

DIARY

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November 4, 1943
9:43 a.m.

Henry
Stimson: Hello.

HMJr: Henry talking.

S: Glad to hear you're back.

HMJr: How are you?

S: You all right?

HMJr: Uh....

S: Physically all right, mentally all right and
morally all right?

HMJr: Well, that relieves me of a lot of worry.

S: (Laughs)

HMJr: At your convenience I'd like to see you and tell
you some of the things that I saw. I have a few
constructive criticisms that I'd like to give you.

S: Well, I'd be very glad to see you, indeed. I --
I am in a considerable drive just now. It would
be a day or two I should think perhaps.

HMJr: Well, when -- whenever you've got the time, I
have the time.

S: Well, that's kind of you to say that. That's
very kind.

HMJr: Uh....

S: I'll let you know very promptly.

HMJr: Will you? I think McCloy might be interested
in some of the AMGOT.

S: Yes, I know he would.

HMJr: Well, then I'll wait until I hear -- I'll wait
'till I hear from you.

S: All right. And you would like to include McCloy
in the -- in the talks, would you?

HMJr: Well, I think that he'd be interested in it.

S: Yes, I know he would.

HMJr: Because a lot of it has to do with AMGOT and lend-lease.

S: Yes.

HMJr: Mili.... I don't know who does your military lend-lease.

S: Well, the -- let me see -- the fellow that did it is gone I think to something else. I don't know who does it now.

HMJr: Yes.

S: I'll find out. McCloy knows in general. He's the civilian in it.

HMJr: I offer as a suggestion to you that I could give you a moderately good lunch here Saturday.

S: Well, if I'm in town I think I can do it.

HMJr: I see.

S: All right.

HMJr: Well, you let me know.

3 ✓
November 4, 1943
10:21 a.m.

HMJr: ...loud speaker and Paul and Smith are in the room here - and Mrs. Klotz also. What do you think -- you know there was a story yesterday that the Treasury was supposed to have frozen the funds of the two big Argentinian banks.

John W. Pehle: Yes, sir.

HMJr: Now, I've got a press conference at 10:30 and supposing they ask me about it -- what about it?

P: I'm sure that what State would like us to do is to say, "The Treasury has no comment." Let that be the official position. But I should think that it would be entirely in order for you to informally indicate to the Press that those reports are pretty well founded.

HMJr: I see. What the hell is the name of those banks?

P: Banco de la Provincia....

HMJr: Hey, wait a minute -- wait a minute -- wait a minute -- Banco....

P: de la....

HMJr:de la....

P:Provincia.

HMJr:Provincia. P-r-o -- how do you spell that?

P: P-r-o....

HMJr:v-i-n-c-i-a?

P: That's right.

HMJr: Yeah.

P: The other is Banco de la Nacion.

HMJr: Banco de....

P: la Nacion.

HMJr: How do you spell....

P: N-a-c-i-o-n.

HMJr: N-a-c....

P:i-o-n.

HMJr: Yeah. Now, are those semi-governmental banks?

P: One of them, the Nacion, is entirely government owned and the other one is half-owned by the government.

HMJr: And their assets are frozen?

P: They are frozen.

HMJr: I see. And you think that I can by inference admit that they have been frozen?

P: I think so. I think we ought to.

HMJr: Well....

P: But I think that the official comment ought to be, "No comment".

HMJr: Yeah. I get it. Okay.

P: Thank you.

November 4, 1943
2:14 p.m.

Grace
Tully: How are you?

HMJr: I'm fine, and you?

T: Fine, thank you.

HMJr: I think I got mixed up on my days on these State Chairmen of War Bonds that are coming here. As I get it they are coming Tuesday, the 9th, and Wednesday, the 10th.

T: Tuesday, the 9th, and Wednesday, the 10th?

HMJr: Yes. There's about fifty of them.

T: About fifty?

HMJr: They're Chairmen of -- each is Chairman of a State. Don't ask me how there are fifty but there are.

T: Yeah. Well, I suppose the territories, too, huh?

HMJr: That's right.

T: Yeah. That's how you get up there.

HMJr: Originally, the President told me, before I left, that he would see them.

T: Yes.

HMJr: I think it would be good all around.

T: All right. Fine. We'll try and put it down for the 9th or 10th. Huh?

HMJr: That's right.

T: All right, Mr. Secretary. We'll let you know.

HMJr: Thank you.

T: All right, sir.

general Mc Sherry ^{11/4/49.}
 my home!

Alakar.

Munition Assignment Board

Board man to
 Algeria - request
 of General Byrke

Italian soldiers
 in U.S.
 Pay

These were my notes
 for Gen'l Marshall



THE UNDER SECRETARY OF THE TREASURY
WASHINGTON

November 4, 1943.

MEMORANDUM TO THE SECRETARY:

Yesterday you scheduled an appointment to see Mr. Eccles Monday afternoon at three o'clock on the excess reserve matter. I have talked to Marriner and he says that the Chairmen of the various Federal Reserve Banks will be in here all day Monday and he would like to have Mr. Sproul present at the conference with you and, if it is convenient, would prefer to have it late Tuesday afternoon; three o'clock will be all right, but if it could be made three-thirty, it would give us a little more time with the Board.

If this is agreeable, the Board will cancel its scheduled meeting for tomorrow and have its Executive Committee meeting early Tuesday morning; meet the Treasury representatives about twelve o'clock, and then we could all be prepared to meet you at three or a later time if convenient to you.

DWB

Appointment Changed to
3:30 pm Tuesday
by H.M.J. e.j.f.
DWBell advised



TREASURY DEPARTMENT
1943 NOV 4 PM 12 44
OFFICE OF THE SECRETARY OF THE TREASURY

Reference A



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

November 4, 1943

Honorable Daniel W. Bell,
Under Secretary of the Treasury,
Treasury Department,
Washington, D. C.

Dear Dan:

In line with my telephone conversation with you, I am enclosing three copies of a memorandum that I have had prepared as a basis for discussion by the executive committee at its next meeting. Since this memorandum has not as yet been submitted to or approved by the members of the committee, it does not in any way commit any member of the committee to the views expressed. I am also enclosing three copies of a draft of a press statement to be released if an agreement is reached to arrange for the exchange of maturing bills held by the System.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "M. S. Eccles".

M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosure

November 3, 1943

MEMORANDUM FOR DISCUSSION AT MEETING OF MEMBERS OF
EXECUTIVE COMMITTEE ON NOVEMBER 5

Treasury financing. - The selling of 18.9 billion dollars of securities in the Third War Loan drive on subscriptions from investors other than commercial banks shows a real improvement over the results achieved in the two previous drives. Sales to individuals increased from 1.6 billion dollars in the first drive to 3.3 billion dollars in the second drive and to 5.4 billion in the third drive. Sales of Series E bonds increased from 700 million dollars in the first drive to 1.5 billion dollars in the second drive and to 2.5 billion in the third drive. These results are an important contribution to the Government's anti-inflation program.

A study of developments in the third drive, however, indicates that certain modifications would further the joint objectives of the Treasury and the System. It is estimated that in September commercial banks purchased between 3 and 4 billion dollars of Government securities that were sold by other investors. Commercial bank loans also increased sharply during the drive. Between September 8 and October 6, loans by weekly reporting member banks to brokers and dealers in securities increased by 892 million dollars, and loans to others for purchasing or carrying securities increased by 774 million. It is believed that a large part of the securities purchased with the help of bank loans will be sold in the near future and that they will be sold principally to banks. Although it is realized that commercial banks cannot be kept entirely out of indirect participation in the drives, certain changes in the program might be expected to reduce such participation substantially.

First, the elimination of certificates from future drives is again recommended. Although 4.1 billion dollars of certificates were sold in the drive, at least 1.2 billion of old certificates have been bought by the banking system. From August 18 to October 13, reporting member banks added 804 million dollars to their holdings of certificates. From August 18 to October 27, the System Account added 480 million dollars to its holdings; details of these transactions are shown in Table 1.

The elimination of certificates from future drives would have many advantages. It would place nonbank holdings on a longer-term basis. It would reduce the playing of the pattern of rates. It would reduce the incentive to meet quotas by means of temporary investments, which are ultimately passed on to the banking system. It would increase sales of savings notes, which are the fairest type of issue as long as the present pattern of rates prevails, since the Treasury pays and the investor receives a rate of return based solely on the length of time that the Treasury has used the funds. It would eliminate the large refunding problem of as much as 5 billion dollars on a single issue that now arises after only a year. By reducing the number of kinds of issues, it would simplify the Treasury's financing program.

Second, dealers and brokers should be prohibited from subscribing for new issues offered in the drives other than the 2 1/2s. Such subscriptions are placed solely for the purpose of resale. The major part of the new issues sold from the dealers' portfolios is purchased by commercial banks.

November 3, 1943

Third, the Treasury in the offering circular should request commercial banks to refrain from making speculative loans for purchasing or carrying the new issues. In addition, it would appear to be desirable to resume the policing of subscriptions, at least to the extent of eliminating the most flagrant free-riding, which in the third drive reached large proportions.

Short-term interest rates. - The demand for three-month Treasury bills at $3/8$ of one per cent has continued to decline sharply. Banks in the money centers, which have heretofore provided the principal outlet for bills, have no surplus funds, and banks with funds are generally not interested in bills at $3/8$ of one per cent. From the end of May to the middle of September, the outstanding amount of bills increased by 2.2 billion dollars, and during the same period the System's holdings increased by 3.3 billion. Since that time, the outstanding amount has not changed. At first, the System's holdings declined temporarily as a result of the release of reserve funds during the drive, but subsequently as reserve funds have been absorbed the System's holdings have again increased. There is also a lack of demand for short-term certificates. Table 1 shows the amount of short-term certificates that the System purchased from August 18 to October 27.

The short-term pattern that the System is maintaining was adopted and was appropriate in a period when there were large amounts of idle funds, a limited demand for credit, and uncertainty regarding the maintenance of longer-term rates. It does not appear to be appropriate now, when idle funds are limited, demands are large, and longer-term rates are generally accepted as stable. With short-term rates at present levels, commercial banks are encouraged to sell short-term securities and to purchase longer-term securities, if necessary by bidding up the prices of those securities. This procedure results in the creation of additional reserves, which can become the basis of a 5-to-1 expansion of bank credit. It also reduces the yields on longer-term securities.

The Federal Open Market Committee is in complete agreement that this problem is serious and should be solved. Two approaches to a solution were considered by the Committee. The aim of both proposals is to narrow the spread between long-term and short-term rates. Either proposal would accomplish some of the desired objectives. Those plans and the principal arguments in their favor are stated below.

Under the first approach, the present three-month bills and one-year certificates would be replaced by nine-month bills. These bills would be issued in a total amount of not exceeding a billion dollars a week, unless a demand developed for a larger amount. Tenders for \$100,000 or less would be allotted in full at $3/4$ of one per cent, and larger tenders would be allotted to the highest bidders. The Committee would establish a buying rate and repurchase option at $3/4$ of one per cent on the new nine-month bills.

Under this proposal, commercial banks would be much more inclined to hold bills at $3/4$ of one per cent than to hold bills at $3/8$ of one per cent or certificates, which under existing practices command increasing premiums. The new bills would attain a much wider distribution among smaller banks than do the present three-month bills at $3/8$ of one per cent. The System would no longer be faced with the increasingly difficult problem of maintaining a variable pattern of rates on maturities of less than nine months. Speculators could no longer

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make a profit by playing the pattern of rates on short-term issues; most of the playing of the pattern has been in short-term issues, and an extension on any large scale to longer-term issues is unlikely because of the greater risk that it involves. Finally, the proposal would simplify the Treasury's financing program and eliminate a large refunding problem.

Under the second approach, the problem would be met by continuing to issue one-year certificates at $7/8$ of one per cent and at the same time diminishing the spread in yields by substituting for the present bills four-month bills at $5/8$ of one per cent. Under this proposal, the existing pattern of financing and types of securities would be maintained. This proposal would not involve a drastic change in the one-day interest rate. The shift to a four-month basis would permit of some reduction in the amount of the weekly bill offering without a change in the aggregate amount outstanding.

The proposal would help to widen the distribution of short-term securities among smaller banks, which have excess reserves and whose deposits are increasing most rapidly. It would make it more expensive for banks to sell bills to the Reserve Banks than to borrow at the differential rate of $1/2$ of one per cent. It would not increase the amount of outstanding securities on which the System has a buying rate. It would reduce the downward pressure on the long-term rate, as well as the incentive for banks to shift from short-term to long-term securities. It would diminish the incentive for playing the pattern of rates.

System bill replacements. - In recent months, the System has been faced with a replacement problem in bills that has increased in magnitude as the amount of its maturities has increased. The System holds on the average 400 million dollars of each billion dollar issue of bills. Under present arrangements, other investors must place tenders for not only the amount of bills that they wish to hold but also an additional amount that they almost immediately sell to the System.

In the last three months, the dealers have been allotted 1,899 million dollars of new bills, as shown in Table 2. Of this amount, they have sold only 107 million dollars to customers and have placed 149 million in their portfolios. The System Account has immediately purchased from the dealers 1,152 million dollars and the New York option account 491 million. In addition, many commercial banks have placed underwriting tenders and have immediately sold their allotments to the option accounts. The System's maturities in this period have totaled 1.1 billion dollars in the System Account and 3.5 billion in the option accounts.

It is estimated that between now and the end of the calendar year the System will need to supply 2.2 billion dollars of reserves, including 1.3 billion to offset an increase in required reserves and 900 million dollars to offset an increase in money in circulation. In this situation, the System will replace all of its maturing bills by new issues. We feel strongly, therefore, that the System should, as a rule, place a tender with the Treasury each week at $3/8$ of one per cent in an amount not exceeding the amount of bills that mature in both the System Account and the option accounts and that the Treasury should give to the System the privilege of exchanging maturing bills for whatever amount of new bills are allotted to it, adjusting the discount in cash. The System would receive the same percentage of its tender as would other bidders at the same rate. A precedent has already been established for replacing maturities, since the System now places subscriptions with the Treasury for maturing certificates.

November 3, 1943

STRICTLY CONFIDENTIAL

Table 1

SYSTEM ACCOUNT PURCHASES OF CERTIFICATES BY ISSUES
(Amounts in thousands of dollars and
yields in per cent.)

Week ended	December 1		February 1		April 1		Other		Total
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount
Aug. 25	11,000	.50-.51	--	--	4,000	.74	--	--	15,000
Sept. 1	53,350	.50-.51	10,000	.66-.67	12,500	.75	--	--	75,850
8	13,000	.50	5,000	.66-.67	20,000	.74-.75	--	--	38,000
15	34,500	.49-.50	27,600	.65-.67	24,500	.72-.75	1/ 2,000	.74	84,600
22	5,000	.50	--	--	8,000	.74	--	--	13,000
29	5,000	.50	--	--	24,100	.75	--	--	29,100
Oct. 6	4,400	.50	--	--	7,500	.75	--	--	11,900
13	--	--	10,000	.61	10,000	.73	--	--	20,000
20	58,500	.46-.50	37,400	.57-.62	23,000	.73-.75	--	--	118,900
27	3,900	.46	47,100	.53-.57	24,200	.70-.73	2/ 2,000	.80	73,200
Total	188,650	.46-.51	137,100	.53-.67	157,800	.70-.75	4,000	.74-.80	472,550

1/ Sales of May 1 certificates.

2/ Sales of October 1 certificates.

Table 2

DEALER TRANSACTIONS IN TREASURY BILLS
(In millions of dollars)

Date of issue	Allotments	Sold to			Placed in portfolios
		System Account	Option account	Customers	
Aug. 4	117	90	2	10	15
12	111	82	--	4	25
19	134	87	28	3	16
26	143	93	25	9	16
Sept. 2	198	100	77	14	7
9	180	88	71	2	19
16	105	45	32	21	7
23	93	62	25	--	6
30	155	95	33	20	7
Oct. 7	176	118	48	1	9
14	188	124	46	8	10
21	133	87	32	14	--
28	166	81	72	14	12
Total	1,899	1,152	491	107	119

FEDERAL RESERVE SYSTEM MATURITIES OF TREASURY BILLS
(In millions of dollars)

Date of maturity	System Account	Option accounts
Aug. 4	60	288
12	9	179
19	69	184
26	90	226
Sept. 2	99	220
9	65	241
16	72	301
23	118	275
30	118	305
Oct. 7	97	443
14	99	342
21	87	221
28	79	270
Total	1,092	3,495

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Statement for the Press

For immediate release

November 1943.

The Treasury Department this week revised its Treasury bill offering circular so as to permit the Federal Reserve Banks to obtain new Treasury bills by the exchange of an equivalent amount of maturing bills to the extent that tenders of the Reserve Banks are accepted. Concurrently, the Federal Open Market Committee authorized the Federal Reserve Banks to place weekly tenders for bills at a price approximately equivalent to a yield of $3/8$ of 1 per cent per annum (99.905 for 91-day bills), in an amount not exceeding the amount of their weekly maturities. The Federal Reserve Banks will receive the same percentage allotment of bills as will other bidders at the same price. Acquisitions of bills by the Federal Reserve Banks in this manner will represent the replacement of bills originally purchased in the market and, like other exchanges of maturing securities for new securities, will not be subject to the limitation contained in subsection (b) of Section 14 of the Federal Reserve Act (which limits to 5 billion dollars the aggregate amount of Government securities acquired directly from the United States that can be held at any one time by the twelve Federal Reserve Banks).

No new credit will be made available to the Treasury by the Federal Reserve Banks as a result of this change in procedure, nor will new reserve funds be placed at the disposal of the banks of the country. Reserves that have already been provided to support a rising currency circulation and rising member bank deposits will merely be maintained.

These related actions were taken to relieve a situation that has become mechanically more difficult as weekly maturities of bills held by the Federal Reserve Banks have increased in recent months, until at times they are equal to half or more of the weekly offerings. In the past, the market has taken all of each week's offering of Treasury bills and has promptly sold to the Federal Reserve Banks that portion of the offering that it did not wish to hold. Thus, the Federal Reserve Banks indirectly replaced part or all of their Treasury bill maturities. This procedure worked well when the amount of maturing bills held by the Federal Reserve Banks was a relatively small proportion of the weekly offering and allowed the market to determine directly the amount of the new issue of bills it wished to hold. Now that the amount of maturing bills held by the Federal Reserve Banks ranges up to and above 500 million dollars each week, however, such a procedure means that the market must place tenders for new issues of bills in amounts substantially in excess of market requirements, the excess being taken for the purpose of almost immediate sale to the Federal Reserve Banks. In these circumstances, a more direct method of replacing maturing bills held by the Federal Reserve Banks has been deemed desirable.

The test of the bill market will now be found in the bids of investors other than the Federal Reserve Banks at prices slightly above the price tendered by the Federal Reserve Banks and in the allotment to the Federal Reserve Banks and to others at the fixed price of the Federal Reserve Bank tenders. At times when there is reason to expect a substantial increase in market demand, of course, the Federal Reserve Banks can tender for less than the amount of their weekly maturities.

ADVANCE RELEASE ----- ADVANCE RELEASE

OFFICE OF WAR INFORMATION
OFFICE OF ECONOMIC STABILIZATION

ADVANCE RELEASE: For Use AFTER 8:30 p.m., EWT, THURSDAY, November 4, 1943.

NB-1686

Text of address by Judge Fred M. Vinson, Director of the Office of Economic Stabilization, at the thirty-second annual meeting of the Investment Bankers Association of America, in the Waldorf-Astoria, New York City, at 8:30 p.m., EWT, Thursday, November 4, 1943.

Tonight I intend to talk about taxes. Fiscal policy is the heart of economic policy. This is particularly true in time of war when the government purchases such vast quantities of the implements which are now spelling certain destruction for the enemies of freedom.

Taxation is a complicated business, but the underlying principles of a wartime fiscal policy are in essence simple and understandable. Naturally, it is the desire of some for economic self-interest or political advancement to becloud these simple issues by complicated smoke screens of argument and statistical legerdemain. Perhaps, in this field as in many others through which the winds of doctrine have blown so hard, we need what the late Justice Holmes called "education in the obvious."

Back in 1876 that distinguished Kentucky pundit, the late Henry Watterson, was discussing some of the fiscal and financial controversies of his day. "Marse Henry" said rather sharply:

"All of us cannot be educated political economists capable of nice, hairsplitting distinctions. For our part, the sum of our financial knowledge has not materially increased since the day we bought a ginger cake for five cents, traded it for a ten-cent watermelon and sold the watermelon on credit to a black boy, who afterward repudiated the debt."

Certain facts about our wartime economic picture are indisputably true. From these facts there flow certain almost inevitable conclusions. Once these facts are stated and the conclusions drawn, many of the controversies which attend the construction of a wartime revenue system melt as mist before the sun.

I want first to state some of these facts, along with the conclusions which, to my mind, follow.

Our Federal Government is spending 100 billion dollars a year for war. We are training, equipping and sending into battle a vast army, a vast fleet, and a vast air armada. Soldiers, sailors and airmen must be fed and clothed and supplied with the tools of war. This necessary equipment must be produced, assembled and transported to the battle grounds. To do this requires money, manpower, raw materials and machinery.

(over)

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Sometimes I believe that it is impossible to comprehend the magnitude of this productive effort. In economic terms, it means that the unequalled resources of America are not only for the first time fully employed, but are directed toward a single objective -- military might and military victory. Total mobilization for total war is our objective.

In peace time, it is the aim of economic policy to secure the fullest employment for our human and material resources in the production of useful goods and services for civilian consumption. In peace time we all share the common desire to see jobs available for every man and woman who wants to work, so that we may produce more food, more clothes, more shoes, more automobiles, more refrigerators, more radios, more houses and more goods and services of all types. In war time, our national objective is the very opposite. We not only witness full employment for every man and woman who wants a job, but we go into the highways and byways to search out new sources of manpower and womanpower. Men and women who formerly were able to get work for only two or three days a week are now working long hours of overtime. But, contrary to our peace time policy, we have cut the production and reduced the consumption of civilian commodities to the lowest level consistent with the maintenance of maximum productivity for our labor force. All the rest of our creative energies we are devoting, or at least we should be devoting, to the production of goods and services for use on foreign battlefields, rather than in American homes.

Financially, however, the story is quite different. The expenditure of unprecedented sums of money for war has created a national income at unprecedented levels. With every available man and woman working on a full time or overtime basis, wage and salary payments are at the highest levels in our history. Increased food and fiber production and the increased demand for the products of the farm has brought agricultural income to an all-time high. Business volume and business profits are also higher than ever before in our history.

Consequently, the total income received by all the individuals in the nation is at a record level. For the calendar year 1944 it will reach 157 billion dollars. During this period of time, we shall produce only 90 billion dollars worth of consumer goods and services.

Of course, this does not mean that all of our income will or can be spent. Twenty billions will be collected in state, local and Federal taxes, at existing rates. The Treasury estimates that approximately 9 billions will go into ordinary long-term savings -- repayment of personal indebtedness, payment of insurance premiums, building and loan funds and mutual savings accounts.

War bond purchases must also be taken into account. It is estimated that, during the calendar year 1943, individual investors will buy about 17 billion dollars worth of war bonds. We may assume that these purchases will not decrease during the calendar year 1944.

If, however, we add up all these offsets against the national purchasing power -- taxes, war bond purchases, and all other forms of individual saving, there will still be left a current surplus of 20 billion dollars in individual purchasing power. And this is not the whole measure of excess spending power. We can not ignore the 40 billions in individual demand and time deposits and the 16½ billions in currency held by individuals.

In the realm of fiscal policy, the principal problem confronting the American people therefore is what to do with these billions of excess spending power. As I see it, there are three alternatives: First, people could, through the processes of democratic government, decide to levy taxes sufficient to absorb a substantial portion of the excess purchasing power. Second, the people could, acting individually and cooperatively, try to add to the volume of their individual savings through the purchase of more war bonds. Or, third, and most disastrously, the people, acting individually and competitively, could set off a spending orgy in trying to outbid each other for the limited supply of consumer goods and services available. Such a spending spree would find its manifestation in a continuous rise in the level of retail prices and living costs -- and it is that which we define as inflation.

No one of these methods of attack need be exclusive. In fact, we have, during the past two years, tried a combination of all three. Our tax burden has increased substantially since Pearl Harbor; our individual savings have also increased markedly; and the cost of living has undergone a sharp rise.

The question which confronts us today is whether we shall continue to try all three methods, or whether we shall increase the emphasis upon any one of them.

Theoretically, any one policy or any given combination of policies might work, though the consequences would by no means be the same. Certainly the experience of the past two years does not indicate that we can rely upon further increases in voluntary saving to absorb the necessary billions of excess purchasing power. The success of such a policy would require the American people at least to double their individual war bond purchases during the coming year. I do not believe that we can take the risks inherent in any such optimistic hope. Certainly the record of purchases up to the present time would not give substance to the hope.

Why not let prices rise? Increasingly there are voices clamoring for this solution. Moderate inflation, they say, is a stimulant to the body economic. It encourages production and tones up the circulation. After all, those specious critics cry, higher prices are themselves deflationary, since they absorb excess purchasing power and thereby balance the demand for goods and services with the limited supplies which are available.

Such an argument assumes, however, that we can allow prices to rise while we freeze wages and salaries. Such an assumption, once it is stated, almost refutes itself. Manpower, like all the other factors of production, is at a premium in time of war, since we need more than we have. Men simply do not remain at work for fixed rates of pay while the prices of the things which they must buy are allowed to soar.

For some workers, particularly the substandard wage-earners and the white-collared employes who live on relatively fixed incomes, rising prices mean an inability to buy the bare necessities of life for themselves and their families. Even if these millions of men and women were willing to work at fixed rates of pay in the face of soaring prices, their productivity would soon suffer.

(Over)

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Therefore, it is plain as day that if prices go up, wages will soon follow them. Rising wages, of course, mean rising incomes, and we should soon find ourselves faced with the same difficulty we had at the beginning -- an excess of purchasing power over the goods and services available to meet the effective demand in the hands of consumers. This see-saw of rising prices and wages is what we know as the inflationary spiral.

It results in the inordinate growth of the public debt, the destruction of all fixed values, the dilution of the people's savings, instability in the financial structure, in social conflicts of every pernicious variety -- strikes and slowdowns, bitterness and discord. It is the broad highway to national disaster. That road we must not travel.

There remains, therefore, the alternative -- additional taxation designed to siphon off the maximum amount of individual purchasing power from all those persons who possess incomes above the level of decent war-time subsistence.

Higher taxes, in combination with increased personal war bond purchases, afford the one safe fiscal road which we can travel in these perilous times.

The critical question is not whether we must have more revenue, but how we shall raise it, and how much we need.

Certainly, we need all we can get. The Secretary of the Treasury, with the President's approval, has asked the Congress for \$10,500,000,000 more. From the standpoint of fiscal needs and from the standpoint of economic stabilization, this is, in my considered judgment, a conservative request -- a minimum and modest amount.

By what method, then, shall this money be raised?

Taxation is somewhat like the sulphur and molasses our parents used to give us for tonic in the spring of the year. Everyone admitted that it was a highly beneficial elixir -- for someone else to take. In this respect taxation is not very different from all the other tools of economic stabilization. Just as some want wages frozen while prices are allowed to rise, and vice versa, so do many join enthusiastically in the job of raising taxes -- for the other fellow.

As for myself, I am thoroughly of the opinion that, when every alternative is canvassed and every argument exhausted, we had best stick to the tried and true principle of taxation based on ability to pay.

This does not, however, mean that we can afford to place the entire burden of new revenues upon a small minority of the population. While ability to pay is still, in my judgment, the soundest yardstick by which to measure tax proposals, we must also remember that the great mass of our citizenry possesses today a greater ability to pay taxes than ever before in our history.

Four-fifths of our national income is in the hands of individuals earning \$5,000 a year or less. If we are to siphon off purchasing power from the levels of income where inflationary pressures are the most severe, those who fall in these income groups and whose incomes are above the level of decent war-time subsistence must bear a substantial portion of the increased burden. This can be accomplished by lowering the present personal and dependency exemptions, by raising the normal and surtax rates, and by placing sharply increased excises upon luxuries.

Such proposals, or others similar to them, are, I believe, decidedly preferable to a general sales tax, levied upon the necessities of life, irrespective of income and disregarding the minimum subsistence needs of the marginal income recipients.

Any proposal which reduces ruthlessly the already imperiled living standards of the substandard groups -- especially the 4,000,000 wage earners still earning less than 40 cents per hour and the millions of white collar employees whose modest incomes have remained at fixed levels in the face of rising prices -- is wholly inconsistent with the most elementary standards of justice and fair play. Unless we were to suffer from a material impairment of their productivity, the enactment of an indiscriminate sales tax on the necessities of life would compel widespread readjustments in the wages paid to these employees. Such increases, themselves in part inflationary, would go far to neutralize the effect of the revenue program.

We must, therefore, forge a revenue policy which will draw substantial amounts from those earning \$5,000 a year and less without gutting the living standards of those who suffer from substandard conditions. In this connection, and contrary to the impression widely prevalent, it should be noted that more than half of the total tax increases recommended by the Treasury, including both income and excise levies, would come from those in brackets below \$5000.

Some of our business and political leaders have argued that the American people do not possess additional capacity to pay more taxes. This contention is demonstrably false. The very perplexity which confronts us is an excess of purchasing power over goods and services available to consumers. The real question is not whether we can afford higher taxes but whether we can afford to try and get by without them.

Americans are this year spending astronomical sums for jewelry, furs, fine clothes and other luxuries. In department stores, for instance, women spent 104% more for furs in July 1943 than they spent in July 1942. Likewise, they spent, in the same month, 65% more for coats and suits, 37% more for dresses, 30% more for blouses, skirts and sportswear, 31% more for underwear, slips and negligees, 24% more for corsets and brassieres and 41% more for gloves.

Likewise, the American people are spending an increased amount to eat, drink and make merry. In August 1943 -- in the middle of this second year of allegedly total war, receipts of eating and drinking places were 27% higher than in August of the previous year. Expenditures in theaters, cabarets, concerts and other places of amusement rose 30% over the same period. On flowers, the people spent, it is estimated, 30% more in August 1943 than in August 1942. Similar increases are estimated for beer, wines and liquor, for cosmetics and toilet preparations, and substantial increases for cigars, cigarettes and tobacco.

As compared with the average for the typical pre-war years, 1936-39, expenditures in clothing stores had increased 102%, at eating and drinking places 143% and in jewelry stores 218%.

Who, in the face of these startling figures, will contend that the American people cannot pay more taxes. I do not believe that the sober citizenship of this great democracy desire ease and luxury for themselves while their boys are dying on the battle fields of this titanic global war.

Some day our boys will return. Many will come back wounded, crippled and maimed. I pray God they may not come back to find that, through love of ease and pleasure, through political cowardice and personal ambition, we have betrayed them.

We are the fiduciaries of their freedom, the trustees of their future. I pity the political truckler and the sunshine patriot who must say, when called before the bar of judgment by the returning heroes, "I thought the American people could not afford to pay more taxes. I have passed onto your shoulders the financial burdens of this war which you have fought and won. I took the bread from the mouths of your wife and children while you fought for me, while the American people were spending their substance on luxuries and entertainment."

There may be some among us who regard inflation as a kind of abstraction -- a theory concocted by the impractical visionaries who dream up ways to make our lives complex. There are others, known to me, who would welcome a touch of inflation and are exerting their pressure and influence to take off the lid. But I assert to you that unless we as people have the vision and the courage to accept without complaint the restraints necessary for stability, we will pay for our folly with a bitter and hideous coin.

We speak of sacrifices. Most of us at home have no basis to use the word seriously unless, perchance, a loved one has laid his life upon the altar of freedom. I do not pretend to preach or scold, but I say to you with earnestness that too many still seek to improve their economic position as individuals and as groups at the expense of total mobilization for economic stability in war and peace.

An incessant parade files through my office -- and I welcome them and appreciate their concern -- each seeking in his turn to claim exemption from the rules that have been laid down to keep our economy whole.

War can afford no occasion for privilege or immunity. Nor can all the old inequities in our economic structure be remedied in the midst of total war.

There is no easy road, no short cut by which to solve the problems that confront us at home. Our capacity for self-discipline must be equal to the irritations and restraints made necessary by war. And, though the military news be encouraging and our diplomatic achievements a proud moment in our history, we can not relax our vigilance until the evil hordes of tyranny and brutality are eradicated from the face of the earth.

No, inflation is not an abstraction. It is not a theory, an intangible will-o'-the-wisp. It is a monstrous evil that must be prevented from destroying the America which we at home have the responsibility to keep whole for the return of our fighting men who are at this moment offering their lives for us.

And these boys, the best and bravest of our youth, do not lightly regard that which we at home too often ignore. They are thinking perhaps more than we of the America to which they long soon to return. Recently I was given a letter received by a friend from an enlisted man in West Africa. These lads have time to think soberly and, perhaps, more clearly and fundamentally than ever before. Their minds are directed toward simple, eternal, American values. And if you think inflation is to them a meaningless abstraction, I beg you to consider carefully the words of this American boy who is fighting for you and for me in the European theater of war:

"You well know," he writes his friend and old teacher, "the results of inflation. But this time there will be even greater cause for discontent and unrest. This time we will have some ten million men and women from the military services who will form a formidable group if their plans are shattered by inflation.

"You might be surprised," this American dough-boy continues, "At the number of men who are making plans already for their return to civilian life. Publicly they may not say much about it, but I have talked to innumerable men who are saving all the money they possibly can for the time they get back. Some are married or plan to be married and they are putting their money into a house, a farm, or furniture. But this is rare. The majority are saving their money -- counting it carefully -- and dreaming of the comforts it is going to buy.

"But the point is that they are dreaming of these things in terms of pre-war prices. We in the Army are not vitally affected by prices. Those of us in foreign services chalk up differences against the country in which we happen to do our small amount of buying. But we read about the price of furniture at home going up 100% or some other price index going up to 50%. But it does not strike home the way it would if we looked at a radio that we almost bought before the war for \$25 and now find we have to pay \$50 for it.

"After the war that is the experience that each and every one of us in the Army is going to have. We have saved our money -- denied ourselves many pleasures and we are dreaming of a down payment on a house, new clothes, marriage, etc. But our air castles will fall with a very discomfoting thud when we find we can buy only half, or a third, or some smaller fraction of the commodities we had planned. That is when the protesting murmurs of ten million hearts will swell to a crashing crescendo of condemnation against our government. The results may well be catastrophic."

Those are the words of an American soldier on a foreign fighting front. He is calling to you and to me. He is beseeching us for himself and on behalf of his comrades to maintain the value of the dollars he is saving in the service of his country. He is praying that those of us at home will not fail him and that his dreams -- dreams he conjures in the stillness of the desert night -- will not be dashed to earth by timorous political time servers.

Marriage, a house, new clothes and an America of opportunity. I can only pledge that insofar as I have power to stop it, no orgy of inflation will prevent this American hero's simple dream from becoming a living reality.

I call solemnly and reverently upon the American Congress and the great American people to join with us in a courageous tax program. Let us keep faith with our fighting men. Let us keep faith with America's future.

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE November 4, 1943

TO Secretary Morgenthau
FROM Randolph Paul
Subject: Study "Considerations Respecting a Federal Retail Sales Tax"

Attached is a mimeographed copy of "Considerations Respecting a Federal Retail Sales Tax," a study prepared in the Division of Tax Research. This study was submitted to the Ways and Means Committee in its recent public hearings on revenue legislation.



Attachment

CONSIDERATIONS RESPECTING A FEDERAL RETAIL SALES TAX

History of Federal Sales Tax Proposals

Factors Affecting the Choice of a Retail Sales Tax
in Preference to the Other Types of Sales Taxes

Factors Affecting the Structure of a Federal Retail Sales Tax
Under Wartime Conditions

Possible Modifications of a Federal Retail Sales Tax:
Personal Exemptions, Graduated Tax Rates,
and Compulsory Lending

Effects of a Federal Retail Sales Tax
on the Anti-Inflation Program

State Sales Taxes:
Summary of Principal Provisions and Practices

Canadian Federal Sales Tax

British Purchase Tax

Australian Wholesale Sales Tax

Division of Tax Research
Treasury Department, Washington, D. C.
October 12, 1943

HISTORY OF FEDERAL SALES TAX PROPOSALS

Division of Tax Research
Treasury Department, Washington, D. C.
October 9, 1943

History of Federal Sales Tax Proposals

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History of Federal Sales Tax Proposals

Although the Federal Government has never imposed a general sales tax, Congress has given consideration at various periods to such a tax. A general sales tax was first proposed in the United States during the Civil War. In the opening year of the War, Congress had adopted the first income tax and, in addition, had introduced a comprehensive system of excises. Opposition to these war taxes developed and, as a consequence, agitation for a general sales tax began in 1862. The New York Chamber of Commerce, the Boston Board of Trade, and similar organizations petitioned Congress in that year to adopt a sales tax, but proposals offered both in Committee and on the floor as an amendment to the Revenue Bill were defeated. ^{1/} Encouragement was given to the proponents of the sales tax in 1864 when the Commissioner of Internal Revenue advocated a sales tax as a temporary war finance measure, but the Ways and Means Committee proposed other methods of increasing revenue, including a 20-percent increase in the existing tax on manufactured articles. When the Revenue Bill was being debated in the House, an amendment providing for a sales tax of one-half of one percent was offered, but the House rejected it and adopted instead increases in existing excises. ^{2/}

The movement for a Federal sales tax developed considerable strength during the years following the first World War and during the depression years following 1929. Several sales tax proposals introduced in Congress in the early 'twenties were linked with the financing of soldiers' bonuses, but none of these received serious consideration. After 1935, when old-age pensions, particularly the so-called "Townsend pension plans," were being considered, sales taxes of broad application (gross income or gross transactions taxes) were offered as a means of financing the pension proposals. Recent discussions have accorded a prominent position to the sales tax as a source of wartime revenue. Congressional committees discussed the tax in the course of their deliberations on the Revenue Bill of 1942, but it was not brought before Congress for a vote.

I. Proposals, 1918-1941

The attached table presents a chronology of Federal sales tax proposals during the period 1918 through 1941 and shows the principal provisions of these bills. Some of the more important proposals are treated in the following discussion.

A. 1918-1921

In the years following the first World War, the sales tax became an important issue. ^{3/} The war Revenue Acts of 1917 and 1918 had greatly

^{1/} Smith, H. E., The United States Federal Internal Tax History, 1861-1871, Boston, 1914, pp. 257-258.

^{2/} Ibid., p. 259.

^{3/} A few months before the close of the war, Senator Borah had introduced a bill providing for a transactions tax, but no Congressional action had been taken on it.

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increased the rates of personal and corporate income taxes, and in addition had introduced an excess profits tax and special war excises on many commodities and services. After the war, demand arose for the repeal of the excess profits tax, reduction of the surtax rates on individual incomes, and elimination of the special war excises. The proponents of these changes suggested a general sales tax as a possible alternative source of revenue.

Advocates of the sales tax formed organizations with the purpose of stimulating public interest in the sales tax and presented their case in pamphlets, and newspaper and magazine articles. 1/ Questionnaires were distributed by business organizations to their clients inviting expressions of opinion on the sales tax issue and results of the referenda were publicized. 2/

Several sales tax proposals were offered by witnesses appearing before the Ways and Means Committee hearings in December 1920. 3/ One of the supporters of the sales tax admitted in his testimony that an organized campaign, sponsored by chambers of commerce and other business organizations, was under way to "educate" the people of the country on the sales tax question. 4/ By the summer of 1921 the movement had gained such strength that the Senate Finance Committee issued a special invitation to proponents and opponents of a sales tax to appear before it. More than a score of witnesses testified on each side of the issue. 5/ The discussions in the hearings were directed toward the general question of the desirability of a sales tax rather than to the provisions of a specific bill. Most of the witnesses who favored the enactment of a sales tax also advocated the repeal of the excess profits tax and selective excises, and the reduction of surtax rates on individuals. The sales tax was looked upon not as a possible additional source of Federal

1/ Buehler cites as examples of these organizations: the Business Men's Tax Committee, the Tax League of America, and the Business Science Club of Philadelphia. (Buehler, A. G., General Sales Taxation, New York, 1932, p. 13.)

