conform to changing economic and social circumstances. It is not at all unlikely that henceforth taxation may help to determine what those conditions will be. In any eventuality we are forced to agree with Professor Commons that "governments must have revenues in increasing amounts—because the social needs of education, ethics, morality, art, equality, liberty, protection of the weak, highways, health, recreation, grow faster in an improving civilization than do the private needs of food, luxury, ostentation."[112]

The answer to these questions of fiscal policy means much to the commonwealth's weal or woe. Our problem in California is to adapt our tax system to the needs of the new day and to the needs of the days to come. Happily taxation is not simply the power to destroy. It is the power through enlightened government to build to the end that more of the people may share in and enjoy the advantages of advancing civilization. Is it too much to hope that California, in part through the operation of her tax system, will take a rightful place in the vanguard of progressive legislation and enlightened social policy?

NOTES TO CHAPTER X

[1] *Budget of the State of California for the Biennium July 1, 1935, to June 30, 1937*, pp. 64, 535. The constitutional provisions with respect to state indebtedness will be found in *California Constitution*, Art. XVI, sec. 1. See *The Revenue Laws of California* (1936), pp. 52–53, for statement of the constitutional provision and a brief comment upon the interpretation thereof.

[2] Amendment adopted November 7, 1922, Art. IV, sec. 34. See *The Revenue Laws of California* (1936), pp. 9–11, for statement of the section and a brief comment upon the interpretation thereof. For a description of the California budget and budgetary procedure see Rolland A. Vandegrift, "Control of State Expenditures through Budgeting and Budgetary Procedure," National Tax Association, *Proceedings* (1931), pp. 189–211.

[3] *Budget of the State of California, 1935–1937*, Part I, pp. 3–15.

[4] *Ibid.*, p. 1.

[5] See "Principles of State Aid," in Tax Policy League, *Taxbits*, vol. II, no. 10 (August, 1935), for a summary discussion of these principles and problems.

[6] As of June 30, 1936, registered warrants to the amount of $49,913,562.84 were outstanding. See Department of Finance, Division of Budgets and Accounts, "Monthly Summary Financial Statement" (July 15, 1936).

[7] The net current deficiency is stated as being $43,128,553.65. See *ibid.*

[8] *Senate Daily Journal*, May 15, 1935, p. 37. Minority report at p. 204.

[9] As reported in the *Santa Monica Outlook*, February 5, 1936. In the issue of February 3, it was pointed out that the Governor, in his address to the conference, had presented eight specific recommendations to the representatives of ninety-nine California organizations. He urged the conference to:

1. Make definite recommendations which can be translated into effective measures for reducing government costs and the general tax burden.

2. Favor reënactment of the 5 per cent budget limitation law, which would guard against increased spending by the state and its political subdivisions.

3. Name a committee to study the desirability of a general revision of the entire tax system, taking into consideration the possibility that the voters may repeal the sales and income taxes next November.

4. Study the transactions or gross income tax with a view to its adaptation to the needs of this state.

5. Determine how far the government is to expand itself in rendering public service.

6. Consider consolidation of counties as a means of reducing expenses.

7. Study the question of merging all highways into the state system as an economy and efficiency move.

8. Investigate the question of duplications of the functions of government by the state, county, and city.

[10] *Final Report of the California Tax Commission* (Sacramento, March 5, 1929), pp. 116–132. Part of the discussion was devoted to state and part to local tax administration.

[11] The Governor's conference upon taxation passed up a proposal looking toward the establishment of a tax commission. Subsequently the State Board of Equalization, seeking separation of liquor control from tax administration, both of which have been and are vested in its authority, recommended the reorganization of the board into a state tax commission with two representatives instead of one from the southern district in order to equalize representation. This proposal for an enlarged, elective board based upon district representation hardly conforms, however, to the type of tax commission envisioned in the commission report of 1929.

[12] John R. Commons, *Institutional Economics* (New York: Macmillan, 1934), p. 831.

APPENDIX A

[Amendment to Article XIII of the California Constitution (a new section), as adopted November 8, 1910, and known as Constitutional Amendment No. 1.]

Sec. 14. Taxes levied, assessed and collected as hereinafter provided upon railroads, including street railways, whether operated in one or more counties; sleeping car, dining car, drawing-room car and palace car companies, refrigerator, oil, stock, fruit, and other car-loaning and other car companies operating upon railroads in this state; companies doing express business on any railroad, steamboat, vessel or stage line in this state; telegraph companies; telephone companies; companies engaged in the transmission or sale of gas or electricity; insurance companies; banks, banking associations, savings and loan societies, and trust companies; and taxes upon all franchises of every kind and nature, shall be entirely and exclusively for state purposes, and shall be levied, assessed and collected in the manner hereinafter provided. The word "companies" as used in this section shall include persons, partnerships, joint-stock associations, companies, and corporations.

