

Economic and Legal Aspects of the Sales Tax

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The economic depression has caused the states to turn to new sources of revenue, such as the sales tax. The federal government has for many years levied in various forms selective sales taxes, the principal one at the present time being the processing tax on various commodities. The sales tax system is widely in vogue in Europe, particularly in Germany and France. Over half of the American states now impose the sales tax in one of its varied forms. In Canada, a sales tax has been in force since 1920. In the Dominion it has been found that the sales tax has operated with satisfactory results. The following quotation, taken from the testimony of George W. Jones, Department of National Revenue, Canada, was given before the United States House of Representatives in 1932:

No government would have continued such a form of taxation for a period of 11 years if it had been found to affect business adversely. As against any objections that have been offered by individual manufacturers, the Retail Merchants' Association of Canada, a national organization, has placed itself on record as being heartily in favor of the retention of the sales tax.

There are four types of taxes more or less commonly described as sales taxes.

1. The general sales tax, which applies to all sales whether involving the production of raw material, manufacturing, wholesaling or retailing. This type is in force in France.
2. A retail sales tax such as the Ohio type, which attempts to lay a tax upon the ultimate sale or sale for consumption.
3. The gross receipts tax which is levied not upon the sale but upon the receipt of money by the taxpayer and depends

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largely upon the definition for its operative scope, such as that in force in West Virginia.

4. The gross income tax. This tax usually applies to the gross income of all taxpayers such as that received from services and other types of income, as well as that derived from sales of tangible personal property. A good example of this type may be found in Indiana.

The taxes imposed by the European nations are turnover taxes, which tend to produce pyramiding in their application. The retail sales tax law in force in Ohio is so drawn that the tax applies only upon sales to the ultimate consumer and has no application to those commodities which might be consumed by a manufacturer or fabricator in the process of production. In a general sales tax as distinguished from the retail sales tax, the problem of pyramiding is presented, which causes the product finally sold and taxed to have included in it many items which have been previously subject to the general sales tax. For example, in a sale to a customer of a suit of clothes, under a general sales tax there would be a tax upon the sale of raw materials, a tax upon the sale of the yard goods to the manufacturer and a tax upon the sale of the finished suit by the manufacturer to the retailer and again a tax upon the sale of the suit by the retailer to the consumer. The pyramiding of the tax in the case of a gross sales tax is such that upon various commodities such as clothing, fabrics, tires, and sugar, a tax of 1 per cent becomes pyramided into a tax of about 2.75 per cent. This pyramiding problem is practically eliminated in the case of a retail or consumer's sales tax such as that in force in Ohio, as there is but one tax when the commodity is sold in its finished form and not a series of taxes buried in the price of the commodity, as well as the final sales tax.

The general theory of sales taxation has been sustained in *Miles v. Department of Treas.*, 193 N.E., 855 (Ind. 1935), involving the Indiana Gross Income Tax, and in *Boyer Campbell Company v. Fry*, State Circuit Court, County of Wayne,

involving the Michigan Retail Sales Tax, although the Supreme Court of the United States on March 11, 1935, in the case of *Stewart Drygoods v. Lewis*, 55 Sup. Ct. 525, 79 Law Edition 539 (1935), held Kentucky's progressive gross receipts tax law unconstitutional. Most of the decisions dealing with the question of sales taxation have involved technical questions of statutory interpretation.

Generally sales tax laws have contained various types of exemption such as to farmers, manufacturers, refiners, processors, etc. These exemptions have caused much administrative confusion. In New York the exemption of human foods caused more administrative trouble than all the other details of the law put together. In Ohio, the definition of "retail sale," while comprising but a few lines of the act, has caused the sales tax section more concern in interpretation than other provisions of the sales tax law. The principal question arises on the interpretation of the commission that sales to manufacturers, retailers, processors, refiners, and utilities to be exempt must be directly used in that particular process. For example, a truck used between two units of a factory in hauling unfinished parts would be directly used in the process of manufacturing, whereas a truck used for delivery by the same concern would not be directly used in the process. Likewise, in the case of a retail merchant, an advertising display is construed not to be directly used, but a showcase is held to be directly used and exempt. These very brief examples merely cite the administrative difficulties which arise in administering a general type of sales tax law.

In Ohio we have 210,000 vendors who constitute merchants under the definition of vendor, and for the purpose of administering the law we have created seventeen sales tax districts within the state. It is expected that we will collect in a full year, \$60,000,000 to be divided \$6,000,000 for old age pensions, \$10,000,000 for poor relief, and the remainder, after deductions for administration, to be distributed sixty per cent

to schools and forty per cent to local governments. It should be observed that the state gets no part of the sales tax, except to meet the costs of administration, old age pensions, and poor relief and that the residue is entirely for schools and local government.