2/ Harris, Winthrop and Co., a banking firm, sent out a questionnaire in 1919 and reported that of 1,979 replies received, 1,173 favored and 806 opposed a Federal turnover tax. (Cited in National Industrial Conference Board, General Sales or Turnover Taxation, New York, 1929, p. 194.) The Chamber of Commerce of the United States took referenda on the subject in 1920 and in 1921 and found that its members favored a turnover tax. (For a report on these referenda, see House Committee on Ways and Means, Hearings on Internal-Revenue Revision, (July 26-29, 1921), pp. 137-139.)

3/ House Committee on Ways and Means, Hearings on Revenue Revision, (December 13, 1920-January 17, 1921).

4/ Ibid., pp. 125-126. (Testimony of Moyer S. Rothschild.)

5/ Senate Committee on Finance, Hearings on the Proposed Revenue Act of 1921 (May 9-27), pp. 21-496.

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revenue, but as a substitute for certain existing taxes. In general, those who favored a sales tax were representatives of business interests. ^{1/} The opposition included representatives of the Federal Government, farm and labor groups, producers of raw materials, and marketing and industrial organizations. ^{2/}

Neither of the Congressional Committees took action on the sales tax, but a number of proposals were introduced on the floor of Congress. Senator Smoot sponsored a series of bills which incorporated turnover taxes or manufacturers' sales taxes of varying rates. The first, introduced on April 12, 1921, provided for a 1-percent turnover tax on all sales or leases of goods in excess of an annual turnover of \$6,000. Strong opposition to the turnover tax proposal was expressed on the floor of the Senate, and Senator Smoot offered in its place, as an amendment to the Revenue Act of 1921, a 3-percent manufacturers' sales tax. This amendment was later withdrawn and replaced by another which provided for a 1-percent manufacturers' sales tax. The latter was voted on and defeated November 3, 1921. The following day Senator Smoot proposed a 0.5-percent turnover tax applicable to sales at all levels of production and distribution but allowing credit for the amount of sales tax included in the prices of commodities purchased. This proposal also was defeated. Three days later, a third and final proposal for a 3-percent manufacturers' sales tax was defeated.

Advocates of the sales tax then tried to obtain approval of the sales tax by linking it with the financing of veterans' compensation. During the second session of the 67th Congress (1921-22) Senator Smoot, as well as several Representatives, introduced bills providing for the payment of veterans' compensation from the proceeds of a sales tax, but none of these proposals received serious consideration.

B. 1932

After the repeated defeats of the Smoot amendments, public interest in the sales tax diminished and the issue was not revived until about ten years later in 1932.

When the Ways and Means Committee met in January 1932, it was faced with the problem of rising expenditures and falling revenues. The fiscal year 1931 had closed with a deficit and it was estimated that the deficit for 1932 would be still greater. Secretary of the Treasury Mellon presented the Treasury's tax recommendations to the Ways and Means Committee on January 13, 1932. While recognizing the need for additional

^{1/} For example: National Association of Manufacturers, National Industrial Conference Board, National Retail Dry Goods Association, and National Association of Real Estate Boards.

^{2/} For example: The National Grange, American Farm Bureau Federation, American Federation of Labor, and National Lumber Manufacturers Association.

revenue, he opposed a general sales tax on the grounds that it would be regressive in character and difficult of administration. ^{1/} The Ways and Means Committee, however, began early to consider a manufacturers' sales tax, the Canadian manufacturers' sales tax holding an important place in the discussions. In November 1931, William Randolph Hearst had arranged for a party of about 75 Senators and Representatives to visit Canada to investigate the Canadian sales tax. ^{2/} The Treasury Department had sent Dr. T. S. Adams and Mr. E. C. Alvord on the same mission. On their return, some members of the Congressional party were strong supporters of a sales tax. The Treasury representatives, while admitting that the Canadian tax was successfully administered, advised the Committee against adoption of a sales tax as an emergency measure because of the administrative problems involved.

Opposition to and support of the sales tax in the hearings before the Ways and Means Committee were drawn in general from the same groups as in 1921. In addition to the farm and labor groups, however, a number of retail merchants associations were among the opposition. ^{3/} The National Association of Manufacturers, the Chamber of Commerce of the United States, and the American Petroleum Institute expressed preference for a general sales tax over increases in selective excises.

When the Revenue Bill of 1932 was reported to the House by the Ways and Means Committee, it contained provision for a 2.25-percent manufacturers' sales tax. The Committee's recommendation specified, however, that it was to be "a temporary measure to last only during the period of the present emergency." ^{4/}

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- ^{1/} His reasons for opposing a general sales tax and favoring taxes on selected commodities were stated as follows: "We laid aside all thought of a general sales or turnover tax, not only because generally speaking it bears no relation to ability to pay and is regressive in character, but because of the great administrative difficulties involved and the almost inevitable pyramiding of the tax in the course of successive sales. The objections to a general sales tax are not in this respect applicable to a tax on selective articles of the character heretofore employed in this country and now recommended. ...We concluded that our immediate needs could best be met by utilizing a known general plan with such changes as might be appropriate in the light of altered conditions rather than embarking on new and untried ventures in taxation." House Committee on Ways and Means, Hearings on Revenue Revision, 1932, p. 4.
- ^{2/} See House Committee on Ways and Means, Hearings on Revenue Revision, 1932, pp. 239-252, for a statement of "Proceedings of meeting of delegation of United States Senators and Representatives with officials of Department of National Revenue, Canada, with respect to operation of Canadian sales tax, Ottawa, Canada, November 18, 1931."
- ^{3/} National Retail Dry Goods Association, National Retail Hardware Association, National Retail Furniture Association, National Shoe Retailers, and National Association of Retail Druggists.
- ^{4/} House Committee on Ways and Means, Report on H.R. 10236 (The Revenue Bill of 1932). House Report 708, 72nd Congress, 1st session, p. 8.

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The Treasury Department withdrew its objection to the sales tax, and Secretary Mills in a radio address on March 12, 1932, announced that he was willing to accept the revenue program of the Committee on Ways and Means. Although he opposed the sales tax in principle, he expressed belief that it should be adopted as a temporary measure because of the grave fiscal emergency.

When the Revenue Bill came to the floor of the House for consideration, bitter opposition was expressed to the sales tax. An amendment offered by Representative Doughton to strike the sales tax was adopted. A few days later efforts to restore the sales tax to the Revenue Bill were unsuccessful. As finally enacted, the Revenue Bill provided for an extensive list of selective excises.

C. 1933

When the National Industrial Recovery Act was under consideration in Congress in 1933, an amendment providing for a 1.75-percent manufacturers' sales tax was offered on the floor of the Senate by Senators Reed, Walsh, and Byrd, but it was defeated.

D. 1935-1941

Beginning with the McGroarty bill (the first so-called "Townsend pension bill"), a series of bills, more than a score in number, providing for sales taxes of broad application (transactions taxes or gross income taxes) were introduced during the period 1935 through 1941 as means of financing old-age pensions. Congressional committees gave careful consideration to certain of these bills in connection with House and Senate hearings on the Social Security Bill in 1935 and the hearings of the House Select Committee Investigating Old-Age Pension Organizations in 1936, but only one of them (H. R. 6466 introduced by Representative Hendricks in May 1939) came to the floor for consideration. The latter was reported to the House by the Ways and Means Committee without recommendation and was defeated when it came to vote on June 1, 1939.

II. Public opinion surveys in 1941 and 1942

Wartime revenue needs caused a revival of interest in the sales tax and led several public opinion survey organizations to conduct polls in 1941 and 1942 in an attempt to determine the attitude of voters with regard to the tax. The Gallup Polls conducted by the American Institute of Public Opinion and several surveys made for the magazine Fortune are reviewed below as examples of these polls.

Before presenting the results of the polls, it should be noted that in attempting to draw any conclusion from the answers to a poll, it is essential to determine exactly what the participants were asked to vote upon. Failure to permit the voters to choose between alternatives can readily result in an unrepresentative picture of the public attitude toward an issue such as a Federal sales tax, which to a considerable extent involves a choice between alternatives.

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A. The Gallup Polls

The Gallup Poll has released the results of 6 polls taken during 1941 and 1942 which purported to reveal the attitude of American voters regarding a Federal sales tax.

One of the most significant polls was reported during January 1941. ^{1/} This poll consisted of three questions, the second of which read: ^{2/} "In order to help pay the cost of defense, should the United States collect a national sales tax on everything that people buy?" Forty-six percent of those voting answered "yes" and 54 percent "no." ^{3/} No sales tax rate was suggested and no specific type of sales tax was mentioned, but the use of the words "everything that people buy" probably suggested to most people a retail sales tax covering tangible personal property.

The third question of this poll was: "Which kind of tax would you prefer to raise money for defense - a national sales tax on everything you buy, or an income tax based on the amount of income you receive, and collected from every family except those on relief?" This question elicited the following responses: for a sales tax, 32 percent; income tax, 57 percent; both, 8 percent; other, 3 percent. The percentage of persons in favor of a sales tax thus varied greatly depending upon whether they were permitted to vote only for or against a sales tax or were given an alternative tax source. None of the subsequent polls permitted a choice between the sales tax and another source of revenue. This absence of choice is significant and cannot be overlooked in properly evaluating the results of the polls.

In April 1941 and January, May, July, and August 1942, voters again were polled regarding their reaction to the levying of a Federal sales tax. The question used in each case did not differ significantly from

^{1/} New York Times, January 8, 1941, p. 9.

^{2/} Question number one related to the income tax.

^{3/} The percentages reported in all polls will represent the division of opinion of only those persons expressing an opinion on a question.

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that used in the January 1941 poll and took the following general form: "In order to help pay the cost of national defense (the war), should the Federal Government put a national sales tax of 2 percent (3, 5 percent) on everything that people buy?" A summary of the voters' opinions in all six polls is given below.

Opinion of voters with regard to a
Federal sales tax

Tax rate percent	January 1941		April 1941		January 1942	
	For	Against	For	Against	For	Against
Not mentioned 2	46%	54%	54%	46%	51%	49%

Tax rate percent	May 1942		July 1942		August 1942	
	For	Against	For	Against	For	Against
2	54%	46%	58%	42%	61%	39%
3	46	54	52	48	57	43
5	43	57				

Source: New York Times, January 8, April 4, 1941;
January 14, May 3, July 3, 1942: Washington
Post, August 28, 1942

According to these polls, the voting population of the United States showed an increasingly favorable reaction toward a low rate Federal sales tax during the period January 1941 - August 1942. Assuming the polls were representative, it would seem that a substantial majority would have accepted a 2-percent sales tax in August 1942, provided the only choice was the acceptance or rejection of the tax. In January of the same year, however, the voters had been almost evenly divided with regard to the merits of a 2-percent sales tax.

On the other hand, apparently at no time would the voters have supported a sales tax of 8 or 10 percent, as suggested by a number of witnesses at the hearings on the Revenue Bill of 1942. ^{1/} Although the actual division of opinion was not given, the report on the latest poll,

^{1/} Infra, p. 12.

August 1942, stated that the voters rejected the idea of an 8 or 10-percent sales tax, 1/ even though a higher percentage of sentiment favorable to a low-rate sales tax was reported in this poll than in any of the others.

These polls also appeared to show that the voter's reaction to a sales tax depends somewhat upon his economic status. The April 1941 poll revealed that 52 percent of the low-income group voters 2/ opposed a 2-percent tax; 3/ in May 1942, 48 percent of the low-income voters still opposed a 2-percent sales tax, although in both instances 54 percent of the voters as a whole favored it. 4/ An explanation for this variation in opinion is given by the report on the April 1941 poll which stated that in the above-average income groups "The typical voter ... feels that the adoption of a sales tax would spread the taxation burden more evenly instead of placing it largely on the shoulders of the rich." 5/

Geographically, the most favorable reaction to a Federal sales tax was shown, in the May 1942 poll, by the voters in the South and Middle West, with those living in the Middle Atlantic and New England States showing the least favorable reaction. 6/ No analysis of the reason for these geographical differences in attitudes was given by the report on the poll.

B. The Fortune polls*

1. The Forum of Executive Opinion

In February 1941, the magazine Fortune published a Forum of Executive Opinion dealing with taxes. 7/ The Forum is, as its name implies, a survey of business executives' opinions and is intended to represent the viewpoints of the important businessmen of the Nation.

When asked "Do you favor a Federal sales tax?", 67 percent of those having an opinion answered "yes" and 33 percent "no." The percentage of favorable replies was much higher than the Gallup Poll obtained from its sample of all voters about the same time (January 1941). Only 46 percent of the voters as a whole were in favor of a sales tax according to the Gallup Poll. This result, however, is consistent with the Gallup Polls, since they indicated that a higher percentage of individuals with above average incomes than of voters as a whole approved of a sales tax.

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- 1/ Washington Post, August 28, 1942.
 - 2/ Those with an income of \$20 a week or less.
 - 3/ New York Times, April 4, 1941, p. 37.
 - 4/ Ibid., May 3, 1942, p. 47.
 - 5/ Ibid., April 4, 1941, p. 37.
 - 6/ Washington Post, May 3, 1942.
 - 7/ Fortune, February 1941, p. 66.

*Fortune, February and August 1941: Copyright, 1941, Time, Inc. The research for the Fortune Survey is conducted by the firm of Elmo Roper.

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Eighty-five percent of the business executives in favor of the tax stated that a desirable feature of the levy was that it would "spread the load of taxation more widely." It was not implied, however, that this was the paramount reason for voting for the tax because many executives indicated they thought a sales tax had a number of desirable characteristics.

2. The Fortune Survey

A Fortune Survey of general public opinion published in August 1941 included one group of questions relative to types of taxes persons would be willing to pay if the country became involved in war. ^{1/} Most of the participants in the poll felt that they would willingly pay a general sales tax or much higher taxes on luxuries but were opposed to lowering the income tax exemption to \$500.

The questions asked and the distribution of replies were as follows:

If we were actually in the war and the Government put these things into effect, which would you do willingly, which would you do unwillingly, and which would you fight against?

	Do willingly	Do unwillingly	Fight against
Pay double the present taxes on luxuries such as movies, liquor, tobacco, etc.	81.1%	14.8%	4.1%
Pay a general sales tax on everything you buy	78.3	16.5	5.2
Support a change in income tax requirements to include all incomes over \$500 a year	43.2	31.0	25.8

This poll is not strictly comparable to the Gallup Polls because the voters were asked how they would react to an accomplished fact rather than what they would like to have done. Furthermore, asking the participants whether they would willingly or unwillingly pay certain taxes is different from asking them whether they favored or disliked those taxes, but it may well be that the voters' answers reflected, to some extent, the type of taxes they would like to have imposed.

The percentage of persons stating they would willingly pay a general sales tax (78 percent) is significantly greater than the percentage reported as favoring the enactment of a Federal sales tax by any of the Gallup Polls or even by the Fortune Forum of Executive Opinion. Since the questions are different, it is not unlikely that a considerable amount of the variation in the answers is the result of the difference in the form of the questions.

^{1/} Fortune, August 1941, p. 75.

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It is interesting to observe that the Fortune Survey reported over three-fourths of its participants as unwilling to support a reduction in the income tax exemption to \$500. About six months before, a Gallup Poll had indicated that 57 percent of the voters would have preferred an income tax levied on all except those on relief rather than a sales tax to help pay the cost of defense. The Fortune Survey query, however, did not provide for a choice between alternative proposals and, here too, the significant difference in the results may be due to differences in the questions asked. These two cases indicate the necessity of closely analyzing the form of the questions asked before drawing conclusions from a public opinion poll.

III. Proposals in 1942

A Federal sales tax received a prominent place in the discussions on revenue sources during the consideration of the 1942 Revenue Act. The Treasury Department in its tax recommendations to the Congressional tax committees opposed the adoption of a general sales tax. ^{1/} Many individuals and representatives of organized groups testified on the sales tax question during the hearings of the House Committee on Ways and Means and the Senate Finance Committee, and those Committees considered the possibility of a sales tax while preparing the Revenue Act.

A. Hearings on the Revenue Act of 1942

1. Groups favoring and opposing a Federal sales tax

Public hearings during consideration of the Revenue Act of 1942 revealed a lively interest in the question of a Federal sales tax, with over 70 witnesses expressing an opinion on such a levy. Although a dozen more witnesses spoke in favor of a sales tax than opposed it, numbers alone have little significance in this case. Of more importance, however, is the fact that all representatives of business organizations ^{2/}

^{1/} In his March 3, 1942, statement before the Ways and Means Committee, Secretary Morgenthau opposed a general sales tax, stating that: "No general sales tax is recommended, and indeed I strongly urge that no such tax be made a part of this revenue bill. The general sales tax falls on scarce and plentiful commodities alike. It strikes at necessities and luxuries alike. As compared with the taxes proposed in this program, it bears disproportionately on the low-income groups whose incomes are almost wholly spent on consumer goods. It is therefore regressive and encroaches harmfully upon the standard of living. It increases prices and makes price control more difficult. It stimulates demands for higher wages and adds to the parity prices of agricultural products. It is not, as many suppose, easily collected; on the contrary, its collection would require much additional administrative machinery at a time when manpower is limited." House Committee on Ways and Means, Revenue Revision of 1942, p. 7.

^{2/} For example: National Association of Manufacturers, United States Chamber of Commerce, and the National Retail Dry Goods Association.

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avored a Federal sales tax, while labor 1/ and consumer organization 2/ representatives just as unanimously opposed it. Various other organizations and individuals were divided in their opinions on the subject.

2. Arguments respecting a Federal sales tax

a. For a sales tax

The statements of the large number of witnesses speaking in favor of a Federal sales tax necessarily represented a wide range of opinions. In general, however, the tax was said to possess merits which may be summarized as follows: (1) it would be deflationary or at least not inflationary; (2) the distribution of the sales tax burden would be desirable; and (3) it would be easy and inexpensive to collect.

Among the reasons given for considering a sales tax to be anti-inflationary were the following: (1) it would reduce excess purchasing power and help check rising prices, and (2) it would be less inflationary in its effects on wages and salaries than a withholding tax on income.

The distribution of a sales tax burden was considered desirable because: (1) taxes should be levied not only in accordance with ability to pay but also in accordance with ability to spend; (2) the regressive effects of a sales tax would be offset by the progressive rates on individual incomes in the higher brackets; (3) the tax would distribute the cost of Government with the utmost uniformity; (4) the poor man would pay less than the rich because the former spends less; (5) a sales tax would enable persons in the lower income brackets to help pay for the war with less hardship than would the use of heavier income taxes.

b. Against a sales tax

Opponents of a Federal sales tax were nearly unanimous in placing chief emphasis upon the regressive nature of a sales tax and the consequent inequity of its burden upon the lower income groups. Emphasis was also given to the argument that a sales tax would be inflationary or interfere with price control, while several witnesses stated that the general sales tax should be reserved as a source of State revenue.

3. Suggested types of sales taxes

Witnesses proposing a Federal sales tax generally favored the retail form of the tax. Only one business organization proposed the use of another form of sales tax, although the National Association of Manufacturers recommended the use of either a retail or manufacturers' sales tax.

1/ For example: American Federation of Labor, and the Congress of Industrial Organizations.

2/ For example: Consumers' Union, Washington League of Women Shoppers, and New York League of Women Shoppers.

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Other organizations and individuals recommending a sales tax 1/ also were generally in favor of a retail sales tax, but there were a few suggestions for alternative forms such as a manufacturers' sales tax, wholesalers' sales tax, 2/ turnover tax, or net value-added tax.

Many of the witnesses gave little evidence as to why they advocated a retail sales tax rather than one of the alternative forms. Some witnesses, however, mentioned that a retail sales tax would not be pyramided; that it would not interfere with price controls; or that the repeal of a retail levy would leave no sales tax content in the value of inventories. The one business organization which advocated a manufacturers' sales tax 3/ claimed that the retail form would be expensive to administer, and that it would be difficult to obtain an effective and uniform application of a retail tax.

4. Suggested rates of tax 4/

Not all proponents of a sales tax mentioned the rate of tax they would prefer, but thirteen witnesses suggested rates for the retail form of tax and two for the turnover tax. Only one suggestion was made for a retail sales tax rate of less than 5 percent and the most frequently suggested rate was 10 percent. The relatively high rates suggested for a Federal retail levy greatly exceed the 2 or 3 percent rates of the State sales taxes. Moreover, they are much higher than the rates indicated as acceptable to a majority of the voters in the Gallup Polls. The rates suggested for a turnover tax were 1 and 2 percent.

B. Congressional action on sales tax proposals

Following the public hearings, the question of a Federal sales tax was considered by the Congressional Committees. Some members of the House Ways and Means Committee publicly announced that they favored a sales tax. Shortly before final committee action was taken on the Revenue Bill, Congressman Robertson, who was one of the principal proponents of the sales tax, announced that he was conducting a poll of members of the House to see whether they wanted a sales tax and added that he would not press for a vote in Committee if any considerable number of members of the House expressed disapproval. 5/ Those in favor of the tax did not obtain sufficient support, and the Revenue Bill was reported out of Committee without provision for a sales tax.

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- 1/ For example: Federal Tax Forum, New York County Lawyers' Association, and the American Federation of Investors.
 - 2/ Modeled after the British Purchase Tax.
 - 3/ Ohio Chamber of Commerce.
 - 4/ In a number of cases a range rather than a single rate was suggested. The highest rate is used here in all cases.
 - 5/ New York Times, July 9, 1942, p. 9.

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Sales tax plans were discussed by the Senate Finance Committee, but none was approved for inclusion in the Revenue Bill of 1942. On September 8, the sales tax issue came to a vote in the Committee. According to press accounts of the Committee's action in executive session, Senator George, Chairman of the Senate Finance Committee, offered his Victory tax (a 5-percent gross income tax on all income above \$624 a year) as a substitute for a motion by Senator Guffey for a 5-percent sales tax. ^{1/} The Guffey proposal was reported to have been rejected by a vote of 13 to 6. ^{2/}

^{1/} Ibid., September 9, 1942, p. 1.

^{2/} Wall Street Journal, September 9, 1942, p. 3.

Congressional bills and resolutions pertaining to general sales and gross income taxes, 1918-1941

This tabulation, while not necessarily complete, is believed to include all principal proposals relating to general sales and gross income taxes.

Key Number-For purposes of ready cross reference, bills and resolutions are given key numbers indicating the Congress, the session, and the chronological sequence of the measures introduced during each

Congressional session. Thus, 67-1-2 refers to the second proposal introduced during the 67th Cong., 1st session.

Related proposals-The list of related proposals, which not necessarily complete, is believed to include all proposals identical with or deriving directly from the proposal cited.

Note: Bills marked (a) provide for the financing of veterans' compensation by funds derived from a sales tax. Bills marked (ee) provide for the financing of old-age pensions by funds derived from a sales tax.

Key number	Citation	Principal provisions			Sponsor	Date of introduction	Congressional action subsequent to reference to appropriate committee (Ways and Means or Senate Finance)	Related proposals
		Base	Rate	Exemptions				
65-2-1	S. 4879	All sales transactions of 5¢ or more $\frac{1}{2}$	2/	Federal, State and local governments; allied governments; enlisted men in military and naval service of the U. S. and allied countries; American Red Cross and other relief organizations with respect to purchases for relief work; entertainments and other activities to raise money for war relief work.	Borah (Utah)	8/22/18	Senate Finance Committee Hearings on Revenue Act of 1918 (9/16/18), pages 499-510	
66-3-1	H.R. 14856	(1) Sales of (a) tangible property, (b) intangible property, (c) utility services (light, heat, and power); (2) rentals; (3) amounts received from interest (or discounts) $\frac{1}{2}$	1%	Receipts of \$200 a month; sales of personal services; transportation of persons and property; transportation of oil by pipe lines; communication; seats, berths, etc. on trains and vessels; sales by governments and nonprofit organizations; exports.	Mott (N. Y.)	12/11/20		H.R. 2226 (67-1-1)
67-1-1	H.R. 2226		Same as H.R. 14856 (66-3-1)		Mott (N. Y.)	4/11/21		
67-1-2	S. 202	Sales and leases of all goods	1%	First \$6,000 of annual sales; sales by governmental units, hospitals, Army and Navy commissaries and canteens, nonprofit organizations; exports. Certain articles already subject to selective excises are exempt. (Excises on articles not specifically exempt are repealed.)	Smoot (Utah)	4/12/21	Smoot bill was not specifically considered, but at special invitation of Committee, proponents and opponents of sales tax appeared before the Senate Finance Comm. Hearings on the Revenue Act of 1921, (5/9-27/21), pages 21-496	

67-1-5	H.R. 7867	Combined spending and income tax (1) Spending tax - amounts of expenditure in excess of exemption (2) Income tax - income not spent	$\frac{1}{2}$ 10%	Annual exemption of \$2,000 for single individual and \$4,000 for head of family; all ordinary expenses of business, trade, or profession; taxes; gifts for charitable or educational purposes; medical expenses; investments made during year, including real estate; insurance premiums.	Mills (N. Y.)	7/20/21	Ways and Means Committee Hearings on Internal Revenue Revision, 1921, (7/26-29/21) pages 144-154	
67-1-4	Amendment to H.R. 8245 (Revenue Bill of 1921)	Sales and leases by manufacturers of articles sold or leased for final consumption or use	3%	Same as S. 202 (67-1-2) except for addition of sales of refined gold and silver, and sales by public utilities.	Smoot (Utah)	9/30/21	Offered on floor as amendment. Later withdrawn by sponsor and replaced by 67-1-5	Amendment to H.R. 8245 (67-1-5) (67-1-7) H.R. 10874 (67-2-5)
67-1-5	Amendment to H.R. 8245 (Revenue Bill of 1921)	Same as 67-1-4 except that rate is 1%, and that sales of fava products are exempt.			Smoot (Utah)	11/3/21	Offered on floor as amendment and defeated, 11/3/21	See Amendment to H.R. 8245 (67-1-4)
67-1-6	Amendment to H.R. 8245 (Revenue Bill of 1921)	Sales and leases of all goods $\frac{5}{2}$	0.5%	\$6,000 of gross annual sales; sales to U.S.; sales of refined gold and silver; sales by farmers; articles already taxed; exports.	Smoot (Utah)	11/3/21	Offered on floor as amendment and defeated, 11/4/21	
67-1-7	Amendment to H.R. 8245 (Revenue Bill of 1921)			Same as 67-1-5 except that rate is 3%	Smoot (Utah)	11/7/21	Offered on floor as amendment and defeated, 11/7/21	See Amendment to H.R. 8245 (67-1-4)
67-2-1	H.R. 9410e	Sales by (1) manufacturer and importer (a) to wholesaler (b) to retailer and consumer (2) wholesaler to retailer	1% 2% 1%	Foodstuffs for human consumption; real property; intangible property; life insurance; newspapers, magazines, and publications by educational, religious and charitable organizations.	Rosedale (N. Y.)	12/9/21		H.R. 9497 (67-2-2)

1/ Collected by stamps. Purchaser liable for tax.

2/ Ranges from 1¢ on purchases of 5¢ to \$99.99 up to 1¢ on the first \$1,000 and 3¢ on each additional \$1,000 in a transaction aggregating \$50,000 or more.

3/ No credit allowed for amount of sales tax included in prices of commodities purchased. Penalty for statement (written or oral) that any part of amount charged consists of tax.

4/ Increases 1% for every \$2,000 spent up to \$18,000, and thereafter 1% for every \$1,000 up to \$50,000; 40% on amounts over \$50,000.

5/ The tax applies to sales at all levels of production and distribution less credit allowance for sales tax included in prices of commodities purchased.

67-1-5	H.R. 7867	Combined spending and income tax (1) Spending tax - amounts of expenditure in excess of exemption (2) Income tax - income not spent	$\frac{2}{10\%}$	Annual exemption of \$2,000 for single individual and \$4,000 for head of family; all ordinary expenses of business, trade, or profession; taxes; gifts for charitable or educational purposes; medical expenses; investments made during year, including real estate; insurance premiums.	Mills (N. Y.)	7/20/21	Ways and Means Committee Hearings on Internal Revenue Revision, 1921, (7/26-29/21) pages 144-154	
67-1-4	Amendment to H.R. 8245 (Revenue Bill of 1921)	Sales and leases by manufacturers of articles sold or leased for final consumption or use	3%	Same as S. 202 (67-1-2) except for addition of sales of refined gold and silver, and sales by public utilities.	Smoot (Utah)	9/30/21	Offered on floor as amendment. Later withdrawn by sponsor and replaced by 67-1-5	Amendment to H.R. 8245 (67-1-5) (67-1-7) H.R. 10874 (67-2-5)
67-1-5	Amendment to H.R. 8245 (Revenue Bill of 1921)	Same as 67-1-4 except that rate is 1%, and that sales of fura products are exempt			Smoot (Utah)	11/3/21	Offered on floor as amendment and defeated, 11/3/21	See Amendment to H.R. 8245 (67-1-4)
67-1-6	Amendment to H.R. 8245 (Revenue Bill of 1921)	Sales and leases of all goods $\frac{5}{1}$	0.5%	\$6,000 of gross annual sales; sales to U.S.; sales of refined gold and silver; sales by farmers; articles already taxed; exports.	Smoot (Utah)	11/3/21	Offered on floor as amendment and defeated, 11/4/21	
67-1-7	Amendment to H.R. 8245 (Revenue Bill of 1921)			Same as 67-1-5 except that rate is 3%	Smoot (Utah)	11/7/21	Offered on floor as amendment and defeated, 11/7/21	See Amendment to H.R. 8245 (67-1-4)
67-2-1	H.R. 9410e	Sales by (1) manufacturer and importer (a) to wholesaler (b) to retailer and consumer (2) wholesaler to retailer	1% 2% 1%	Foodstuffs for human consumption; real property; intangible property; life insurance; newspapers, magazines, and publications by educational, religious and charitable organizations.	Rosedale (N. Y.)	12/9/21		H.R. 9497 (67-2-2)

1/ Collected by stamps. Purchaser liable for tax.

2/ Ranges from 1% on purchases of 5¢ to \$99.99 up to 1% on the first \$1,000 and 5% on each additional \$1,000 in a transaction aggregating \$50,000 or more.

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5/ The tax applies to sales at all levels of production and distribution less credit allowance for sales tax included in prices of commodities purchased.

Congressional bills and resolutions pertaining to general sales and gross income taxes, 1918-1941

Key number	Citation	Principal provisions			Sponsor	Date of introduction	Congressional action subsequent to reference to appropriate committee (Ways and Means or Senate Finance)	Related proposals
		Base	Rate	Exemptions				
67-2-2	H.R. 9497*	Same as H.R. 9410 (67-2-1) except that rate on sales by manufacturer and importer to retailer is 5%			Ryan (N. Y.)	12/12/21		
67-2-3	H.R. 9605	Sales and leases at wholesale of goods ready for final consumption or use, including sales of mechanical and electrical energy	5%	Annual sales of \$5,000; sales by governments, hospitals, Army and Navy commissaries and canteens; nonprofit organizations; exports.	Watson (Pa.)	12/17/21		
67-2-4	H.R. 9658*	Sales by manufacturers and wholesalers 5/	1.5% 8/	7/	Volk (N. Y.)	12/20/21		
67-2-5	Amendment to H.R. 10874*	Sales and leases by manufacturers of articles sold or leased for final consumption or use	0.5% 8/	Same as 67-1-5	Smoot (Utah)	8/30/22	Offered on floor as amendment and defeated, 8/30/22	See Amendment to H.R. 8245 (67-1-4)
72-1-1	Title IV, H.R. 10256 (Revenue Bill of 1932)	Sales by licensed manufacturers of articles sold for final consumption or use (including sales of gases and electricity, but excluding sales of real property) 9/	2.25% 10/	Sales for further manufacture or resale; for export; to State or local government; farm products, seeds, fertilizer, feeds; specified foods; newspapers and magazines; books for blind; school books, Bibles; articles and manuals of religious devotion; altars, regalia, etc. for use in churches; articles already taxed.	Crisp (Ga.)	5/7/32	Reported favorably by Ways and Means Committee (House Report 708, 72nd Cong., 1st sess.) Considered on 3/24/32. Amendment offered by Mr. Doughton to strike the sales tax from the Revenue Bill was adopted. Effort on 4/1/32 to restore the sales tax to the Revenue Bill was defeated.	H.R. 13485 (72-2-1) H.R. 1669 (73-1-1) H.R. 6527 (74-1-3)
72-2-1	H.R. 15486	Sales by manufacturers and importers of articles sold for final consumption or use	1.75%	Sales for further manufacture or resale; for export; to State or local government; clothing (wholesale price less than \$25); tools and implements; farm and garden products, seeds, fertilizer, feeds; specified foods; newspapers and magazines; books for blind; school and religious books; articles and manuals of religious devotion; altars, regalia, etc. for use in churches; articles already taxed.	McLeod (Mich.)	12/9/32		See Title IV, H.R. 10256 (72-1-1)

73-1-1	H.R. 1669	Same as H.R. 13486 (72-2-1) except that rate is 2.25%		McLeod (Mich.)	5/9/53		See Title IV, H.R. 10236 (72-1-1)
75-1-2	Amendment to H.R. 5755 (N.I.R.A. Act)	Sales by manufacturers of articles sold for final consumption or use <u>11/</u>	1.75% <u>12/</u>	Sales for further manufacture or resale; sales to State or political subdivision; farm products unprocessed other than by original producer; feeds; food, foodstuffs, coffee, tea; wearing apparel; medicines (other than patent and proprietary); articles already taxed; exports.	Reed (Pa.) Walsh (Mass.) Byrd (Va.)	6/9/53 Offered on floor as amendment and defeated, 6/9/53	H.R. 1424 (74-1-1)
75-2-1	S.Res. 245	Authorized the Committee on Finance to make a complete study with a view to determining the advisability of a Federal sales tax on all articles except foodstuffs		Barbour (N. J.)	5/20/54		
74-1-1	H.R. 1424	Same as Amendment to H.R. 5755 (75-1-2) except that rate is 2.25% <u>12/15/</u>		Treadway (Mass.)	1/5/55		
74-1-2	H.R. 3977 ^{ee}	All sales transactions	2% <u>14/</u>	Income from personal services. <u>15/</u>	McGroarty (Calif.)	1/16/56 Considered in Ways and Means Comm. Hearings on H.R. 4120 (Social Security Bill) 2/1/55, pages 677-760; Senate Finance Comm. Hearings on S. 1150 (Social Security Bill) 2/16/55, pages 1015-1070	H.R. 7154 (74-1-4)
74-1-3	H.R. 6527	Same as H.R. 13486 (72-2-1) except that rate is 5%		McLeod (Mich.)	3/1/55		See Title IV, H.R. 10236 (72-1-1)

5/ Public utility services (transportation, gas, electricity, telephone and telegraph) are taxable at 0.5%; sales of lumber by manufacturer at 2% (importation of lumber at 3%, but no further tax on resale); duty-paid value of imports (1) by manufacturers and wholesalers, 2%; (2) by retailers or consumers, 3%. Tax must be shown separately and must not be included in cost on which profit is calculated.

7/ Specified foods and feed; seeds; farm products; nursery stock; bees; ice; fuel; ores; newspapers and magazines; materials for construction and repair of ships; calcium carbide; artificial limbs and eyes; donations of clothing and books for charitable purposes; settlers' effects; war veterans' badges and monuments to World War soldiers, articles imported for embassies; Bibles and prayer books. Secretary of Treasury may add to list.

8/ Rate was to be 0.5% for the period 11/1/22-11/1/25 and 0.25% thereafter.

9/ Sale price includes charges for coverings and containers, but excludes transportation, delivery, insurance, installation, taxes, or other charges.

10/ Annual license fee of \$2 required of manufacturers whose annual sales are \$20,000 or more.

11/ See footnote 9.

12/ See footnote 10.

13/ 50% of net collections (after refunds) allocated to States on basis of population. If State (or political subdivision) imposes a general sales tax, it will not receive a share.

14/ The President in his discretion may increase or decrease rate by not more than 50%.

15/ Tax is levied in addition to other Federal excises.

Congressional bills and resolutions pertaining to general sales and gross income taxes, 1918-1941

Key number	Citation	Principal provisions			Sponsor	Date of introduction	Congressional action subsequent to reference to appropriate committee (Ways and Means or Senate Finance)	Related proposals
		Base	Rate	Exemptions				
74-1-4	H.R. 7154**	All sales transactions <u>16/</u>	2%	Isolated transfers of property of less than \$100 value, or any isolated transaction of less than \$50 which does not arise in usual course of business; loan, deposit, withdrawal from deposit, pledge of property or money; sales of tax-exempt securities.	McGroarty (Calif.)	4/1/36	See H. Res. 445(74-2-1)	H.R. 3977 (74-1-2) H.R. 10(75-1-1) H.R. 4199 (75-1-2) H.R. 8290 (76-3-3) H.R. 4256 (77-1-7)
74-2-1	H.Res. 445	Authorized the appointment of a select committee of 8 members of the House to inquire into old-age pension plans with respect to which legislation had been submitted to the House, and particularly that embodied in H.R. 7154. (This resolution is important in the history of sales tax proposals because extensive consideration was given to the sales tax provisions of H.R. 7154 (74-1-4) in the hearings held by this committee.)			Bell (Mo.)	3/10/36	The Select Committee Investigating Old-Age Pension Organizations was appointed 3/11/36 and held hearings on selected days between 3/26/36-7/7/36	
75-1-1	H.R. 10**	Same as H.R. 7154 (74-1-4) except that no provision is made for exemption of (1) sales of tax-exempt securities and (2) isolated transactions of less than \$50. <u>17/</u>			McGroarty (Calif.)	1/5/37		See H.R. 7154 (74-1-4)
75-1-2	H.R. 4199**	Same as H.R. 7154 (74-1-4) with certain exceptions <u>18/</u>	2%	Personal services; transactions by governmental agencies or sales of government securities. No tax payable if amount of tax due for any month is less than \$1.	Crosby (Pa.)	2/2/37		See H.R. 7154 (74-1-4)
76-1-1	H.R. 11**	Gross income (less expenditures for wages, taxes and license fees, and interest)	2%	Governmental agencies; China Trade Act corporations; specified nonprofit organizations; \$100 gross income each month; first \$2,000 of amounts received through accident or health insurance, under workmen's compensation, damages on account of personal injuries or sickness; income from government securities; income exempt by treaty; income of foreign governments or their employees; income from life insurance policies; exports.	Sheppard (Calif.)	1/3/39		H.R. 5620 (75-1-5) H.R. 601 (77-1-1)
76-1-2	H.R. 2**		Same as H.R. 4199 (75-1-2)		Hendricks (Fla.)	1/3/39		See H.R. 7154 (74-1-4)
76-1-3	S. 5**		Same as H.R. 4199 (75-1-2)		Pepper (Fla.)	1/4/39		See H.R. 7154 (74-1-4)
76-1-4	H.R. 4581**	All sales transactions	<u>19/</u>	Isolated transactions in amounts not exceeding \$50; contributions to churches and charitable organizations.	Guyer (Illness)	2/28/39		

76-1-5	H.R. 5620**	Same as H.R. 11 (76-1-1) except that first \$60 (instead of first \$100) of gross income each month is exempt		Magnuson (Wash.)	4/6/39		
76-1-6	H.R. 6378**		Same as H.R. 6466 (76-1-7)	Hendricks (Fla.)	5/17/39	Withdrawn by sponsor as defective and replaced by H.R. 6466 (76-1-7)	
76-1-7	H.R. 6466**	Gross income of (1) manufacturers and wholesalers; (2) all other businesses, trades, or occupations (including personal services)	0.5% 2%	National banks; nonprofit organizations; amounts received from life insurance, endowment or annuity contracts; from accident or health insurance, under workmen's compensation; amounts received as compensatory damages for tort injury; amounts collected as Federal, State, territorial gasoline taxes and as Federal amusement taxes; benefit payments; alimony and similar settlements.	Hendricks (Fla.)	5/25/39 Reported by Ways and Means Committee without recommendation (H. Rept. 690, 76th Cong., 1st sess., 5/25/39). Defeated 6/1/39.	
76-3-1	H.R. 8264**	Gross income (in excess of \$250 a month) of all persons and companies	2%	Nonprofit organizations; amounts received from life insurance; property, accident or health insurance; under workmen's compensation; compensatory damages for tort injury; benefit payments.	Hendricks (Fla.)	1/1/40	S. 3255 (76-3-2) H.R. 9048 (76-3-4) H.R. 1036 (77-1-2)
76-3-2	S. 3255**		Same as H.R. 8264 (76-3-1)	Downey (Calif.)	2/2/40		
76-3-3	H.R. 8290**	Same as H.R. 7154 (74-1-4) with certain exceptions 20/	21/	Personal services	Green (Fla.)	2/2/40	
76-3-4	H.R. 9048**		Same as H.R. 8264 (76-3-1)	Green (Fla.)	3/25/40		
77-1-1	H.R. 601**		Same as H.R. 5620 (76-1-5)	Magnuson (Wash.)	1/3/41	See H.R. 11 (76-1-1)	

16/ Includes sale or transfer of real or personal property; interest, rent, commissions; services (including personal services); transportation; communication; amusements; education; art; advertising; public utilities; water rights.