(*a*) All railroad companies, including street railways, whether operated in one or more counties; all sleeping car, dining car, drawing-room car, and palace car companies, all refrigerator, oil, stock, fruit and other car-loaning and other car companies, operating upon the railroads in this state; all companies doing express business on any railroad, steamboat, vessel or stage line in this state; all telegraph and telephone companies; and all companies engaged in the transmission or sale of gas or electricity shall annually pay to the state a tax upon their franchises, roadways, roadbeds, rails, rolling stock, poles, wires, pipes, canals, conduits, rights of way, and other property, or any part thereof used exclusively in the operation of their business in this state, computed as follows: Said tax shall be equal to the percentages hereinafter fixed upon the gross receipts from operation of such companies and each thereof within this state. When such companies are operating partly within and partly without this state, the gross receipts within this state shall be deemed to be all receipts on business beginning and ending within this state, and a proportion, based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into, or out of this state.

The percentages above mentioned shall be as follows: On all railroad companies, including street railways, four per cent; on all sleeping car, dining car, drawing-room car, palace car companies, refrigerator, oil, stock, fruit, and other car-loaning and other car companies, three per cent; on all companies doing express business on any railroad, steamboat, vessel or stage line, two per cent; on all telegraph and telephone companies, three and one-half per cent; on all companies engaged in the transmission or sale of gas or electricity, four per cent. Such taxes shall be in lieu of all other taxes and licenses, state, county and municipal, upon the property above enumerated of such companies except as otherwise in this section provided; *provided,* that nothing herein shall be construed to release any such company from the payment of any amount agreed to be paid or required by law to be paid for any special privilege or franchise granted by any of the municipal authorities of this state.

(*b*) Every insurance company or association doing business in this state shall annually pay to the state a tax of one and one-half per cent upon the amount of the gross premiums received upon its business done in this state, less return premiums and reinsurance in companies or associations authorized to do business in this state; *provided,* that there shall be deducted from said one and one-half per cent upon the gross premiums the amount of any county and municipal taxes paid by such companies on real estate owned by them in this state. This tax shall be in lieu of all other taxes and licenses, state, county and municipal, upon the property of such companies, except county and municipal taxes on real estate, and except as otherwise in this section provided; *provided,* that when by the laws of any other state or country, any taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, are imposed on insurance companies of this state, doing business in such other state or country, or upon their agents therein, in excess of such taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, imposed upon insurance companies of such other state or country, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the legislature upon insurance companies of such other state or country doing business in this state.

(*c*) The shares of capital stock of all banks, organized under the laws of this state, or of the United States, or of any other state and located in this state, shall be assessed and taxed to the owners or holders thereof by the state board of equalization, in the manner to be prescribed by law, in the city or town where the bank is located and not elsewhere. There shall be levied and assessed upon such shares of capital stock an annual tax, payable to the state, of one per centum upon the value thereof. The value of each share of stock in each bank, except such as are in liquidation, shall be taken to be the amount paid in thereon, together with its pro rata of the accumulated surplus and undivided profits. The value of each share of stock in each bank which is in liquidation shall be taken to be its pro rata of the actual assets of such bank. This tax shall be in lieu of all other taxes and licenses, state, county and municipal, upon such shares of stock and upon the property of such banks, except county and municipal taxes on real estate and except as otherwise in this section provided. In determining the value of the capital stock of any bank there shall be deducted from the value, as defined above, the value as assessed for county taxes, of any real estate, other than mortgage interest therein, owned by such bank and taxed for county purposes. The banks shall be liable to the state for this tax and the same shall be paid to the state by them on behalf of the stockholders in the manner and at the time prescribed by law, and they shall have a lien upon the shares of stock and upon any dividends declared thereon to secure the amount so paid.

The moneyed capital, reserve, surplus, undivided profits and all other property belonging to unincorporated banks or bankers of this state, or held by any bank located in this state which has no share of capital stock, or employed in this state by any branches, agencies, or other representatives of any banks doing business outside of the State of California, shall be likewise assessed and taxed to such banks or bankers by the said board of equalization, in the manner to be provided by law and taxed at the same rate that is levied upon the shares of capital stock of incorporated banks, as provided in the first paragraph of this subdivision. The value of said property shall be determined by taking the entire property invested in such business, together with all the reserve, surplus, and undivided profits, at their full cash value, and deducting therefrom the value as assessed for county taxes of any real estate, other than mortgage interests therein, owned by such bank and taxed for county purposes. Such taxes shall be in lieu of all other taxes and licenses, state, county and municipal, upon the property of the banks and bankers, mentioned in this paragraph, except county and municipal taxes on real estate and except as otherwise in this section provided. It is the intention of this paragraph that all moneyed capital and property of the banks and bankers mentioned in this paragraph shall be assessed and taxed at the same rate as an incorporated bank, provided for in the first paragraph of this subdivision. In determining the value of the moneyed capital and property of the banks and bankers mentioned in this subdivision, the said state board of equalization shall include and assess to such banks all property and everything of value owned or held by them, which go to make up the value of the capital stock of such banks and bankers, if the same were incorporated and had shares of capital stock.

The word "banks" as used in this subdivision shall include banking associations, savings and loan societies and trust companies, but shall not include building and loan associations.

(*d*) All franchises, other than those expressly provided for in this section, shall be assessed at their actual cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the state.