The Ohio sales tax is expressed in cents rather than percentage. No tax is levied if the price is less than 8c; 1c if the price is 8c to 40c; 2c where the price is 41c to 70c; and 3c where the price is 71c to \$1.00, with a tax at the rate of three cents for each full dollar thereafter. The Ohio tax is unique to the extent of being expressed in cents rather than percentage. In most states, by merchants' agreement, the tax is collected in brackets because obviously all the variations of the tax are not expressed by coinage. In the states observing the bracket system of collection by agreement, however, the state does not receive the pennies collected by the merchant but only that percentage of the merchants' receipts which the law requires him to pay the state. In Ohio the taxpayer is assured that every cent he pays the merchants has been in turn paid the state through the medium of our prepaid sales tax receipt. Furthermore, the merchant is expressly prohibited from absorbing the tax in any way and is liable for a misdemeanor in the event he tries to absorb.

Without question the complications of interstate commerce cause the sales tax states considerable trouble. The existence of prohibitions on taxing interstate commerce causes Ohio consumers, especially in large volume purchasing, to go outside the state and buy commodities in interstate commerce for the purpose of avoiding the Ohio sales tax. At the present time the Association of States which is vitally interested in securing uniformity of taxation, is attempting to have Congress pass a bill which will permit the states in a nondiscriminatory way to tax under sales tax laws property moving in interstate commerce. There seems to be a fair chance for the enactment of this kind of a measure. If it should be enacted it will remove the greatest

outstanding objection to sales taxation as a permanent basis of revenue.

The general objection to the sales tax at least as voiced by Haig & Shoup in their outstanding work on sales taxation, has been that most sales tax laws tend to require absorption of the sales tax by the merchant, particularly in borderline communities and in the case of small merchants. The general experience seems to have been that chains and large merchants have less trouble in passing the tax on to the consumer. From the merchant's standpoint, the present Ohio law in all probability requires more completely than any other law now in force the passing on to the consumer of the sales tax.

One of the principal objections to sales taxation from the standpoint of the economist is that it tends to fall regressively upon the taxpayer of small income. This objection can not validly be denied. It must be conceded generally that a permanent fiscal system based upon a sales tax must necessarily include in its general scheme an adequate income tax for the purpose of balancing the burden of taxation.

The sales tax was enacted in Ohio because we were in dire need of large amounts of revenue and there was no other way to immediately secure to the state sufficient revenues. Most taxes are not productive for a year or more after the time they were enacted. The sales tax, because of its immediate collection features, provides immediate revenues.

It must be remembered that we are today paying in relation to the national income, approximately twice the national, state, and local taxes that we paid in 1929. We have distinctly a maximum requirement for governmental purposes because of abnormal expenditures with a minimum ability to pay taxes, which more than any other factor accounts for the myriad of new taxes.

Practically all the states have relied upon real estate as the backbone of the fiscal system. The real estate tax and the income tax have definitely broken down during the economic

depression, although it may be said that the real estate tax has not suffered quite as much as the income tax. The general tendency, in addition to this condition, has been to divert from real estate some of the burden of taxation. This has been brought about by constitutional limitations which prohibit the levying of taxes upon real estate beyond the limitation fixed, except under certain express exceptions.

The field of sales taxation is not new in this state in any sense. In 1925 Ohio enacted its first two-cent gasoline tax law and has made additions to that act so that a very substantial portion of all road expenditures now come from that selective sales tax. Ohio has, in addition, levied selective sales taxes on beer, liquor, cosmetics, malt, cigarettes, admissions, and soft drinks.

The federal government at the present time imposes a tax in some form on virtually every commodity which the human being consumes. The most vicious of these is the processing tax which is buried in the price paid by the consumer and consequently multiplied very substantially when paid by the consumer.

Ohio needs a permanent tax program looking into the future. It must not be erected upon a crack-pot premise of raising one's self by his own boot straps. The problem of taxation, in view of the fact that taxes consume such enormous proportions of the nation's income, presents a laboratory problem which should be carefully considered and assayed from all of its angles and from all possible viewpoints, with the ultimate purpose of providing an equitable and complete tax structure which will cast upon all our people their just share of the cost of supporting government. There is definite need for simplification of the taxing system and separation of the fields of state and federal taxation. After all, a popular tax program is not a good tax program, because it only taxes the other fellow.