17/ Tax on personal services (other than professional) collected at source.

18/ The base is the same as that shown in footnote 16, except that it excludes personal services, and includes: use of any raw material or product on which transaction tax has not been paid; receipts from lotteries, betting, payments of wagers, etc.; and membership dues.

19/ Labor-saving machinery, 10%; admissions, alcoholic beverages, cosmetics, 5%; grain transactions, security transactions on organized exchanges, brokerage, etc., .125% per \$1,000; security transactions between individuals not in established business, 1%; personal services (including professional) and all other transactions, 1%.

20/ The base is the same as that shown in footnote 16, except that it excludes personal services (when value is less than \$50 a month), and includes lotteries, betting, payments of wagers, etc., and membership dues.

21/ Real estate and personal property; factory products when sold to jobbers or retailers for resale; insurance premiums and benefits; investments or building and loan contracts; interest; sale of writings, advertising, art; mined coal or ores; crude oil or natural gas; electric power, or public utility profits (privately operated, rural electrification exempted); sundries and notions; returns from stocks and futures; admissions to races, 2%; interest or gross profits from banking; rentals and leases; membership dues (except religious, fraternal, welfare); subscriptions or sales of newspapers, magazines, books; automobiles, aircraft and accessories, service station products; metal products, railroad equipment or shipyard products (privately produced); travel fares; commissions and brokerage receipts; tobacco (except cigarettes, 3%), 1%; syndicated news articles or features; public amusements; winnings from betting; alcoholic beverages; war munitions (privately produced), 5%.

Congressional bills and resolutions pertaining to general sales and gross income taxes, 1918-1941

Key number	Citation	Principal provisions			Sponsor	Date of introduction	Congressional action subsequent to reference to appropriate committee (Ways and Means or Senate Finance)	Related proposals
		Base	Rate	Exemptions				
77-1-2	H.R. 1036**			Same as S. 3255 (76-3-2)	O'Connor (Mont.)	1/5/41	Considered in Hearings before the Special Senate Committee to Investigate the Old-Age Pension System, pursuant to S.Res.129, (7/24/41), pages 151-191	See H.R. 8264 (76-3-1)
77-1-3	H.R. 1410**	Gross income (less cost price of component parts and of articles purchased for resale) <u>22/</u>	2%	Governmental agencies; China Trade Act corporations; nonprofit organizations; \$80 gross income each month; first \$5,000 of amounts received from accident or health insurance, under workmen's compensation, by suit or agreement on account of personal injuries, from life, fire, or other insurance; income from government securities; income exempt by treaty; income of foreign governments or their employees.	Larrabee (Ind.)	1/6/41		S.1178 (77-1-6)
77-1-4	H.R.3995	Sales by licensed manufacturers of articles for final consumption or use <u>23/ 24/</u>	8% <u>25/</u>	Sales for further manufacture or resale; sales to State or political subdivision; farm products unprocessed other than by original producer; articles already taxed; exports.	O'Connor (Mont.)	5/15/41		
77-1-5	H.R. 4015**	All sales transactions (including personal services)	2%	No tax paid if tax due for a month is less than \$1.	Casey (Mass.)	5/14/41		
77-1-6	S.1178**			Same as H.R. 1410 (77-1-3)	Langer (N. D.)	3/20/41		
77-1-7	H.R. 4256**			Same as H.R. 4199 (75-1-2)	Flaherty (Mass.)	5/31/41		See H.R. 7154 (74-1-4)

22/ Tax on wages is collected at source. Credit is allowed to both employer and employee for payroll taxes paid.

23/ See footnote 9.

24/ 90% of net collections (after refunds) allocated to States: 50% on basis of total tax revenues raised within State by State and political subdivisions during preceding year; 30% on basis of total tax revenues derived from taxes other than property taxes during the preceding year; and 30% on basis of population. Purpose of allocation: for reduction of State and local property taxes.

25/ See footnote 10.

Treasury Department, Division of Tax Research

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FACTORS AFFECTING THE CHOICE OF A RETAIL
SALES TAX IN PREFERENCE TO THE OTHER
TYPES OF SALES TAXES

Division of Tax Research
Treasury Department, Washington, D. C.
February 10, 1943,
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Factors Affecting the Choice of a Retail Sales Tax
in Preference to the Other Types of Sales Taxes

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Factors Affecting the Choice of a Retail Sales Tax in Preference to the Other Types of Sales Taxes

The term "sales tax" ordinarily refers to the "general sales tax," which is a levy on the sale of a wide variety of goods and services. Although some writers use the term to refer also to taxes on the sale of particular commodities, these taxes are more commonly called "selective sales taxes" or "excises."

There are several varieties of general sales taxes. Some apply to the sale of a commodity each time it changes hands; these are commonly called "turnover" or "transactions" taxes. More frequently, however, sales taxes are of the "single stage" type, applying to the sale of a commodity only once as it passes through production and distribution channels and into the hands of consumers. The widespread preference for single-stage sales taxes is due principally to the fact that multiple-stage sales taxes discriminate against non-integrated industrial systems. A tax which applies at more than one stage in the production-distribution process encourages business integration and places small independent concerns at a competitive disadvantage. Moreover, a multiple-stage tax at the present time probably would create unmanageable problems in wartime price stabilization.

The single-stage sales tax may take one of three possible forms, depending upon the level of production or distribution at which it is levied. A manufacturers' sales tax, such as has been employed in Canada since 1924, applies to sales by manufacturers, except sales of materials and parts for use in the further manufacturing of other articles. A wholesale sales tax, as levied by Australia since 1930 and introduced in Great Britain in 1940, applies to sales of finished articles to retailers. The retail sales tax, in wide use by the American States since 1933, generally applies to sales of finished products by retailers.

The making of a choice among the three types of single-stage sales taxes is difficult because of the conflicting economic, administrative, and political factors involved. An examination of the characteristics of each type of tax with reference to these factors will clarify the issues involved and will facilitate the careful weighing of the relative merits and disadvantages of the three taxes.

I. Degree of interference with price control

At the present time, prices of virtually all goods and many charges for services are subject to price ceilings established by the Office of Price Administration. The price control regulations of the Office of Price Administration provide that new taxes upon the sale of a commodity or service can be added to prices without readjustment of ceilings if the amount of the tax is quoted separately. If a retail sales tax were introduced, the tax could ordinarily be quoted separately without difficulty. This procedure is followed

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now in most sales tax States. In the case of either the manufacturers' or the wholesale sales tax, however, several difficulties would be encountered in keeping the tax separately stated from the time of the taxable sale to the time of the sale to the final consumer. Marking of merchandise and record-keeping would be complicated and retailers would be inconvenienced. Even more significant is the fact that separate quotation of the tax would reveal distributors' margins to competitors and to the public. ^{1/} Merchants probably would oppose any procedure which revealed their margins on specific articles. If separate quotation were actually enforced, administration of the tax might be impaired by the resentment and ill will which would arise. The alternative to separate quotation would be complete revision of almost all price ceilings, a virtually impossible task for the Office of Price Administration and one which might lead to a serious breakdown of the price control system.

In one further respect, a retail sales tax would be superior to the other types in avoiding interference with price control. As a practical matter, all purchases by business concerns cannot be excluded from a sales tax, yet any tax applying to such sales increases business costs and exerts pressure on price ceilings. Since a retail tax would require a lower tax rate to raise a given amount of revenue than would the other forms of sales taxes, it would exert less pressure on price ceilings per \$1 of revenue.

II. Avoidance of pyramiding and excessive price increases to consumers

During the period of general price regulation, whether a tax is shifted by separate quotation or by revision of prices, it is likely that price increases greater than the amount of the tax would be kept to a minimum.

Once price control is eliminated, however, tax-induced price increases to consumers would tend to exceed the amount of the tax under manufacturers' or wholesale sales taxes. The purchase prices of goods bought by retailers, and in the case of the manufacturers' tax the purchase prices of goods bought by wholesalers, would usually be increased by the amount of the tax. Under the customary pricing procedures of wholesalers and retailers, selling prices are determined by adding to purchase prices a more or less constant mark-up percentage. Thus, the merchants would tend to increase their selling prices by amounts greater than the tax, because the mark-up would be

^{1/} For example, under a 10-percent wholesale sales tax, if an article were offered for sale for \$10 plus 50 cents tax, it would be obvious that the retailers' margin on the article was \$5.

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applied to the higher purchase prices (including the tax). Consequently, consumers would be forced to bear an additional price increase over and above the amount of the tax. ^{1/} It is possible that competitive forces might ultimately eliminate part of the pyramiding, but some price increases due to pyramiding would probably remain.

Under a retail sales tax, pyramiding is far less significant because the tax generally applies at the point of final sale to individual consumers and, accordingly, enters into the costs of business concerns only infrequently. While retailers and other business concerns may ultimately readjust mark-up and selling prices if sales volume falls as a result of the tax, these adjustments are less likely to occur than is pyramiding under manufacturers' or wholesale taxes.

III. Revenue yield at a given tax rate

A retail sales tax is estimated to yield approximately 50 percent more revenue than a wholesale sales tax and about 100 percent more than a manufacturers' sales tax levied at the same rate. The greater yield of the retail tax is due primarily to the larger tax base at the retail level, inasmuch as the tax applies to prices which are higher by the distributors' margins. In part, however, the greater yield is due to the wider coverage possible under the retail tax. During the war period, some additional yield can be anticipated by the reaching of retailers' stocks of goods which would escape the tax under the other forms.

Even though an equal amount of revenue could be obtained from the other types of sales taxes by employing higher rates, it is not likely that in practice a rate sufficiently higher to yield the same revenue would be imposed.

The lower rates required under the retail tax to raise the same revenue would create less incentive to evasion than would be created by the higher rates required under the manufacturers' and wholesale sales taxes. Some taxpayers who would not consider it worthwhile to evade a low rate tax might be tempted to do so under a higher tax. The unfair competition that would arise out of tax evasion would be more serious with a high rate of tax and would tend to lead competing concerns to attempt evasion in self-defense.

^{1/} For example, if a merchant applies a 30-percent mark-up to purchase price, he will sell for \$1.30 an article costing him \$1. If a 10-percent wholesale sales tax is introduced, his purchase price of this article will rise to \$1.10. The merchant, applying his 30-percent mark-up, will sell the article for \$1.43. The price to the consumer thus will have risen 13 cents, although the tax applying to the sale of the article and the tax collected is only 10 cents.

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Finally, as indicated above, the lower rate retail tax would place less pressure on business costs and, thus, on price ceilings, relative to the amount of tax revenue collected.

IV. Adaptability of the tax to desired scope

In general, it is advisable to avoid exemptions in a sales tax wherever possible; but certain exclusions from the tax, especially of articles entering into business costs, are desirable in so far as they are administratively feasible. The larger number of taxpayers and the less adequate sales records generally kept by retailers would make the handling of exemptions and exclusions more difficult under the retail tax than under either of the other types.

In other and more significant respects, however, the retail tax could be adjusted more easily to the desired scope than either of the other types. There is considerable justification for including within the scope of a sales tax services rendered to consumers on a commercial basis by established business enterprises, such as repair and fabrication services, and laundry and dry cleaning. These services are necessarily rendered at the retail level and do not pass through manufacturing or wholesale stages. Although their inclusion within the scope of a manufacturers' or a wholesale tax is not impossible, enforcement would be expensive in relation to the added revenue. The administrative machinery for such taxes would not be geared to the handling of the relatively large number of small taxpayers with inadequate records. A retail sales tax administration, however, would necessarily be set up in such a manner that it could handle taxpayers rendering services as well as those selling goods. Indeed, many concerns rendering consumers' services also sell goods at retail and would be taxpayers under a retail sales tax even if services were not taxed.

Certain types of exemptions which probably would be necessary under manufacturers' and wholesale taxes would not be necessary under a retail tax. Since it probably would not be administratively feasible to include farmers in the category of manufacturers or wholesalers, unprocessed farm products, many of which are sold by farmers directly to retailers, would escape tax entirely under manufacturers' and wholesale sales taxes. If discrimination were to be avoided, all sales of unprocessed foods probably would have to be exempted from either type of tax. Under the retail tax, goods sold by farmers to retailers would be taxed when sold by the retailer.

Sales of secondhand goods would likewise escape taxation under wholesale or manufacturers' sales taxes, since few secondhand goods pass through the hands of manufacturers or wholesalers. Secondhand sales, except those made on a casual basis, could be reached by a retail tax.

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Finally, a retail sales tax reaches the sale of goods already in the hands of retailers at the time of the imposition of the tax. With taxes levied at the manufacturing or wholesale level, such articles escape the tax entirely. In the latter case not only is the tax yield reduced but discrimination results during the first months or years the tax is in operation.

V. Uniform distribution of tax over taxable purchases by consumers

Under flat-rate general sales taxes, it is presumably intended that the tax be shifted to final consumers in proportion to their purchases of taxable articles. This intent would be realized, however, only if the tax represented the same percentage of retail selling price for all articles. If this were not the case, persons who spent disproportionately large percentages of their income on articles bearing more than the average rate of tax would be subject to more tax per dollar of expenditure than those who spent large percentages on articles bearing relatively small amounts of the tax. The latter group would escape part of their proper tax load.

Under a retail sales tax, since the tax applies to sales to final consumers, the intent indicated above generally would be realized. Although some retailers might avoid shifting the tax on some goods and add disproportionate amounts to the selling prices of other goods, such procedure is likely to be infrequent, especially during the time of general price controls. Also, in the case of that part of the retail tax applying to sales to business concerns, the desired uniform distribution of tax would not be attained. 1/

Under manufacturers' and wholesale sales taxes, however, the tax generally represents non-uniform percentages of retail selling prices. The price mark-ups between manufacturer and consumer and between wholesaler and consumer vary widely among different lines of goods. Accordingly, a flat-rate manufacturers' sales tax or wholesale sales tax would represent widely varied percentages of retail selling prices. 2/

1/ This would also be true, however, under the manufacturers' and wholesale sales taxes.

2/ On one article the total distributors' margins may be 50 percent of the retail selling price; on another, only 10 percent. A 20-percent manufacturers' sales tax would represent 10 percent of the retail selling price (net of the tax) of the first article and 18 percent of the second. If both of these articles retailed at \$1, the manufacturer's price of the one would be 50 cents and of the other approximately 90 cents; the sales tax would amount to 10 cents and 18 cents, respectively.

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VI. Number of taxpayers

The costs of tax administration and compliance are to a considerable extent determined by the number of taxpayers. There would be approximately 17 times as many taxpayers under a retail tax as under a manufacturers' tax, and over 9 times as many as under a wholesale tax. ^{1/}

It should be noted that this advantage of the manufacturers' and wholesale sales taxes is due in part to the assumption in the estimates that small taxpayers (those with annual sales of less than \$5,000) would be exempted. Such exemptions probably could be made with these taxes because the competitive disturbances and discrimination created would be relatively minor. With the retail tax, the disturbances probably would be so significant that the exemption of small retailers would not be advisable.

VII. Adequacy of taxpayers' records

The condition of taxpayers' records also affects administrative costs and effectiveness. The accounts and records of retailers are generally much less adequate for computing and checking sales tax liability than are those of manufacturers and wholesalers. This situation is due partially to the smaller average size of retailers as compared with manufacturers and wholesalers. In addition, the more specialized nature of the businesses of manufacturers and to a lesser extent of wholesalers facilitates supplying the type of information needed for sales tax administration. State sales tax experience has demonstrated the virtual impossibility of inducing sufficient improvement in retailers' many records. Accordingly, with a retail tax, errors in calculating tax liability would be more likely to arise and greater opportunity would exist for outright evasion. Complete checking of returns would be more difficult, more time-consuming and, in many cases, impractical if not impossible.

VIII. Valuation problems

Under all types of sales taxes the determination of the proper sale price to which the tax rate should apply presents some problems - so-called "valuation problems." The need for valuation arises partly because the actual sale price does not always represent the actual commercial value of the article and partly because distribution systems of competing concerns are not uniform. Not only do the manufacturers'

^{1/} Revenue Revision of 1942, Hearings before the Committee on Ways and Means, p. 350.

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and wholesale taxes require valuation in a greater number of cases than does the retail tax but, when required, they present much more difficult administrative problems.

The principal source of difference between actual sale price and commercial market value of an article is common ownership or affiliation of seller and buyer in a taxable transaction. Many manufacturers own or control wholesale distribution facilities and retail outlets; wholesalers often operate retail units, and sometimes manufacturing establishments; retailers may own wholesale houses or manufacturing plants. Some taxable transactions consist of transfers of goods from one establishment in such an integrated organization to another without a bona fide sale. When sales are made under such conditions, the price may be far lower than the commercial value of the article and the determination of a proper sale price for tax purposes presents difficult problems. Substantial administrative effort is required to determine a fair price and sufficient administrative authority must be granted to enforce its use. Under a retail tax, since retailers seldom have a financial interest in the consumers of their articles, transactions requiring revaluation are relatively few. Some valuation problems are of course to be found, especially in the case of taxable articles produced for use by business concerns, but they are far less numerous than under the other types of taxes.

The need for readjustment of selling price for tax purposes under manufacturers' and wholesale taxes also arises when manufacturers and wholesalers sell to purchasers at different levels of the distribution system. A manufacturer may sell to wholesalers, to jobbers, to retailers, and to consumers. The prices charged the different types of buyers are usually substantially different. Unless price readjustments are made for tax purposes, the amount of tax applied to sales made directly to retailers and consumers would be substantially greater than the tax on sales to wholesalers. Such direct sales would be discouraged and those producers whose distribution systems are based on direct sale to consumers or to retailers would have their competitive position adversely affected in comparison with those manufacturers normally selling to wholesalers. Similar, though less serious, difficulties exist in the case of a wholesale tax. The process of valuation in such cases is a difficult one, unless the concerns also make sales at the price level which would be used as the basis for revaluation. In contrast, under a retail tax, taxable sales are those made to final users and valuation problems arising out of diversity of distribution systems would be avoided.

IX. Identification of taxpayers and taxable transactions

A retail sales tax probably involves fewer problems of identifying taxpayers and determining whether particular transactions are taxable than do either of the other two taxes. In the case of a manufacturers' sales tax, the chief source of difficulty lies in determining whether certain activities constitute manufacturing. Such activities as packaging, bottling, rebuilding, and cleaning, illustrate the nature of the difficulties. In the case of the wholesale tax, the chief source of difficulty lies in the frequent inability of taxpayers to know at the time of a sale whether it is to be the last wholesale sale and therefore taxable. Many concerns do both wholesale and retail business. If a wholesaler or manufacturer sells to one of these concerns, the sale is taxable if the buyer intends to resell the article to a consumer. It is not taxable if the article is to be resold to a retailer. Chances for error and tax evasion would be numerous and frequent tax readjustments would have to be made when articles were ultimately sold to different types of buyers than was intended at time of purchase.

With the retail tax some problems of determining taxpayers and taxable sales also arise, but in general they appear to be less serious than those arising under the other types of sales taxes. This is due primarily to the fact that most retail sales are made to individual consumers who are not in the business of selling taxable articles.

X. Experience in the United States with various forms of sales taxes

The Federal Government has had only limited experience with taxes levied on sales of goods and services at retail but has had very considerable experience with taxes on sales of goods by manufacturers. Consequently, a manufacturers' sales tax (and possibly a wholesale sales tax ^{1/}) probably could be administered effectively within the framework of existing Bureau of Internal Revenue procedures for the handling of excises. The most efficient administration of a retail sales tax probably would require its integration with the Bureau's administrative organization for the handling of social security and income taxes. The retail tax would, however, require additional administrative machinery and the adoption of some procedures different from those employed to administer existing taxes. These changes would involve difficult problems during the period of wartime manpower and equipment shortages.

^{1/} The Federal Government has had no direct experience with taxes on sales at wholesale.

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Many States have had considerable experience with the administration of retail sales taxes. During the past ten years, more than half the States have used such taxes and, in many cases, administration has been developed to a high level of efficiency. This State experience constitutes an invaluable fund of information for the development of Federal retail sales tax administration.

XI. Attitude of taxpayers and State officials

Successful sales tax administration depends in large part on the willingness of taxpayers to cooperate with the tax administrator. On the basis of available information, most businessmen would prefer a retail sales tax. In large part, this preference appears to be due to the greater ease with which a retail tax could be shifted to consumers under present conditions.

In contrast, most State tax officials, especially in States employing sales taxes, would prefer a Federal sales tax imposed at a level other than retail. This attitude is based principally upon the apprehension that the enactment of a Federal retail tax would interfere with continued use of retail sales taxes by the States.

XII. Conclusion

The considerations involved in appraising the relative merits of the three types of single-stage sales taxes - the manufacturers', wholesale, and retail taxes - are numerous. The order of their superiority from the point of view of the several criteria here considered is summarized in the accompanying table.

Relative merits of retail, wholesale, and manufacturers' sales taxes

Criteria	Order of superiority		
	First	Second	Third
1. Least interference with price control	Retail	Wholesale	Manufacturers'
2. Avoidance of pyramiding.....	Retail	Wholesale	Manufacturers'
3. Greatest revenue yield at a given tax rate	Retail	Wholesale	Manufacturers'
4. Adaptability to desired scope:			
a) Provision for exemptions.....	Manufacturers'	Wholesale	Retail
b) Inclusion of services.....	Retail	(Wholesale (Manufacturers'))
c) Inclusion of agricultural products and secondhand goods.....	Retail	(Wholesale (Manufacturers'))
5. Uniform distribution of tax over taxable consumer purchases.....	Retail	Wholesale	Manufacturers'
6. Number of taxpayers.....	Manufacturers'	Wholesale	Retail
7. Adequacy of taxpayers' records.....	Manufacturers'	Wholesale	Retail
8. Avoidance of valuation problems.....	Retail	Wholesale	Manufacturers'
9. Identification of taxpayers and taxable transactions.....	Retail	Manufacturers'	Wholesale
10. Conformity with past experience:			
a) With Federal experience.....	Manufacturers'	Retail	Wholesale
b) With State experience.....	Retail	Wholesale	Manufacturers'
11. Attitude of taxpayers and State officials:			
a) Attitude of taxpayers.....	Retail	Manufacturers'	Wholesale
b) Attitude of State officials.....	Manufacturers'	Wholesale	Retail

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In certain respects the retail sales tax would be more difficult to administer than either of the other types of single-stage sales taxes, for the number of taxpayers is substantially greater and a larger percentage of the taxpayers keep inadequate records. Both factors lead to greater administrative personnel and equipment requirements and make effective collection more difficult to attain. Furthermore, the Federal Government has not had extensive experience with sales or excise taxes having very large numbers of small taxpayers and consequently the inauguration of a Federal retail sales tax probably would require substantially greater changes in Bureau of Internal Revenue procedures than would the other sales taxes.

There are several administrative features of a retail tax, however, which tend to outweigh these disadvantages. One is the avoidance of the serious valuation problems which would arise under wholesale and manufacturers' taxes. Under the retail tax, the actual sale price would be used in almost all cases in computing tax liability; with the other types of taxes, however, the selling prices frequently would have to be adjusted. The retail tax probably would involve fewer problems of identifying taxpayers and determining taxable transactions than would either of the other types of sales taxes. Moreover, the States have had considerable experience with retail sales taxes and this would tend to offset the lack of Federal experience.

A retail sales tax would introduce less interference with Federal price controls during the war period and less pyramiding of the tax in the postwar period than would the other types of taxes. The retail sales tax could be quoted separately from the prices of taxable articles, and revisions of price ceilings generally could be avoided. With the other types of taxes, separate quotation would not be feasible in most cases and extensive revision of price ceilings might be necessary. Once price control is eliminated, manufacturers' and wholesale sales taxes would tend to pyramid and price increases to consumers would be greater than the amount of the tax.

Furthermore, the retail tax in most respects can be adapted to the desired scope of a sales tax more satisfactorily than can the other types. Consumers' services can be included much more easily and certain exemptions necessary with the other types can be avoided. In one respect, however, the retail tax is less adaptable; the introduction of exemptions impairs administration of the other two taxes less than that of the retail tax.

Not only would the retail tax minimize pyramiding, but it would provide a more uniform distribution of tax over all purchases of taxable goods and services. Under the other taxes, the tax would constitute non-uniform percentages of selling prices to final consumers because of the varied margins of distributors in different fields.

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Finally, the revenue yield under a retail sales tax at any given tax rate is substantially greater than that of the other two taxes. In view of resistance to high tax rates, it is unlikely that either the manufacturers' or wholesale sales taxes would be imposed at a rate sufficiently high to yield the revenue that would be obtained under a retail sales tax. Accordingly, a retail sales tax would serve wartime revenue needs better than either a wholesale or a manufacturers' sales tax.

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FACTORS AFFECTING THE STRUCTURE OF A
FEDERAL RETAIL SALES TAX UNDER WARTIME CONDITIONS

Division of Tax Research
Treasury Department, Washington, D. C.
March 31, 1943
as revised October 9, 1943

Factors Affecting the Structure of a Federal Retail Sales Tax
Under Wartime Conditions

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Factors Affecting the Structure of a Federal Retail Sales Tax Under Wartime Conditions

The effectiveness of a Federal retail sales tax as a revenue and anti-inflationary measure and the efficiency with which the tax could be administered would depend to a large extent upon its scope and structure. The principal issues and problems which arise in determining the desirable scope and structure of a wartime retail sales tax are herein discussed in the light of frequently conflicting objectives, such as those relating to equity for sellers and consumers, revenue yield, anti-inflationary influence, and administrative efficiency.

Estimates of the number of taxpayers, tax base, and yields may be of assistance in evaluating the issues. It is estimated that for the calendar year 1943 there would be about 2,450,000 taxpayers under a Federal retail sales tax. On the assumption that certain selected services would be taxed and that the nongovernmental exclusions from the tax would be limited to feed, seed, and fertilizer, fuel, and commercial, industrial, and agricultural machinery, it is estimated that the net tax base for the calendar year 1944 would be \$63.2 billion. On this base the tax is estimated to yield \$3.16 billion with a 5-percent rate and \$6.32 billion with a rate of 10 percent. ^{1/}

Part One. Scope of the Tax

Determination of the most satisfactory scope of a Federal retail sales tax involves the consideration of three principal issues. These are: (1) the definition of retail sale, with particular reference to the question of the extent to which such sales should include sales of articles used by business concerns; (2) the extent to which services should be taxed; and (3) the extent to which exemptions from the tax should be provided. These issues will be considered in turn.

I. Definition of retail sale

What constitutes a retail sale for tax purposes depends upon the statutory definition of the term and not upon the distinction usually drawn between "wholesale" and "retail" sales. In the following discussion it will be noted that the term as defined for tax purposes would include not only retail sales as ordinarily understood but also certain sales by wholesalers and manufacturers.

^{1/} Detailed estimates are presented below in Part Two, subsection III.

A. The concept of a retail sale

Under State retail sales taxes the concept of a retail sale is, in general, a sale of tangible personal property for the purpose of utilization, rather than resale, by the purchaser. Under this concept of the term, two types of problems are presented. In the first place, it must be ascertained whether the purchaser is engaged in the business of selling tangible personal property.^{1/} If the business activity of the purchaser involves the performance of service rather than the sale of tangible personal property, it follows that all sales of property for use in the performance of that service are retail sales. For example, sales to a telephone company, a laundry, or an insurance company, of property used in the course of its business would be retail sales. Frequently, however, the problem is not so easily solved. Contractors furnish a great variety of articles ranging from materials such as lumber and cement to manufactured products such as elevators and air-conditioning equipment under several different types of contracts for the improvement of real property. The determination of whether their activities under a particular type of contract should be regarded as involving sales or service may be very difficult. The States, for example, have differed in their treatment of the activities of printers, photographers, and shoe repairmen, some States regarding one or more of these activities as services while others have concluded that they involve, to some extent at least, the sale of tangible personal property.

If the business activities of the purchaser involve the sale of property, it becomes necessary to distinguish between the property purchased for use and that purchased for resale. Under State practice, property is generally considered to be purchased for resale only if it is to be resold in its original form or as a part or material physically incorporated into other tangible personal property.

^{1/} The term "sale" includes all transfers for a consideration of title to property and possession of property under conditional sales and similar contracts. In addition, the term is defined to include the furnishing of meals and drinks. By the term "tangible personal property" is meant all corporeal personal property. It should be noted that stocks, bonds, mortgages, and other similar claims to property are not tangible personal property. Real property consists of land and improvements thereon such as houses and store and factory buildings.

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Under this definition, all sales to business concerns are retail sales except sales of materials and articles to be resold by the concerns. Thus, sales of locomotives to railroads, sales of fuel and machinery to manufacturing plants, and sales of show cases to retailers are retail sales. This concept is substantially different from the usual one outside the sales tax field, in which retail sales are considered to be sales to individual ^{1/} consumers. As the concept has developed in the tax field, whether a sale is a retail sale does not depend in any way upon the nature of the property or upon the character of the seller or purchaser, but rather upon the intended disposition of the property by the purchaser.

It must be emphasized that under this definition many retail sales are made by concerns not generally considered to be retailers, in contrast to the common concept of a retail sale as one made by a concern engaged primarily in the business of selling at retail. Most wholesalers make some sales to individual consumers and industrial users. Although these sales would be regarded as sales at wholesale in business terminology, under the above definition they are retail sales rather than sales for resale. Likewise, sales by manufacturers to individual consumers and to business concerns of property for use by the purchaser are retail sales. On the other hand, a sale made by a concern engaged primarily in the business of retailing to another retailer for resale by the latter is not a retail sale. Whether a sale is a retail sale does not depend in any way upon the general nature of the business of the seller.

The principle which distinguishes a retail sale from a sale for resale is known as the physical-ingredient or component-part rule. Under this rule, an article not to be resold in its original form must become a physical ingredient or component part of other tangible personal property if its sale is to be considered as a sale for resale. ^{2/} Thus, sales of flour and eggs used in the making of bread are considered to be sales for resale. Sales of fuel, however, used to bake the bread are considered retail sales. It is not necessary that the ingredient retain its separate identity when incorporated into the article; it is sold for resale if the materials or elements of which it is composed become, in a physical sense, a part of the article to be sold. It may be clearly identifiable in the article, as in the case of drawer knobs sold to a furniture manufacturer; it may be completely changed in form, as in the case of cement sold to a concrete pipe manufacturer; or it may be completely changed through chemical reaction, as is coal used in making plastics.

^{1/} The term "individual" is used herein to differentiate between persons and business concerns.

^{2/} If an article becomes a component part of real property (a house or other building) which is to be sold, the sale of the article is a retail sale rather than a sale for resale. The sale is a sale for resale only if the article becomes a component part of tangible personal property which is to be sold.

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Here, too, difficult problems of interpretation may be encountered. Chemical analysis may be required to ascertain whether certain compounds actually enter into the final products which are to be sold or serve merely as catalytic agents. The question of the character of sales of feeds to livestock producers and of seeds and fertilizer to producers of agricultural products is not so readily answered. The fact that the term "retail sale" is generally defined in some such way as a sale for any purpose other than resale gives rise to another group of problems. Containers and packing materials generally pass on to the purchaser of the commodities packed therein. As might be expected, however, there is a difference of opinion as to whether they are purchased for the purpose of use or consumption in the dealer's business or for resale to his customers. Certain property may in fact be purchased for a dual purpose, e.g., coke purchased by a foundry may be used for the purpose of adding carbon and furnishing heat.

B. The scope of taxable retail sales

1. Application of the tax only to retail sales

Apart from the taxation of certain services, as discussed below, it is highly desirable that the tax apply only to retail sales. That is, it should not be extended to include any sales for resale.

State experience has demonstrated the feasibility of so limiting the tax to sales at retail. ^{1/} The inclusion of sales for resale would destroy the single-stage nature of the tax, since it would then apply more than once to sales of a particular article or parts thereof before the article reached the final consumer. The tax would become a multiple-stage tax with all the undesirable features of the latter, such as discrimination against independent business concerns, furthering of integration, pyramiding, and unnecessary interference with price ceilings.

The physical-ingredient rule provides a workable administrative test for drawing the line between articles used and those resold. The buyer of goods ordinarily knows at the time of purchase whether he intends to resell or use the goods. There are, however, exceptions to this general rule as in the case of plumbers. The plumber

^{1/} None of the States tax sales for resale under retail sales tax acts. Under multiple-stage taxes, however, rates lower than those applied to retail sales are imposed on sales made by manufacturers and wholesalers for resale.

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ordinarily is regarded as a consumer of at least some portion of the materials furnished by him in the performance of contracts for the improvement of real property. Frequently he also sells materials to other plumbers for use by them and, in these instances, he is entitled to purchase such property for resale. Perhaps the most important source of difficulty in handling the separation will arise out of the incomplete record-keeping of many concerns making both types of sales. However, the average small retailer, the type of taxpayer most likely to have inadequate records, does not ordinarily make sales for resale.

A system of resale certificates generally is employed as the means by which the purchaser informs the seller of the intended disposition of the property purchased. The resale certificates are retained by the seller as prima facie evidence that the sales covered by the certificates are not subject to the tax. Almost all sales tax acts provide for the licensing of sellers, which facilitates the operation of the resale-certificate system.

2. Restriction of the tax to retail sales to individual consumers

a. Desirability of excluding from the tax sales to business concerns

For several reasons of considerable importance it would be desirable, if administratively feasible, to confine the tax to retail sales to individual consumers and to exclude from the tax sales to business concerns of articles to be used in their operations.

In general, the reasons for not taxing sales for resale apply with equal force to sales of all articles used in production and distribution. If the retail sales tax is to be truly a single-stage tax and avoid the disadvantages of the multiple type, the tax should apply so far as possible only to sales to individual consumers. The essential reason why materials should not be taxed is that costs of materials enter into the prices of the finished products, and not the fact that the materials become physical ingredients or component parts of the products. Since fuel costs, for example, as well as material costs, enter into the costs of the finished products, fuel used by business concerns for purposes of production and distribution should not be subject to the tax if exclusion is feasible.

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The fact that fuel is not a physical ingredient does not alter the economic desirability of excluding it from the scope of the tax. 1/

The purpose of levying a retail sales tax is to obtain revenue from individuals in proportion to their expenditures for taxable goods and services. A retail sales tax is not generally regarded as a tax which applies to sales of articles used by business concerns, and most persons advocating such a tax probably do not intend that it be borne by business concerns but expect it to be shifted to individual consumers. Such intent could be fully realized only if the tax were restricted to sales of finished goods to individual consumers. It is true that the portion of the tax applying to sales to business concerns would in many cases ultimately be shifted forward to individuals, but the shifting is often a slow process requiring many readjustments and causing competitive disturbances. 2/

In so far as the portion of the tax applying to sales to business concerns would not immediately be shifted forward, it would rest as an inequitable burden on the concerns. Those firms using processes which require relatively high percentages of taxable goods would be placed at a disadvantage in competing with firms producing the same or similar articles by the use of processes which require smaller percentages of taxable articles. New firms starting business after the enactment of the tax would be placed under a temporary handicap because their older competitors purchased their capital equipment before the tax was in operation. Even in the absence of price ceilings, producers would find it almost impossible, except over a long period of time, to shift the tax forward. 3/

Apart from these discriminatory and inequitable aspects, the application of a high rate of tax to sales of articles used by business concerns would encourage the use of methods of production requiring relatively small percentages of taxable articles, methods which may be somewhat less efficient than others and which would not be used in the absence of the tax. 4/ To the extent that such shifts occurred, maximum utilization of resources would not be attained and full benefit of the most efficient methods of production would not be realized.

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- 1/ That fact may be of significance, however, in determining the administrative feasibility of excluding fuel.
 - 2/ Even when shifting did occur the tax would not be distributed in proportion to consumer purchases of taxable goods and services.
 - 3/ Producers of articles of which there is a substantial shortage probably could shift the tax without much difficulty in the absence of price ceilings.
 - 4/ Change in methods of production would not be frequent during the war period but could occur more freely once shortages of manpower, materials and equipment were eliminated.

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Under present conditions, the attempts of business concerns to shift the tax applying to articles they use in production and distribution would encounter the price ceilings. The tax would be an additional cost to business concerns and would come at a time when the increasing cost pressures against price ceilings already are very great. The task of the Office of Price Administration in maintaining the ceilings would be made more difficult, and it is possible that the number of readjustments which would be required would endanger the entire system of price control. Similarly, the business costs of war contractors with the United States would also be increased and upward adjustments might be required in a large number of cases even in the absence of contractual tax clauses. During the war period, therefore, the administrative difficulties encountered in excluding from tax sales of articles entering into the cost of production and distribution must be weighed against the administrative problems which would be encountered in connection with price controls and fixed-price war contracts if they are not excluded.

Once price control were eliminated, however, and most concerns were able to shift the tax, there would be a tendency for the tax to pyramid and burden consumers by amounts greater than the tax. Under customary pricing procedures, wholesalers and retailers would apply more or less constant mark-up percentages to the now purchase prices of articles reflecting the tax, and thus raise their selling prices by amounts greater than the tax.

b. Administrative obstacles to exclusion
of sales for business purposes

While there is good reason for restricting the tax to sales to individual consumers, in practice it would be virtually impossible from an administrative standpoint to avoid inclusion of many sales of articles used by business concerns. The basic source of the difficulty is the fact that a great many articles can be used either for production or consumption purposes. Examples include automobiles, typewriters, coal, gasoline, light bulbs, and building materials. Accordingly, it would not be feasible to exempt all sales to business concerns either by exclusion of all classes of articles which are sold for use by business concerns, or by exclusion of all sales actually made to such concerns, regardless of the nature of the article. With the former method an unnecessarily large portion of the tax base would be eliminated because a very wide variety of articles are sometimes used by businesses. The latter method could not be used because owners of businesses would be able to purchase articles tax-free for their individual use and the use of their friends, since the Government would be unable to make a sufficiently complete check to discover such diversions. Accordingly, the only alternative would be to provide for the exclusion of all sales to business concerns of articles to be used in operation of the businesses.

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Theoretically, this method would avoid the loopholes under the other methods, but, in practice, it would be impractical to administer. In the first place, sellers in many cases would not be able to determine the ultimate use of articles at the time of sale. Because of the very large number of small transactions, it would be impossible to check the subsequent use of articles purchased and widespread evasion would be inevitable. Furthermore, for effective control to be exercised, all business concerns would probably have to be licensed and required to quote their license numbers when purchasing articles for business use. This procedure would require the licensing of about 6 million farmers as well as other business groups which in any case would not be licensed. Thirdly, many articles are used for both business and consumption purposes, as for example fuel purchased by a grocer to heat a building containing both his store and his home. Finally, and of great importance, is the fact that many retailers do not keep records sufficiently complete to assure accurate distinction between sales for consumption and production purposes. Many retailers keep virtually no records and a large part of those who maintain records do not have adequate ones.

It is clear, therefore, that administrative considerations preclude complete exemption of all sales for business use. Examination of the principal classes of articles used primarily or largely for business purposes indicates, however, that exclusion of several important groups may be feasible. Before indicating those classes, the criteria for determining the feasibility of excluding particular classes of commodities purchased by businesses will be discussed.

c. Criteria for determining feasibility
of excluding particular classes of
articles sold to business concerns

The following criteria appear to be significant in deciding whether it is feasible to exclude particular classes of producers' goods from the tax.