(*e*) Out of the revenues from the taxes provided for in this section, together with all other state revenues, there shall be first set apart the moneys to be applied by the state to the support of the public school system and the state university. In the event that the above named revenues are at any time deemed insufficient to meet the annual expenditures of the state, including the above named expenditures for educational purposes, there may be levied, in the manner to be provided by law, a tax, for state purposes, on all the property in the state including the classes of property enumerated in this section, sufficient to meet the deficiency. All property enumerated in subdivisions *a*, *b*, and *d* of this section shall be subject to taxation, in the manner provided by law, to pay the principal and interest of any bonded indebtedness created and outstanding by any city, city and county, county, town, township or district, before the adoption of this section. The taxes so paid for principal and interest on such bonded indebtedness shall be deducted from the total amount paid in taxes for state purposes.

(*f*) All the provisions of this section shall be self-executing and the legislature shall pass all laws necessary to carry this section into effect, and shall provide for a valuation and assessment of the property enumerated in this section, and shall prescribe the duties of the state board of equalization and any other officers in connection with the administration thereof. The rates of taxation fixed in this section shall remain in force until changed by the legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof. The taxes herein provided for shall become a lien on the first Monday in March of each year after the adoption of this section and shall become due and payable on the first Monday in July thereafter. The gross receipts and gross premiums herein mentioned shall be computed for the year ending the thirty-first day of December prior to the levy of such taxes and the value of any property mentioned herein shall be fixed as of the first Monday in March. Nothing herein contained shall affect any tax levied or assessed prior to the adoption of this section; and all laws in relation to such taxes in force at the time of the adoption of this section shall remain in force until changed by the legislature. Until the year 1918 the state shall reimburse any and all counties which sustain loss of revenue by the withdrawal of railroad property from county taxation for the net loss in county revenue occasioned by the withdrawal of railroad property from county taxation. The legislature shall provide for reimbursement from the general funds of any county to districts therein where loss is occasioned in such districts by the withdrawal from local taxation of property taxed for state purposes only.

(*g*) No injunction shall ever issue in any suit, action or proceeding in any court against this state or against any officer thereof to prevent or enjoin the collection of any tax levied under the provisions of this section; but after payment action may be maintained to recover any tax illegally collected in such manner and at such time as may now or hereafter be provided by law.

APPENDIX B

[Amendment to Article XIII, as adopted November 6, 1928.]

Sec. 16. Notwithstanding any other provision of the constitution:

1. (*a*) Banks, including national banking associations, located within the limits of this state, shall annually pay to the state a tax according to or measured by their net income, which shall be in lieu of all other taxes and licenses, state, county and municipal, upon such banks, or the shares thereof, except taxes upon their real property. The amount of the tax shall be equivalent to four per cent of their net income.

(*b*) The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, in lieu of such tax, may provide by law for any other form of taxation now or hereafter permitted by the congress of the United States respecting national banking associations; *provided*, that such form of taxation shall apply to all banks located within the limits of this state.

(*c*) If it be finally determined that any tax levied upon or respecting any bank, national banking association, or the shares thereof, is invalid, said bank or association, or the shares thereof, shall be reassessed in conformity with any method provided by law. No claim against the state for refund or rebate of taxes paid shall be allowed without first deducting therefrom the amount of any such unpaid reassessment.

2. (*a*) All financial, mercantile, manufacturing and business corporations doing business within the limits of this state, subject to be taxed pursuant to subdivision (*d*) of section 14 of this article, in lieu of the tax thereby provided for, shall annually pay to the state for the privilege of exercising their corporate franchises within this state a tax according to or measured by their net income. The amount of such state tax shall be equivalent to four per cent of their net income. Such tax shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes paid by such corporations to the state or political subdivisions thereof, but the offset shall not exceed ninety per cent of such state tax. In any event, each such corporation shall pay an annual minimum tax to the state, not subject to offset, of twenty-five dollars.

(*b*) The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may provide by law for the taxation by any other method authorized in this constitution of the corporations, or the franchises, subject to be taxed pursuant to subdivision (*a*) of paragraph 2 of this section or subdivision (*d*) of section 14 of this article.

3. The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may change by law the rates of tax, or

the percentage, amount or nature of offset provided for in paragraphs 1 and 2 hereof.

4. Notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein, of the classes now taxable to the owner thereof and not otherwise taxed under subdivisions (*a*) or (*b*) of section 14 or under section 15 of this article, shall be declared in a manner to be prescribed by law and shall be taxed upon their actual value at the rate of three-tenths of one per cent. The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may by law change the rate or rates upon any one or more of the classes of property herein enumerated, *provided*, that no rate shall exceed four-tenths of one per cent. Said tax shall be in lieu of all other property taxes thereon, and the proceeds of said tax shall not go to the state but to such political subdivisions thereof, and in such manner, as may be provided by law.

5. The Legislature shall define "corporations" and "doing business"; shall define "net income," and may define it to be the entire net income received from all sources; shall provide for the allocation of income, for the assessment, levy and collection of the aforesaid taxes, and for reassessment in the event of the invalidity of any tax under 2 (*a*) or 2 (*b*) hereof. Said taxes shall become a lien on the first Monday in March of 1929 and of each year thereafter. The Legislature shall pass laws necessary to carry out this section. The acts of the forty-eighth session of the Legislature passed pursuant to this section shall be effective immediately upon their passage.

APPENDIX C

[Senate Constitutional Amendment No. 30.—A resolution to propose to the people of the State of California, an amendment to the Constitution of the State by adding a new section to be numbered 34*a* to Article IV, by amending section 12 of Article XI, by adding a new section to be numbered 20 to Article XI, by amending sections 14, 15 and 16, by adding three new sections to be numbered 14½, 15½ and 16½, and by repealing sections 12½ and 18 of Article XIII, relating to taxation.]

Resolved by the Senate, the Assembly concurring, That the Legislature of the State of California, at its fiftieth regular session, commencing on the second day of January, 1933, two-thirds of all the members elected to each of the houses thereof voting in favor hereof, hereby proposes to the people of the State of California that the Constitution of said State be amended as follows:

First—That a new section, to be numbered 34*a*, be added to Article IV, to read as follows:

Sec. 34*a*. Appropriations from the general fund of the State for any biennium, exclusive of appropriations for the support of the public school system, shall not exceed by more than five per centum the appropriations from such fund, exclusive of such public school appropriations, for the preceding biennium unless two-thirds of all the members elected to each house of the Legislature vote in favor thereof; provided, that no amount appropriated in excess of such five per centum shall become a part of the base for determining the maximum appropriation for a succeeding biennium. Should the appropriations in the budget act for any biennium exceed the limitations herein prescribed, and such budget act be not passed by such two-thirds vote, the several items of appropriation therein shall be deemed reduced by that percentage which the excess amount of appropriation bears to the total appropriation. Should the prescribed limit for any biennium be exceeded by reason of any other appropriation or appropriations from the general fund, then the appropriation first passed by the Legislature without such two-thirds vote, which exceeds such prescribed limitation, shall be deemed reduced by the amount of such excess, and all other subsequent appropriations from the general fund not passed by such two-thirds vote shall be void. Nothing herein contained shall prevent the Governor from vetoing any bills or reducing any appropriation therein or any appropriation reduced as herein provided.

Not more than twenty-five per cent of the total appropriations from all funds of the State shall be raised by means of taxes on real and personal property according to the value thereof.

Second—That section 12 of Article XI be amended to read as follows:

Sec. 12. Except as otherwise provided in this Constitution, the Legislature shall have no power to impose taxes upon counties, cities, towns or other public or municipal corporations, or upon the inhabitants or property thereof, for county, city, town, or other municipal purposes, but may, by general laws, vest in the corporate authorities thereof the power to assess and collect taxes for such purposes.

All property subject to taxation shall be assessed for taxation at its full cash value.

Third—That a new section, to be numbered 20, be added to Article XI, to read as follows:

Sec. 20. The expenditures, other than expenditures to pay interest and redemption charges on bonds heretofore or hereafter issued, of any county, city and county, municipality, district or other political subdivision of this State, whether or not operating under freeholders charters, shall not in any year exceed by more than five per centum the expenditures, other than expenditures to pay interest and redemption charges on bonds heretofore or hereafter issued, of such county, city and county, municipality, district or other political subdivision for the preceding year unless previously authorized by two-thirds vote of the qualified electors of any such county, city and county, district or other political subdivision, or by a majority vote of the electors of any such municipality voting at an election held for that purpose or unless previously authorized by the State Board of Equalization in such manner as may be provided by law; provided that no amount expended in excess of such five per centum shall become a part of the base for determining the maximum expenditure for a succeeding year; provided further, however, that any county, city and county, municipality, district, or other political subdivision of this State that decreases the amount of its expenditures in any year or years may increase, in any subsequent year or years, the amount of its expenditures by the amount, or any fraction thereof, so reduced, or by an amount not more than five per centum of the amount expended in the year immediately preceding. The limitations imposed in this paragraph shall be effective until June 30, 1935, but the Legislature may impose thereafter the same limitations for such period or periods as it may determine; provided, however, that the limitation upon expenditures imposed or authorized by this section shall not apply to expenditures by or on behalf of publicly owned public utilities, including publicly owned facilities operated for the promotion and accommodation of commerce and navigation, irrigation districts, county water districts, reclamation districts, municipal utility districts or metropolitan water districts organized or existing under the laws of this State or to expenditures arising out of any gift, bequest or donation.

On and after January 1, 1935, the Legislature shall have power, by two-thirds vote of all the members elected to each of the two houses, to limit the amount of taxes which may be imposed upon real and personal property according to the value thereof for county or city and county purposes.

The Legislature shall pass all laws necessary to carry into effect the provisions of this section.

Fourth—That section 14 of Article XIII be amended to read as follows:

Sec. 14. All pipe lines, flumes, canals, ditches and aqueducts not entirely within the limits of any one county, and all property, other than franchises, owned or used by (1) railroad companies including street railways, herein defined to include interurban electric railways, whether operating in one or more counties, (2) sleeping car, dining car, drawing-room car, and palace car companies, refrigerator, oil, stock, fruit and other car-loaning and other car companies operating upon the railroads in the State, (3) companies doing express business on any railroad, steamboat, vessel or stage line in this State, (4) telegraph and telephone companies, (5) companies engaged in the transmission or sale of gas or electricity, shall be assessed annually by the State Board of Equalization, at the actual value of such property.

All property so assessed by said board shall be subject to taxation to the same extent and in the same manner as other property.