(1) The class of commodities should comprise a relatively important element in business costs. Administrative difficulties inherent in the exclusion of particular groups of commodities from the tax are such that exclusion is not justified unless the commodities concerned are important business costs.

(2) The class should be clearly definable so that both the administrator and sellers will be in agreement as to the scope of the exclusion in order that frequent resort to litigation may not be required.

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(3) The articles should be used primarily for business purposes. If the article is widely used for individual consumption purposes, too many persons will escape proper tax payment and the tax yield will be reduced unnecessarily.

(4) The sales should be made for the most part by relatively specialized sellers who keep satisfactory records. If the articles are sold by concerns selling many other articles and generally not maintaining satisfactory records, the exclusion will lead to incorrect tax payments and evasion.

(5) Administration of the exclusion will be facilitated if transactions in the commodities are, on the average, of considerable size.

Also, it is essential that there be only a limited number of separate exclusions. Each exclusion gives rise to some interpretative questions, increases the difficulties of sellers in applying the tax properly, in keeping records and in making proper tax returns, and results inevitably in some underpayment of taxes and evasion. If the excluded classes are held to a small number, serious impairment in the administration of the tax is less likely to occur. As the number of excluded classes is increased, however, the effectiveness of tax administration tends to be reduced.

d. Classes of goods used for business purposes which might be excluded from the tax

Examination of the articles bought by business concerns indicates that at least three classes of such articles are of sufficient importance to warrant serious consideration of their exclusion from the tax in the light of the foregoing criteria. These classes are: feed, seed, and fertilizer; fuel; and industrial, agricultural and commercial machinery.

(1) Feed, seed, and fertilizer

Feed, seed, and fertilizer are important cost elements in agricultural production. They account for about 39 percent of those commodities used in production that are included in the index of prices paid by farmers. ^{1/} It is estimated that farmers will spend about \$2.0 billion on these items in the calendar year 1944.

^{1/} Indexes of Prices Paid by Farmers for Commodities and of Prices Paid, Interest, and Taxes, 1910-42, U. S. Department of Agriculture, Bureau of Agricultural Economics, July 29, 1942.

Evidence is available that these items may be defined with sufficient clarity to permit the effective administration of the exclusion. Under the majority of State sales taxes, sales of feed, seed, and fertilizer to persons engaged in the commercial production of livestock and agricultural products have not been taxed as retail sales either by statutory exclusion and exemption or by administrative interpretation that such sales are sales for resale. Some problems would arise, however, in defining the exact scope of the exclusion. For example, in the case of feed, it might be desirable to limit the exclusion to feeds for livestock and poultry in order to tax sales of feeds consumed by household pets. Furthermore, it might be necessary to distinguish between feeds and medicines, also between assimilated feeds and such items as granite grit used by poultry producers. It might be advisable, on the other hand, to extend the exemption to medicines, and perhaps even to the non-assimilated articles, so as to avoid these distinctions.

In the case of seed and related articles, the problem of clearly defining the exclusion may be more complex because of the differences between annual seeds, perennials, bulbs, plants, and trees. The question also arises whether the exclusion should be limited to seeds, etc., used in the production of food and fiber or whether it should be extended to those used for decorative purposes, such as for flowers, bushes, lawns, and ornamental trees. Still another line of distinction might be made between sales of the latter items to commercial producers and sales to individual consumers.

In defining fertilizers, the exclusion might include soil correctives, as well as plant foods, in order to avoid the necessity of distinguishing between the two.

Feeds, seeds, and fertilizers are used primarily for commercial production purposes although substantial quantities of seeds and fertilizers are used in home gardens and for ornamental plant purposes. Under some of the State sales taxes the attempt is made in various ways to exclude sales of the articles used in commercial production for resale and to tax the noncommercial sales. Serious difficulties are encountered, however, in the administration of the distinction, since it is necessary to tax that portion of the sales to commercial producers which is used in producing farm products for their own consumption. Other States avoid these administrative problems by exempting the articles as classes of commodities, irrespective of whether the buyer is a commercial user or individual consumer and regardless of their intended use.

The concerns dealing in feeds, seeds, and fertilizers generally are relatively specialized sellers, although a wide variety of concerns are selling seeds, plants, and fertilizers for garden and ornamental

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purposes. Moreover, the size of the sales transaction may frequently be small, as for example, the purchase of one or two packets of vegetable or flower seeds.

Feed, seed, and fertilizer are comparable to physical ingredients in so far as the commercial purchasers thereof are concerned. Consequently, since physical ingredients and component parts would be excluded from the tax, feeds, seeds, and fertilizers should also be excluded. The exclusion of the articles as classes of commodities might be the most practical method of defining the scope of the exclusion.

(2) Fuel

The nation's fuel bill for the calendar year 1944 is estimated to be \$10.9 billion, excluding gas and electricity. The importance of fuel as a cost element varies significantly among different types of businesses. It is a particularly significant cost item in the field of transportation and in the production of electricity, gas, and in the heavy industries such as steel. It is a relatively unimportant item in commercial establishments and certain types of agriculture. A large portion of the nation's fuel consumption is directly connected with all phases of the war program.

Another consideration in determining whether fuel should be excluded is the possible discrimination which may arise among different types of producers if fuel is taxed. For example, large integrated business organizations such as steel companies sometimes own their sources of fuel supply. In order to avoid tax discrimination it would be necessary to tax the fuel produced and used by integrated business organizations as well as sales of fuel. The taxation of fuel produced and used by the integrated organizations, however, raises the question of the practicability of administering such a provision. Since there is no sales price, the tax would have to be measured by some such basis as the fair market value of the fuel. The determination of that amount can be expected to produce serious controversies between the taxpayers and the administrator. The taxing of fuel would lead to problems for the producers of electricity and gas, whose rate structures are fixed by public utility commissions, and for other producers whose selling prices are fixed by price control. If fuel sales were taxed but sales of gas and electricity excluded, competitive disturbances might be introduced between the sellers of gas and electricity and other forms of fuel since all of these commodities are sold in competition with each other.

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No great difficulties are expected to be encountered in defining the term fuel. It would include such commodities as coal, coke, fuel oils, diesel oil, kerosene, gasoline and cord wood. ^{1/}

Perhaps the most serious objection to the exclusion of fuel arises from the fact that a considerable amount of it is purchased for individual consumer use in home lighting, heating and cooking and in the operation of automobiles. In this connection, it should be noted that a number of States provide for tax-free sales of fuel to certain business users. The extent of the exemption varies among the States, but, generally, sales to manufacturers and to public utilities such as electric, gas, and transportation companies are excluded. If it is attempted to restrict the fuel exclusion to certain business users, such as manufacturers, it appears that important administrative difficulties would be encountered. In the first place, it would be necessary to distinguish between manufacturing and other activities. In addition, there would be many instances in which only a portion of the business activities of a concern would constitute manufacturing, and in such cases it would be necessary to determine what portion of the fuel consumed was for manufacturing purposes. Consequently, the desirability of restricting the exclusions in this manner is to be questioned. Moreover, restricted exclusions of the foregoing type may be impractical unless the businesses entitled to the exclusions are licensed for the purpose of controlling their applications for tax-free sales. Licenses, however, would not solve the problems of improper tax-free sales since they merely provide a means of identifying the users. Therefore, investigation would be required to insure that fuel purchased for manufacturing purposes was not diverted to other uses.

Fuels are to a very large extent distributed through specialized dealers, such as wood and coal yards, fuel oil companies, and service stations. Sales range all the way from small transactions involving a sack of wood or coal or a few gallons of gasoline to those involving carloads of coal or thousands of gallons of oil. If it is determined that fuel sales should be excluded, the administrative problems involved in distinguishing between sales for business and individual consumption purposes might require exclusion of all fuel sales, even though substantial portions of fuel sales are for other than business purposes.

^{1/} If gas and electricity were not otherwise exempted (See II B below) from the tax, they probably should be included within the definition of the term "fuel."

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(3) Industrial, commercial and agricultural machinery

It is estimated that in the calendar year 1944 about \$3.1 billion will be spent on industrial, commercial and agricultural machinery, including parts. 1/

Machinery is a very important cost factor in some industries, especially the heavy industries most needed for producing war materials, but it is relatively unimportant in other fields of business such as retail trade. In addition to the effects on profits of business concerns which had to absorb the tax and on price ceilings where the tax was permitted to be shifted forward, application of the sales tax to machinery would tend to introduce short-run discrimination among business enterprises. That is, concerns which did not buy machinery for several years after the imposition of the tax would be placed in a relatively better cost position than their competitors who bought machinery and had to pay the tax. This discrimination, however, would decrease in importance with the passage of time as business concerns replaced their machinery. During the war period practically all machinery sales will be made to business users 2/ of which a large number will use the machinery for the production of military goods and supplies.

It appears that it would be extremely difficult to define with clarity and exactness the type of product intended to be excluded. To attempt to exclude machinery by employing in the tax act merely the expression "industrial, commercial and agricultural machinery, and parts therefor" would raise a host of interpretative questions and, undoubtedly, lead to considerable litigation. The tax administrator would have to draw several lines of distinction. For instance, what is the dividing line between machinery and tools? Tools, such as hand saws and hammers, are certainly not machinery, but the line is not so easily drawn in the case of other articles such as hand drills and certain types of gauges. Furthermore, since the term "machinery" embraces the appurtenances necessary to the working of a machine, numerous questions would arise as to what portion of the considerable body of non-mechanical equipment used in connection with machinery could be considered to be machinery. If the operator of a machine

1/ The estimate excludes expenditures for military machinery and ordnance. It includes, however, some sales to the Federal Government and to war contractors.

2/ Exceptions are sales of replacement parts for and secondhand sales of household types of machines.

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must use a special tool to adjust it, is the tool machinery? Another line of distinction that would have to be clarified involves the difference between industrial, commercial and agricultural machinery and other kinds of machinery. This would first entail a definition of the terms "industry," "commerce," and "agriculture." It would then be necessary to decide whether machinery of the type usually used in industry, commerce, or agriculture was exempt irrespective of where used, or whether machinery of any type was exempt only when used in industry, commerce, or agriculture. Either alternative would require an extensive number of administrative interpretations. If it were decided to use the first alternative, then an individual buying an industrial lathe for his hobby could buy it tax-free, while business concerns would have to pay the tax on some purchases of machinery, e.g., a household refrigerator.

Machinery might be excluded from the tax on somewhat the same basis as in certain State sales tax laws. Only a few of the State retail sales taxes exclude machinery and other articles used directly in production. The most notable are those of Michigan and Ohio. The Michigan definition of a retail sale excludes sales of tangible personal property for consumption or use in industrial processing or in agricultural production. Sales of both machinery and materials for use directly in production are therefore not taxable. The regulations interpret the industrial processing exclusion to cover sales of tools, dies, patterns, and machinery used in manufacturing or processing; oil, grease, waste, wiping cloths and cleaning compounds used in connection with such tools and machinery; and substances used to create a chemical reaction in manufacturing or processing. Materials for use in administrative departments, however, are subject to tax as are also sales of items used only incidentally in production, such as clocks, janitors' supplies, and fire extinguishers.

Ohio's definition of a retail sale excludes not only sales of tangible personal property for consumption or use directly in manufacturing, processing, refining, mining, production of crude oil and natural gas, and farming, but also those for consumption or use directly in making retail sales. Thus, sales of store fixtures, such as shelves, show cases, cash registers, and other equipment used by a retailer in his business, are not taxable.

The States' regulations indicate that these methods of excluding sales of articles used by business concerns have proved to be exceedingly complex in their administration. Very detailed regulations have become necessary and many fine distinctions have been drawn. It can be readily seen that the taxing, in Michigan, of items used only incidentally in production cannot help but raise many questions

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as to whether an article is taxable. It appears that exclusions of the Michigan and Ohio types cannot be administered with any high degree of effectiveness. ^{1/} Consequently, it is doubtful whether these plans would offer the most practical means of excluding machinery and other business cost items from the tax.

Still another method of excluding machinery would be to list by name in the tax act those articles which could be sold tax-free. This seems to be an extremely difficult task since it would require that Congress determine the taxable character of thousands of articles. It should be noted, however, that even if Congress effected the exclusion by definition, the administrator would have to specify by regulation the names of articles embraced within the definition.

A suggested solution of the machinery exclusion problem might well be deferred until the interested parties have had an opportunity to present methods which they consider desirable. The issues are so complex that it appears necessary to have aid from all possible sources before making the final decision.

e. Taxation of other articles
purchased by business concerns

The other principal classes of articles sold at retail for use by business concerns include: (1) durable equipment (other than machinery), such as tools, desks and tables, filing cabinets, and show cases; (2) livestock for breeding purposes, work animals, dairy cows, and poultry for laying purposes; (3) consumable articles (other than fuel), such as returnable containers, lubricants, abrasives and polishing agents, and chemicals (other than those becoming physical ingredients); (4) miscellaneous supplies, such as cleaning materials, stationery, and light bulbs; and (5) building materials.

^{1/} According to the Commissioner of Revenue in Michigan, "In the cases of sales for industrial processing, agricultural production, and commercial advertising, however, there are cogent arguments against their being treated as deductible sales. For example, the task of administration is complicated to an extreme degree in determining whether property sold is for consumption or for use in industrial processing...It is therefore recommended that the Legislature define these exemptions in precise fashion so that the department may determine with greater accuracy what is or is not an exempt sale." (Michigan Department of Revenue, Annual Report, fiscal year ending June 30, 1942, p. 8.)

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If either the Michigan or Ohio plan were adopted, the foregoing articles would be excluded to the extent they were used directly in production. It will be readily apparent that the administration of either plan would be extremely difficult in connection with many of these articles. For example, light bulbs used in a plant would be tax-free whereas light bulbs used in an office connected with the plant would be taxable. Similarly, hand or platform trucks used in the plant would be exempt while those used in the shipping department would be taxable. The question may be raised as to the tax status of trucks used in transporting property from the plant to the shipping department. An engine used on a farm for pumping water for livestock would be tax-free. A similar engine used for pumping water for the farm house would be taxable. What would be the tax status of an engine which performed both functions?

The extent to which these groups of articles are important cost factors in industry is not clear. It may be, however, that certain of these articles such as abrasives and polishing agents are important cost elements in specific industries as in the metal-working and optical goods industries. In other instances chemicals may be important as in the case of the photographing and the cleaning industries.

Containers may be important taxable cost elements depending upon the method of their treatment. If all containers are regarded as used by the concerns packaging and bottling commodities therein, the tax may be an important cost element, as for example in the toilet preparations industry. It is doubtful, however, whether it would be consistent with the concept of retail sale to tax sales of containers when, for all practical purposes, they are integral parts of the articles sold to consumers. If sales of such containers were regarded as sales for resale, returnable containers would be the only class of such articles which might be subject to tax. Returnable containers are used in the distribution of milk, soft drinks, fermented malt liquors, gases, and chemicals. Returnable containers are a cost element at least to the extent of breakage and depreciation in the hands of the bottler or packager. For this reason and because of the difficulty of distinguishing between returnable and nonreturnable containers it might be desirable to exempt all containers.

Since the general group of articles under discussion is composed of commodities differing widely in nature, it would be impossible to develop an inclusive definition which would be clear in its application. Consequently, exclusion of these articles from the tax would require a number of separate provisions such as detailed definitions or the listing of particular commodities.

A very large number of the articles under discussion, e. g., lubricating oils, light bulbs, stationery, and building materials, are commonly sold to individual consumers as well as to business firms. Others, such as chemicals and containers, are probably sold almost entirely to business firms. The number and variety of the articles preclude any generalization as to the relative proportions in which they are sold to the two types of purchasers. This consideration may be of little moment, however, since from the standpoint of definition it is unlikely that the articles could be considered as a class. The attempt to exclude the articles only when sold to business concerns would involve the administrative difficulties of checking diversion from business to individual use and of dual use already mentioned. Administrative difficulties generally would also be encountered if it were sought to exclude groups or particular commodities, since each additional exclusion would give rise to interpretative problems and intensify record-keeping and auditing problems.

It is likewise impractical to generalize so far as the matters of sales through specialized sellers and size of sales are concerned. Here, too, the various articles fall into different categories. Chemicals and containers are generally sold by specialized firms, but light bulbs and stationery are widely sold in relatively small amounts by retail stores selling many other lines of goods. While from the standpoint of dollar volume the great bulk of building materials are probably sold by building materials supply houses, innumerable sales of small inexpensive items of builders' hardware are sold by five-and-ten-cent stores, department stores, and hardware stores.

II. The taxation of services

A retail sales tax is frequently regarded as a tax applying only to sales of goods and not to the rendering of services. Perhaps the reason for this conception is the recognition of substantial differences in the nature of most transactions involving the rendering of services as compared with the nature of those involving the sale of goods. A great many services are not rendered by established commercial enterprises on a buyer-seller basis, but rather by individuals hiring themselves to business concerns or individuals on an employee-employer basis. Even in the case of many of those services rendered to the public at large, as for example professional services, the methods of conducting business and the relationships between the customer and the person rendering the service differ from those of the usual sales transaction.

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The effective administration of a retail sales tax requires that the tax be applied in so far as possible only to sales by established business enterprises operated on a commercial basis. Consequently, it would be desirable not to extend the scope of the tax to services which generally are not rendered by such enterprises. Furthermore, a large number of services, both those provided by established enterprises and by individuals, are rendered to business concerns and the taxation of such services would be undesirable for the same reasons that taxation of other purchases by business concerns is undesirable.

On the basis of these considerations, it appears that a sales tax should not be applied in blanket fashion to all services. An examination of the various types of services, however, reveals several whose inclusion within the scope of the tax would not only be feasible but would actually facilitate efficient administration as well as further the attainment of the other objectives of the tax. There is another group of relatively important services which also might be included within the scope of the tax but which are, for the most part, already subject to selective excises and probably can be taxed somewhat more satisfactorily in that manner.

A. Services which might be taxed

The group of services which might be included within the scope of the tax consists of consumers' services ordinarily rendered by established commercial enterprises conducting business in a manner substantially the same as that of concerns selling tangible personal property. ^{1/} The group includes:

1. Repair and fabrication of taxable articles, such as shoe repair, tailoring, and household appliance repair. ^{2/}
2. Laundry service and dry cleaning.
3. Barber shop and beauty parlor services.
4. Rental of taxable tangible personal property, such as linen, clothing and costumes, automobiles, and bicycles. ^{3/}

^{1/} Most States do not tax such services. Of the retail sales tax States, West Virginia and Colorado alone have general provisions for taxation of a wide range of services.

^{2/} Not including repair of real property nor repair of articles the sales of which are not taxed.

^{3/} Rental of real property or of space in or on such property would not be taxed.

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These services might be included for the reasons that administration of the sales tax would be facilitated and tax revenue would be increased. The total value of such services for the calendar year 1944 is estimated at about \$2.9 billion.

From the standpoint of administration, inclusion of these services would actually facilitate efficient collection of the tax on sales of property. Many of the enterprises rendering these services make some sales of tangible personal property and, thus, would be taxpayers even if the services were not taxable. If the services were not taxed, it would be necessary for many of these concerns to distinguish between sale and service elements in keeping records of transactions. The determination whether certain repairs (such as shoe and furniture repairing) should be regarded as involving sales of tangible personal property as well as the rendering of service is frequently a difficult administrative problem. If the repair transaction is regarded as involving the sale of property, it is necessary for the repairman to allocate a portion of his charges to sales of property and to maintain records showing the allocations. This procedure renders tax compliance more difficult for the taxpayer and also increases the audit work for the administrator.

B. Services subject to excises

Two important groups of services, namely, those performed by public utilities and the amusements industry, can either be included within or excluded from the scope of a retail sales tax. 1/

Public utility services are rendered by regularly established concerns ordinarily of substantial size. They are subject to regulation in the public interest and ordinarily maintain adequate books and records. Accordingly, a sales tax applied to all public utility services should not cause unusual administrative difficulty. Subjecting these services to a sales tax, however, might be undesirable. 2/

1/ Under State general sales taxes, 17 States tax some types of public utility services and 16 States tax amusements.

2/ For purposes of equity the sales tax would have to be levied on the consumers of the services and not on the "retailers," since the rates charged by the utilities are fixed by public commissions and cannot be changed readily.

In the first place, as in the case of fuel, public utility services are to a large extent consumed by business concerns. Taxation of this portion of the services would be undesirable because it would increase the cost of operations of businesses of all types. Ordinarily the tax on business consumption of utility services would be very difficult to shift forward to consumers and, at present, shifting would also require revisions of price ceilings. It would, of course, be inconsistent to put tax pressure on price ceilings at the same time that a major purpose of the tax was to facilitate the maintenance of the price ceilings. Secondly, many large industrial users produce their own gas, electricity, and water, and, for purposes of equity, it might be necessary to tax the retail value of such production. Finally, most public utility services already are subject to Federal excise taxes, some at substantially higher rates than would appear feasible under a general sales tax. Consequently, it might be more practical not to include public utility services under the general retail sales tax plan and to make any necessary or desirable tax changes through the excise tax structure.

Amusement services are also rendered by established commercial enterprises and clearly are consumer services. Commercial entertainments charging admissions already are taxed under the Federal excise on admissions. Inclusion of admissions under the sales tax would subject the charges to two taxes at the same level and the industry would have to make two sets of tax returns. Failure to include admissions under the sales tax would not create administrative problems since the rendering of such services does not involve the sale of tangible personal property. Consequently, it might be preferable to retain the excise tax on admissions and make such changes as are desirable in the excise rather than subject the charges to the sales tax.

Application of the sales tax to cabarets may present some administrative problems. At present, cabarets are taxed at the rate of 5 percent of their charges for admission, refreshment, service, and merchandise. In the absence of special provisions in the sales tax act, it would be necessary to distinguish between sales of goods, such as meals and drinks, and charges for entertainment. If it is attempted to avoid this problem by applying the sales tax to the total charges of cabarets, the taxpayer would have to make two sets of returns, a procedure which would involve unnecessary effort and expense for both the taxpayer and the Government. One alternative would be to apply the sales tax to the total charges of cabarets and to repeal the present excise. If, however, the sales tax rate were no higher than the present excise tax rate, the method would have the weakness of not obtaining additional revenue from this source. In this case it might be desirable to apply a higher rate of sales tax to cabarets than to other sellers. Although sales tax rate differentiation generally is considered to be undesirable from the administrative

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standpoint, additional difficulties probably would not arise in this case since differentiation already exists under the present law. Another method would be to exempt from the sales tax all charges made by cabarets and to increase the rate of the existing excise tax. Since many cabarets, however, also operate as restaurants during other periods of the day, their sales of meals would be subject to the sales tax even though their cabaret charges were exempted and subjected only to the present excise. Consequently, this method would seem to be the less desirable of the two, since it would involve the separation of receipts and the additional effort incident to compliance with the two taxes.

C. Other services

In general, it might be questioned whether services other than those mentioned above should be included within the scope of a retail sales tax, because of the nature of the transactions involved and because their inclusion would produce definite disadvantages. These other services fall within one or more of the following classes.

1. Services not provided by regularly established enterprises operated on a commercial basis

There are a number of services that are ordinarily not provided by regularly established enterprises on a commercial basis comparable to those engaged in selling commodities. Some of these services are rendered by individuals hiring themselves out on a more or less permanent basis either to business concerns, as for example employees of businesses, or to individuals, such as domestic servants and gardeners. In other cases, although more or less regularly established places of business are operated, the services are of such nature that the transactions are quite different from those of typical commercial sales. Examples include the various professions, the furnishing of education, many housing services, and many services involving repair of real property.

Taxation of such services would add numerous additional taxpayers, many of them difficult to locate and liable for only small amounts of tax. In most cases, if a tax were to be placed on transactions of this sort, it could be administered much more easily if it were levied upon the "purchaser" (the employer) rather than upon the "seller" (the employee). In general, other forms of tax are more suited to the taxation of wages paid to individuals and similar charges than a retail sales tax designed primarily to reach an entirely different type of transaction.

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2. Services rendered to business concerns

A very substantial part of all services, including many of those falling into the first group above as well as many provided on a commercial basis by established enterprises, are rendered to business concerns. Examples, apart from that of practically all wage earners, include legal, architectural, engineering, and accounting services, and rental of business property. The taxation of these services would be undesirable for the same reasons that taxation of sales of materials and other articles purchased by business firms is considered to be undesirable. Taxation of these services would infringe upon the single-stage nature of the tax and would introduce the disadvantages of multiple taxation, especially pyramiding, inequity among competing firms, and unnecessary pressure on price ceilings.

3. Housing services

The application of the tax to rent might be considered inadvisable because of the inability to prevent discrimination against renters as compared to home owners without creating an impracticable administrative task. To tax only rents actually paid would be very inequitable to renters; yet to attempt to determine the use value of all owner-occupied homes would create a tremendous administrative task which could not be accomplished with any satisfactory degree of efficiency. Apart from this problem, application of the tax to rents would be made difficult by the existence of many small landlords who do not operate commercially established businesses.

4. Services not involving consumption

There are several important services which do not involve consumption in the usual sense of the term. The two principal examples are insurance and the lending of money. Insurance premium payments are made for the purpose of handling certain risks in an orderly fashion and also as a means of saving. Neither would generally be considered as constituting consumption. Furthermore, a large part of all insurance premium payments, other than those on life insurance, are made by business concerns. The borrowing of money, while enabling persons to increase their current consumption over the levels which would otherwise be possible, in itself involves no consumption. Also, as in the case of insurance, a very large portion of interest charges are paid by business concerns.

5. Services not sufficiently important to warrant special provisions to make them taxable

There are a number of relatively unimportant services which would probably not yield sufficient revenue to warrant their inclusion within the scope of the tax. Examples include automobile parking charges and food locker rentals.

III. Considerations respecting exemptions

The effectiveness of a retail sales tax depends in large measure upon the extent to which exemptions are limited. In determining the desirability of various possible exemptions, the effects upon the realization of the objectives of equity, revenue, inflation control, and efficient administration must be considered. The principal exemptions found in sales tax laws may be classified into three general types: those made on the basis of type of commodity, type of buyer, and type of seller.

A. Exemption of sales of particular commodities

The three principal classes of articles for which the possibility of tax exemption warrants consideration are those articles generally considered to be necessities, especially food, medicine, and clothing; articles already subject to Federal excises; and secondhand goods. Before considering each in turn, certain general objections to the exemption of any particular class of goods should be pointed out.

In the first place, exemptions reduce the yield of the tax. It may not be possible to obtain increases in rate to offset the loss, and in any case, high tax rates tend to increase administrative problems and magnify the significance of inequalities in the application of the tax.

Secondly, exemptions are likely to produce discrimination. Regardless of the amount of care taken in defining an exemption, in many cases one of two articles competing for a particular use will be taxable and the other will be exempt. A certain amount of discrimination in favor of the producers and distributors of the exempted article results.

In the third place, as the number of exemptions increases, it becomes more difficult to refuse exemption to other articles. Various groups of producers or users of particular commodities will seek exemptions and the scope of the tax may be determined largely on the basis of such pressures. If the number of exemptions can be kept very small, there is less opportunity for groups to seek other exemptions and less basis for their arguments.

Finally, and of great importance, is the serious effect of exemptions on efficient administration. Regardless of the care with which the exemptions were defined in the law, numerous administrative rulings would be necessary to determine the exact scope of each exemption. At the same time, taxpayers would be in doubt as to the applicability of the tax to many transactions and almost certainly would make mistakes in application. A substantial educational program would be necessary to instruct sellers as to the exact scope of the tax. Many sellers keep no records

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other than total sales figures. Moreover, the records of those concerns which maintain more complete accounts do not normally show sales of different commodities and cannot easily be adjusted to do so accurately. Accordingly, many sellers would have no means of knowing their exact taxable sales volume and in making returns would be forced to use estimates. The natural tendency, of course, would be to maximize the estimates of exempt sales. State sales tax experience has demonstrated that it is virtually impossible to force all sellers to keep records adequate for tax purposes. In the case of stores selling many items in small quantities, the keeping of accurate records of sales of different types of commodities is virtually a physical impossibility.

1. Necessities

One of the principal objections to a sales tax is the relatively heavy burden it places on the very low income groups. In general, lower income persons spend a larger percentage of their incomes on taxable articles than do persons with higher incomes and, accordingly, pay a relatively larger percentage of their incomes in sales tax. The problem of regressiveness itself may not be too serious during a period when income tax rates are being made more progressive, but the problem of the tax burden on the very low income persons remains.

If the basic necessities of life were excluded from the tax, the burden on the low-income groups would be lightened materially and the regressiveness reduced. In this connection, one of the chief problems would be the selection of those commodities to be exempted. 1/ There is no clear-cut distinction between luxuries and necessities. If an attempt were made to exempt broad classes of commodities, many luxury articles would automatically be exempted and the tax yield would be unnecessarily reduced. Thus, for example, if food were exempted, various luxury foods such as expensive steaks, certain types of bakery goods, vegetables and fruits out of season, and many imported foods would be included in the exemption. 2/ If clothing were exempted, all luxury items as well as articles of absolute necessity would be tax-free. Exemption of all medicines would exclude from the tax many proprietary preparations of doubtful medicinal value. The exemption might be limited, however, to medicine furnished upon prescription.

1/ California, North Carolina, Ohio, and New York City have general food exemptions. West Virginia allows taxpayers an exemption of 50 cents upon the purchase price of food products. North Carolina and New York City also exempt medicine.

2/ Rationing, of course, tends to reduce the extent of luxury expenditures.

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The alternatives to the exemption of large classes of articles raise serious problems of their own. The selection of a list of specific items within the classes would not be an easy task because of the lack of any generally accepted concepts of exactly which articles constitute necessities. This task would be especially difficult in the case of clothing. But apart from this issue, the administrative problems created by the exemption of long lists of articles would be serious. Another alternative would be to limit the exemption to specific articles sold below certain prices, as for example meat sold for less than 30 cents a pound and men's suits sold for less than \$25. This method requires the drawing of sharp and arbitrary lines of exemption. The drawing of reasonably satisfactory lines for a number of articles would be difficult in itself, but enforcement would be virtually impossible. For example, retailers would attempt to avoid the tax on suits selling at more than \$25 by selling the pieces separately. While it might be possible to define the exemption to preclude such action so far as the statute was concerned, the problem of enforcement would remain. Even though auditors made detailed and time-consuming investigations of sales records, it is doubtful if avoidance or evasion of this type could be prevented. In many cases higher prices indicate not luxury articles but goods which are more durable and serviceable, and the use of an exemption of this type would discriminate against those persons who prefer to buy better quality merchandise because they find it more economical in the long run.

Apart from the problem of selecting necessities, this type of exemption suffers from all the disadvantages of any exclusion of particular commodities, especially those of loss of revenue and impairment of administrative efficiency. The revenue obtained from a sales tax at a particular rate would be reduced very materially even if food alone were exempted, and especially if food, clothing,

Article	:	Retail sales (Billions)
1. Food and kindred products (excluding restaurant sales)	:	\$17.34
2. Restaurant sales of food and kindred products	:	6.25
3. Wearing apparel	:	11.01
4. Medicines and drugs	:	<u>1.58</u>
Total	:	\$36.18

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and medicines were tax-free. It is estimated that during the calendar year 1944 total retail sales of food, clothing, and medicines would total \$36.2 billion. From the standpoint of effect on revenue yield, a basic criticism of exempting necessities is the fact that the exemption would apply to all sales rather than merely to those to low-income groups in whose interest the exemption would be provided. As the war continues and other articles become more scarce, the relative importance of food, clothing, and medicine in the tax base will increase. 1/

2. Commodities subject to excises

In addition to obtaining appreciable tax revenue, one of the objectives to be attained by a retail sales tax is the maximum absorption of consumer purchasing power for the purpose of limiting inflationary forces. It would be generally inconsistent with such intent, therefore, either to exempt from the sales tax commodities subject to Federal excises, to repeal the excises, or adjust their rates downward because of the application of the sales tax. 2/ It is estimated that in the calendar year 1944 the retail value of commodities subject to Federal excises will total about \$13.1 billion. 3/ It would appear, therefore, that only in those cases where the addition of the sales tax would unduly burden the industries producing or distributing articles subject to excises, or where the additional burden on consumers would be clearly undesirable, could a strong case be made for the repeal or reduction of an excise. In general, such unduly burdensome tax effects are not to be expected during the war period. 4/

Most of the commodity excises are levied at the manufacturers' sales level and, consequently, only infrequently would the same sale be subject to both the excise and retail sales taxes. Three

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- 1/ There are several alternative methods of reducing the burden on low-income groups. These plans involve some sort of grant to those with low incomes, either of coupons with which to pay sales tax or of refunds in cash or redeemable bonds to cover the amount of sales tax paid.
 - 2/ A few States exempt from sales tax all articles subject to State excises. The more common practice is to exclude only certain articles subject to excises, especially gasoline, tobacco, and alcoholic beverages.
 - 3/ This estimate excludes fuel, and commercial, industrial, and agricultural machinery subject to excise.
 - 4/ Articles subject to excise are for the most part characterized by inelastic demands and high income elasticities and, at the same time, supplies are insufficient to satisfy existing demands.

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of the existing excises, however, involve sales of articles at the retail level: Namely, the excises on jewelry, furs, and toilet preparations. ^{1/} If both the existing excises and the retail sales tax were applied to these articles, the retailers would have to make two sets of returns covering the same sales transactions, a procedure which would involve unnecessary effort and expense for both the taxpayers and the Government. One alternative would be to repeal the present 10 percent excises applying to the sales of these articles and to subject the sales to the general sales tax. Unless the sales tax rate exceeded 10 percent, this method would not yield additional revenue. If the sales tax rate were 10 percent or lower and additional revenue were desired from these sources, a rate exceeding 10 percent might be applied to the sales of these articles. It generally is considered to be administratively undesirable to use differential rates under a retail sales tax. It may be, however, in this type of case no administrative problems would be encountered in addition to those now presented by the existing excises. It would, of course, also be possible to exempt these articles from the retail sales tax and to increase the rates of the existing excises. This procedure, however, might be less desirable than the former, since it would involve duplication of effort on the part of both the taxpayers and the Government. Practically all the retailers selling these three classes of articles also sell other articles which would be taxable under the sales tax.

3. Secondhand articles

Many articles are used in the course of their lifetime by more than one consumer. It is sometimes argued that taxation of sales of secondhand goods involves double taxation, since the tax applies to more than one sale of the same article. The second and subsequent consumers of an article can be considered to be subject to the tax twice on the same article only if the secondhand purchase price reflects entirely or to a significant extent the tax which applied to the original sale of the article. It is unknown to what extent the prices of secondhand articles would be affected by the sales tax paid on previous sales. Many of the secondhand articles that will be available, however, would not have been subject to the Federal sales tax at previous sales and, consequently, double taxation would not be involved in these cases. From the revenue standpoint, it would be desirable that a Federal sales tax apply to sales of secondhand articles. Because of stoppage or great reduction in the production of many articles, there is increased reliance upon used goods and the tax yield would be decreased by their exemption.

^{1/} The issues concerning the inclusion and exclusion of charges of cabarets and those for admissions and utility services have already been discussed.

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Furthermore, since secondhand articles are frequently sold by dealers who also sell new articles, the administration of the sales tax would be facilitated by taxing both used and new goods alike.

B. Exemption of sales to certain types of buyers

There are two general classes of buyers, namely, governments and charitable organizations, sales to which are frequently exempted under sales tax laws. ^{1/} The features of the two classes of exemptions are somewhat different and will be treated separately.

1. Sales to governments

If the Federal Government taxes sales made to itself there would be no direct revenue gain from such sales since government expenditures would almost certainly increase by the amount of the tax revenue collected from the sellers. Since a certain amount of expense is involved in the collection of taxes, application of a sales tax to Federal purchases ordinarily should be avoided unless the administration of the exemption is more expensive than the cost of collecting the tax. Apart from administrative costs, taxation of sales to the Federal Government would require adjustments in current budget allotments to various Federal agencies and probably would also require adjustment of many outstanding contracts for purchase of goods by the Government. Inclusion of sales to government within the tax would make the gross tax yield appear to be greater than the actual net revenue and perhaps lead to confusion in the making of policy decisions in regard to the tax.

Federal taxation of sales to States and their political subdivisions does result in a net increase in Federal revenue. Taxation of sales to the States ^{2/} involves a departure, however, from the intent of the sales tax that individuals be required to pay tax in proportion to their purchases of taxable goods and services. Moreover, the States and local governments would be forced to pass the tax on to their own taxpayers. This policy might lead sales tax States to tax sales to the Federal Government.

Complete exemption of all sales to government, however, would raise administrative problems of such significance as to make advisable a reappraisal of the policy of exempting such sales. The exemption of sales to government does not operate automatically. It creates two basic

^{1/} Seven States exempt sales to charitable organizations. Approximately half of the States exempt sales to themselves and their political subdivisions.

^{2/} The term "State" is used to refer to both States and their political subdivisions in this and subsequent sections. It should be noted that sales to States could be taxed only if the tax were imposed on the retailer.

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problems. The first is the need for identifying government purchases to prevent individuals from making tax-free purchases for personal use. Effective identification would require the use of exemption certificates executed by authorized persons on behalf of the government. These would be delivered to sellers and retained by them in their records to establish the tax-free character of the sales. When government purchase orders were issued and payments were made by government checks, the handling and checking of the exemption certificates would be comparatively simple, but the execution and handling of the certificates would nevertheless involve a certain amount of expense. In the case of emergency purchases, however, which were made through petty cash funds or directly by governmental employees who were subsequently reimbursed, there is opportunity for the improper use of government exemption certificates. Since the certificates would have to be readily available throughout government offices if they were to be used for these purchases, they could be used by employees or others in connection with their individual purchases. The only check upon such improper use of exemption certificates lies in the audit of sellers' records and investigation of the purchases to determine whether they were actually made on behalf of governments.

The second basic problem is that of insuring adequate record-keeping and correct reporting by concerns selling to governments. The bulk of government purchases, especially on the part of the Federal Government, are made in large quantities from more or less specialized concerns, but a very substantial number are made from ordinary retail stores. State experience demonstrates that retailers' records are frequently inadequate and that they do not contain proper evidence of tax-exempt sales. Accordingly, as in the case of other exemptions, field audits would be required to determine the accuracy of the deductions taken by retailers.

Thus, in general, the exemption of the great number of small purchases by governments, probably would involve more cost to the governments and taxpayers than the expense of handling the tax collections if such transactions were taxed. The exemption, therefore, if any is made at all, should be limited so far as possible to purchases from which there is definite gain to be realized.

Several methods might be used in selecting classes of purchases for exemption. These are type of contract, monetary value of the purchase, and class of commodity. Under the first method, the exemption would be limited to purchases made under certain types of contracts, such as the general schedule contracts of the Procurement Division of the Treasury Department and comparable War and Navy Department contracts. There are, however, so many different types of contracts in use and such variety of purchasing procedures that it would be impractical to employ this method.

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Under the second method, exemption would be limited to purchases above a certain monetary figure, perhaps \$250. With this method also, a dividing line can be determined only with difficulty and on a more or less arbitrary basis. This method would present the problems of determining exactly what constituted a purchase, and of handling transactions which appeared at first to be on one side of the dividing line and proved ultimately to be on the other side. Finally, it would tend to discriminate against small governmental units making most of their purchases in relatively small amounts.

The third method would exclude from the tax particular classes of articles when purchased by governments. A portion of all government purchases would be excluded, of course, if sales of fuel and of various types of machinery were excluded from taxable retail sales as discussed in previous sections. In addition, sales of military machinery and ordnance, which are of such great significance during the war period, might be exempted. It is questionable whether this method would prove advantageous except where the exemption is extended to all sales of particular articles (irrespective of the character of the buyer), or where the nature of the article is such that it is sold only to governments.