All companies herein mentioned and their franchises, other than insurance companies and their franchises, shall be taxed in the same manner and at the same rates as mercantile, manufacturing and business corporations and their franchises are taxed pursuant to section 16 of this article; provided, that nothing herein shall be construed to release any company mentioned in this section from the payment of any amount agreed to be paid or required by law to be paid for any special privilege or franchise granted by any political subdivision or municipality of this State; provided further, that no excise, or income tax or any other form of tax or license charge shall be levied or assessed upon or collected from the companies, or any of them, mentioned in the first paragraph of this section, in any manner or form, different from, or at a higher rate than that imposed upon or collected from mercantile, manufacturing and business corporations doing business within this State.

The Legislature shall have the power to provide for the assessment, levy and collection of taxes upon all forms of tangible personal property, all notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein, not exempt from taxation under the provisions of this Constitution, in such manner, and at such rates, as may be provided by law, and in pursuance of the exercise of such power the Legislature, two-thirds of all of the members elected to each of the two houses voting in favor thereof, may classify any and all kinds of personal property for the purposes of assessment and taxation in a manner and at a rate or rates in proportion to value different from any other property in this State subject to taxation and may exempt entirely from taxation any or all forms, types or classes of personal property.

The total tax imposed on notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages and any legal or equitable interest therein in pursuance of the provisions of this section shall not be at a rate in excess of four-tenths of one per cent of the actual value of such property and no tax burden shall be imposed upon any personal property either tangible or intangible which shall exceed the tax burden on real property in the same taxing jurisdiction in proportion to the actual value of such property.

Every insurance company or association doing business in this State shall annually pay to the State a tax, assessed by the State Board of Equalization, of two and six-tenths per centum upon the amount of the gross premiums other than gross premiums from ocean marine insurance, received upon its business done in this State, less return premiums and reinsurance in companies or associations authorized to do business in this State; provided, that there shall be deducted from said two and six-tenths per centum upon the gross premiums the amount of any taxes paid by such companies on real estate owned by them in this State. This tax shall be in lieu of all other taxes and licenses, State, county, and municipal, upon such companies or their property, except taxes upon their real estate; provided, that when by the laws of any other State or country, any taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, are imposed on insurance companies, of the State, doing business in such other State or country, or upon their agents therein, in excess of such taxes, fines, penalties, licenses, fees, deposits of money, or of securities, or other obligations or prohibitions, imposed upon insurance companies of such other State or country so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurance companies of such other State or country doing business in this State.

Every insurer transacting the business of ocean marine insurance in this State shall annually pay to the State a tax, assessed by the State Board of Equalization, measured by that proportion of the underwriting profit of such insurer from such insurance written in the United States, which the gross premiums of the insurer from such insurance written in this State bear to the gross premiums of said insurer from such insurance written within the United States, at the rate of five per centum, which tax shall be in lieu of all other taxes and licenses, State, county and municipal, upon such insurer, except taxes upon real estate, and such other taxes as may be assessed or levied against such insurer on account of any other class of insurance written by it. The Legislature shall define the terms "ocean marine insurance" and "underwriting profit," shall provide for the assessment, levy, collection, and enforcement of said tax.

The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may by law change the rate or rates of taxes herein imposed upon insurance companies.

The word "companies" as used in this section shall include persons, partnerships, joint stock associations, companies and corporations.

Nothing herein contained shall be construed to subject to assessment and taxation property which is exempt from taxation under other provisions of this Constitution.

Fifth—That section 15 of Article XIII be amended to read as follows:

Sec. 15. Out of the revenue from State taxes for which provision is made in this article, together with all other State revenues, there shall first be set apart the moneys to be applied by the State to the support of the public school system and the State university. The Legislature shall provide for the raising of revenue by any form of taxation not prohibited by this Constitution in amounts sufficient to meet the expenditures of this State not otherwise provided for and in amounts sufficient to apportion, and shall apportion, to each county or city and county of this State, an amount equal to the entire amount required to be raised by each such county or city and county respectively under the provisions of section 6 of Article IX of this Constitution; provided, however, that all sums so apportioned shall be considered as though derived from county and city and county school taxes for the support of county and city and county government and not money provided by the State within the meaning of said section, nor shall any revenues so apportioned be regarded as appropriations from the funds of the State within the meaning of section 34*a* of Article IV of this Constitution.

If the Legislature limits the amount of revenue which may be raised from taxes upon the real and personal property according to the value thereof in pursuance of its power so to do under section 20 of Article XI of this Constitution, then the Legislature shall provide for the raising of revenue by any form of taxation not prohibited by this Constitution in amounts sufficient to apportion and shall apportion to each county and city and county an amount equal to the deficiency in the revenues thereof resulting from such limitation, as such deficiency shall be determined by law; provided, however, that no tax shall be levied by the Legislature in pursuance of this section upon property in proportion to the value thereof in excess of the limitation for which provision is made in section 34*a* of Article IV of this Constitution with reference to taxes for State purposes on real and personal property; and further provided that no taxes upon property in proportion to the value thereof shall be levied in pursuance of this section for the support of any county or city and county government.

No injunction or writ or mandate or other legal or equitable process shall ever issue in any suit, action or proceeding in any court against this State, or any officer thereof, to prevent or enjoin the collection of any tax levied under the provisions of this article; but after payment thereof action may be maintained to recover, with interest, in such manner as may be provided by law, any tax claimed to have been illegally collected.

Sixth—That section 16 of Article XIII be amended to read as follows:

Sec. 16. 1. (*a*) Banks, including national banking associations, located within the limits of this State, shall annually pay to the State a tax according to or measured by their net income, which shall be in lieu of all other taxes and licenses, State, county and municipal, upon such banks, or the shares thereof, except taxes upon their real property, at the rate to be provided by law.

(*b*) The Legislature may provide by law for any other form of taxation now or hereafter permitted by the Congress of the United States respecting national banking associations; provided, that such form of taxation shall apply to all banks located within the limits of this State.

2. The Legislature may provide by law for the taxation of corporations, their franchises, or any other franchises, by any method not prohibited by this Constitution or the Constitution or laws of the United States.

3. Any tax imposed pursuant to this section must be under an act passed by not less than two-thirds vote of all the members elected to each of the two houses of the Legislature.

Seventh—That sections 12½ and 18 of Article XIII be repealed.

Eighth—That all laws now in effect under which taxes are levied or imposed shall be continued in effect until altered or repealed by the Legislature; provided, however, that immediately upon adoption of the foregoing constitutional amendments it shall be the duty of the Legislature to pass all laws necessary to carry into effect the provisions of said amendments and to repeal or amend all laws inconsistent therewith.

Ninth—That a new section, to be numbered 14½, be added to Article XIII, to read as follows:

Sec. 14½. The provisions of section 14 of this article as they read on May 1, 1933, shall remain fully operative to and including December 31, 1934, notwithstanding any other provision in this Constitution. From and after January 1, 1935, said provisions shall no longer be of any force and effect; provided, however, that any taxes assessed in pursuance thereof, prior to said date, shall remain fully collectible.

Tenth—That a new section, to be numbered 15½, be added to Article XIII, to read as follows:

Sec. 15½. The provisions of section 15 of this article as they read on May 1, 1933, shall remain operative for the purpose of the assessment and collection of State taxes as therein contemplated to and including December 31, 1934, but nothing in this section shall be construed as making inoperative the provisions of said section as amended subsequent to said date, in so far as they relate to other matters. From and after January 1, 1935, the provisions of section 15 of this article as they read on May 1, 1933, shall no longer be of any force and effect; provided, however, that nothing herein contained shall be construed to affect the collection or distribution of taxes assessed under said section prior to January 1, 1935.

Eleventh—That a new section, to be numbered 16½, be added to Article XIII, to read as follows:

Sec. 16½. The provisions of paragraph 4 of section 16 of this article, as they read on May 1, 1933, shall remain operative to and including December 31, 1934, notwithstanding any other provision in this Constitution. From and after January 1, 1935, the provisions of said paragraph 4 shall no longer be of any force and effect; provided, however, that all taxes assessed thereunder, prior to January 1, 1935, shall remain fully collectible.

APPENDIX D

[Memorandum to City Attorney Ray L. Chesebro, dated August 19, 1935, in re public utility reassessment proceedings before the State Board of Equalization, prepared and submitted by Carl I. Wheat, public utilities counsel.]

Pursuant to your direction, Mr. Guillou and I attended the State Board of Equalization hearings held at Sacramento from August 5 to 14, inclusive, for the purpose of listening to protests filed by various public utility corporations in respect to the assessments placed on their properties by that Board. Under the so-called "Riley-Stewart Tax Plan" these utility properties have been returned to local tax rolls, the law providing they shall annually be assessed by the State Board of Equalization at their "actual value," and that properties "so assessed" shall be taxed in like manner and to the same extent as other properties on local tax rolls.

Schedules showing proposed utility property assessments, totaling almost two billion dollars (full value), were prepared and distributed by the State Board early in June, and on August 5th these were formally adopted as the actual assessments. Utilities were allowed two weeks in which to ask for reassessment. (All assessments of tangible property were made on the basis of 50% of the "actual value" determined by the Board's valuation staff.)

The total of these proposed assessments on tangible public utility property in the City of Los Angeles is approximately $132,000,000,* of which no less than $107,000,000 represents properties of utilities which petitioned for reassessment. This is therefore a matter of large public importance to the City, and in addition to your office, the City Comptroller, the Director of Budget and Efficiency and the Board of Public Utilities sent representatives to attend the reassessment hearings. For a number of months your office has been coöperating with the cities of San Francisco and Oakland, in conferences with the State Board and its staff, and these cities were represented at the hearings, as was the League of California Municipalities. Los Angeles County also sent an attorney and the Chief Deputy County Assessor, whose presence proved to be important, since the County acts as agent of the City in assessing all common (i.e., nonutility) property in the City.