Closely related to the problem of exempting sales to governments is that of exempting sales to business concerns of articles to be used in fulfilling government contracts. These articles include building materials, fuel, machinery and equipment and supplies used in the performance of contracts for the improvement of real property or the production of finished articles for sale to governments. In general, the reasons favoring the taxation or exemption of such sales are the same as those respecting sales made directly to governments. The exemption procedures become more involved in these cases, however, and are more open to abuse. For example, it would be necessary to determine the taxability of articles (e. g., trucks and other equipment) purchased partly for use in the performance of government contracts and partly for other purposes. Then, too, contractors frequently purchase such articles as building materials in greater quantities than necessary for the completion of a particular project. If the exemption were extended to these purchases, it would be necessary for the contractor to report and pay the tax on the excess of articles remaining upon completion of the government contracts. Consequently, the chances for evasion through improper use of exemption certificates probably would be greater than in the case of direct sales to governments, and the handling of exemptions would be complicated because of the large number of relatively small purchases made by many contractors from retailers.

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2. Sales to religious, charitable, and other nonprofit organizations

The taxation of sales to religious, charitable and other eleemosynary institutions is in many respects undesirable. The burden of a sales tax must rest either upon the funds of these institutions or upon the individuals supplying the funds; yet neither is desirable from the standpoint of the intent of a sales tax. If the burden rests upon the institutions' funds, their ability to carry on their work is reduced by the amount of the tax collected. If the tax is in some manner shifted to those supplying the funds for the organizations, it obviously is not resting in the manner intended under a sales tax, namely, upon persons in proportion to their consumption.

The administration of exemptions of this type would require the determination of the various kinds of organizations covered. There would arise a number of borderline cases requiring specific administrative rulings. It would be necessary to identify the exempt organizations and to provide a system of exemption certificates by which the exemption could be established. Since there would be thousands of exempt organizations, the tax might be evaded through purchases in the name of any one of such organizations by unauthorized purchasers. It would appear, accordingly, that in view of the additional expense that would be incurred in the administration of the exemption, the possibility of fraudulent use of the exemption certificates, and the errors that would occur in reporting taxable sales due to the inadequacy of sellers' records, the exemption would probably not be desirable. Furthermore, many nonprofit organizations, other than religious and charitable organizations, are engaged in business in competition with private enterprises, and exempting sales to such organizations would be inequitable and would tend to decrease the good-will and cooperation of other taxpayers.

C. Exemption of sales made by certain types of sellers

In general, exemption on the basis of class of seller avoids most of the administrative problems of exemption by class of article or by class of purchaser. The only significant administrative problem under this type of exemption would be that of identifying the organizations covered. This type of exemption, however, would give rise to inequalities and tend to reduce taxpayer good-will, since the exempt sellers frequently would be competing with other sellers who would be taxpayers.

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1. Sales by governments

Activities of governments may be classified into two general types: those of an essential governmental character and those of a commercial or proprietary nature. The former group consists almost entirely of services, such as police and fire protection. The second group includes the rendering of services, such as electricity and transportation, and sales of commodities, such as alcoholic beverages and electrical equipment.

It would appear desirable to apply the tax to sales made by governmental agencies in the course of proprietary or commercial activities. Exemption of such sales would discriminate against private businesses competing with the publicly owned enterprises and would allow those consumers who were fortunate enough to be able to purchase from publicly owned enterprises to escape their proper share of the sales tax.

2. Sales by charitable and other nonprofit organizations

In general, exemption of sales by charitable and other nonprofit organizations would not appear to be desirable. Sales made by many charitable organizations are in large measure competitive with sales by business concerns. The tax on such sales, as in the case of other retail sales, would tend to be passed on to the purchaser and would not be a charge on the funds of the charitable organizations or their contributors. The exemption of such sales would allow those persons purchasing articles from the organizations to escape tax and would discriminate against private business establishments.

The same objections apply to the exemption of sales by other nonprofit organizations, such as farm and consumer cooperatives, and are more significant here because sales of these organizations are even more directly competitive with other private businesses than are those of eleemosynary institutions.

An additional reason for not providing a general exemption of sales by charitable and nonprofit organizations is the administrative difficulties involved in distinguishing between bona fide charitable organizations and organizations the activities of which are only partially or incidentally directed toward charitable functions.

There are two situations, however, in which the exemption might be desirable. The first involves sales of meals and clothing at lower than market prices by charitable organizations exclusively as a matter of charity or assistance to the purchasers. It would appear desirable on the basis of equity considerations neither to tax the charity nor the recipients of the charity. The second

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involves sales of meals and publications by schools of less than collegiate grade or by student or parent-teacher organizations of such schools. Collection of the tax on such sales would be relatively costly and difficult, and neither equity nor revenue considerations would appear to warrant their taxation.

3. Casual sales

A substantial number of sales, primarily of secondhand goods and farm products, are made by individuals not regularly engaged in the business of selling at retail. Examples include the sale of a used washing machine to a neighbor, and occasional sales of eggs by a farmer not regularly engaged in the business of selling at retail.

To attempt to tax such transactions would in most cases involve more expense than the amount of revenue involved and, in any case, a substantial number of sales would inevitably escape taxation. The cost of discovering such transactions and the handling and auditing of returns would frequently be greater than the amount of tax due. In the light of these considerations, casual, occasional, or isolated sales probably should be exempted from the tax.^{1/} There would be little or no loss in net revenue and administrative effort could be used more advantageously.

The exemption probably should be limited to sales made by persons who are not regularly engaged in the business of selling at retail. The exemption should not apply, for example, to sales at roadside stands or through regular routes, since in such cases the seller would be offering his goods at retail to the public. Moreover, the exemption probably should not extend to sales by retailers of property previously used in the course of their business operations, as for example, a cash register or show case. Since the sellers would be taxpayers it would be feasible to tax such sales. In addition, the problem of distinguishing between such sales and retail sales of commodities of the type ordinarily sold would be avoided.

Part Two. Tax Rate and Yield

There are two principal problems in regard to the rate of a sales tax, namely, that of the choice between a single, uniform rate and a multiple-rate system applying different rates to different classes of commodities, and that of the amount of the rate.

^{1/} Almost all State sales taxes exempt casual sales.

I. Choice of uniform or differential tax rates

The use of a differentiated rate structure, 1/ if it could be effectively administered, would tend to further both the equity and revenue objectives of the tax. The application of lower rates to articles of wide and necessary use, such as food and clothing, and of higher rates to less necessary articles would tend to reduce the burden on the low-income groups and lessen the regressivity of the tax. During the war period, however, a large portion of the tax base will consist of sales of necessities. Consequently, only to a limited extent could decreases in revenue from lower rates on necessities be offset by higher rates on nonessentials.

The problem of selecting the articles and services to be placed in the various rate groups would be a difficult one. As indicated in the discussion of exemption of necessities, there are no definite and generally accepted criteria of necessity and luxury. Differentiation of rates would tend to impair the efficiency of administration in much the same manner as would the exemption of necessities, primarily because most retailers do not keep adequate records of sales by classes of commodities. From the taxpayers' viewpoint, problems of interpretation of the scope of the various rate classes would introduce appreciable uncertainty as to the proper tax rate applicable to particular commodities and, consequently, some misapplication of rates would result.

In view of the foregoing considerations, a uniform rate would appear preferable to a differential rate structure, 2/ In the case of furs, jewelry, toilet preparations, and cabarets, however, differentiation already exists. Consequently, additional administrative problems might not arise if the existing excises on these items were repealed and higher sales tax rates applied.

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- 1/ In a sense, if exemptions from the tax are provided, differentiation is introduced into the rate structure, since on the exempt commodities the rate is zero and on other commodities the rate is a positive figure. The concept of rate differentiation usually is confined to the use of two or more positive rates. Many of the problems arising out of exemptions, however, are similar to those arising out of the use of differentiated rates.
- 2/ Practically all State retail sales taxes employ uniform rates. There are, however, a limited number of exceptions. For example, in Alabama and New Mexico sales of automobiles are taxed at rates lower than the regular sales tax rate.

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II. Amount of the tax rate

In determining the amount of revenue to be obtained from a sales tax, considerations of governmental financial requirements and inflation control must be balanced against the need of avoiding excessive tax burdens on the very low income groups, inability to exclude all cost goods from the tax, and the greater administrative difficulties to be expected as the rate increases. The latter would arise primarily because of the greater incentive for taxpayers to attempt to avoid or evade high tax rates. In turn, evasion at high tax rates by some taxpayers would be of more serious concern to other taxpayers who would be making proper tax payments, since the latter would be subjected to more severe, unfair competition. In this way, the number of taxpayers that would be subjected to greater pressure to evade the tax would tend to increase and administrative problems would be magnified.

III. Yield

On the assumption that certain selected services would be taxed and that the nongovernmental exclusions from a retail sales tax would be limited to feed, seed and fertilizer, fuel, and commercial, industrial and agricultural machinery, it is estimated that the net tax base for the calendar year 1944 would be \$63.2 billion. On this base the tax would yield \$3.16 billion with a 5-percent rate and \$6.32 billion with a rate of 10 percent.

The following table presents detailed information and estimates respecting the composition of the tax base and yields at designated rates of tax.

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Estimated base and yield of a Federal retail sales tax,
calendar year 1944 ^{1/}

(In millions of dollars)

Classes of retail sales	Tax base	Tax yield at specified rates	
		5%	10%
Food (other than restaurant sales) ^{2/}	\$17,340	\$ 867	\$1,734
Restaurant sales of food	6,250	313	625
Liquor and tobacco	8,790	440	879
Medicines and drugs	1,580	79	158
Wearing apparel	11,010	551	1,101
House furnishings, equipment, and furniture	3,420	171	342
Passenger automobiles, parts, and accessories	400	20	40
Building materials and hardware	430	22	43
Equipment, chemicals, and materials ^{3/}	5,700	285	570
Selected services ^{4/}	2,850	143	285
Sales to State and local governments	890	45	89
All other	4,520	226	452
<u>Net tax base and yield ^{5/}</u>	<u>\$63,180</u>	<u>\$3,159</u>	<u>\$6,318</u>
Sales to Federal Government (other than military machinery and ordnance)	13,880	694	1,388
<u>Gross tax base and yield</u>	<u>\$77,060</u>	<u>\$3,853</u>	<u>\$7,706</u>
Principal classes of exclusions:			
Feed, seed, and fertilizer	\$ 2,000		
Fuel ^{6/}	10,900		
Commercial, industrial, and agricultural machinery ^{6/}	3,110		
Military machinery and ordnance	62,000		

Treasury Department, Division of Research and Statistics October 4, 1943

Note: Figures are rounded and will not necessarily add to totals.

For footnotes see next page.

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Estimated base and yield of a Federal retail sales tax,
calendar year 1944 ^{1/}

Footnotes

- ^{1/} At estimated business levels and prices for calendar year 1944.
- ^{2/} Includes sales of kindred products such as candy and soft drinks.
- ^{3/} Excluding commercial, industrial, and agricultural machinery and chemicals and materials which become physical ingredients or component parts of taxable articles which are to be sold by the business concerns making the purchases.
- ^{4/} The services included are (a) repair and fabrication of taxable articles (e.g., shoe repair, and automobile repair); (b) laundry and dry cleaning services; (c) barber shop and beauty parlor services; and (d) rental of taxable articles (e.g., rental of linens, clothing, automobiles, and bicycles).
- ^{5/} The estimated retail sales value of commodities subject to existing Federal excise taxes, other than the value of commodities assumed to be excluded from the sales tax base, is \$13,100,000,000. The value of these commodities is included in the appropriate classes in the table.
- ^{6/} These classes consist of sales to all types of purchasers including sales to the Federal Government and war contractors and, consequently, would not entirely represent net tax base items if they were included in the tax base.

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Part Three. Measure of the Tax

The measure of the tax, i.e., the amount to which the tax rate is applied to determine the extent of tax liability, should be fixed in the light of certain considerations of equity and administrative practicability. It would appear that the tax, in general, should apply to the bona fide sales prices of commodities and services, including payments for taxable services rendered in conjunction with the sale of commodities but not including payments for nontaxable services so rendered. The measure of the tax might, accordingly, be regarded as the seller's gross sales of taxable goods and services, less deductions ^{1/} for discounts taken, returned goods, the amount of the tax and other retail sales taxes, and delivery, finance, interest, and other service charges which would not be taxable when the services were rendered independently of a sale.

I. Gross sales or gross receipts

A sales tax may be applied either to gross sales, the total value of all taxable sales made during the reporting period, or to gross receipts, the total amount of money received from taxable sales during the period. While the sales and receipts of stores selling exclusively for cash will be identical during any given period of time, those of stores selling on credit will be different. The gross sales basis appears to be the more satisfactory of the two, both from the standpoint of tax revenue and, of far greater importance in this instance, of administration.

Regardless of the extent to which exemptions would be avoided, many concerns selling at retail would make both taxable and nontaxable sales. When such concerns sell on a credit basis and merely make additions to the customer's account in connection with taxable and nontaxable sales, difficulties are unavoidable under the gross receipts basis when the customer makes a payment on the account without allocation to any particular sale. Some plan for the segregation of the amount paid between the two classes of sales would have to be devised and the seller would in each instance have to make the computations required under the plan. Sellers' records generally are not kept in such a manner that computations of this type can readily be made and, accordingly, their compliance costs could be expected to increase if the gross receipts method were employed.

^{1/} While precise terminology would probably require the use of the term "exclusion" rather than "deduction" in this connection, the latter is being used herein since it is generally employed in the sales tax States.

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A division of gross sales into taxable and nontaxable sales can be made much more easily. The gross sales method would prove far simpler of administration in the event that at some time after the imposition of the tax, the rate was changed or exemptions were either added or eliminated. Under this method the statute as modified would apply to sales made after the effective date of the amendments. Under the gross receipts method, however, if discrimination between cash and credit sales made before the change in the law were to be avoided, it would be necessary to apply the old rate after the effective date of the amendments to amounts paid pursuant to sales before that date. In the case of changes in exemptions, the seller would have to distinguish in his records between sales of the affected commodities before and sales thereof after the effective date of the amendments in order properly to collect and return the tax. For example, if the law as originally enacted did not exempt food, but an exemption of food were subsequently provided, the seller would not collect and pay the tax on food sales made after the date of the amendment. He would, however, continue to collect and pay it after that date with respect to amounts paid him on food sales made on credit before that date. Confusion would be inevitable and the keeping of records would be greatly complicated.

From a revenue standpoint, the use of the gross sales method would not only secure earlier payment of the tax on credit and installment sales, but would also avoid loss of tax revenue when payments were not ultimately made. In the case of installment sales, the seller can protect himself against loss under the gross sales method by adding the tax to the down payment. In the case of ordinary credit sales, however, the tax must in most cases be regarded by the seller as an additional factor to be considered in determining the amount of credit to be extended to a purchaser.

II. The nature of gross sales

Gross sales consist in general of the sum of the prices actually charged for all articles sold or services rendered, regardless of whether payment is made in cash, property (such as used articles traded in), or services; and regardless of whether the entire price is actually paid. In relatively few cases the prices actually charged would not be bona fide arm's-length selling prices because of an identity of ownership or control of both the buyer and seller. Under such conditions, the amounts charged might be far less than the bona fide selling prices of the articles, and readjustment of the selling prices would be necessary to prevent avoidance of the tax.

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III. Deductions from gross sales

Charges for services, such as delivery and installation, are frequently made in connection with retail sales. If the services were taxable when rendered independently of a sale, no question would arise as to the deductibility of the charges. If, however, the services were not taxable when independently rendered, it appears that a deduction should, under certain conditions, be allowed for such charges when made in connection with sales. The principal charges of this nature are those made for interest, insurance, delivery, and installing tangible personal property in real property. If deductions were not allowed in these cases, there would be discrimination against sellers rendering the services in conjunction with sales of articles and such sellers in many cases would cease providing these services. It would probably be advisable to confine the deductions to those additional charges for services which were stated separately from the prices of the articles. This requirement provides a somewhat limited safeguard against the tendency of sellers to overstate the deduction as a means of avoiding the tax and would lighten the task of the Government in determining whether the deductions were reported correctly by taxpayers.

Since the measure of the ~~tax~~ is intended to be the actual selling price of taxable articles and services, any discounts taken, such as those provided on a cash, trade, or quantity basis, would also seem to be proper deductions.

Furthermore, it would probably be advisable to allow the deduction of amounts collected by sellers from purchasers as reimbursement of the tax, and for the amounts of other retail sales taxes applying to the transactions, provided the taxes are separately quoted. The deductions should probably apply both to specific excises on retail sales of particular commodities, such as the Federal jewelry, fur, and cosmetics taxes, if they were retained, and to general retail sales taxes imposed by the States and cities regardless of whether the latter were levied upon the retailer or the consumer. This distinction in the manner of imposition of State sales taxes would appear to be without significance so far as the question under discussion is concerned. The deduction would apply, however, only to separately stated taxes. Manufacturers' and wholesale excise or sales taxes probably should not be deductible in view of the difficulties involved in determining the amount of the retail selling price representing such taxes. While it might be administratively feasible to permit the deduction of such taxes when the retail sale (within the meaning of the Federal retail sales tax law) was made by the manufacturer or wholesaler, such a practice would appear undesirable in so far as it would result in discrimination against transactions wherein the retail sale was not so made.

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The selling price of returned articles should, of course, be deductible, since in such cases no sale occurs. When payments on credit sales are not made in full, however, it is doubtful whether a deduction should be allowed for the unpaid portion of the selling price, regardless of whether the article sold was repossessed. The allowance of a deduction for bad debts would add to administrative difficulties since it would introduce into the sales tax not only most of the problems arising under the income tax law in this connection, but would require even additional effort and record-keeping in the case of sellers making both taxable and non-taxable sales. If an account representing both classes of sales proved uncollectible, the seller would be required to examine it item by item to ascertain the amount deductible, for he could deduct only such amounts as arose from taxable sales. When audits were made, the representative of the Government would also be required to follow this procedure, at least to the extent of a test check, to verify the accuracy of the deductions claimed by the seller. Furthermore, if the deductions were allowed, persons failing to pay for their purchases in full would be enabled to escape a portion of their tax liability. If sellers were liable for the full amount of the tax regardless of whether all payments were made, they would be encouraged to require full payment of tax at the time of purchase. Such a procedure would be in line with Federal Reserve Board credit purchase requirements and would tend to further the anti-inflationary influences of the tax. It should be noted, however, that retailers generally believe they are entitled to a bad debt deduction and, consequently, allowance of such deduction would tend to increase their good-will toward the tax.

IV. Allowance to retailers

The introduction of a sales tax results in an increase in the costs of retailers. ^{1/} Not only are costs of keeping records increased but a certain amount of expense arises out of the handling of returns. In addition, retailers are not always able to shift the entire amount of tax on a sale to the purchaser.

^{1/} The Shoup study of the New York City sales tax indicated that every store investigated reported the tax had increased accounting costs, in many cases the increase amounting to 5 to 10 percent of the tax collected. See Shoup, "The Experience of 2,000 Retailers under New York City's Sales Tax," National Tax Association Bulletin, January 1936.

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The good-will and cooperation of sellers are of paramount importance in the administration of a sales tax. It is questionable, however, whether an allowance designed to cover increases in costs due to the tax, as granted by several sales tax States, is desirable. ^{1/} The allowance would reduce the net yield of the tax and one based on the amount of taxable sales might be very discriminatory in its application to various sellers. Take, for example, the case of two sellers with total annual sales of \$100,000. One might make only taxable sales, and, assuming a tax of 10 percent and an allowance of 3 percent of the tax, would receive a benefit from the allowance of \$300. The other might make both taxable and nontaxable sales and, assuming an even division between the two classes of sales, would receive an allowance of only \$150. Despite the fact that the sales tax compliance costs of the latter would probably be greater than those of the former, since he would have to obtain resale or exemption certificates and keep his records in such a manner as to separate the taxable and nontaxable sales for tax reporting purposes, he would receive only one-half the allowance granted the former. No allowances are provided to cover the substantial compliance costs to taxpayers resulting from the income, excise, and payroll taxes, and it may be inadvisable to establish a precedent for such allowances.

^{1/} Eight States provide such an allowance.

Part Four. Legal Liability for and Shifting of the Tax

The tax could be imposed upon sellers or consumers. In either case, however, the tax would be paid to the Government by the seller and collected by him, either as a tax or as tax reimbursement, from his purchasers. Advertising of absorption of the tax by the seller should probably be prohibited as a means of preventing unfair trade practices.

I. Legal liability for the tax

Whether the sales tax was imposed in the form of a tax upon the privilege of selling at retail, upon retail sales, upon property sold at retail, or upon consumers, it would in legal effect be a tax levied upon either the seller or the consumer. Even though it was imposed upon the consumer the statute would necessarily require that it be collected from him by the seller and paid by the latter to the government. There are advantages in placing legal liability for the tax solely upon the seller and State experience indicates that this method is the more satisfactory of the two.

The imposition of the tax upon the seller would make it possible to tax sales to the States and their political subdivisions, if it was deemed advisable to do so. A tax upon the consumer in all probability would not be constitutional as applied to such sales. A tax imposed upon the seller would be deductible only by the seller for income tax purposes, but the deduction would be offset since the seller would be required to include in his gross income the amount collected from his customers as tax reimbursement. If levied upon the consumer, however, even though collected and paid by the seller, the tax would be deductible by the consumer in the absence of express provision precluding the deduction. In general, a Federal sales tax should not be deductible by consumers for income tax purposes. ^{1/} On the whole, such a deduction would tend to make the tax more regressive, since the privilege of deduction is of no value to low-income groups paying no income tax, but increases in importance as the marginal rates of the income tax increase in successively higher income brackets. The deduction would of course reduce the yield of the income tax.

II. Shifting of the tax

Since the retail sales tax is intended to be a tax resting finally upon individual consumers in proportion to their purchases of taxable articles and services rather than a tax upon business firms, it is

^{1/} Allowance of deductions of all State sales taxes by consumers may be desirable as a means of avoiding discrimination arising from the fact that some States place the tax on consumers while other States place it on sellers. Allowance of deduction of all State retail sales taxes was provided by the Revenue Act of 1942.

desirable that the entire amount of the tax be shifted from sellers to consumers. If the tax were levied upon the consumer, he would be required by law to pay it to the seller in connection with taxable sales. If, however, the tax were levied upon the seller, the statute might compel shifting, might be silent upon the matter of shifting, or might contain a statement of policy to the effect that sellers are expected to shift the tax. The first alternative is of doubtful desirability. It might have the effect of changing the form of the tax to one imposed on the consumer and would probably be virtually meaningless and unenforceable. Sellers could readily avoid the requirement, if they desired to do so and except as they might be restricted by the operation of fair price acts, simply by reducing their selling prices (exclusive of tax) by the amount of the tax. In almost all cases, the tax would be shifted to the same extent regardless of the treatment of the matter in the statute. In order that there be no doubt as to the intention of Congress, however, it might be advisable to set forth in the law a general policy statement that sellers are expected to shift the tax to their purchasers whenever feasible. ^{1/}

It might also be well to provide in the statute that it is unlawful for sellers to advertise that they are absorbing the tax. Advertisements of this nature are misleading, since concerns may frequently shift the tax by price readjustments even if they do not collect it as a separate item. The prohibition would accordingly check a form of unfair competition and aid in obtaining the good-will of sellers.

In general, quotation of the tax separately from the selling price of the article or service is preferable to shifting of the tax by readjustment of the price, since with separate quotation there is greater likelihood of the shifting of the exact amount of the tax. Under present price-control regulations sellers would have to quote the tax separately, since only by this means could they shift it without obtaining a readjustment of their price ceilings. In the postwar period also, the separate quotation procedure is likely to be followed, even in the absence of special statutory provisions. ^{2/} To encourage the practice, a statement that sellers would be expected to quote the tax separately when feasible might be included in the law.

^{1/} Such a provision is found, for example, in the California sales tax law.

^{2/} The practice of separate quotation is almost universal in the sales tax States. One of the few exceptions is the retail tax portion of the Indiana gross income tax, which has a very low rate.

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Another problem relating to shifting is that of passing forward an amount of tax involving a fraction of a cent. Two principal methods are available, namely, the use of mill coins or a schedule of brackets. The latter method involves essentially the adjustment of the amount of tax to an even cent.

Mill coins, comparable in many respects to the tokens used by several States, involve a certain amount of expense, the cost of manufacturing such coins often being equal to or greater than their face value. Sellers and consumers might find them inconvenient, especially when they were first introduced. While there may be justification for the use of tokens with the low rate State sales taxes, it is questionable whether there would be sufficient need for mill coins under a relatively high rate Federal tax to justify the expense and inconvenience involved.

Under the bracket method, a schedule indicating the amount of tax to be collected on each sale price would be established. For example, a possible schedule under a 10-percent tax might be as follows:

Amount of Sale		:	Tax
		:	
1¢	to 4¢	:	0
5	" 14	:	1¢
15	" 24	:	2
25	" 34	:	3
35	" 44	:	4
etc.			

Under this system, a purchaser would frequently not pay the precise amount of tax actually due on any particular purchase but, on the average, would probably pay a rate of tax equal to the tax rate provided by the statute. This method is the simpler of the two for both merchants and consumers and, in general, is equitable for both groups, although a small group of concerns having a high percentage of sales in the lowest bracket might not collect enough tax reimbursement to cover their tax payments. ^{1/} With a 5-percent

^{1/} Operators of vending machines, however, might not be able to collect any tax reimbursement.

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or 10-percent tax rate, the number of concerns thus affected would be small. It would seem advisable not to set forth the bracket schedule in the statute and, assuming it were to be prescribed by the Government, to issue it by regulation. It would then be much easier to readjust the brackets should experience indicate such need. If the schedule were deemed to be solely a matter of adjustment between sellers and their customers, the Government might refrain even from issuing it by regulation. In this case a schedule or schedules would undoubtedly be provided by merchants' associations.

Part Five. Administrative Provisions

The effectiveness with which a retail sales tax might be collected depends to a large extent upon the statutory provisions relating to the administration of the tax. Some of the important issues which might arise in this connection will be discussed.

I. Licenses

To facilitate administration, twenty of the twenty-three sales tax States require that licenses be obtained by all persons selling at retail. 1/ So far as State practice is concerned, it appears that licenses are believed to be desirable.

Licenses are employed for several important purposes. First, they provide a means of establishing a list of sellers subject to the tax. Through the application for license the Government is able to obtain necessary information such as the exact names and addresses of the owners of business concerns, the nature of the businesses and whether seasonal, the date the business started if opened after the effective date of the tax act, and the name and license number of the prior owners of the business if the business was purchased after the effective date of the tax. Information could also be obtained respecting the financial responsibility of the applicant for the purpose of ascertaining the most desirable tax return period for him and whether he should be required to furnish security to insure compliance with the act.

Secondly, the threat of revocation and actual revocation of licenses in cases of tax delinquency have proved to be extremely effective means for enforcing payment of the tax. 2/ Under a retail

1/ Taxpayers are also licensed under the Canadian manufacturers' sales tax and the Australian and British wholesale sales taxes.

2/ Thirteen of the twenty States which require licenses have specific statutory provisions authorizing revocation.

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sales tax there would be thousands of small retailers, operating from hand to mouth, who frequently would be delinquent in their tax payments even though they had collected the tax from their customers. These retailers would have little in the way of property which could be levied upon to satisfy the tax liability. Some States have found a forceful license revocation procedure a more effective collection method than seizure of the retailers' property. When notified to show cause why their licenses should not be revoked for failure to pay tax, retailers make every possible effort to meet their liabilities or to enter into arrangements with the government for the orderly settlement of the liability in order that they may continue in business.

Thirdly, licenses provide a means whereby manufacturers and wholesalers can identify business concerns entitled to make tax-free purchases for resale. A retail sales tax imposes a great responsibility upon sellers to ascertain the disposition of goods sold by their purchasers. It would appear that the Government owes a duty to sellers to assist them in identifying persons entitled to make tax-free purchases for resale. Although the results might be harsh in certain cases, the effective administration of a retail sales tax requires that liability for the tax be definitely fixed upon the seller. If, through error or misrepresentation, a person buying for consumption furnishes the seller a resale certificate and the transaction later is discovered by the Government to have been a taxable sale, the seller would be liable for the tax. ^{1/} Licensing would not only provide sellers with a means of identifying persons entitled to purchase for resale (through quotation of license numbers), but would also provide the Government with a means of controlling the misuse of resale certificates, since repeated misuse of the resale certificate by a business concern would be a ground for the revocation of its license.

In the light of these considerations it might be desirable to license all sellers of tangible personal property, for it then would be possible to require that resale certificates bear a license number. Farmers, however, probably could be exempted from the licensing requirement without significant effect upon the operation of the resale certificate system. Assuming that feed, seed, and fertilizer were exempt from the tax, the only important classes of property purchased for resale by farmers would be containers and packing materials, livestock, poultry, and eggs for hatching. It would be impractical to license several million farmers for the

^{1/} In this case, it probably would also be possible to subject the purchaser to liability for the tax.

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purpose of controlling their limited number of purchases for resale. It would seem preferable to permit farmers to execute resale certificates for the purpose of purchasing the foregoing classes of property for resale without quotation of license numbers.

Although the licensing system provides very valuable aids to the administration of a sales tax, it should not be assumed that licenses are absolutely essential. That is, licensing really supplements other methods of enforcement which would be employed in any event and which might prove adequate in the absence of licensing. A list of sellers could be developed from existing lists of Federal taxpayers, such as the old-age insurance tax, the Federal retail excise taxes, and occupational taxes. Additional sources are also available, such as State sales tax and trade association lists. Even though licenses were required, it would be necessary to check the licensees against the existing lists of sellers. It would also be necessary to conduct extensive field investigations to determine whether sellers required to file tax returns actually were doing so. Moreover, a limited amount of the information that would be obtained through the application for license could also be obtained on the tax return forms.

Methods other than revocation of license could be employed for the handling of delinquencies. The existing Federal tax laws already give collectors of internal revenue broad powers to enforce payment through levy on personal property and the placing of liens against real property.

The resale-certificate system could be operated even though licenses were not required. The imposition of a penalty for the misuse of resale certificates by buyers would tend to prevent the unwarranted use of the certificates.

The licensing of more than 2.5 million sellers ^{1/} would be a large undertaking requiring substantial amounts of personnel and equipment. While it is probably true that licenses would increase personnel and equipment requirements, it should be noted that even in the absence of licenses large amounts of personnel and equipment would be needed. The additional advantages which would be offered by the licensing system, therefore, should be considered in the light of the larger manpower and equipment requirements.

If licenses are provided, permanent licenses might be preferable to annual or periodically renewable licenses. The licenses, however, probably should be nontransferable as respects either change of ownership or location. Since the license requirement is intended as a method of control and not as a source of revenue, only a nominal fee, if any, should be charged.

^{1/} It is estimated that for the calendar year 1943 there would be about 2.5 million taxpayers. If all sellers (excluding farmers) of tangible personal property were licensed, this number would be somewhat larger.

II. Tax returns

The retail sales tax returns might be required on a monthly, bimonthly, or quarterly basis. The quarterly basis probably would be preferable. Although monthly returns would provide a more frequent check upon retailers, they would materially increase the expense of administration. ^{1/} Under the monthly basis, it would be extremely difficult if not impossible to complete the checking of returns and the preparation of a delinquency list for any month prior to the filing of the returns for the following month. Efficiency of administration would be increased if the delinquencies for one period were cleared, through payments or other arrangements, before the delinquencies for the next period were ascertained. This would be possible under a quarterly return basis.

While the quarterly basis should prove satisfactory for most taxpayers, in some cases shorter periods might be desirable. For example, more frequent returns would be desirable in the case of financially unstable concerns and from concerns operating on a seasonal basis. Accordingly, the tax administrator might be authorized to require the filing of returns for other than quarterly periods.

III. General administrative powers

The powers, similar to those existing in the case of the Federal excise taxes, probably should be conferred upon the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Collectors of Internal Revenue with respect to the retail sales tax.

IV. Cooperative arrangements with the States

The efficiency with which a Federal retail sales tax could be administered might be increased and the cost reduced through Federal cooperation with State and city agencies engaged in tax administration. Accordingly, the Commissioner of Internal Revenue might be authorized to enter into cooperative arrangements with State and local officials for the purpose of facilitating administration of the sales tax.

^{1/} Monthly returns would require the handling of approximately 30 million returns annually as compared to about 10 million on a quarterly basis.

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POSSIBLE MODIFICATIONS OF A FEDERAL RETAIL SALES TAX:
PERSONAL EXEMPTIONS, GRADUATED TAX RATES,
AND COMPULSORY LENDING

Division of Tax Research
Treasury Department, Washington, D. C.
April 15, 1943
As revised - October 12, 1943

Possible Modifications of a Federal Retail Sales Tax:
Personal Exemptions, Graduated Tax Rates,
and Compulsory Lending

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Possible Modifications of a Federal Retail Sales Tax:
Personal Exemptions, Graduated Tax Rates,
and Compulsory Lending

Introduction

Several proposals have been made in connection with the consideration of a Federal retail sales tax to modify the usual form of the tax with a view to ameliorating its regressive effects and, in some cases, enhancing its anti-inflationary effectiveness. It has been suggested (1) that universal personal exemptions be provided, (2) that personal exemptions be provided for low-income families and individuals, (3) that the tax be imposed at graduated rates, and (4) that the tax collections be treated, in part at least, as compulsory loans repayable to the taxpayers after the war. It should be noted that any one of these proposals would have to be superimposed upon a retail sales tax of the usual type.

Personal exemptions

To provide personal exemptions under a Federal retail sales tax, it has been proposed that the Government either refund part of the tax collections to everyone in the form of a certificate redeemable for cash, or distribute to everyone free of charge a specified amount of sales tax coupons acceptable in payment of the tax. Consumers would then pay the tax added by sellers to the regular selling prices of taxable goods and services either with money or with the tax coupons.

Under an alternative plan, only those with low incomes would be entitled to the tax refund. Here, too, either certificates or coupons could be employed.

Personal exemptions would minimize, in some cases even eliminate, the heavy burden that a sales tax would impose on those with very low incomes. In this way a progressive distribution of the tax load within the lower and middle income groups would be achieved. Thus, if a feasible administrative system could be devised to handle the distribution of the exemption to millions of individual consumers, one of the important arguments against a sales tax would largely be nullified.

Graduated tax rates

To provide for a sales tax imposed at graduated rates, it has been suggested that the Government furnish to consumers at a low tax rate coupons good for paying the tax on a specified amount of

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expenditures ^{1/}, but sell them additional tax coupons at successively higher rates according to a tax schedule based on expenditures. For example, if an adult consumer were required to buy coupons for the first \$200 worth of taxable expenditures at a 2-percent tax rate, he might be charged 10 percent for the next \$200 worth of coupons, 20 percent for the next \$200, 30 percent for the next \$200, etc. The sales tax would be paid by consumers directly to the Government through the purchase of coupons. Consumers would deliver the coupons to sellers in settlement of sales tax liability when they bought taxable goods and services.

Under this plan, low-income consumers might be relieved of an unduly heavy tax burden. In addition, the tax could be made as progressive as desired in relation to expenditures. Proponents of the graduated sales tax plan have indicated the possibility of controlling consumer spending by devising a graduated rate schedule which would tax purchases in excess of a specified amount at rates sufficiently high virtually to prohibit excessive and inflationary spending.

Compulsory lending

Another proposed modification of the retail sales tax is to use the tax as a means of enforcing compulsory lending. Under this plan, sellers would be required to purchase sales loan stamps from the Treasury and to deliver to their customers an amount of stamps equal to the amount of sales tax collected from the customers in connection with sales of taxable goods and services. These stamps would be exchangeable by consumers for non-negotiable savings bonds redeemable after the war. The postwar redemption might be at the full face value of the bonds or some limit to redemption might be established in accordance with the size of holdings.

These possible modifications of the general retail sales tax are considered in the following sections.

Part One. Personal Exemption System: Universal Exemptions

The fact that a retail sales tax rate as high as 10 percent would unduly burden those with very low incomes has led to the suggestion that a certain amount of essential expenditures be exempted from the tax. One suggested method would provide a system of tax refunds under which the Government would give back to all individuals a portion of the sales tax collections. These tax refunds might be in the form of certificates which could be cashed or exchanged for war bonds depending upon the current needs of individuals. ^{2/}

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- ^{1/} Consumers might be given the first quantity of tax coupons free as under the exemption plan.
- ^{2/} Current redemption might be limited to those below a certain level of income, redemption to others being deferred until after the war.

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An alternative method of distributing the exemption would employ tax coupons. An amount would be distributed to each individual equal to the tax liability on the exempt specified amount of purchases, the coupons then to be used for paying the tax.

The administration of a personal exemption system presents many problems in addition to those ordinarily involved in the enforcement of a sales tax. The size of the administrative requirements depends largely on the nature of the plan adopted. The simplest personal exemption plan provides for the distribution of the benefit to everyone. Universal distribution of exemptions might be at a flat amount per capita or varied according to age or dependency status. In the following discussion, attention is focused on both the equitableness and the administrative practicability of the exemption provisions. ^{1/}

I. Size of personal exemptions

A sales tax refund system consistent with the purpose of relieving low-income persons from the burden of the tax might exempt an amount of expenditure necessary to preserve a maintenance standard of living. This amount depends on the classes of expenditures which would be excluded from the sales tax, the size of family, and the cost of providing essential needs to families differently situated.

Because of administrative and other considerations, there probably would be excluded from a Federal retail sales tax many classes of consumer expenditures. Even though expenditures for education, fuel, rent, medical services, transportation and other utilities were excluded from the tax, many essential goods and services would be taxable. These include food and beverages, clothing, medicine, household supplies and furnishings, and personal care.

The amount of the personal exemption might be gauged by the cost of food necessary to health and efficiency. ^{2/} The cost of a "maintenance" food budget for a family of four is estimated at about \$600.^{3/} Since the

^{1/} Since the two proposed methods (certificates and coupons) are similar in most respects, the discussion will not distinguish between them except where it is necessary to do so.

^{2/} Exemption of food from the tax offers an alternative method of providing this relief. The distribution of the benefits, however, would be substantially different because expenditures on food increase as income increases whereas nutritional requirements for a maintenance standard of living are more closely related to factors such as age and activity. See "Factors Affecting the Structure of a Federal Retail Sales Tax Under Wartime Conditions," Part One, section III, A.

^{3/} "Intercity Differences in Costs of Living, March 1935, 59 Cities," Works Progress Administration, Research Monograph XII, U.S.G.P.O., 1937, p. xix. The \$448 estimate given in this study was adjusted for current prices by the August 1943 cost-of-living index for food. It should be noted that this "maintenance" standard is above that of an "emergency" level of \$340 for March 1935. Many items included in the "maintenance" food budget are no longer obtainable in the quantities prescribed.

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cost of a family's food requirements generally varies with its size, a per capita exemption would be better than a flat exemption per family. An allowance of \$150 for each member, for example, would compensate for the sales tax on \$600 of expenditure by a family of four. The annual value of this exemption would depend on the tax rate; at 10 percent it would amount to \$60. The per capita allowances might also be varied according to age or dependency status of individuals such as \$200 for adults and \$100 for minors.

Different allowances might also be justified by reason of variations in cost of living between different sections of the country and between urban and farm families. For example, since home-produced food would not be subject to tax, a smaller personal exemption for farm families might be justified. ^{1/} Differentiation between farm and urban families, however, would be difficult. Moreover, many urban families are producing a considerable portion of their food requirements in "Victory gardens."

II. Basis of allotment

A choice would have to be made among several bases of allotment to the 40 million single persons and families in the United States. Since the cost of a maintenance standard of living varies with family size and composition, it might be desirable to establish the amount of family exemptions in accordance with these variables. Under one method there would be provided a flat amount of exemption to each member of the civilian population. ^{2/} The alternative methods depend largely on the desirability of distinguishing between adults and minors, or between income recipients and those with dependency status. Thus, the size of the exemption given a minor or dependent might be smaller than that given to an adult or income recipient. The practicability of administering each of these plans, however, should be balanced against the purpose of achieving an equitable adjustment of the benefit to personal and family needs.

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- ^{1/} Home-produced food accounted for 57 percent of the total money value of food for rural farm families in 1941. (See "Rural Family Spending and Saving in Wartime," U.S. Department of Agriculture, Miscellaneous Publication No. 520, June 1943, p. 32.) However, the cost of producing this food should be considered, and it should be noted that the amount produced varies considerably among farm families.
- ^{2/} Certain members of the armed forces providing for their own subsistence would also be entitled to exemptions.

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A. Equal per capita exemptions

If a flat exemption of, say, \$150 were given to everyone regardless of his income, dependency status, or age, the administration of an exemption system would be greatly simplified. Distribution of this amount to every member of the civilian population would reduce the sales tax base by about \$19 billion. It is questionable, however, whether this plan would apportion this amount in the most equitable manner among single individuals and families of different size. The cost of maintaining a family does not increase in proportion to the increase in its size. Consequently, under a flat per capita exemption, large families would tend to get a disproportionate amount of the benefits as compared to single individuals and small families.

B. Adult-minor classification

Reduction of the annual allowance to persons below 18 years of age from \$150 to \$100 would tend to be more commensurate with the increase in costs of family maintenance. This would permit the allotment to those above 18 years of age to be raised to \$175 without additional reduction in the sales tax base. ^{1/} An adult-minor classification would increase the administrative difficulties since it would be necessary to require evidence of the age of all individuals.

C. Dependency classification

Some justification might be made for the adoption of an exemption system similar to the present income tax classification of taxpayers into married couples, heads of families, single individuals, and dependents. According to this classification a married couple, or the head of a family together with his first dependent, would be entitled to about twice the benefit granted a single person, with an additional allowance for each dependent. As in the case of the adult-minor classification, the dependency classification also would tend to be more commensurate with the increase in costs of family maintenance.

Many additional complexities would be introduced since it would be necessary to verify the personal status of single individuals, married persons, heads of families, and the dependency of persons for whom exemption claims were made. Moreover, continuous revision of the Government's records would be necessary to account for changes in marital status, births, and deaths, etc.

^{1/} It is estimated that in 1943 there will be approximately 86.2 million persons above 18 years of age and 40.4 million below 18.

III. Effect of personal exemptions on the distribution of a Federal retail sales tax

Universal personal exemptions would bring about a substantial change in the distribution of a Federal sales tax among various income groups. The burden on those with low incomes would be greatly reduced and in many cases eliminated. In fact, those whose annual expenditures for taxable goods were less than the annual exemption would realize a small increase in their incomes under the certificate plan. This would also tend to occur under the coupon plan because of the difficulty of preventing the coupons from being sold or transferred.

As a result of the exemptions, the distribution of the sales tax on the lower and middle income groups is made slightly progressive. Table 1 illustrates the effect of a flat per capita exemption of \$170 on the distribution of a 10-percent retail sales tax. ^{1/} On the average, those families with incomes below \$500 would receive a greater value of exemption than their expenditures on taxable goods. The burden of the sales tax would increase from this negative amount to a maximum of about 3.9 percent of average income at the income levels between \$2,500 and \$4,000, and would then decline in the higher income levels.

Contrasted with this distribution is that of a 10-percent sales tax with a food exemption. The lowest income group would experience the highest ratio of tax to income, 5.7 percent. Between this group and the \$4,000-\$5,000 level, the percentage of tax to income would decline gradually to about 3.4 percent; above the \$5,000 level, the regression would be more rapid. The major differences in distribution of burden between a sales tax with personal exemptions and one with a food exemption, therefore, would be within the lowest income groups up to about \$1,500.

^{1/} The \$170 per capita exemption was chosen in order to aggregate the same amount (about \$21 billion) as estimated store and restaurant sales of food in 1943. Food sales for the calendar year 1943 have been estimated more recently at about \$23 billion or about \$185 per capita. The later estimate has not been used in distributing the sales tax load by income classes since the inadequacy of the available consumer income and expenditure data does not warrant recomputation of the information shown in Table 1.

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Table 1

Federal Retail Sales Tax Plans;
 Estimated Distribution of Tax by Income Levels,
 Civilian Families and Single Consumers
 Calendar Year 1943

Money income levels	Average tax as a percent of average money income			
	10% tax including food	15 $\frac{1}{2}$ % tax excluding food	10% tax excluding food	10% tax with personal exemption
		1/	1/	2/
Under \$500	9.4%	8.8%	5.7%	-3.8% 3/
\$ 500 - 1,000	7.7	7.0	4.5	1.6
1,000 - 1,500	7.2	6.6	4.3	3.3
1,500 - 2,000	6.6	6.2	4.0	3.6
2,000 - 2,500	6.2	6.0	3.9	3.8
2,500 - 3,000	5.9	5.7	3.7	3.9
3,000 - 4,000	5.5	5.5	3.5	3.9
4,000 - 5,000	5.1	5.2	3.4	3.8
5,000 - 7,500	4.5	4.7	3.0	3.5
7,500 - 10,000	3.8	4.0	2.6	3.0
10,000 and over	2.1	2.2	1.4	1.7
All levels	5.0	5.0	3.2	3.2

Treasury Department, Division of Tax Research

June 30, 1943

Source: Based on information supplied by Division of Research,
 Office of Price Administration; and Division of Research
 and Statistics, Treasury Department.

- 1/ The food exemption covers store and restaurant sales of food and kindred products (not including sales of alcoholic beverages) estimated at about \$21 billion. A 15 $\frac{1}{2}$ -percent tax excluding food will yield the same amount as a 10-percent tax including food. A 10-percent tax excluding food will yield as much as a 10-percent tax with a personal exemption of \$170.
- 2/ A personal exemption of \$170 for each member of the estimated civilian population is used for purposes of comparison with a tax exempting food. A personal exemption of this amount would exempt the same aggregate amount of spending as a food exemption.
- 3/ This income group would receive, on the average, an excess of personal exemption over estimated taxable expenditures equal in value to about 3.8 percent of its money income.

IV. Anti-inflationary effectiveness ^{1/}

The effectiveness of a tax as an anti-inflation measure is a function chiefly of the amount of revenue yielded, the distribution pattern of the tax among different income groups, and the tax effects on production and on wartime price and wage stabilization controls. A personal exemption system would weaken the anti-inflationary effectiveness of the sales tax in some respects, and strengthen it in others. It would substantially reduce the tax paid by low-income groups and might reduce the tax yield, depending on whether the tax rate were raised to compensate for the revenue loss inherent in the exemption. ^{2/} In these respects, therefore, the tax would be less anti-inflationary than one without exemptions.

It is possible, however, that the Government's stabilization policy might be adhered to more effectively if personal exemptions were provided than if a sales tax of the usual type were enacted. Since the exemption plan would provide a certain amount of tax relief toward protecting a maintenance standard of living, and since it would also increase the equitableness of the tax as respects low and middle-income brackets, it would probably be less difficult to hold the line on the wage front. Provision for personal exemptions might also ease the tax pressure on farm prices, but it is difficult to predict whether it would be sufficiently effective to enable legislative action to be taken excluding the sales tax from parity-price computations. If the tax were included in the parity index, rises in farm prices would be inevitable and these would be reflected in higher retail food costs. Such price rises, of course, would weaken the Government's ability to curb demands for higher wage rates and, therefore, would tend to spur the forces of inflation.

V. Administrative organization

The nature of the administrative problem under the several exemption plans has been briefly indicated. Further consideration should be given to the nature of the organization required for the registration of individuals, the distribution of exemptions and their redemption, and the routine operation of the plan.

^{1/} See "Effects of a Federal Retail Sales Tax on the Anti-Inflation Program."

^{2/} Raising the tax rate would intensify sales tax enforcement and collection problems, and would increase certain undesirable tax effects on business operating costs since various business purchases cannot feasibly be exempted from the tax.

A. National registration

The distribution of a substantial sales tax exemption in the proper amount to each single individual and family requires the development of an organization and technique which would eliminate at least the major opportunities for abuse. One of the prerequisites is a system of national registration which would guard against false claims and duplicate registration. For this purpose the latest war ration book registration might be employed. The certificate or coupons could then be issued upon presentation of the ration books by authorized persons. In order to provide a check on duplicate registration, surrender of a designated ration stamp could be required.

The present rationing registration is inaccurate and incomplete in a number of respects. For this reason it should be used with care, and checked for the elimination of invalid books. One abuse which has been difficult to avoid in the past is multiple registration for the war ration books themselves. In addition, many books have not been turned in as required in cases of death or induction into the armed forces. While the statements of age on the ration books might be used to classify the population according to adult-minor status, they would not give sufficient evidence of dependency. Should the latter basis be employed for distribution of different amounts of benefits, a supplementary certificate or other evidence of dependency status would be necessary.

B. Issuance of exemptions

It might be advisable to withhold the issuance of an exemption until the validity of the claim had been verified. Issuance immediately upon registration might encourage false claims since it would appear that the statements made by the registrant were not being adequately verified. While the present rationing organization could be utilized for registration purposes, it is questionable whether it should be authorized to issue the exemption. An independent check on the distribution of exemptions would assure better accountability for the certificates or coupons issued, and assist in the prevention of fraud or collusion.

A separate administrative organization might be established in the Treasury Department to approve the issuance of exemptions. It would supervise the conduct of the registration, be responsible for the verification of the registration statements, and undertake investigations of doubtful and fraudulent cases. An adequate and independent administrative system would reduce misrepresentation and provide a means for correcting honest mistakes arising from ignorance and misinterpretation of the law and regulations. In any case an extensive educational program would be necessary to inform the public of its privileges.

VI. Redemption of exemptions

Provision would have to be made for the redemption of the exemptions if they were issued in the form of certificates. They should be made redeemable as currently as possible in order to provide relief in necessitous cases. The time of redemption should be at the option of the individual, however, so that he might save the cash value of the exemption if he so desired. Redemption of the certificates could be made in cash or war savings bonds at banks, post offices, or other authorized agencies. Suggestions that the certificates not be redeemable until after the war are not consistent with the purpose of keeping unimpaired the necessary expenditures of low-income consumers.

If tax coupons were employed, redemption would involve transfer of the coupons to retailers who, in turn, would use them in payment of their sales tax liabilities to the Government. Use of exemption coupons, however, would entail a coupon collection system. While a tax coupon system obviates the distribution of cash and would probably identify the exemption more closely with its purpose of rebating the sales tax, there are objections to this plan. Probably the most serious objection would be the additional costs of compliance. The handling of the tax coupons by retailers would introduce a new complication and probable confusion with the multiplicity of rationing coupons. ^{1/}

VII. Conclusions on universal personal exemptions

A. Merits

If a Federal retail sales tax were modified by an exemption system covering a minimum amount of essential expenditures, the burden imposed on those with very low incomes would be minimized and in some cases entirely eliminated. The importance of the relief would depend on the tax rate and the size and basis of allotting the exemption. The universal exemption system would relieve low-income families from the sales tax burden more effectively than would a food exemption of the same aggregate amount.

If a sales tax is desired as a means of exacting a contribution to the Government from those who are not subject to the personal income tax, a system of personal exemptions offers a means of achieving this objective without making the burden too oppressive on the lowest income

^{1/} See discussion in Part Three, section VI, B, 5, below.

groups. ^{1/} At the same time a personal exemption system would achieve a progressive distribution of the tax within the lower and middle income groups. While the regressivity of the tax would not be altered appreciably within the higher income levels, the income tax effectively compensates for this.

B. Objections

Personal exemptions extended to everyone would reduce significantly the revenue yield of a retail sales tax at any given rate. ^{2/} The benefits would relieve the tax burden on low-income consumers and allow them to maintain their consumption of goods and services. In many cases their spending power would actually be increased by the tax value of the excess of the exemptions over the amount of taxable purchases. Among the higher income consumers the benefits would reduce the amount of excess spending power which would be withdrawn by a sales tax.

The use of a personal exemption system would add greatly to the administrative requirements of enforcing a sales tax. A flat exemption to everyone, however, would be the simplest form of exemption to administer. Administrative complexities would be increased by attempting to adjust the size of the exemption to family cost-of-living requirements on the basis of either age or dependency status. It would be impracticable to take account of differences in cost of living between urban and rural areas as well as among various sections of the country.

The abuses which might arise under an exemption system (for example, counterfeiting of tax coupons, collusion, misrepresentation, and falsification) are potentially great and would have to be guarded against in order to maintain confidence in the tax system.

Finally, the nature and form of the exemption itself may be objectionable. It may be difficult to justify a sales tax rebate to everyone irrespective of need in order to protect only a minority of the population. Furthermore, the essential connection between an exemption certificate and a sales tax refund may be lost in the process of redeeming it in cash or exchanging it for war bonds. Sales tax coupons would be more directly related to the purpose, but would increase retailers' costs of compliance with a sales tax.

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- ^{1/} For example, a family of four with an annual income of \$1,500 may have nontaxable expenditures of \$500 (rent, life insurance, medical expenses, etc.) and taxable expenditures of \$1,000 on which a tax of \$100 was paid at 10 percent. A rebate of \$60 (10 percent on \$150 for each member of the family) would reduce the rate of tax to 4 percent, which is less than 3 percent of income.
- ^{2/} The reduction in net sales tax revenue could be compensated for by higher rates but other problems would be intensified, including the taxation of business purchases which cannot feasibly be exempted from a sales tax.

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Part Two. Personal Exemption System:
Exemptions Limited to Low-Income Groups

In principle, personal exemptions should be limited to those whose health and efficiency would be impaired by the tax. Little purpose would be served by a wartime tax rebate to those whose incomes provide an adequate family budget. Sales tax revenue would be unnecessarily reduced. Consideration should therefore be given to the practicability of distributing sales tax exemptions only to those who can least afford to bear the tax.

In restricting the benefits to those with low incomes it would be necessary to establish certain income limits for individuals and families of different sizes above which the exemptions would not be allowed. In addition, a notch provision would be required for the equitable adjustment of the exemption benefits between those with incomes just below and just above these limits. For example, it would be quite inequitable to grant a \$60 tax benefit to a family of four with an income of \$1,500 and give no benefit to another family of the same size with an income of \$1,505.

I. Determination of eligibility requirements

A. Definition of income-receiving unit

With regard to the income limit, decision would have to be made between the adoption of a family-income unit or an income-recipient unit, or some workable compromise between these two. Basing the claim for exemption on family income has some justification in so far as the members of a family pool their incomes, but ignores the fact that many families have more than one self-supporting member entitled to separate consideration. However, it would be difficult to distinguish between families where income is pooled for consumption purposes and where it is not. It might be preferable, therefore, to choose the present income tax basis. According to this classification, individuals with incomes below \$500, and married couples and heads of families with incomes below \$1,200 would be eligible for the exemption; and \$350 additional income would be allowed for each dependent. Thus, a family of four would be eligible for exemption benefits if its income were \$1,900 or less. These income limits would also have the advantage of avoiding confusion between the income tax and the sales tax personal exemption systems.

Many complications would arise, however, in adapting a sales tax personal exemption system to the income tax classification. One is the treatment of dependent children over 18 years of age. If they are students, for example, and still a responsibility of their parents, the heads of families probably should be entitled to an additional exemption allowance. The separation of income between husband and wife presents another problem. Here the separate incomes probably should be treated on a family-unit basis (joint-return basis), if both contribute to the support of the family. The problem in community-property States might be treated in the same way.

Whether the income limits should be calculated on a net or gross income basis would also have to be decided. While deductions of necessary business expenses would be justified, it would be questionable whether deductions for items such as donations, taxes, and interest should be allowed. Moreover, the adoption of a strictly net income basis would unduly complicate the administration of the plan because of the year-end adjustments necessary.

B. Equitable adjustment of income limits

The income limits should be adjusted in order to avoid the harsh discrimination between those just above and below the exemption lines. If such adjustment were not provided, the exemption plan would be inequitable in its sharp differentiation between individuals and families who, for all practical purposes, would have about the same ability to pay taxes. In addition, the plan would tend to place an undue premium on evasion by providing substantial benefits to those who could meet the income requirements by slightly underreporting their incomes.

The inequality could be ameliorated by a notch provision which would reduce the size of the exemption to those within a certain range of income either below or above the income limits. For example, if a family of four with an income of \$1,900 were entitled to an exemption of \$600, its value would be \$60 at a tax rate of 10 percent. Under a notch provision the benefits of the full exemption might be extended only to those whose incomes were less than the income limits by \$200 for each adult and \$100 for each dependent. In this case, the full \$60 benefit would be given only to families of four with incomes of \$1,300 or less (that is, \$1,900 less \$600). Families of four with incomes of more than \$1,300 but less than \$1,900 might be given only one-half the full benefit or \$30. The notch could, of course, be graduated, but this would increase the administrative problems.

II. Administration of the refunds

An exemption system limited to those with incomes below specified amounts would create many administrative difficulties which would not be encountered if the benefits were granted to all. ^{1/} If the sales tax exemption is to serve the purpose of providing relief to needy cases, it should, in principle, be made on a current income basis. Income in the preceding year would not be a good criterion because the majority of incomes fluctuate from year to year. The most feasible plan probably would be to pro-rate the exemption on a quarterly basis so as to reduce the lag between income receipts and expenditures. Distribution of the benefits would then be determined by the income of the preceding quarter. This method probably would be impractical, however, with respect to farmers and small business men.

^{1/} An alternative plan would provide for the universal distribution of exemption certificates, with current redemption limited to those with incomes below a certain amount. This plan would introduce an element of compulsory lending, the salient features of which are discussed in Part Four in connection with another proposal.

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A. Registration and control

Initial application for exemption benefits would require registration in person of those whose incomes in the preceding quarter were below the income limits. Subsequently, a more routine administration of the quarterly claims might be developed, which would eliminate need of personal application except for new applicants. For example, forms might be made available for filing the claims by mail and the exemption certificates or coupons might also be mailed. To require personal application at all times would not only increase the personnel requirements and office facilities needed to administer the system but it would also inconvenience workers who would lose valuable working time in reporting to the designated office.

If it were planned to grant coupons only to those with incomes below specified levels, a more extensive organization would have to be developed for the purpose of reviewing the quarterly applications. While it should not be necessary to file each quarterly application in person, the registration offices should be conveniently located in order to permit personal interviews with new registrants and to provide a place to handle complaints, conduct investigations, etc. The extent of decentralization and size of these offices would depend on the degree of standardization that could be installed in handling the applications. In any event, it probably would be necessary to handle around 10 to 15 million quarterly applications throughout the country, depending on the income standards adopted and the level of national income. The tremendous personnel requirements of such an organization are readily apparent, not only for initial registration, routine inspection of applications, typing and filing of records, mailing of certificates or coupons, but particularly for the current investigation and post-audit of incomes to reduce errors and to prevent fraud.

B. Problems of verifying income statements

Verification of claims for exemptions would entail a considerable amount of administrative work which might delay the distribution of the tax refund certificates or tax coupons. One means of minimizing delay would be to require proof of earnings for the preceding period. For this purpose an employer's statement of wages might be used. Income of the self-employed could not be obtained, however, except by affidavit. Those dependent on pensions, annuities, or income from trust funds could be required to secure income statements from the payors.

Numerous difficulties would arise in the adoption of the foregoing type of plan. Where more than one job was held in the previous period, an income statement from one employer would understate the applicant's income. A check on such underreporting could be provided by requiring a statement of the length of time worked so that other employment during the period would

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be disclosed. 1/ Other special problems would also arise where wives were working or where supplemental income was received from investments or from a part-time job. If exemptions were pro-rated on a quarterly basis, cases would arise of benefits being received by individuals whose annual incomes exceeded the maximum limits because of seasonal fluctuations, wage increases, etc. Finally, another objection to the plan is the additional work that would be placed on employers.

C. Post-audit and investigation

If an adequate system of investigation and post-audit were instituted for the enforcement of a sales tax exemption plan, it might prove possible to dispense with preliminary proof of income. In this case, initial reliance would be placed on the individual's statement that he earned less than the required amount, but his application would be subject to post-audit and investigation. Penalties imposed for falsification, such as repayment of excess payments and forfeiture of future benefits, would tend to reduce abuse.

Should the income limits for exemption purposes be equivalent to those established for the individual income tax, auditing might be facilitated by the use of the income tax returns. The adoption of similar income exemption limits would enable a check to be made on the basis of the gross income reported for income tax purposes. 2/ The time necessary to audit income tax returns, however, would greatly delay the coordination program, even if an adequate system of coordination could be worked out.

An alternative method of checking might be provided by the withholding tax returns filed by employers with respect to wages and salaries of persons whose tax was withheld at the source. This information, however, would have certain shortcomings. The returns would not contain information on investment income or wages of domestics, farm laborers and others not subject to withholding. Verification of income derived by one person from more than one employer would necessitate the collating of the separate reports of employers of the individuals who may have been moving from job to job and often from one part of the country to another. The same sort of difficulty would be encountered in checking the income of working wives.

1/ Evidence of unemployment might be required in order to account for this time.

2/ This suggests another possibility of integrating the sales tax exemption system with the income tax by having universal distribution of sales tax exemptions with a requirement that the value of the exemption be returned by those with income above the specified eligibility limits.

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III. Evaluation of the plan

A. Merits

A personal exemption system limited to those with low incomes would have about the same advantages described above for a universal exemption system without some of its objections. Restricting the exemption would avoid gratuitous benefits to those able to pay the sales tax and the net yield of the tax would be larger. It is difficult to conclude whether restriction of exemptions to low-income families would strengthen or weaken the anti-inflationary effectiveness of the sales tax as compared with a universal exemption plan.

B. Objections

While it would be more desirable to limit sales tax exemptions to those below a maintenance standard of income, the size of the administrative requirements appears to be prohibitive. The cost of operating the plan on a scale necessary to insure efficient administration and enforcement would be excessive and would represent a drain on scarce manpower and facilities. An extensive organization would have to be established for the purpose of reviewing the quarterly claims for refund, maintaining a permanent file of the beneficiaries, investigating questionable claims and auditing the incomes of exemption recipients in order to guard against errors and misrepresentation. The treatment of persons with incomes subject to marked fluctuations during the year would raise additional complexities.

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Part Three. A Sales Tax with Graduated Rates 1/

A retail sales tax imposed at graduated rates differs from the usual retail sales tax in that it is collected in the first instance by selling coupons to consumers at rates which increase with the aggregate amount of their taxable purchases. This type of tax should be distinguished both from a graduated spendings tax 2/ and from sales taxes with rates differentiated according to classes of goods and services. 3/

The sales tax would be paid in tax coupons purchased from the Government at graduated rates. Coupons equivalent in face amount to the first bracket expenditures would be obtainable at a low rate of tax, or could be issued free. Coupons covering the next bracket of expenditures would be purchased at a higher tax rate. Additional coupons would be obtainable at successively higher tax rates depending on the size of the expenditure brackets. The tax coupons would ordinarily be sold in booklets, the coupons bearing face values equal to money units of taxable purchases (such as 1 cent, 5 cents, 10 cents, \$1). Thus, a book of coupons would be good for payment of tax on purchases aggregating, say, \$200, whether the consumer had paid \$2 (1 percent tax), \$20 (10 percent tax), or \$60 (30 percent tax) for it. Sellers would be required to collect the coupons in face amounts equivalent to the dollar value of their taxable sales and to remit them periodically to the Government in discharge of their tax liability.

The principal features of the plan requiring detailed consideration include exemption of expenditures and tax rates for each bracket of expenditure, registration of consumers, issuance and sale of coupons, collection and accounting for coupons by sellers, and the taxation of sales to business concerns.

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- 1/ The similarity of this plan to general expenditure rationing should be noted. In the latter plan, persons would exchange their money for a special type of money which would be required for purchasing articles at retail. The amount allowed each person would be limited to a certain percentage of income. Both plans would attain the same objectives from the standpoint of inflation control and would give rise to similar problems. However, the expenditure rationing plan would yield no tax revenue.
- 2/ Differences arise because of the difference between "sales" and "expenditures" and by reason of the usual exclusion from a retail sales tax base of expenditures on rents and various services.
- 3/ Some of these plans advocate a sales tax on different classes of goods graduated according to the degrees to which they are subject to inflationary pressure. Others would classify sales according to the degree of "necessity" or "luxury" of the articles.

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I. Determination of graduated tax rates

The size of the initial bracket might be determined on the basis of an estimate of the amount of expenditures for taxable goods and services which would be essential to a maintenance standard of living. ^{1/} A low rate of 1 percent on the first expenditure bracket would obviate the need for the distribution of free coupons. Free coupons might be issued, however, either to everyone or only to those with incomes below specified amounts. In general, the size of succeeding expenditure brackets and the rates of tax applied would depend on the extent to which the tax was intended to raise revenue and to check inflation. Spending beyond a certain level could be made prohibitive by employing and enforcing sufficiently high tax rates. Table 2 presents a hypothetical tax schedule for purposes of illustration. The rates are of course not presented as recommended rates; they merely illustrate the kind of a tax that might be designed as a severe check on consumer spending.

Table 2

An Illustrative Graduated Sales Tax Schedule

Tax rates	Annual Taxable Expenditures		
	Single person	Married couple, no dependents	Married couple, two dependents
1%	\$ 1-\$ 200	\$ 1-\$ 400	\$ 1-\$ 600
10	200- 400	400- 800	600- 1,200
20	400- 600	800- 1,200	1,200- 1,800
30	600- 800	1,200- 1,600	1,800- 2,400
40	800- 1,000	1,600- 2,000	2,400- 3,000
50	1,000 and over	2,000 and over	3,000 and over

^{1/} See discussion of "Size of personal exemption," Part One, section I.

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As shown by Table 3, under this hypothetical schedule a married couple without dependents would pay a tax of \$404 on \$2,000 of taxable expenditures; a married couple with two children would pay \$246 on the same amount; and a single person would pay \$702 on \$2,000 expenditures. If this schedule were thought too punitive it could easily be modified by increasing the expenditure brackets or reducing the rates.

Table 3

Illustrative Graduated Sales Tax:
Tax Liability for Selected Taxable Expenditures

Amount of Annual taxable expenditures	Amount of Tax Payable		
	Single person	Married couple, no dependents	Married couple, two dependents
\$ 250	\$ 7	\$ 3	\$ 3
500	42	14	5
750	107	39	21
1,000	202	84	46
1,500	452	214	126
2,000	702	404	246
3,000	1,202	904	606
4,000	1,702	1,404	1,106

II. Basis of allotment

Administrative considerations require the use of an easily-defined consumer unit. The tax schedule might be devised on the basis of equal per capita expenditure brackets as shown in the "single person" and "married couple, no dependents" columns of Table 2. Or the schedule might vary the expenditure brackets for minors or dependents as shown in the "married couple, two dependents" column of Table 2. The basic problems encountered in evaluating these alternative plans are discussed in Part One, section II, above.

III. Issuance of coupons

Some of the prerequisites to the sale of the coupons are similar to those outlined in Part One in connection with the distribution of exemptions. 1/ Registration of all individuals and some system of checking

1/ See discussion in Part One, section V.

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their identities when they purchase coupons would be necessary to prevent multiple registration. Although existing agencies, such as rationing boards, might be used for the initial registration of individuals and families, a substantial personnel force would be required to check the accuracy of the registration statements.

Following registration and verification of personal and dependency status, some form of receipt book (similar to a bank book) could be issued to each separate consumer unit. This book would be used to record the amount of coupons issued. ^{1/} Coupons could be purchased only upon presentation of the book for entry of the amount received.

Agencies would have to be established for the sale of tax coupons. These agencies probably would be under the direct supervision of the Treasury. The selling organization would have to be greatly decentralized for the convenience of coupon purchasers so as to avoid standing in line, loss of working time, and to minimize other costs of taxpayer's compliance. At the same time, adequate control over coupon sales, in order to tax consumers at the proper graduated rates, would require additional administrative controls if individuals were allowed to buy coupons at more than one designated office. In this case, duplicate records would have to be kept for each person in order to provide some internal check on the sales of coupons and the accuracy of the tax rates applied, and to facilitate handling cases where receipt books were lost or stolen.

One approach to the solution of these difficulties would be to establish local sales agencies under centralized control. Each individual would be assigned to a central office covering a limited territory. This office, managed by the Treasury, would be responsible for keeping the records of sale and taxes paid for each individual's account. Existing agencies, such as banks and post offices, could be authorized to sell the coupons upon the presentation of any individual's own receipt book. The amount of sale and the tax paid would be recorded in this book and a duplicate receipt sent to his central office (as designated in the individual's receipt book) where the amount of coupons purchased and tax paid would be posted to his account.

The advantages of such an organization would be severalfold. Consumers would be free to buy coupons at the place most convenient to them at the time of need. Moreover, full utilization of existing selling facilities would limit duplication of office space, machines, and personnel and, thus,

^{1/} If coupons were issued in blocks of standardized amounts, some provision would have to be made for year-end refunds of unused coupons.

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reduce cost of operation. 1/ A record would be available of each individual's purchases, enabling a check to be made on excess purchases at each rate. A system of control over the selling agencies would be possible by charging their accounts with the taxable value of coupons transferred to them. 2/

IV. Collection of coupons and enforcement of retailers' liability

At the time consumers purchased taxable goods and services they would be required to give retailers an amount of tax coupons equal in face value to the money value of the purchases made. Anyone who did not have enough tax coupons at time of purchase would be required to pay tax in cash at the maximum rate provided in the tax schedule. By this means evasion of the graduated rate features of the tax might be reduced.

Retailers would be required to file periodic returns (similar to those under the usual form of sales tax) showing their liability for collection of a face value of tax coupons equal to their net taxable sales. If retailers failed to return sufficient coupons to cover their tax liability, they would be required to pay the difference in cash at the maximum rate provided in the tax schedule. This requirement would tend to induce retailers to collect from consumers either the correct value of coupons or cash equal to the maximum rate provided under the tax.

V. Taxation of sales to business concerns

It is probable that a Federal retail sales tax would apply to a substantial volume of sales of articles used by business concerns 3/ The reasons which are given for the adoption of a progressive sales tax do not apply to sales of articles used by business concerns. In addition, the application of graduated tax rates to sales of articles used by industrial, agricultural, and commercial users would have drastic effects on business profits and price controls. Unless existing price ceilings were evaded or reestablished to allow for the increased costs of the graduated tax rates, the tax on sales of articles used by businesses would be extremely inequitable. Accordingly, some means would have to be provided to avoid application of the graduated tax to business purchases.

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- 1/ A fee would be necessary to reimburse the selling agencies, as in the case of ration banking.
 - 2/ Coupons carrying different rates could be differentiated by number or color.
 - 3/ There seems to be no satisfactory way of excluding from the scope of a retail sales tax all sales of articles to be used by business concerns.

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A special type coupon, carrying the lowest tax rate, might be used by business concerns for purchases of articles not exempt from the tax. ^{1/} At the end of specified accounting periods, the concerns might be required to account for the coupons purchased by showing that the taxable purchases had been used for business purposes. This procedure would entail substantial personnel and effort to handle the applications and to audit taxable purchases in order to prevent evasion of the progressive rate feature by individuals. It would be impossible to check the invoices of the many small business concerns, especially farmers, with any degree of care, and it would be inevitable that many purchases, ostensibly made for business purposes, would be used for personal consumption.

The sale of coupons of a different design to business concerns might provide some check on evasion if retailers were forbidden to accept such coupons for other than business purchases. Many opportunities for evasion would remain, however, even though retailers were policed. In the case of dual purpose goods even the best intentions of retailers would be defeated since the goods could be put to different use from that declared by the purchaser. A farmer buying paint for his barn could use it to paint his house. A merchant buying light bulbs and fixtures for his store could install them in his home. There are literally thousands of articles covered by a sales tax which can be used for both business and individual consumption purposes.

VI. Evaluation of the plan

A. Merits

If a graduated sales tax could be administered, it would possess important advantages over a uniform rate sales tax. The burden on low-income consumers would be limited if the initial rates were very low, or if a basic amount of coupons were distributed free. At the same time, progression would be introduced into the sales tax structure.

Of greatest importance under present conditions, however, would be the substantial influence which this type of sales tax could be designed to have in checking inflationary spending. If the rates were steeply graduated so that expenditures beyond levels necessary to maintain a reasonable living standard would involve very high tax liability, the tax would effectively curtail unnecessary spending. Moreover, because retailers would not collect the tax by increasing their prices (except in

^{1/} In some respects, issuance of coupons to business concerns free of charge would be preferable to sales at the lowest rate, since there are serious objections to taxing sales of articles used for business purposes. However, issuance of the coupons free of charge would increase the incentive for evasion of the tax by individuals.

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the rare case of consumers paying the highest tax rate because they do not have coupons), the tax could not be expected to enter the index of prices paid by farmers and the index of cost of living. Consequently, it might not have the direct price-increasing effects of the usual type of sales tax. The graduated sales tax would operate to curb inflation in essentially the same manner as a spendings tax, and, because payment would be entirely on a current basis, it might be more effective in this respect than a spendings tax.

B. Objections

Analysis of a graduated-rate retail sales tax reveals many administrative difficulties which would seriously impair its efficacy in achieving the desired ends. The principal problems are those of the transfer of coupons among individuals, the control of registration and sale of coupons, the exclusion of purchases for business use from the graduated rates, the auditing of retailers, and the inconvenience and cost of complying with the plan.

1. Transfer of coupons

There appears to be no satisfactory method of controlling transfers of coupons and, consequently, of enforcing the graduated tax rate structure. If the objectives of the tax are to be attained, it is essential that persons be able to obtain coupons only from authorized sales agencies. In practice, it would be virtually impossible to prevent trafficking in coupons because of the mutually advantageous opportunity for persons with large incomes and high expenditures to buy coupons from those with a lower level of expenditure who could purchase additional coupons at lower rates. Not only would individuals buy and sell these uncontrolled coupons on a casual basis, but it is likely that an organized tax coupon market would arise.

There are various devices which might contribute to checking coupon transfers. Persons might be required to present their coupons to retailers undetached from the coupon books, and the retailers required to identify the purchaser and to detach the coupons at time of sale. This provision would add to the inconvenience arising from the tax. Moreover, it would be virtually impossible to prohibit retailers from accepting detached coupons. Another suggested control measure would be a requirement that persons turn in their coupon receipt books with their income tax returns. It is difficult to see how this requirement would provide any conclusive evidence of dealings in coupons. Unauthorized coupon sales by those not required to file income tax returns would not be discovered. Furthermore, there is no satisfactory standard for prescribing a relationship between the amount of income and the amount of taxable purchases.

Unless a method can be devised to prevent sales of coupons from lower to higher expenditure groups, the effectiveness of the graduated rates in

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checking excess spending would be lost. Once the abuses of such a system were practiced by only a small percentage of the population, a serious breakdown in its administration would be inevitable. To entrust the operation of the plan to the goodwill and cooperation of consumers would result in a tax on honesty and provide another opportunity for a black market.

2. Control of registration and coupon issue

Universal registration would be a prerequisite to the distribution of tax coupons. The task of registering all persons and checking registration statements would involve considerable expense and scarce manpower. An adequate administrative organization for investigations would be indispensable to the equitable operation of the plan and to the realization of effective graduation in rates. Changes in dependency, births, and deaths, as well as migration from one district of registration to another, would have to be taken into account.

The task of selling coupons would also be of considerable magnitude, even if existing agencies could be used. Apart from personnel, office space, and equipment necessary to handle the distribution and sale, the task of preventing fraud would be great. It would be necessary to control the improper use of stolen and lost coupon receipt books and to prevent trafficking and counterfeiting.

Many abuses might be circumvented by the maintenance of duplicate records of registered individuals in central offices. One function of these central offices would be to trace stolen books and to discover fraudulent practices of selling agencies and others. Considerable labor and machines would be required, however, merely to post coupon purchases to individual accounts and to file the receipts by name or account number. The cost of such a system would have to be added to the usual administrative cost incident to a sales tax.

3. The exclusion of sales to business concerns from graduated rates

Some system would have to be developed for the exclusion from the graduated rates of sales of articles for business use. This exclusion, however, would provide a means of evasion of the graduated rates unless careful audits were made of the actual use of articles bought under the special provision for business concerns.

The enforcement of such a system would place much additional work on the sales tax auditing personnel and would necessitate a significant increase in the size of this force. In any case, careful checking of the invoices of several million business concerns would be virtually impossible in view of the need to trace down the actual use of the articles purchased if evasion were to be prevented.

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Complete exemption from the tax of sales of articles to be used by business concerns would be even more unsatisfactory, since such a provision would afford an opportunity for individuals to escape the entire tax rather than only the graduated rates.

4. Control over retailers

Aside from previously indicated causes of evasion, retailers would have virtually the same opportunities to evade the graduated retail sales tax as they would to evade a sales tax of the usual type. The filing of returns by sellers and audit of their accounts would be essential; otherwise retailers would not only fail in some cases to collect tax coupons but would sell some of the coupons which they received. ^{1/} Persons making substantial expenditures would have particular incentive to buy from retailers who did not demand coupons and such retailers could profit by charging higher prices and selling a larger volume. Retailers could also profit by reselling coupons either to individuals or black-market brokers. A requirement that coupons be perforated by retailers immediately upon receipt would aid in checking coupon resales, but only to a limited extent. The only effective means of insuring proper collection of coupons would be to audit retailers' accounts in the same manner as under a retail sales tax of the usual type.

5. Inconvenience and cost of handling tax coupons

a. Consumers

Individuals would be required to have tax coupons in addition to money and ration coupons before they could complete an ordinary daily purchase. If they failed to have coupons at time of purchase, they would be subject to the maximum tax rate. If special provisions were made to sell "convenience" coupon books with a tax value of \$1 or \$2 in order to accommodate low-income consumers who could not afford to lay out \$5 or \$10 tax at any one time, these consumers would be subject to the additional trouble of frequent trips to selling agencies and the nuisance of standing in line. It is difficult to estimate the reaction of consumers to such inconveniences. Patriotism, and the realization that many wartime controls are necessary for a more orderly living, might make them tolerated; but, while each inconvenience in itself may be small, the sum total of these inconveniences might be very burdensome. About all that can be said is that the tax coupon system would add to the growing list of wartime controls which cost the consumer considerable time and energy in his attempt to adjust the family's daily business of living with a minimum of necessary hardship.

^{1/} The necessity of holding sellers liable for collection of tax coupons is often overlooked by proponents of classified graduated sales taxes.

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b. Businessmen

The complications of present-day retail selling would also be increased by the introduction of sales tax coupons. Sellers would be obliged to collect not only cash and ration coupons, but tax coupons as well. The length of time necessary to complete each transaction would be increased and operating costs would be correspondingly increased, particularly if coupon change had to be made. ^{1/} Besides this, sellers would be obliged to exercise special care with respect to sales of articles for business use and might incur additional tax liability as a result of ignorance of the law or an erroneous determination that certain property was purchased for business use. Sellers would also be required to sort the coupons received and to protect them against loss and theft. It might be necessary that they open special tax coupon bank accounts in addition to their checking and ration coupon accounts. Moreover, the nuisance and confusion involved in handling tax coupons would be an additional source of irritation to retailers who have to deal with the intricacies of point rationing. All these factors contribute to an increase in the cost of tax compliance (compared with a sales tax of the usual form) for which retailers might be entitled to compensation.

The utilization of existing agencies such as banks and post offices would greatly increase the wartime demands on their facilities which cannot be ~~expanded~~ readily because of scarcities of space, equipment, and personnel. It is questionable whether these agencies actually could handle the distribution of coupons to consumers and provide for the deposit of the tax coupons collected by retailers.

c. Government

The complications introduced by a graduated rate sales tax would entail substantially greater cost to the Government than would the administration of a uniform rate sales tax. In summary, these additional expenses would include the cost of national registration, compensation to agencies employed to sell tax coupons to consumers and to receive them from retailers, maintenance of duplicate records for each consumer unit in the central issuing offices of the Treasury which would be set up for the control of coupon sales, additional personnel to cope with the increased possibilities of fraud, trafficking in coupons, and counterfeiting, and, finally, the considerable cost of printing and distributing the coupons.

^{1/} Unless coupon books could be designed to eliminate the necessity for making such adjustments, it would be necessary to permit the use of detached coupons and this would limit the ability to control a black market in coupons. It should be clear, however, that the coupons are really a special kind of tax money and, consequently, present organizational, control, and distribution problems similar to those of the money and banking system.