The companies which have property in the City and which protested their assessments are listed in the following table, which also shows their

* Intangible property in the City was assessed at approximately $8,600,000, making a total "assessed value" on tangible and intangible property of over $140,600,000. The tangible property assessment in this *City* exceeds that in any *County* of the state, except Los Angeles County, by over $40,000,000, representing San Francisco, and is more than double that in any other *county*. The importance of these assessments to the City of Los Angeles and its taxpayers is therefore very great.

total assessment (both within and without the city), the amount and percentage of their claimed reduction, the toal of their assessment in the City and the proportionate reduction in assessment that would follow were their contentions to be upheld by the State Board in full:

CLAIMED REDUCTIONS IN ASSESSMENT IN CITY OF LOS ANGELES

Taxpayer	Total (system) assessment	Claimed reduction amount	Per-centage	Assessment in City of Los Angeles	Proportionate reduction in City of Los Angeles
1. Great Northern Railway.....	....	....	..	$ 80	....
2. Pacific Electric Railway Company..............	$18,000,000	$ 6,500,000	36	8,000,000	$ 2,900,000
3. Southern California Edison Company..............	130,000,000	30,000,000	23	7,500,000	1,700,000
4. Southern California Gas Company..................	25,000,000	7,000,000	28	9,300,000	2,600,000
5. Los Angeles Gas and Electric Corporation............	46,000,000	15,000,000	32	35,600,000	11,600,000
6. Southern Counties Gas Company..................	11,498,000	2,600,000	23	2,400,000	500,000
7. Southern California Telephone Company..............	65,000,000	42,000,000	65	38,700,000	25,000,000
8. Santa Fe Railway Company..	43,200,000	7,000,000	16	4,800,000	600,000
9. Pullman Company..........	1,990,000	900,000	50	70,000	35,000
10. Associated Telephone Company..................	5,900,000	2,655,000	45	700,000	300,000
Totals...............	$346,588,000	$113,655,000		$107,070,080	$45,235,000

Omitting all details, the main arguments made by the several utilities above listed were as follows:

1. *The Great Northern Railway*

No specific objection was made to the assessment of its properties in Los Angeles, its position being that it had no through passenger service in this state; that it operated in California only a short line, disconnected from its main system, and that the California portion of its property is not now making operating expenses. Its sole properties in this city consist of a small amount of office furniture assessed at $80.00.

2. *The Pacific Electric Railway Company*

Contending that it is not now able to operate at a profit, this company urged that most of its properties have only a "junk" or salvage value for tax purposes. It also protested the Board's values on the right-of-way lands, alleging that such property could be sold for little, if anything, if rail service were abandoned.

3. *Southern California Edison Company*

Contending that if taxes are collected on the basis of the State Board's tentative assessment, it will be forced to bear an undue share of the tax burden, this company examined several assessors, in an endeavor to prove that had local assessors' methods been followed its properties would have reached the tax rolls at materially lower figures than the State Board used. (This contention is based upon the theory that unless utility property is "equalized" with common property by using the local assessor's methods the utility will be forced to bear an unjust proportion of taxes.)

4. *Southern California Gas Company*

5. *Los Angeles Gas and Electric Corporation*

6. *Southern Counties Gas Company*

The positions taken by these companies were essentially similar, and here again the main argument was that the methods used by the local assessors in respect to common property would, if applied to the utility property, yield figures for assessment purposes materially lower than the methods used by the State Board. Certain striking examples of the assessments so complained of were offered, in respect to the items of buildings, improvements and personal property.

7. *Southern California Telephone Company*

This company contends that for tax purposes its properties should be assessed no more than \$23,000,000 (signifying \$46,000,000 "actual value" not including its corporate franchise), although at the same time it is claiming a fair value for rate-making purposes of \$175,000,000. No more striking illustration of the manner in which certain large companies attempt to "blow hot and cold" when the public is concerned has come to the writer's attention in many years. In asking for reassessment the "actual value" of property is urged by the company to be of no weight or importance whatever, because of the methods being pursued by local assessors respecting common property. This is purely an "equalization" contention, and no proof was offered that the State Board had in any instance assessed any item or element of this company's property at an amount greater than its true or actual "value."

8. *Santa Fe Railway Company*

After complimenting the State Board on the thoroughness and general fairness of the work of its valuation engineers in preparing the utility assessment data, this company's representative urged that too little weight had been accorded to the element of stock and bond value. (*Note.*—This argument was precisely the opposite of those made by certain of the other companies, notably the gas, electric and telephone utilities.)

9. *The Pullman Company*

A failure on the part of the State Board to allow sufficiently for the element of depreciation was alleged by this company. The Board used a depreciation of 40%, whereas it was claimed that the company's books showed this item to be around 60%.

10. *The Associated Telephone Company*

This company claimed that its buildings were improperly assessed because of a failure to "equalize" with assessments made by local assessors on similar common property. The contention was also made that the State Board had overassessed the item of materials and supplies.

Considering the fact that this was the first assessment of its kind in California; that fully 19,000 separate and distinct taxing areas or units were involved (in each of which a separate assessment of utility properties had to be made for each utility therein operating); that an appropriation of but $150,000 and only a year and a half of time were available, and that the value of the properties to be assessed amounted, in total, to approximately two billion dollars, it seems proper to state that the work of the State Board of Equalization and of its valuation staff, under the direction of Mr. A. G. Mott, has been a remarkable illustration of efficient and, as far as we can ascertain, wholly nonpolitical governmental effort. The fact that, out of over 500 utilities whose properties were assessed, only about a dozen filed protests is remarkable, to say the least. On the whole, while there are a few companies and a few items as to which we feel the assessments are somewhat low, we are convinced that an honest and determined effort was made to arrive at fair and reasonable values.