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Part Four. Retail Sales as the Basis for
a Compulsory Lending Program

Another sales tax modification has been proposed as a method of compulsory lending to the Federal Government. The scope of a compulsory lending program based on retail sales would be similar to that of the usual retail sales tax. However, major differences would arise in the operation of the plan with respect to the method of collection and redemption of the assessments. The collection of the compulsory loan by means of stamps, the exchange of stamps for bonds, and the general administrative problems will be considered in turn.

I. Collection of the loan

The essential feature of a compulsory lending program based on retail sales is the compulsory sale of loan stamps by retailers according to a certain percentage of the selling prices of assessable goods and services sold to consumers and business concerns. Liability for the assessment and collection of the loan would be placed on persons selling at retail. Sellers would buy the stamps at face value from the Treasury or authorized agencies such as banks and post offices. The stamps would be surrendered to buyers upon payment of the assessment.

The basis of the assessment would be sales of goods and services taxable under a general retail sales tax. The liability of the sellers would be measured by their assessable sales; provisions for shifting the assessments to buyers would be similar to those under a retail sales tax.

The rate of the assessment would be determined by the amount of revenue desired, the extent to which the plan was intended to serve as an inflationary control measure, and the need for avoiding excessive burden on low-income consumers. A uniform rate on all goods and services covered probably would be essential to satisfactory administration.

The compulsory loan might be combined with a sales tax. For example, under a 10-percent rate, 5 percent might be sales tax and 5 percent might be sales loan. ^{1/} The following discussion is limited to the compulsory lending feature.

^{1/} The term "sales loan" is used to distinguish the compulsory lending from a sales tax.

II. Plan for redemption

The execution of each compulsory loan would be accompanied by the transfer of stamps to a buyer at the time of payment to the seller of the sales loan assessment. These stamps would be exchanged for a special type of war savings bond. The bonds would not be redeemable or negotiable until a certain period after the end of the war. Payment of interest on the bonds would be determined by the same considerations influencing the payment of interest under any other system of compulsory lending.

It would be necessary to the effective operation of the plan that stamps not be sold and purchased by individuals except in connection with the sale of assessable goods and services. It would appear desirable, therefore, that the sales loan stamps, as well as the bonds, be made nonnegotiable. It would be impossible, however, to enforce such a provision with respect to the stamps.

Since the immediate burden of a compulsory sales loan on low-income groups would be little different from that occasioned by a sales tax of the same rate, provision might be made for some limited current redemption of stamps. It might be possible to include a special relief provision which would allow for current redemption of stamps in needy and emergency cases. An alternative plan would permit those with small incomes to cash their stamps currently. The administrative difficulties encountered in such a plan would be similar to those described in Part Two for a personal exemption limited to low-income consumers. The stimulus to misrepresentation of income probably would not be as serious, however, since everyone would be repaid his loan sooner or later.

A graduated sales tax might be combined with this collection device by redeeming the bonds at rates varying inversely with the size of individual holdings. The redemption schedule might also be made to depend on marital and dependency status. For example, assuming a sales loan rate of 10 percent, a single person might be given a refund at the rate of 8 percent on the first bracket, 6 percent on the second bracket, and so on until the rate reached 1 percent on bonds held over a certain amount, depending on the number of years the plan was in operation. The inability to control the transfer of stamps, however, would tend to limit the effectiveness of such graduation, since the size of individuals' holdings could be adjusted among themselves in order to maximize the redemption value and to minimize the tax.

III. Administration

The administration of the compulsory sales loan would be similar in many respects to that of a retail sales tax. For effective enforcement it would be necessary to require retailers to file returns. Returns,

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however, might be required less frequently than under a sales tax. The compulsory loan liability as shown on the returns would be audited and checked against the value of stamps purchased by retailers during the same period, after adjustment for changes in the retailers' inventories of stamps.

The problems of enforcing collection of a sales loan would not be materially different from those connected with a sales tax. Retailers would have the same opportunity to increase their business by failing to assess customers for the loan. Since this would be made possible only by underreporting of assessable sales, investigation and auditing requirements would be as essential as under a sales tax. In one respect, however, the sales loan plan would be easier to enforce. Since purchasers would insist on their savings stamps if they paid the assessment, there would be less opportunity for retailers to default in payment to the Government for sales loans actually collected.

IV. Evaluation of the plan

An appraisal of the plan requires careful consideration of its effectiveness as an anti-inflationary influence, its equitable features, and its administrative practicability.

A. Effectiveness in controlling excess spending

A compulsory lending program based on retail sales would tend to curtail inflationary spending by withdrawing substantial amounts of spending power from persons in the lower and middle income groups who otherwise would spend the money for current consumption purposes. Many persons not subject to the individual income tax and those who might evade a portion of their correct liability under a type of self-assessed compulsory lending based on income would be reached by the sales loan measure. In addition, the plan would reach those making expenditures from capital, which would not necessarily be curbed by a levy based on income.

The effectiveness of this plan in controlling inflation is improved by the fact that collections are on a current basis. While compulsory loan collections on an income or spendings base can be withheld at source, there are limitations to the scope of such plans. For many income recipients it would be difficult, and in some cases impossible to utilize, a withholding plan: for example, those operating their own businesses, many of those receiving income from interest and rent, and domestic and farm workers. Periodical returns would be the only substitute for securing current collection.

There are definite limits to the possibility of checking inflation by a sales loan plan. In the first place, there are limitations imposed by the size of the sales tax base and the rate of assessment. A sales tax base is limited by the administrative difficulties encountered in assessing many types of services and goods which could be subjected to a spending tax. Moreover, since the rate should advisably be uniform,

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the necessity of avoiding excessive burden on the low-income groups would preclude making it high enough to serve as a significant deterrent to spending by those with high incomes. ^{1/} Enforcement difficulties would also be increased by very high rates.

From one viewpoint, it would appear that, dollar for dollar, a sales loan would be less effective as a wartime anti-inflationary measure than a sales tax. Even if no interest were paid, many individuals probably would consider the sales loan as an offset to voluntary savings and, consequently, would tend to increase their total expenditure outlay by the amount of the compulsory assessment. Under a sales tax, however, the payment would be made once and for all and individuals would be less likely to increase their total expenditure outlay inclusive of tax as much as under the sales loan. On the other hand, a sales tax would tend to increase the incomes of certain consumer groups through wage-rate and farm-price increases, and the Federal Government might have to pay more for what it buys. These price-and income-increasing effects of a sales tax would decrease its anti-inflationary influence. A sales loan, however, is not expected to have such effects. It is questionable, therefore, whether a sales loan would on balance be less anti-inflationary during the war period than a sales tax.

The most serious problem appears to be the impossibility of preventing the transfer of stamps. Those wishing to avoid the lending of their funds to the Government would be induced to sell their stamps at a discount to persons willing to invest their voluntary savings. To the extent that this occurred, the compulsory aspects of the lending scheme would be reduced. The curb on spending of the low-income groups in this case would be influenced largely by the size of the discount borne by the stamps. Those selling stamps would spend the money received, whereas many of those buying the stamps probably would have saved the money in any event. There appears to be no effective means of checking such stamp sales.

B. Equity considerations

The immediate burden of a sales loan on low-income consumers would correspond to that of a sales tax. While there is a promise to refund the amount of the compulsory assessment after the war, this does not alleviate the hardship on those deprived of purchasing power necessary to the maintenance of a minimum living standard during the interim.

An attempt to limit the burden on low-income groups would encounter problems similar to those arising under the exemption provisions outlined in Part Two. Perhaps the most feasible method of providing relief

^{1/} Unless, of course, provision were made for current redemption to those showing need.

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from the burden of the sales loan would be to allow current redemption of stamps on proof of need. If a means test is objectionable, some income standard might be employed. In the latter case, the income level of those entitled to current redemption probably should be allowed to vary with the number of dependents in order to avoid discriminating against large families. The income standard, however, would not be flexible enough to take care of emergencies and unusual expenses arising among those with incomes above the limits.

In the absence of relief provisions, the situation of low-income consumers might not be as serious as under a sales tax because of the probability that a market for the stamps would arise. Since the present value of stamps to those least able to pay would be somewhat less than for other persons, a market for the stamps would tend to arise on a discount basis. The size of this discount would depend, of course, on the factors influencing supply and demand: the interest rate attached to the sales loan bonds, the size of the sales loan rate, the anticipated duration of the war, and the redemption features. For example, if the bonds were made interest-bearing the rate of discount would tend to be reduced. If the percentage of an individual's holdings of stamps or bonds that would be redeemed in the postwar period were made to decrease as his total holdings increased, the discount rate on sales of stamps would be increased.

The stamp discount market would in effect take advantage of the current need for more purchasing power on the part of those with low incomes or those facing an unusual emergency condition. The stamp market would be an alternative to a relief provision for current redemption of stamps. It would seem desirable that the Government should avoid any loan or tax plan that would enable some individuals to exploit the hardships of others who have been placed at a disadvantage by the law itself. If trafficking in stamps cannot be effectively prevented or limited by a current redemption provision the plan would be extremely inequitable.

C. Administrative considerations

A sales loan assessment could probably be better enforced with the same amount of administrative effort than could a retail sales tax, since one important opportunity for evasion would be eliminated. If retailers were required to surrender sales loan stamps in receipt for the assessment, consumers would assist in enforcing the plan by demanding the stamps. However, the plan is not quite so self-enforcing in this respect as it appears, since retailers and consumers would be able to profit by evading the sales loan. Retailers could also profit by purchasing stamps from irregular sources (perhaps even from their customers) at a discount. In general, the administrative problems encountered under a retail sales tax are also encountered under a sales loan. A sales loan plan would seem to be an unnecessarily difficult and expensive method of collecting a compulsory loan. Unless the compulsory sales loan were merely complementary to

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a retail sales tax, it would be difficult to justify the inauguration of such a new base and the additional administrative organization and procedures necessary, when compulsory loans might be tied to an already existing levy such as the individual income tax.

It is apparent that the sales loan base would have to be set up and that retailers would have to file returns of sales and other necessary information periodically. Those returns would have to be audited in order to insure compliance with the law, since the same motives would exist as under a sales tax to stimulate sales by failure to collect the assessment. Evasion of liability could be achieved principally by the underreporting of assessable sales.

There are several additional administrative problems arising out of the compulsory lending features. Printing and distribution of stamps to retailers would entail considerable expense and personnel. ^{1/} If distribution were made by banks, compensation would have to be given for their services. Exchange of the stamps for bonds would be a big task, but might be handled by existing bond sales agencies.

D. Problems of retailers and consumers

1. Retailers

In general, the compliance problems that would confront retailers are somewhat greater than those presented by a retail sales tax. The retailer would have to purchase stamps in advance of collection or reimbursement from his customers. Since the stamps probably could be obtained easily and quickly, he might not need to keep more than a day's supply on hand. The amount of capital required to be invested in stamps, therefore, might be relatively small.

The issuance of stamps to customers would create some delay at time of sale and lessen the number of customers a clerk could handle.

2. Consumers

For consumers, a certain amount of nuisance would be involved in carrying the stamps home, placing them in albums, and exchanging the latter for bonds. Although the promise of redemption after the war would encourage consumers to take good care of their stamps and bonds, some loss would be inevitable.

^{1/} The task of stamp issuance would be comparable to that of Ohio under its retail sales tax system. The stamps used under the Ohio sales tax have a limited current redemption value; they are redeemed at 3 percent of their face value if presented by religious and charitable organizations.

WORKING-PRESS REPORTERS

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EFFECTS OF A FEDERAL RETAIL SALES TAX
ON THE ANTI-INFLATION PROGRAM

Division of Tax Research
Treasury Department, Washington, D. C.
May 20, 1943
as revised October 11, 1943

Effects of a Federal Retail Sales Tax on the
Anti-Inflation Program

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Effects of a Federal Retail Sales Tax on the
Anti-Inflation Program

1. Introduction

While Federal taxes have been increased substantially in recent years, there is ample evidence that still further increases are needed to give full protection to the Government's price and wage stabilization program. 1/ Individual incomes after personal taxes under present law are expected to exceed the current value of the available civilian supply of goods and services by approximately \$42 billion in the fiscal year 1944. 2/ In addition, consumers will have on hand an abnormally large fund of liquid assets in the form of bank deposits, currency hoards, and savings bonds, which represent a continual threat to the inflation-control program. A Federal retail sales tax is one of the many fiscal measures which have been suggested to siphon off some of the excess consumer spending power and ease the current inflationary situation.

To contribute to the anti-inflation program, a tax should satisfy both of these criteria: (1) It should curtail excess consumer spending with a minimum impairment of productive efficiency and incentives. (2) It should not interfere with the Government's capacity to "hold the line" against inflation through its direct anti-inflation controls. A Federal retail sales tax is analyzed from these two viewpoints in the following sections.

The first of these criteria is important because it is excess consumer spending which is at the root of the current inflation problem. A large divergence between the amount of money consumers have at their disposal and the current value of the goods and services available for them to buy is inevitable in a war economy, because so large a part of the Nation's money income is earned in producing instruments of war instead of goods and services for the civilian market. In order to preserve the existing price level, consumer spending must be drastically reduced and an unparalleled amount of consumer savings must be stimulated. The unavailability of many goods, together with consumer-goods rationing, restrictions on installment buying, and war bond campaigns aid in achieving this objective. It is one of the principal functions of wartime tax policy to buttress the anti-inflation program by preventing excess consumer spending power from being used to bid up, or inflate, selling prices.

The reductions in consumer spending needed to balance effective demand and available supply at current price levels should be

1/ See "The Need for More Taxes," Revenue Revision of 1943, Hearings before Committee on Ways and Means, Part 1, Unrevised, pp. 23-28.

2/ Statement of Secretary Morgenthau, Hearings, supra, p. 3.

accomplished without encroaching upon minimum living standards and thereby running the risk of impairing productive efficiency. It is essential, also, that production incentives remain unimpaired by the consumption cuts. The dangers to the anti-inflation program are equally great whether the stimuli to further price rises have their origin in an expansion of spending power or in a reduction in available supplies.

The second criterion which an anti-inflationary tax measure should satisfy is peculiar to the specific price and wage controls which are being heavily relied upon by the Federal Government in its attempt to stem the rising tide of inflation. Because of general economic and institutional relationships, the effectiveness of these controls is dependent in large part upon the careful maintenance of inter-price and wage-price balance in the economy. If new taxes are levied which disturb this delicate balance and set in motion forces which result in breaks in the existing price and wage ceilings, any anti-inflationary effects which the taxes achieve through the absorption of spending power and the curtailment of spending would be counteracted by the tax-induced price and wage increases. The net result might be a loss rather than a gain on the anti-inflation front.

II. Effects of the tax on consumer spending

For analytical purposes it is desirable to separate the effects of the sales tax on consumer spending from the tax effects on prices and wages. Accordingly, these two types of effects are studied separately in this section and the one following. In reality, of course, no such separation is possible, for to the extent that the sales tax affects prices and wages it also affects consumer spending. Therefore, the different tax effects are interrelated in the concluding section.

A. Absorption of spending power

The first way in which a Federal retail sales tax would affect consumer spending is through its effect on consumer spending power. The tax would absorb spending power to the extent that it yielded net tax revenue to the Treasury. Not all the funds collected from the tax, however, would represent net revenue because that part of the tax which applied to items sold to the Federal Government or to war contractors probably would be shifted to the Government in the form of higher prices. Therefore, the enlarged Federal outlays would partially offset the gross tax revenue. Furthermore, if the tax raised Government outlays indirectly by increasing prices by more than the amount of the tax and by boosting wage costs, these additional offsets to the sales tax revenue would have to be taken into account.

If it is assumed that the sales tax would not generate any significant price and wage increases in addition to the price increases resulting from the direct application of the tax to selling prices, the net yield of a 5-percent retail sales tax in the calendar year 1944

would be \$3.2 billion, and of a 10-percent tax, \$6.3 billion. ^{1/} If wage and price increases were generated which compelled the Government to pay more for the goods and services it purchased, the net tax yield would be reduced by the amount of the additional costs.

The mere fact that a tax would effect a sizable net withdrawal of spending power does not necessarily indicate that the tax would make a significant contribution to the wartime anti-inflation program. If the funds absorbed by the tax represented spending power which would otherwise have remained inactive (that is, if the tax were paid at the expense of savings instead of current spending), the immediate anti-inflationary effects of the tax would be negligible. Over a longer time period, however, the tax might prove of some worth from an anti-inflation viewpoint, since the supply of funds which could be drawn upon to increase consumption in a future period would be less. It is the relative curtailment in current consumer spending which determines the present-day worth of the sales tax as an anti-inflation measure.

If a 5- or 10-percent Federal retail sales tax were enacted under present wartime conditions, the selling prices of the goods and services included within the tax base would generally be raised by the approximate amount of the tax. In other words, it can be assumed for all practical purposes that the tax would be fully shifted forward to consumers in the form of higher prices. Consumer reaction to this tax-induced price rise would vary according to the amount of income which individuals and families had available to spend and to save, and the relative ease with which adjustments in spending and saving could be made. Different family situations can be delineated where, on the one hand, the tax would induce almost a dollar-for-dollar reduction in spending (exclusive of sales tax payments) and, on the other hand, the tax would not effect any reduction in consumption spending.

In the case of many low-income families the levying of a sales tax would necessitate proportionate reductions in the value (excluding tax) of the goods and services which these families would be able to buy for every-day living needs. These families frequently require their whole incomes to purchase the bare necessities of life. They have been the group hardest hit by the rising cost of living. Having no savings margin to fall back upon, they are compelled to consume less, when living costs increase, or to seek aid from charities, relatives, or friends. With respect to such families, therefore, the sales tax would effect almost dollar-for-dollar reductions in spending and would be powerfully anti-inflationary in so far as that one aspect of the tax is concerned. However, if the consumption curtailments effected by the tax impaired the productive efficiency of low-income workers, the resulting loss of

^{1/} For detailed estimates of the tax yield and for a list of items included and excluded from the tax base, see "Factors Affecting The Structure Of A Federal Retail Sales Tax Under Wartime Conditions," Part Two, section III, above.

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production would intensify the existing inflationary situation. ^{1/} On balance, therefore, by inducing too severe reductions in consumption in certain areas, the tax might aggravate rather than make a net contribution to the anti-inflation program.

A second case where the withdrawal of spending power effected by the sales tax would occur largely at the expense of consumption includes those families whose savings are small and rigidly fixed in amount by existing commitments, such as insurance policies or debt repayment contracts. Such families would be unable to maintain their consumption if a retail sales tax were enacted unless they defaulted on their commitments, utilized liquid assets, or resorted to borrowed funds. ^{2/} Because many of these families would probably choose to reduce their consumption spending rather than resort to these latter alternatives, the sales tax would be anti-inflationary in these cases.

In the above two situations reductions in consumption would result either because family income permitted no savings or because the amount saved was an inflexible element in the family budget. At the other extreme are numerous high-income families whose current incomes are sufficient to permit substantial savings each year. The amounts which they spend for consumption seem to be determined primarily by the cost of the living standard they desire to maintain. That portion of their incomes not needed to purchase this standard of living is saved; that is, the amount of their savings is determined residually. If living costs were increased by a sales tax, it is likely that these high-income families would continue to purchase substantially the same amount of goods and services as before, so that their share of the tax would be paid almost wholly at the expense of savings. With respect to these groups, therefore, the sales tax would be ineffective as a wartime anti-inflation measure.

In between the above situations are the many families who would react to the price increases induced by the sales tax by making adjustments in both their consumption spending and their savings. Those in this group with the lowest incomes probably would make the greatest adjustments in their consumption; those with the highest incomes would do the reverse. In other words, the consumption-reducing effects of the sales tax would tend to vary inversely with consumer income, so that in the lower income brackets the tax would be highly anti-inflationary and in the upper brackets only slightly anti-inflationary.

In summary, the sales tax would make a definite contribution to the anti-inflation program in so far as it reduced consumer spending

^{1/} Of course, tax measures which encroach upon minimum living standards have important social implications and might endanger war production.

^{2/} In some cases, also, it might prove possible to readjust their insurance policies or amortize their mortgage payments over a longer period.

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by removing spending power from private channels. The tax-induced reductions in consumption would be most significant in the lowest income brackets. In the middle income range consumer spending would be reduced somewhat as a result of the tax, but the reductions would be less than the dollar amounts of tax payments made by consumers in those income brackets. The contribution of the tax to the current anti-inflation program would be negligible among high-income consumers because the tax would be paid almost wholly at the expense of savings.

B. Direct deterrent to spending

In addition to the absorption-of-spending-power aspect of the tax, the sales tax would be anti-inflationary because it would be a tax on sales and would therefore be a direct deterrent to consumer spending. Consumers would be able to reduce their sales tax payments by reducing their purchases of taxable goods and services. People would react to a retail sales tax in about the same way that they would react to a widespread price rise of an amount equivalent to the tax. In a few cases they might shift their purchases to nontaxable items, so that there would be no net reduction in total consumer spending and no net contribution to the anti-inflation program. In other cases, however, the tax might induce people to buy less and save more because of the higher cost of the things they might want to buy.

This effect of the tax in directly deterring or penalizing consumer spending is separate from the tax-induced cuts in consumption resulting from the spending-power withdrawal. By penalizing spending, the tax would tend to induce people to spend a smaller part of their incomes. Its effectiveness in this respect would depend upon the relative price elasticities of spending and saving, and upon the coverage and rate of the tax. It would not be possible to measure this effect of the tax by the amount of revenue received. On the contrary, the more effective the tax was as a deterrent to spending, the smaller would be the tax yield. A steeply graduated tax on total consumer spending would be extremely effective in directly deterring spending even though it yielded only small amounts of revenue.

While the sales tax would tend to reduce the money volume of consumer spending both because of the absorption of spending power and the penalizing of spending, there need be no significant reduction in the aggregate physical quantity of goods and services consumed. In a war period, effective consumer demand tends to exceed the value of the available supply by considerable amounts. At present this disparity seems to exist over almost the whole range of consumer goods and services. The sales tax, by reducing effective demand would lessen this disparity and, consequently, would reduce the inflationary pressure on prices. However, it would not necessarily reduce aggregate real consumption. If the tax compelled some families to spend less, it is

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likely that the goods and services which were released would be purchased by other consumers who had ample spending power despite the tax. ^{1/} In this manner, the excess demand of these other families would be satisfied, at least in part, without any price inflation other than the price rises reflecting the shifting of the sales tax forward to consumers. Although the dollar volume of spending (excluding sales tax payments) might be less as a result of the tax, the real quantity of goods and services sold would remain largely unaffected by the sales tax.

III. Effects of the tax on price and wage stabilization

Counteracting the anti-inflationary effects of the sales tax on consumer spending are certain price-increasing and wage-increasing tax effects which are especially significant at this time because they would interfere with price and wage stabilization and weaken the Government's capacity to "hold the line" against inflation.

A. Direct price effects

If a Federal retail sales tax were enacted as a wartime revenue measure, the amount of the tax would generally be added to selling prices as a separately-stated item. If the tax rate were 10 percent, the prices of food, clothing, house furnishings, and other taxable goods and services sold at retail would be raised 10 percent. It is likely that there would be only minor exceptions to this general rule, for most business firms would encounter little resistance to shifting the sales tax forward to their customers under present conditions.

If the term "inflation" is used to refer to any price rise, regardless of its cause and economic effects, then a retail sales tax would be an "inflationary" measure, for its immediate effect is to boost prices by the amount of the tax. Most persons, however, prefer not to brand such direct tax-induced price increases as inflationary, since they lack other characteristics usually associated with price inflation in the generally accepted sense of the term. Such price rises would occur at the retail level only, and the higher prices would not result in income increases as do ordinary price rises. If the sales tax is to be opposed as a war revenue measure on the ground that it would be inflationary, rather than anti-inflationary, it must be shown that prices would increase by more than the amount of the tax, and that these price increases probably would outweigh the anti-inflationary effects of the sales tax on consumer spending.

^{1/} The existence of rationing might limit this effect of the tax.

B. Direct cost-increasing effects

Unfortunately, the price effects of the sales tax would not be limited to the immediate price rises resulting from the direct application of the tax to the selling prices of taxable goods and services. The tax would have other repercussions on the price structure, and it is through these repercussions that the tax would be able to exert undesirable inflationary pressures. The first of these would result because it would not be possible to confine the tax to retail sales to individual consumers and exclude from the tax all sales to agricultural, commercial and industrial users. ^{1/}

From an economic standpoint, it is generally desirable to view retail sales as including only sales to individual consumers for consumption, and to exclude from the concept of retail sales all sales to business concerns of goods and services to be used in production. For retail sales tax purposes, however, a more workable definition is needed. Most State sales tax laws define retail sales as all sales of tangible personal property except sales for resale. Sales for resale generally are defined to include only sales of articles to be resold in the form in which purchased and sales of articles which become physical ingredients or component parts of other tangible personal property which is to be sold.

The sales tax concept of retail sales of tangible personal property is therefore broader than the economic concept. Whether a sale is a retail sale is made to depend not upon the nature of the article sold or upon the character of the seller or purchaser, but rather upon the intended disposition of the article by the purchaser. Not only are all sales to individual consumers included within the sales tax concept of retail sales, but many sales to business concerns are also included. For example, sales to a bakery of flour and eggs used in the making of bread are considered sales for resale, but sales of fuel used to bake the bread are considered retail sales.

While it may be both feasible and desirable to exempt from the retail sales tax by specific provision many important business cost items which would not necessarily be excluded by the sales-for-resale principle (for example, fuel, feed, seed, and fertilizer), many other business cost items cannot be excluded from the tax without creating unmanageable administrative problems and sacrificing substantial amounts of revenue. ^{2/} Some of the articles sold for use by business concerns which might be taxable under a Federal retail sales tax are various types of durable equipment (such as tools, desks, and tables), many consumable articles (such as lubricants, abrasives, polishing agents,

^{1/} See "Factors Affecting the Structure of a Federal Retail Sales Tax Under Wartime Conditions," Part One, section I.

^{2/} Few States have gone beyond the physical-ingredient rule in order to exempt from their retail sales taxes sales to business users, except that the majority of States provide for the exemption of sales of feed, seed, and fertilizer to commercial producers.

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and chemicals which do not become physical ingredients), miscellaneous supplies (such as cleaning materials, stationery, and light bulbs), and building materials.

In a great many cases the business cost increases which would result from the taxation of these items under the retail sales tax would be of minor importance and could be absorbed by the businesses making the taxable purchases without any increases in their selling prices. In other cases, however, the tax-induced cost increases might necessitate upward price-ceiling revisions. ^{1/} Although these ceiling adjustments in themselves might not be of great importance in the over-all price picture, they would tend to have repercussions on other parts of the price structure. Furthermore, there is a danger that they would prove to be an opening wedge for other price ceiling revisions not directly due to the sales tax. ^{2/} Experience has shown that if price control is to be effective, it must be enforced with a firm hand. If some concerns are successful in obtaining ceiling increases, other firms are encouraged to apply for similar relief and the original break in the ceilings tends to be widened.

Because of its cost-increasing effects, a Federal retail sales tax would conflict with the objectives of price control. Therefore, if the tax is to make a net contribution to the anti-inflation program, it is essential that the sales tax law be designed to keep these tax effects at a minimum.

C. Effect on agricultural prices ^{3/}

A second way in which a Federal retail sales tax might contribute to the development of price inflation is through its effect on agricultural prices. Although all farm products, with only minor exceptions, are subject to price control at one or more stages between the time they leave the farm and the time they reach the consuming public, the ceiling and support prices for most of these products are linked either

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- ^{1/} For example, firms which utilize substantial amounts of chemicals as catalytic agents might find themselves subjected to undue hardship if they were not permitted to raise their selling prices. This might hold true also for industries where abrasives and tools are important cost items.
 - ^{2/} In most cases it would be extremely difficult to limit ceiling adjustments to the exact cost increase due to the sales tax, since it would be impractical to determine the cost increase per unit of goods sold. There is a likelihood, therefore, that more than the amount of the tax would be shifted forward.
 - ^{3/} The Division of Statistical and Historical Research, Bureau of Agricultural Economics, Department of Agriculture, made the statistical estimates of the tax effects on agricultural prices and rendered valuable assistance in the preparation of this subsection. The estimates were first made in February 1943, and were rechecked in June 1943. At that time it appeared that the results would be substantially the same if the analysis were redone.

directly or indirectly to farm parity prices. Because parity is a relative rather than a fixed price concept, these ceiling and support prices are relative rather than fixed prices.

1. Meaning of parity

A Federal retail sales tax would affect many agricultural prices and retail food costs because it would raise the level of farm parity prices. The parity formula defines a relationship between the prices paid by farmers generally and the prices they receive for their crops. For any given commodity as of any given date, the parity price is computed by multiplying the average price received by farmers for the given commodity during a specified base period 1/ by the corresponding index number (expressed in percent) of prices paid by farmers. Allowances for real estate taxes and interest on farm mortgages are included in the parity index, except when a post World War I base period is used. If at a given date the parity index is 10 percent higher than in the base period, the parity price for any given commodity would be 10 percent above the average price farmers received for the commodity during the base period.

The index of prices paid by farmers represents an attempt to measure as accurately as possible the over-all changes that occur in the level of prices charged to farmers and their families for the articles they buy to meet their living needs and to operate their farms. It is compiled on the basis of the prices of 86 items used in family living and 88 items used in farm production. 2/ These prices are weighted according to the estimated quantity of each commodity purchased by farmers and combined into an index. 3/

2. Changes in parity, ceiling, and support prices

A Federal retail sales tax would tax the sale of many of the items whose prices are included in the index of prices paid by farmers. Assuming a tax rate of 10 percent and a reasonably broad tax base (that is,

1/ The base period is August 1909 - July 1914 for most commodities. For potatoes and commodities for which satisfactory data are not available for 1909-1914 the base period is August 1919 - July 1929. For burley and flue-cured tobacco the base period is August 1934 - July 1939.

2/ These items include clothing, household supplies, food, furniture and furnishings, building materials, automobiles, trucks, tractors, gasoline, oil, tires, farm machinery, feed, seed, fertilizer, general equipment and other supplies.

3/ It should be noted that the index measures changes in value of a fixed bill of goods taken as typical of farmers' purchases. The weights used are annual averages for the years 1924-1929. The index is not adjusted for commodities which are "war casualties" and cannot be purchased by many farmers at present.

that food, clothing and similar goods are taxed, but that feed, seed, fertilizer, fuel, utility services, and agricultural machinery are tax-exempt), the parity index would be increased by 6 or 7 percent, depending upon whether or not interest and property taxes are included. This rise in the index would result in a corresponding rise in the level of farm parity prices, in the same manner as would price increases due to any other cause. Of course, it is possible for the sales tax law to prohibit the inclusion of the tax in the index of prices paid, and in that case the index would remain unaffected by the direct price effects of the tax. ^{1/} In the absence of such legislation, however, the sales tax would be included in the index, since it is the intent of the index to measure prices actually paid by farmers. Moreover, the index has always taken into account State sales taxes.

A rise of 6 or 7 percent in the parity index would have significant repercussions on the agricultural price structure. Parity prices for all agricultural commodities would immediately rise by 6 or 7 percent due to the operation of the parity formula. The effect which this automatic boost in parity would have on the market prices of the various agricultural commodities and on retail food costs would depend on the changes that would be occasioned in agricultural ceiling and support prices. These changes would vary considerably among commodities, depending upon the following considerations:

(1) Legal provisions relative to price ceilings on farm products now stipulate that minimum ceiling prices shall be the higher of the following two alternatives: (a) the parity price for such commodity, adjusted for grade, location, and certain other factors; or (b) the highest price received by producers for such commodity between January 1, 1942, and September 15, 1942, similarly adjusted in the manner prescribed in the Price Control Act. Prices for commodities for which parity is now the ceiling would be free to rise to the extent that parity is increased by the sales tax. Whether these prices would actually rise to the permitted extent would depend upon the particular market situations for the various commodities. On the other hand, the legally required ceiling prices for those commodities whose minimum ceilings are the highest prices between January 1 and September 15, 1942, would not be affected by the imposition of the sales tax, except in those few cases where the tax raised parity above the January 1 - September 15 level and, therefore, made the price ceilings dependent on parity.

^{1/} Even though the index remained unchanged, the Government might find it necessary to increase some ceiling and support prices because of the higher farm costs due to the tax. Therefore, exclusion from the index would not necessarily prevent the sales tax from inducing some farm price increases. Also, if the tax should increase prices indirectly (for example, through its effects on business costs or wages), the index would be increased and parity raised to a higher level.

(2) Certain basic farm commodities are tied to parity by laws providing for price supports. These laws specify that prices of tobacco, cotton, and quota peanuts shall be supported by loan and purchase programs at not less than 90 percent of parity, and that corn and wheat prices shall be supported at not less than 85 percent of parity. Consequently, the rise in parity caused by the sales tax would automatically raise these support prices and might also raise the market prices of the given commodities. ^{1/}

(3) Prices of the so-called "Steagall commodities" ^{2/} (including hogs, eggs, chickens, turkeys, butter, and other products) are determined by support levels announced by the Secretary of Agriculture. These levels are different for the various commodities, but they cannot be less than 90 percent of parity. Farm products compete with each other for land, machinery, and labor, and feed prices affect the profitability and the scale of operations for important livestock, dairy, and poultry enterprises. Consequently, increased prices for the basic crops whose prices are tied directly to parity might necessitate higher support prices for many of the Steagall commodities, ^{3/} as well as for other commodities where the Secretary of Agriculture has complete discretion in establishing price supports. For example, estimates indicate that the support prices already announced for eggs, chickens, and dairy products for 1943 would probably have to be revised upward as a result of the tax-induced increase in parity prices. Also, the increases in corn and feed prices which would be induced by the tax would disrupt feeding ratios and probably would necessitate higher support prices for livestock products. Feeds are a basic element in the cost of producing meats. Increases in feed prices would reduce the margin over costs for meat producers and might curtail production unless meat prices were correspondingly increased.

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- ^{1/} Support prices place a floor under the prices of the commodities in question. As long as these support prices are below parity and ceiling prices, actual market prices will be at levels between support and ceiling prices, depending on the forces of demand and supply. Therefore, raising the support prices will raise the market prices only in those cases where the new support prices are higher than the previously existing market prices.
- ^{2/} These are commodities for which price supports have been announced by the Secretary of Agriculture under the provisions of the Steagall Amendment (as amended by the Act of October 2, 1942) directing him to support farm prices when such supports are needed to encourage production. These supports must be continued at not less than 90 percent of parity until two complete calendar years after the formal cessation of hostilities.
- ^{3/} That is, support prices in excess of 90 percent of the revised parity price (since that is the minimum support price permitted under the Steagall Amendment) and in excess of the support prices already announced by the Agriculture Department.

(4) Finally, "necessary" support prices have been announced by the Department of Agriculture in an attempt to influence the production of many other farm products. Some of these price supports are maintained through the operations of the Commodity Credit Corporation or through Lend-Lease or other Government purchasing programs. Although these support prices are not required by law to be tied directly to any parity price, they are influenced to an important degree by the prices and production of commodities which are linked directly to parity because of the competitive and joint relations existing between the various agricultural products. Consideration must be given to production goals and allotments and to returns from alternative farm enterprises, as well as to general supply and demand conditions, in order to determine to what extent "necessary" support and ceiling prices would be affected by the other price increases resulting from the enactment of the sales tax.

3. Changes in market prices and retail food costs

Translation of the various tax-induced changes in parity, ceiling, and support prices into the resulting changes in actual market prices requires detailed price analyses of the many farm products. In general, the individual commodities will fall into one of these four price situations: (1) For those products whose market and ceiling prices are at the parity level, it is likely that raising parity would induce corresponding advances in market prices. ^{1/} (2) In those cases where market prices are at the support price levels, increasing the support prices necessarily would increase the market prices. (3) For products with prices between support and ceiling levels, price increases would result only if the revised support prices were higher than the previously existing market prices. (4) Finally, when the market and ceiling prices are above parity, it is likely that market prices would remain unchanged because of the tax, except in those cases where the revised parity prices exceeded the former market prices. In the latter case market prices could be expected to rise to the new parity (and ceiling) levels. In all of these price situations it is possible that additional price adjustments would be required because of the close inter-relationship among the prices of the various farm products.

The price reactions resulting from the sales tax would not be instantaneous due to the time required for the operation of administrative and market processes. The discussion so far has taken into account only the first round of price-increasing influences set in motion

^{1/} It is assumed in this case that the existence of price ceilings has kept these prices below their equilibrium levels.

by the tax. This round would require about a year to work itself out. There would also be a second round of price reactions, since farmers are consumers as well as producers of farm products. Some of the prices which are in the index of prices paid (e.g., feed, seed, and food prices), and therefore are parity-determining, are themselves determined by parity.

The first wave of price-lifting influences would result from the direct application of the tax to purchases made by farmers. It would raise parity and thereby increase the many prices tied directly or indirectly to parity. The second wave of price reactions would occur because the prices of feed, seed, food, and other items in the prices-paid index would tend to increase as a result of the original tax-induced boost in parity. These price increases would boost parity a second time. Tertiary and subsequent reactions on parity and market prices also would occur, although it probably would take several years for these reactions to transmit their influences through the distribution system. Furthermore, after the first wave of price increases, the magnitude of the price advances would tend to diminish rapidly, so that it is possible to neglect the tertiary and subsequent effects in making estimates of the price increases.

As has already been noted, a 10-percent tax on all retail sales (including food, but excluding fuel, machinery, utility services, feed, seed, and fertilizer) would directly induce a 6- or 7-percent increase in parity. Taking into account the market situations of the various commodities, it is possible to estimate the increases in actual market prices that would occur. 1/ Assuming the sales tax had become effective July 1, 1943, the index of prices received by farmers would average 4 percent higher in 1944 as a result of the tax. Price advances at the farm level would be reflected in higher prices at wholesale and retail levels. The estimated increase in retail food prices during 1944 would average 6 percent. 2/ If the direct price effects of the 10-percent tax are also taken into account, average retail food costs would be approximately 17 percent higher in 1944. The prices of commodities other than food would also be affected, but these price increases probably would be of minor importance and have not been estimated. 3/

1/ The estimated price increases are in addition to the price rises that can be anticipated regardless of whether or not the sales tax is enacted.

2/ This estimate assumes orderly increases in processors' and distributors' margins in response to increased costs and lower physical volume.

3/ The chief commodities other than food are cotton, wool, and tobacco. Raising parity by 6 or 7 percent probably would leave wool and tobacco prices unchanged, and would have only a small effect on cotton prices.

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The estimated farm price rises that would result from the effect of a 10-percent retail sales tax on parity prices would increase the Bureau of Labor Statistics cost-of-living index by about 3 percent in 1944. This increase, of course, would be in addition to the cost-of-living increase which would result from the direct price effects of the tax. Taking into account both the direct price increases and the indirect tax-induced increases in food prices, the index would rise approximately 10 percent. ^{1/} Although the tax would effect further price rises in the years subsequent to 1944, these rises would be much less significant.

It should be noted that the estimated tax effects on food prices, for example, would be inconsistent with the "rollback" and subsidy portions of the Government's stabilization program. The attempt to roll back prices to any given level would be made more difficult and the necessary outlays under a subsidy program would be increased.

4. Effect on farm income and spending power

The farm price increases indicated above would boost the gross incomes of farmers and, to a lesser extent, processors and middlemen by about \$2 billion in 1944. Consumers, on the other hand, would be required to pay \$2 billion more in food costs, in addition to the higher prices they would pay as a result of the direct application of the tax to retail food prices. It is estimated that the rise in farm income would more than offset the cost of the sales tax payments farmers would have to make on their purchases. For processors and middlemen, the income rise would be a partial offset.

In the aggregate, therefore, the estimates indicate that the sales tax would have no net effect in absorbing spending power in the hands of farmers. In fact, it might result in a net increase in farm spending power. On the other hand, the sales tax would be doubly effective in absorbing funds held by the other groups in the economy -- the bulk of the consuming public -- who do not derive their income from either agricultural production or distribution. These people would pay the price increases resulting from the impact of the tax on the farm price structure, as well as the higher prices resulting from the direct application of the tax to the things they buy.