The efforts of certain utility representatives to divorce values in taxation wholly and completely from values on which consumers are asked to pay a return in rates appear to be ill-advised, to say the least. The City is not seeking unfair values for purposes of taxation, but on the other hand it must insist that what is value for that purpose is definitely related to value for rate purposes. The contention of certain utility representatives that the two are wholly unrelated is as fallacious as it is unjust to the public. We cannot allow this attempt to procure unduly low values for taxation and unduly high values for rates to succeed. Somewhere there is a proper and just mean, and certainly the contention of the local telephone company that it should be allowed to earn a return in rates on an alleged "value" of $175,000,000, and at the same time be taxed on a basis of only $46,000,000 (twice its claimed assessment) on the same properties is absurd. Indeed, it is so absurd that the very fact that this contention has been made (with a straight face) by this concern should have a salutary effect.

Litigation will no doubt follow the final action of the State Board on these assessments, and the City should be prepared to appear as *amicus curiae* in any such court actions as may affect its interests. Moreover, the State Board of Equalization will in the near future be forced to commence the collection of data for its second assessment of utility properties. We are now in a position to know the methods which are to be followed in this work, and the City should keep continuously in touch with the State Board and the other cities as the work progresses, in order that its interests may be fully protected at all stages. In this connection it is believed that much more complete "returns" should be required of the several utilities, and that the City should request copies of such returns or access to them in the State Board's office. This will prove of importance not only in respect to taxes, but also in connection with any rate proceedings which may be brought by the City.

The alleged disparity between local assessments of common property and the State Board's assessments of utility property may well lead in the near future to a movement for more centralized control over the methods and practices of local assessors. If this should develop, it is important for the City to make sure that the central, directing agency will adopt proper methods and practices. The revenues of the City are being "eaten into" in so many directions by state agencies that this matter of utility assessment assumes large proportions, and your office should keep closely in touch with all phases of the situation at all times, in collaboration with the other cities of the state.

It is to be regretted that the State Board did not fix a day at the close of its recent hearings for argument by representatives of all protesting utilities. Able attorneys would, in such an argument, have been found attempting to maintain diametrically opposed positions in respect to the reasons on which they were urging that the State Board's assessments were erroneous. After listening to the entire series of hearings, it seems improbable to the undersigned that any material alteration in the preliminary assessments will be made by the Board. However, only in the cases of the Los Angeles Gas and Electric Corporation and the Southern California Telephone Company would a complete acceptance of protestants' position materially affect the City's tax roll. In the cases of those companies, it is believed that the nature of their protests is such that, except for the correction of any possible mathematical errors in the original assessment, the State Board will approve that assessment. In the litigation which no doubt will follow such action, this City should play an important part.

I am attaching a table showing in summary form (from the State Board's preliminary statement) the utilities whose properties were assessed in this city, together with the amounts of their several assessments. Slight corrections made since the preliminary statement have raised the total for tangible property from $131,993,055 to $132,025,840.

Respectfully submitted,

CARL I. WHEAT
Public Utilities Counsel

SUMMARY OF ASSESSED VALUES OF PUBLIC UTILITY PROPERTIES LOCATED IN THE CITY OF LOS ANGELES, AS SHOWN IN PRELIMINARY STATEMENT BY THE VALUATION DIVISION OF THE STATE BOARD OF EQUALIZATION, 1935

Company code number	Company	Total tangibles	Total intangibles	Total assessed value
151	Southern Sierras Power Company	....	$ 260	$ 260
201	Associated Telephone Company, Ltd.	$ 700,320	120	700,440
321	Western Union Telegraph Company	484,305	10,690	494,995
592	The Pullman Company	66,560	....	66,560
802	Angeles Flight Railway	9,500	15,100	24,600
822	Court Flight Incline Railway	2,150	....	2,150
829	Great Northern Railway	80	....	80
879	Sunset Railway	....	900	900
881	Tonopah & Tidewater Railroad	500	2,340	2,840
886	Western Pacific Railroad	1,105	....	1,105
150	Southern Counties Gas Company	2,389,650	900	2,390,550
856	Pacific Electric	7,946,690	12,320	7,959,010
856	Pacific Electric Railway Motor Equipment	186,750	....	186,750
580	Pacific Fruit Express	610,085	....	610,085
303	Southern California Telephone Company	38,712,845	2,690	38,715,535
124	Los Angeles Gas and Electric Corporation	35,616,510	5,684,900	41,301,410
845	Los Angeles Railway Corporation	7,248,560	76,010	7,324,570
148	Southern California Edison Company	7,519,490	2,980	7,522,470
149	Southern California Gas Company	9,302,780	2,237,710	11,540,490
264	Mackay Radio	4,690	....	4,690
719	Railway Express Agency	347,735	3,240	350,975
843	Los Angeles and Salt Lake Railway	5,007,755	480,410	5,488,165
854	Outer Harbor Terminal	6,960	....	6,960
872	Southern Pacific Railway	10,901,815	79,420	10,981,235
295	San Fernando Telephone Company	44,490	....	44,490
306	Sunland Rural Telephone Company	23,960	30	23,990
701	California Merchants Association	150	....	150
706	Fast Freight Forwarding Company	100	....	100
716	Pacific Motor Transport Company	140	....	140
804	Atcheson, Topeka and Santa Fe Railway	4,857,380	2,670	4,860,050
		$131,993,055	$8,612,690	$140,605,745

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