D. Effect on wage stabilization program

The successive rounds of agricultural price increases set in motion by the effect of the tax on parity would not develop into an upward price spiral by themselves, since the magnitude of the price increases would diminish to negligible proportions after the second round. A price spiral

^{1/} Due to recent changes in the weights used in the Bureau of Labor Statistics cost-of-living index, the estimated tax effects on the index have been increased from somewhat more than 8 percent to approximately 10 percent.

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could be initiated, however, if the tax-induced rises in agricultural prices and incomes encouraged the adoption of countervailing measures by nonfarm groups. In particular, if the direct and indirect price effects of the tax should necessitate the granting of wage increases in contradiction to the Government's wage stabilization program, the development of inflation would be greatly encouraged, since price and wage increases are mutually interacting.

1. Tax-induced increases in living costs

The retail sales tax would affect wages because it would raise the cost of living in three ways: (1) As a result of the direct application of the tax to the prices of food, clothing, house furnishings, and other items included in the tax base, the cost of these goods would be increased by the approximate amount of the tax. Under a 10-percent sales tax, these direct tax-induced price increases would cause a 7-percent rise in the Bureau of Labor Statistics cost-of-living index. ^{1/} (2) The index would rise an additional 3 percent because of the indirect price effects of the tax on food prices. (3) Finally, further increases in the cost of living would occur to the extent that the tax compelled upward price ceiling revisions through its effects on business costs.

While it is true that wage rates are not determined solely by the cost of living, there is ample evidence that cost-of-living increases encourage demands for higher wages. The National War Labor Board has frequently emphasized that "it should be frankly recognized that such stabilization of wages at September 15, 1942, levels demands a correlative stabilization of prices." ^{2/} Without an effective stabilization of living costs, the Government's wage stabilization policy is made extremely difficult, if not impossible, to enforce. The wage demands stimulated by the sales tax might prove to be considerably more important than is indicated by the magnitude of the cost-of-living increases that would be caused by the tax. If at the time the sales tax is enacted there are already in existence other significant factors straining the enforcement of existing wage ceilings, it is possible that the addition of the tax to these other factors would prove to be the "straw that breaks the camel's back," so that the whole wage stabilization program would be disrupted.

^{1/} It is assumed that food sales and other sales of tangible personal property, except sales of fuel, machinery, feed, seed, and fertilizer, would be taxable. A few consumer services would also be included in the tax base.

^{2/} Majority opinion in the "Big Four" meat packing case, February 8, 1943.

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2. Scope of present wage controls

Demands for wage increases now have to cope with two important control measures. The first is the Government's wage control program which aims to stabilize wage rates at September 15, 1942 levels. Authority for such action was contained in the Act of October 2, 1942, amending the Emergency Price Control Act. All wages as well as certain salaries under \$5,000 a year are now under the control of the National War Labor Board. The Commissioner of Internal Revenue has jurisdiction over all other salaries.

Under the terms of the President's Executive Order of April 8, 1943, as supplemented by Economic Stabilization Director James F. Byrnes' directive of May 12, 1943, the War Labor Board is directed to authorize no further wage increases except such as are clearly necessary to eliminate substandards of living or to give effect to the Little Steel Formula. A further exception relates to "minimum and non-inflationary adjustments which are deemed necessary to aid in the effective prosecution of the war or to correct gross inequities."

In order to provide guides and definite limits for making wage adjustments, "going wage-rate brackets" are being established for all occupational groups and labor market areas. Presumably, wage rates below these brackets can be adjusted under the Board's authority "to correct gross inequities." All rates within these brackets will be regarded as stabilized rates, except that the Board can make adjustments (1) to eliminate substandard conditions of living; (2) to give effect to the Little Steel Formula;^{1/} or (3) to aid war production "in rare and unusual cases" in which the setting of a wage at some point above the minimum of the going wage bracket is required. In addition, certain other adjustments can be made in order to avoid intra-plant inequities. The Byrnes' directive stipulates that the approval of the Economic Stabilization Director is required for all wage adjustments which may furnish the basis either to increase price ceilings or to resist otherwise justifiable reductions in price ceilings, or which may increase production costs above the level prevailing in comparable plants.

^{1/} The Little Steel Formula permits wage increases up to 15 percent of straight-time average hourly earnings paid in January 1941. In addition to serving as a yardstick for appraising claims for wage increases, this formula is used to limit the operation of labor union "escalator" contracts (that is, contracts providing for automatic pay increases to compensate for rises in the cost of living). (See General Order No. 22, National War Labor Board.) The formula applies regardless of whether the wage increases in question were agreed upon mutually by the management and the union.

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Exempted from War Labor Board control at present are (1) wages and salaries paid by employers of eight or less workers; ^{1/} (2) wages and salaries of railway workers (subject to control by the National Railway Labor Panel), and government employees; (3) agricultural wages of less than \$2,400 per year, which are under the control of the Secretary of Agriculture and will be permitted to increase until or unless the Secretary deems otherwise; and (4) increases in wage or salary rates which do not bring such rates above 40 cents per hour. ^{2/} Furthermore, it is not intended that the wage control regulations will prevent appropriate wage or salary readjustments "in the case of promotions, reclassifications, merit increases, incentive wages or the like, provided that such adjustments do not increase the level of production costs appreciably or furnish the basis either to increase prices or to resist otherwise justifiable reductions in prices." ^{3/}

The second control measure with which tax-stimulated wage demands would have to cope at present is price regulation by the Office of Price Administration and the Office of Economic Stabilization. Although some wage rates are outside War Labor Board jurisdiction, they would be free to increase as a result of the sales tax only to the extent that the higher wage costs did not necessitate upward price ceiling revisions. Price control also tends to limit increases in wages under the Board's jurisdiction.

3. Implications for wage control policy

How wage and price policy would be applied in the face of the wage demands likely to be stimulated by the sales tax is extremely difficult to answer at this time. Some of the considerations on which the answer hinges are the following:

(1) The wage stabilization program is under constant pressure, since the actual cost-of-living increases are in excess of the 15-percent figure on which the Little Steel Formula is based. Because the price effects of the sales tax would increase this disparity by a substantial amount, present wage control policy would be made much more difficult to enforce. Imposition of the tax might occasion the reopening of the whole wage control issue.

^{1/} There are a few minor exceptions to this exemption.

^{2/} Under the provisions of General Order No. 30 issued March 16, 1943, such increases may be made without War Labor Board approval, provided they do not furnish a basis "either to increase price ceilings of the commodity or service involved or to resist otherwise justified reductions in such price ceilings."

^{3/} Excerpt from the President's Executive Order of April 8, 1943.

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(2) The tax-induced price rises would be much greater for food prices than for other prices. ^{1/} Since wage earners are very conscious of the prices they pay for food, the wage demands likely to be stimulated by the tax would be more significant than is indicated by the estimated over-all increases in the cost of living.

(3) The estimates indicate that unless the sales tax is excluded by law from the index of prices paid by farmers, the farm groups in the aggregate might be able to recoup more than the amount of their sales tax payments because of the operation of the parity mechanism. If the sales tax should raise parity prices and farm income, it is very doubtful whether the War Labor Board and the Office of Economic Stabilization would be able to enforce a wage and price policy preventing factory workers and other wage earners from obtaining similar offsets to their share of the sales tax.

(4) Labor groups have long opposed a Federal sales tax on equity grounds, as is evidenced by their testimony before Congressional tax committees. ^{2/} If they felt that the sales tax discriminated against them, enactment of the tax might provide a further stimulus for demanding a re-opening of the wage stabilization issue.

(5) Employer resistance to wage demands will probably be less in the future. In fact, many employers may themselves originate requests for higher wages in an attempt to reduce labor turnover. If the tax-induced price rises should stimulate workers to seek better-paying jobs, employer pressure for permission to increase wage rates would be intensified. (On the other hand, the problem of labor turn-over is being attacked directly by the War Manpower Commission.)

Some tax-induced wage increases could be permitted within the framework of the existing policy and controls. For example, it would not be inconsistent with War Labor Board policy to permit wage increases where the tax and its accompanying price rises impinged on minimum living standards or increased inequities among workers. Also, some wage raises would undoubtedly accrue as a result of the tax to workers whose wages are not subject to War Labor Board control, provided that upward price-ceiling adjustments were not required. However, as long as the wage raises stimulated by the tax are kept within the narrow range permitted by the existing control machinery, the resulting inflationary threat would not be great. The chief danger to the anti-inflation campaign is that the sales tax might compel substantial wage and price increases wholly inconsistent with the existing stabilization program, and that these would culminate in a complete breakdown of the anti-inflation control machinery.

^{1/} It is estimated that retail food costs would increase 17 percent under a 10-percent sales tax. (See section III, C, 3, above.)

^{2/} See "History of Federal Sales Tax Proposals."

E. Subsequent price and wage reactions

The price and wage effects of the sales tax are potentially able to develop into an upward price spiral because price and wage increases are mutually reinforcing. The greater the price increases generated by the tax, the greater would be the pressure for compensating wage increases. If wage rates were raised, costs would be increased and further strain placed on price ceilings. To maintain the orderly flow of goods to the market, additional ceiling adjustments would have to be made. These would have repercussions on farm parity prices and wages, and another wave of price-increasing influences would be initiated.

Furthermore, once breaks are permitted in wage and price ceilings, strong pressures develop for widening these breaks. Because of vertical and horizontal price relationships, price increases for a given product at a given stage in the production-distribution process tend to be reflected in many other price rises. Similarly, wage increases tend to spread because both inter-industry and intra-industry wage balance must be maintained. When wage increases are granted to some groups of workers, it is frequently necessary to grant compensating adjustments to related groups.

If the Government stabilization policy could be applied firmly and administered effectively regardless of the pressures caused by the sales tax, the price and wage increases stimulated by the tax could be held to minor proportions. Only with respect to those prices and wages not subject to control by the Office of Economic Stabilization would the inflationary influences of the tax have free play. These uncontrolled areas are not important in terms of the over-all inflation picture. While the agricultural price increases generated by the tax might be important, these increases would be self-limiting, assuming that the wages and prices subject to Government control were effectively stabilized.

From a realistic viewpoint, however, absolutely rigid application of price and wage controls in the face of the many pressures resulting from the sales tax cannot be expected. Some upward price-ceiling adjustments would have to be permitted by the authorities. Wage increases might also prove necessary in some cases. To the extent that a firm and effective stabilization policy was not maintained, the inflationary forces would be encouraged and permitted to cumulate. In such a situation it would be considerably more difficult to prevent serious wartime inflation.

F. Price increases as offsets to tax revenues

There is a further aspect to the inflationary effects of the sales tax. The price and wage increases stimulated by the sales tax would affect the cost of goods and services purchased by the Government, as well as the cost of items purchased by individual consumers and businesses.

Consequently, larger governmental outlays would be necessitated. These increased outlays would add to the funds in the hands of the public and offset, at least in part, the deflationary effects of the tax resulting from the absorption of spending power represented by the tax revenue.

Since the Federal Government is currently the largest purchaser of goods and services, this offset might prove to be substantial. In the fiscal year 1944, Government purchases will total approximately \$100 billion. Therefore, for each percentage point rise in the average cost of the goods and services purchased by the Government, Federal expenditures would be increased \$1 billion. Of course, there would be some offset to this added cost because price rises would increase the nongovernmental sales tax base and the tax yield. This offset would be very small, however. If it is assumed that prices and wages increase in such a manner that their aggregate cost is distributed equally between Federal purchases and taxable nongovernmental purchases, and if it is further assumed that all Federal purchases are nontaxable, Federal outlays would increase twenty times as fast as the yield of a 5-percent sales tax, and ten times as fast as the yield of a 10-percent tax. This would result because the Government would recoup only one-twentieth or one-tenth of the added cost as a result of the application of the 5- or 10-percent tax to the increased cost of nongovernmental purchases. ^{1/}

IV. Summary and conclusions

One of the important functions of wartime tax policy is to aid in curbing inflation. It has been maintained in some quarters that a Federal retail sales tax would serve this purpose effectively, since it would absorb excess spending power and curtail consumer spending.

It is evident, however, that the sales tax would exert inflationary as well as deflationary pressures. The tax would conflict with the operation of the Government's stabilization program because of its price-increasing and wage-increasing influences. ^{2/} Business costs would be increased in many cases. If the tax were permitted to raise farm parity prices, it would be ineffective

^{1/} Although price and wage increases would also be reflected in higher receipts from other Federal taxes (for example, income taxes), the additional revenues would be only a small fraction of the additional costs to the Government.

^{2/} Some foreign countries have recognized this conflict. For example, exemptions under the British Purchase Tax have been extended to "utility" clothing, footwear, textiles, and furniture to help stabilize the cost of living. Australia recently reduced the sales tax rate on certain rationed articles to 7½ percent in order to help keep living costs at the April 1943 level. Canada has not increased its sales tax rate during the war period. The Minister of Finance has stated that "The imposition of the price ceiling has added conclusively to the weight of argument against general rather than selective increases in consumption taxes." (See "British Purchase Tax," "Australian Wholesale Sales Tax," and "Canadian Federal Sales Tax.")

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in reducing the spending of farm groups. Moreover, the food price increases that would result, together with the tax effects on living costs, would exert a powerful pressure for wage increases. The price and wage increases induced by the sales tax would interact and give new stimuli to the development of wartime inflation. The existing anti-inflation controls might not be able to cope successfully with these pressures. To the extent that the increases in prices and wages were passed on to the Government, they would represent offsets to the spending-power withdrawal effected by the tax. To the extent that the tax-induced price and wage increases merely enabled some sections of the population to shift their respective shares of the tax to other groups who were less strategically situated, compelling the latter groups to curtail their spending to a greater extent than would otherwise be necessary, the tax would prove to be an extremely inequitable instrument for distributing a part of the war costs.

Even if it is assumed that the existing price and wage controls would generally be able to withstand the inflationary pressures generated by the sales tax, it is unlikely that the tax would make a significant contribution to the anti-inflation program. Some price and wage increases would be inevitable, and these would counteract the tax-induced reductions in consumer spending and necessitate higher Government outlays. On the other hand, there is a very real possibility that the tax would be dangerously inflationary in the present situation due to its inconsistency with the price and wage stabilization programs. Clearly, the amount of inflation that would result would vary inversely with the effectiveness with which the existing price and wage ceilings were maintained. It is impossible to predict how effective the price-and-wage-control machinery would be in the face of the pressures exerted by the tax, although it is clear that the risk of stimulating a dangerous inflation would be great.

While certain steps could be taken to minimize the inflationary effects of the sales tax, it would not be possible to eliminate these effects entirely. ^{1/} Interference with wartime price controls would be lessened to the extent that business cost items were excluded from the tax base. It has been suggested that exclusion of the sales tax from the official cost-of-living index would tend to reduce tax-inspired wage demands, but it would seem that either its inclusion or exclusion would make little difference in this respect. The effect of the tax in increasing farm prices might be minimized by excluding the tax from the index of prices paid by farmers but the pressure of higher costs would still exist.

^{1/} Preliminary investigations indicate that the exemption of food sales would reduce the inflationary effects of the tax even though the tax rate were adjusted to compensate for the resulting revenue loss.

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Finally, it may be that the inflationary tendencies of the sales tax would be reduced if the statute required that the tax be added to selling prices as a separately-quoted item, and if a policy statement were included in the statute to the effect that wage increases and price increases (other than the price rises reflecting the shifting of the tax forward by retailers to consumers) to compensate for the sales tax would be wholly inconsistent with wartime tax policy and anti-inflation controls. Even if these steps were taken, however, the pressures generated by the tax would still remain.

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State Sales Taxes:
Summary of Principal Provisions and Practices

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State Sales Taxes:
Summary of Principal Provisions and Practices 1/

I. Extent of State taxation of general sales

In recent years general sales taxes have been employed in 31 States. 2/ At present only 23 of the laws are in effect; eight have expired or have been repealed. Table 1 indicates the years in which State sales taxes were adopted and also shows the dates of expiration or repeal of those taxes which have been discontinued. Most of the State sales taxes were adopted during the period 1933-1935. Since 1937 no additions have been made to the list. 3/

II. Types of State sales taxes

Eighteen States impose sales taxes under which the base generally is restricted to retail sales. 4/ Seven States levy broader forms of taxes which apply to other kinds of transactions as well as to retail sales. 5/ Washington and West Virginia are included in both

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- 1/ In addition to the State sales taxes, the retail sales taxes imposed by the cities of New York and New Orleans are also considered.
- 2/ This study does not include the low rate license taxes imposed on a sales or purchase basis upon merchants in Delaware and Virginia, and Connecticut's unincorporated business tax applicable to gross income of manufacturers, wholesalers, and retailers.
- 3/ Louisiana enacted a sales tax on September 1, 1942, but this tax replaced one which had been repealed in 1940. Oregon's 1943 legislature enacted a 3 percent retail sales tax which is to be referred to the electorate for approval at the next general election. Oregon voters refused to approve a sales tax on at least two previous occasions.
- 4/ Alabama, Arkansas, California, Colorado, Illinois, Iowa, Kansas, Louisiana, Michigan, Missouri, North Dakota, Ohio, Oklahoma, South Dakota, Utah, Washington, West Virginia, and Wyoming.
- 5/ Arizona, Indiana, Mississippi, New Mexico, North Carolina, Washington, and West Virginia.

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Table 1. Years of adoption of sales taxes by States

1929	:	1930	:	1932	:	1933
Georgia <u>1/</u>		Mississippi		Pennsylvania <u>1/</u>		Arizona California Illinois Indiana Iowa Michigan New Mexico New York <u>1/</u> Oklahoma South Dakota Utah Washington West Virginia
1934	:	1935	:	1936	:	1937
Kentucky <u>2/</u> Missouri Ohio		Arkansas Colorado Florida <u>3/</u> Idaho <u>2/</u> Maryland <u>1/</u> New Jersey <u>2/</u> North Carolina North Dakota Wyoming		Alabama Louisiana <u>4/</u>		Kansas

1/ Expired: Georgia, 1931; Pennsylvania, 1933; New York, 1934; Maryland, 1936.

2/ Repealed: Idaho and Kentucky, 1936; New Jersey, 1935.

3/ Repealed 1941. The Florida flat 1/2 of 1 percent tax on gross receipts of retailers was part of the chain-store tax, the graduated gross receipts tax provisions of which were held unconstitutional.

4/ Repealed 1940; reenacted 1942.

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groups since they levy retail sales taxes as well as broader forms of business and occupational taxes which apply to the gross receipts or gross income of retailers. Of the multiple-stage taxes, those of North Carolina and Arizona are the most restricted. North Carolina applies a tax at both the wholesale and retail levels; a low rate of 1/20 of 1 percent being applied in the former case and 3 percent in the latter. The Arizona tax reaches the manufacturing and processing of agricultural products, and extracting, as well as retailing. Mississippi, New Mexico, and Washington extend the scope of the tax still further to include personal and professional services. The broadest type of sales tax is levied by Indiana and West Virginia and includes, in addition to all the above-mentioned transactions and receipts, the important categories of salaries, wages, investments, and other nonbusiness income.

Limitations on the States' taxing power under the Federal Constitution prevent the application of State sales taxes to certain transactions wherein property is purchased outside the State or in interstate commerce. In order to prevent avoidance of their sales taxes through out-of-State purchases or purchases in interstate commerce, 17 of the States have enacted use taxes which impose a tax equal to that of the sales tax with respect to property purchased outside the State or in interstate commerce for use within the State. The definitions, rates, and exemptions of the use tax acts are similar to those of the sales tax acts. While the use tax is considered a complementary tax, the usual practice is to impose a uniform tax on the use of all property and then to exempt the use of property upon which a retail sales tax is paid to the taxing State, and, in the case of some States, to exempt the use of the property to the extent to which a retail sales tax is paid thereon to another State. Since one of the chief purposes of the use tax is to remove the discrimination that would otherwise result to local business, some of the States exempt from the use tax commodities "not readily obtainable in the State."

III. Scope of taxable retail sales

A. Retail sales of tangible personal property and of specified services

1. Application to retail sales

The States generally have attempted to limit the application of the retail sales tax to a single stage by applying it to sales of tangible personal property to final users and consumers. The determining factor in classifying a sale as taxable or nontaxable is whether the article is to be used or consumed by the purchaser or is to be resold, and not whether the seller is a manufacturer,

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wholesaler, or retailer. That is, retail sales consist of all sales except those made for resale. Sales for resale consist of sales of articles to be resold either in the form in which purchased or as ingredients or component parts of other tangible personal property.

In order to control sales for resale, most States require that sellers secure exemption certificates from buyers stating that the goods are purchased for the purpose of resale. 1/ The exemption certificate may be accepted by the State as prima facie evidence that the goods were sold for resale, or auditors may examine all the facts relative to the purchase and sale before honoring the certificate. The seller is not necessarily relieved of liability for tax by taking a resale certificate, but the certificate operates to relieve him of the burden of proving that the sale was not a retail sale. For example, the California administrative agency states that the law places direct responsibility for the tax upon the retailer and, where subsequent investigation discloses that the sale was in fact a retail sale, the retailer is liable for tax even though a resale certificate was given. 2/ Generally, however, in the absence of bad faith, the seller is not held responsible for checking whether the buyer actually resells the article. The good faith of the seller is questioned if he has knowledge of facts which give rise to a reasonable inference that the purchaser does not intend to resell the property, as for example, knowledge that a purchaser of particular merchandise is not engaged in selling that kind of merchandise.

In cases where substantially all the purchases made by a concern are for resale, the seller may be authorized to take a blanket certificate of resale from the purchaser stating that all of his purchases "until further notice" will be purchased for resale. Blanket certificates, as well as those covering single sales, frequently state that the purchaser assumes liability for payment of the sales tax in the event the property is used by him. Issuance of the blanket exemption certificate does not relieve the seller from keeping detailed records of all sales for resale, but it does relieve both seller and buyer of the considerable amount of additional work that would be involved in the issuance and filing of an exemption certificate for every sale.

If the State retail sales taxes were strictly single-stage taxes, they would exempt from tax all articles which enter into the cost of producing and distributing finished articles. Actually, multiple taxation exists in that they apply ordinarily not only to retail sales of consumers' goods but also to final sales of finished articles, such

1/ The form of the exemption certificate is usually proscribed by statute or regulation.

2/ Letter of State Board of Equalization to Prentice-Hall, Inc.

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wholesaler, or retailer. That is, retail sales consist of all sales except those made for resale. Sales for resale consist of sales of articles to be resold either in the form in which purchased or as ingredients or component parts of other tangible personal property.

In order to control sales for resale, most States require that sellers secure exemption certificates from buyers stating that the goods are purchased for the purpose of resale. 1/ The exemption certificate may be accepted by the State as prima facie evidence that the goods were sold for resale, or auditors may examine all the facts relative to the purchase and sale before honoring the certificate. The seller is not necessarily relieved of liability for tax by taking a resale certificate, but the certificate operates to relieve him of the burden of proving that the sale was not a retail sale. For example, the California administrative agency states that the law places direct responsibility for the tax upon the retailer and, where subsequent investigation discloses that the sale was in fact a retail sale, the retailer is liable for tax even though a resale certificate was given. 2/ Generally, however, in the absence of bad faith, the seller is not held responsible for checking whether the buyer actually resells the article. The good faith of the seller is questioned if he has knowledge of facts which give rise to a reasonable inference that the purchaser does not intend to resell the property, as for example, knowledge that a purchaser of particular merchandise is not engaged in selling that kind of merchandise.

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as machinery, equipment and supplies to industrial and commercial users. The extent to which cost goods are exempt will be discussed in more detail below under "Exclusions and Exemptions."

2. Leases and rentals

Some of the State retail sales taxes specifically cover leases and rentals of tangible personal property. ^{1/} Transactions whereby possession of the property is transferred but the seller retains the title as security for full payment are deemed sales in all States. In cases where the tax does not cover leases, however, it has been avoided to some extent through leasing agreements whereby title is not transferred and installments of "rent" are paid during the useful life of the property in amounts aggregating the normal purchase price. This arrangement has been used particularly with respect to transfers of durable personal property such as machinery. Several States prevent avoidance of the tax through this device by including this type of lease in the definition of taxable transactions. ^{2/}

3. Services

a. Taxable services

In general, State retail sales taxes apply only to the rendering of a few specified services. Most commonly taxed are the operation of places of amusement and selected public utility services. In a few cases, however, the tax also applies to such services as advertising, hotel, and auto storage. ^{3/}

Ten States ^{4/} specifically include sales of admissions to places of amusement in the definition of retail sales, ^{5/} and all except six States tax some types of public utility services. Table 2 indicates

^{1/} Among these are: Louisiana, West Virginia, and Ohio.

^{2/} The Colorado law, for example, includes lease or rental considerations where "right to continuous possession or use of any article of tangible personal property is granted under a lease or contract, and such transfer of possession would be taxable if outright sale were made." (Colorado Laws of 1937, chap. 230, art. I, sec. 2 (q).)

^{3/} Meals served in restaurants are taxable in all States as sales of tangible personal property.

^{4/} Alabama, Arkansas, Iowa, Kansas, Missouri, North Dakota, Oklahoma, South Dakota, Utah, and Wyoming.

^{5/} In addition, the gross receipts or gross income of amusement operators is subject to tax in six States (Arizona, Indiana, New Mexico, North Carolina, Washington, and West Virginia).

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the extent to which the various types of public utility services are taxed under State sales taxes. Of the retail sales taxes, the West Virginia tax probably has the broadest service coverage, applying to all types except professional, personal, and certain public utility services. 1/ Colorado levies a special tax on service charges and, although imposed under a separate act, it in effect serves as a supplement to the sales tax. Identical rates are imposed, similar deductions are allowed, and a combined sales and service tax return is employed. The service tax is of broad scope, covering amusements, hotels, contractors, professional, 2/ technical and scientific services rendered on a fee basis, advertising, banks (except as to interest on money loaned), barber shops, beauty shops, laundries, credit bureaus, finance companies, parking lots, and specified repair and fabrication services.

b. Nontaxable services

Generally the State retail sales taxes do not apply to personal and professional services. With limited exception, it is only in those few States which levy the broader scope taxes that these services are reached. 3/

c. Special problems relating to sales of property and services

Difficulties arise in the case of sales which include both the rendering of services and the transfer of property, but in which a lump sum is charged for the whole. The States generally have classified the various occupations and professions and indicated the tax liability of each. 4/

(1) Businesses primarily engaged in rendering services

Businesses primarily engaged in rendering services but incidentally selling tangible goods (such as barber shops and beauty

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- 1/ Services which are taxable include: amusements, blacksmithing, hotels, restaurants, laundries, cleaning and dyeing, shoe repairing, photographers, garages, machinery repair shops, paper hanging, painting, plumbing, roofers, moving vans, and all other service-businesses not specifically exempted by law or regulations.
- 2/ Certain professional services are exempt, e.g., physicians, dentists, nurses.
- 3/ Indiana, Mississippi, New Mexico, Washington, and West Virginia.
- 4/ See B. U. Ratchford, "The Measure of Consumption Taxes," Law and Contemporary Problems, Summer 1941, pp. 574-575; Sherman P. Cohen, "The Taxable Transaction in Consumers' Taxes," Law and Contemporary Problems, Summer 1941, pp. 530-535.

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Table 2. Taxation of public utility services
under State general sales taxes.

(x denotes services which are taxed)

State	: Gas :	Electricity :	Water :	Transportation of Freight :	Persons :	Telegraph and telephone
Alabama		x				
Arizona	x	x	x	x	x	x
Arkansas	x	x	x			x
California						
Colorado	x	x				x
Illinois ^{1/}	x	x				x
Indiana	x	x	x	x	x	x
Iowa	x	x	x			x
Kansas	x	x	x			x
Louisiana						
Michigan	x	x				
Mississippi	x	x	x	x	x	x
Missouri	x	x	x		x	x
New Mexico	x	x		x	x	x
North Carolina						
North Dakota	x	x	x			x
Ohio						
Oklahoma	x	x			x	x
South Dakota	x	x	x			x
Utah	x	x		x	x	x
Washington						
West Virginia (gross income tax only)	x	x	x			
Wyoming	x	x		x	x	x

^{1/} The taxes on utilities are imposed under a separate act.

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shops) usually are exempt on their principal activity but are liable for the tax on sales of tangible personal property. ^{1/} Ordinarily, sales of tangible personal property to such persons for use in connection with the performance of services (for example, shaving soap used by the barber) are considered sales for final consumption and are taxable. Anomalous situations may exist in certain cases, however, as illustrated by Illinois' treatment of glasses furnished by optometrists prior to the amendment of the tax act in 1941. In this case, the Illinois Supreme Court, after holding that an optometrist was not liable for tax on glasses furnished to his patient since the sale was merely incidental to the rendering of a professional service, ruled that sales of glasses by an optical supply house to the optometrist were sales for resale and nontaxable, since the optometrist did not use or consume the glasses.^{2/}

(2) Businesses primarily engaged in selling goods

Businesses primarily engaged in selling tangible goods but incidentally rendering some services (for example, florists and photographers) usually are subject to tax on their total receipts even though a part of their charges may be for services.

(3) Businesses in which both services and sale of property are important

Businesses in which both the rendering of service and the sale of property are important present the difficult problem of separating charges for services from those for sales of property. Repair trades fall in this group. Generally, if separate charges are made and separate records kept, the service charges are not taxable under State sales taxes. ^{3/} In the case of automobile repairs where material costs are a relatively high portion of the entire cost of a repair job and where trade practice in billing has been to itemize labor and material costs, serious problems do not exist. Shoe repairing, however, presents a real problem because of the difficulty of determining the value of leather used in each repair job and the trade practice of lump-sum

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- ^{1/} State experience appears to indicate that careful records are not kept of articles used in the performance of services and those sold as a side line, and that this procedure provides possibilities for evasion of the tax.
- ^{2/} Babcock v. Nudelman, 367 Ill. 626, 12 N.E. (2d) 635 (1937); American Optical Co. v. Nudelman, 370 Ill. 627, 19 N.E. (2d) 582 (1939). Cited by Wahrhaftig, Felix S., "Meaning of Retail Sale and Storage, Use, or Other Consumption," Law and Contemporary Problems, Summer 1941, p. 553.
- ^{3/} The Washington retail sales tax, unlike most State sales taxes, provides specifically for the inclusion in retail sales of charges for "the installation, cleaning, decorating, beautifying, repairing or otherwise altering or improving real or personal property of consumers."

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billing. Since many of the business units are small and have poor accounting systems, the States often permit an arbitrary apportionment of receipts to services and to goods. The apportionment varies from State to State. Shoe repairmen, for example, are taxed on proportions of total charges ranging from 25 to 50 percent. ^{1/}

d. Transportation, installation, interest and carrying charges

Certain other services rendered in connection with the sale of tangible personal property generally are exempt if separately billed. These include transportation, installation, interest and carrying charges, and insurance. ^{2/} The Washington retail sales tax law, unlike most State sales tax laws, provides specifically for the inclusion in retail sales of installation charges. In Illinois, if the seller is required to install the property in order to complete the sales contract, the installation charges are taxable.

B. Exclusions and exemptions

Certain types of property and sales are outside the scope of State sales taxes. These sales either may be excluded from the definition of retail sale or they may be specifically exempted from the taxable class. The exclusions and exemptions fall into four major categories: (1) articles which enter into the cost of production and distribution, (2) necessities, (3) articles and services already taxed, and (4) administrative exemptions. ^{3/} The bases of these exclusions and exemptions are avoidance of multiple taxation, equity considerations (applying either to producers or to consumers), administrative expediency, and political pressures.

1. Articles which enter into cost of production

a. Physical-ingredient or component-part rule

All the State retail sales taxes exclude from the tax base sales of goods for resale, but the definition of a sale for resale has been restricted in most States by the physical-ingredient or component-part test. In other words, property is not sold for resale unless it

^{1/} Ratchford, B. U., op. cit., p. 575.

^{2/} For a more detailed discussion of the treatment of such charges, see the section on measure of the tax.

^{3/} For a discussion of these various classes of exemptions, see George T. Frampton and Numa L. Smith, "Commodities and Transactions Exempt from Consumption Taxes," Law and Contemporary Problems, Summer 1941, p. 579.

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becomes a constituent part of other tangible personal property which ultimately is to be sold at retail. The ingredient or component-part test first appeared as a matter of administrative construction, but is now set forth in the tax acts of several States. ^{1/}

b. Machinery and other articles used directly in production

Sales of machinery or materials for use in carrying on the business of production and distribution, but which do not become a component part of the finished product, usually are taxable. A few States, however, have gone beyond the physical-ingredient rule and exclude (or exempt) from tax the materials and machinery which are used in industrial processing and in distribution.

Alabama restricts the exemption to machinery used in mining, quarrying, compounding, processing, and manufacturing.

Michigan's definition of retail sale excludes sales of tangible personal property for consumption or use in industrial processing or in agricultural production. Sales of both machinery and materials for use directly in production are thus not taxable. The regulations interpret the industrial processing exclusion to cover sales of tools, dies, patterns, and machinery used in manufacturing or processing; oil, grease, waste, wiping cloths and cleaning compounds used in connection with such tools and machinery; and substances used to create a chemical reaction in manufacturing or processing. Materials for use in administrative and distributive departments, however, are subject to tax as are also sales of items used only incidentally in production, such as clocks, janitors' supplies, and fire extinguishers.

Ohio's definition of retail sale excludes not only sales of tangible personal property for consumption or use directly in manufacturing, processing, refining, mining, production of crude oil and natural gas, and farming, but also those for consumption or use directly in making retail sales. Thus, sales of trade fixtures, such as shelves, show cases, cash registers, and other equipment used by a retailer in his business, are not taxable.

^{1/} For a discussion of the application of the ingredient or component-part test, see Wahrhaftig, Felix S., "Meaning of Retail Sale and Storage, Use or Other Consumption," Law and Contemporary Problems, Summer 1941, p. 543.

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Four States exclude certain sales which otherwise would be taxable by defining them as wholesale sales rather than retail sales. West Virginia defines as a wholesale dealer (and therefore exempt from the retail sales tax) a person who sells "machinery, supplies and material" to persons engaged in the business of manufacturing, transportation, transmission, communication, or in the production of natural resources. Under the North Carolina tax, sales of mill machinery or mill machinery parts and accessories to manufacturers are classified as wholesale sales and are subject only to the wholesale rate of tax (1/20 of 1 percent in comparison with the retail rate of 3 percent). Under a 1942 amendment to the Mississippi sales tax law, sales of machinery, machine parts and supplies to manufacturers within the State are construed to be wholesale sales and are taxable at the wholesale rate which is only 1/8 of 1 percent whereas the retail tax is 2 percent. The Indiana gross income tax act excludes from the retail sales category a limited number of transactions by defining them to be wholesale sales. ^{1/} Under the regulations, there have been excluded from the retail sales category such transactions as sales of explosives to coal mines, gasoline for tractors used in cultivating crops, cleaning fluids and soap to dry cleaners and laundries.

c. Fuel

Materials which are consumed in the production of another commodity without becoming a part of it (such as coal used as fuel by a manufacturer) are not excluded from tax by the physical-ingredient rule. Fuel used for manufacturing purposes, however, is not taxable in several States either because it is considered a sale for resale or because it is specifically exempted. Table 3 indicates the method of exemption or exclusion employed in the various States.

^{1/} "... Sales of any tangible personal property as a material which is to be directly consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, repairing, mining, agriculture, or horticulture; ... Sales of tangible personal property to be directly consumed by the purchaser in the business of industrial cleaning; and/or ... Sales of any tangible personal property to be directly consumed by the purchaser directly in the business of rendering public utility service: Provided, however, ... That the term 'consumed' as used herein shall refer only to the immediate dissipation or expenditure by combustion, use, or application, and shall not mean or include, the obsolescence, discarding, disuse, depreciation damage, wear, or breakage, of tools, dies, equipment, rolling stock or its accessories, machinery or furnishings."

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Table 3. Exemption or exclusion of fuel from State sales taxation

State	Method of exclusion or exemption	Scope of exemption
Alabama	Specific exemption	Sales of coal or coke to manufacturers, electric power companies and transportation companies
Colorado	Defined as wholesale sale	Sales of electricity, coal, gas, fuel oil and coke for industrial uses
Indiana	Defined as wholesale sale	Fuel, except electricity and gas, directly consumed in direct production in manufacturing, processing, refining, repairing, mining, agriculture, or horticulture, or directly consumed in industrial cleaning, or rendering public utility service
Iowa	By definition of retail sale	Fuel used in creating heat, power, or steam for processing or for generating electric current
Kansas	Specific exemption	Sales of electricity and fuel <u>1/</u> for industrial purposes <u>2/</u> and to persons engaged in furnishing taxable services <u>3/</u>
Michigan	By definition of retail sale	Fuel used directly for manufacturing or processing <u>4/</u>
Missouri	Specific exemption	Fuel <u>5/</u> used in producing taxable utility services <u>6/</u>
Ohio	By definition of retail sale	Fuel used in industrial processing
Wyoming	Defined as wholesale sale	Sales of power or fuel for consumption directly in manufacturing, agriculture, or in generating motive power for transportation.

1/ Coal, gas, fuel oil or other petroleum products.

2/ Manufacturing, processing, mining, drilling, refining, irrigation, building, construction.

3/ Taxable services include: telephone and telegraph, gas, water, electricity, heat, sales of meals or drinks, and sales of admissions.

4/ The exemption applies when fuel is used directly in manufacturing or processing. Fuel used for the heating of buildings is not exempt.

5/ Coal, coke, fuel oil, gas or other combustibles.

6/ Power, electricity, artificial gas, or steam. Sales of fuel for other types of processing, for example, sales to bakeries and to foundries or steel mills when used in heating ore, or to railroads, are subject to tax.

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d. Feed, seed, and fertilizer

In the majority of States, sales of feed, seed, and fertilizer to persons engaged in the commercial production of livestock and agricultural products have not been taxed as retail sales either because of statutory definitions or exemptions or because of administrative interpretations that such sales are sales for resale. ^{1/} Nine States have specific statutory exemptions relating to products entering into agricultural production. The nature of these exemptions is indicated in Table 4.

Administrative difficulties arise in the determination of whether livestock or agricultural products are to be sold, consumed by the producer, or both, for if the products are consumed by the producer, the sales of feed, seed, and fertilizer usually are taxable. Ohio avoids these administrative problems by exempting feeds and seeds as classes of commodities, irrespective of whether the buyer is a farmer and regardless of their intended use. Kansas seeks to simplify administration by taxing feed and seed according to predominant use; that is, feed is tax-free when used primarily for purposes of producing for resale and taxable when used primarily for consumption.

Missouri attempts to draw fine lines of distinction between taxable and nontaxable sales. According to the regulations, sales of feed for feeding brood sows are taxable but feed purchased to fatten the pigs, if the pigs are to be fattened for market, is not taxable. The burden is placed upon the seller of feed to determine at the time of the sale whether or not the sale is taxable. Therefore, the seller is directed to take from the purchaser, in proper cases, a blanket certificate ^{2/} which states that grain purchased by him will be used for purposes of feeding livestock or poultry for market. The purchaser agrees that if he should at any time purchase feed for other than the above-named purpose he will notify the merchant and pay the tax.

Michigan's definition of retail sales excludes sales of goods used in agricultural production. As interpreted by regulation, the tax does not apply to sales of materials to persons regularly engaged in business as farmers which are to be used in the production of crops or raising of livestock and poultry to be sold for ultimate consumption. ^{3/} Goods sold to the farmer to be used in the production of products for his own consumption are subject to the tax. A number of complexities have arisen in the administration of this exemption. In order to

^{1/} Wahrhaftig, Felix S., *op. cit.*, p. 544.

^{2/} The blanket certificates are not furnished by the State Auditor, but the regulations indicate the form to be used.

^{3/} Sales of fertilizer, for example, to be used on lawns and home or private gardens, or used by landscape gardeners, are presumed to be for use other than agricultural production and are subject to tax.

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Table 4. Specific statutory exemption of feed, seed, and fertilizer under State sales taxes

State	Specific exemption
Alabama	Seeds for planting purposes, and fertilizer
California	Feed, seeds, annual plants and fertilizer, the products of which are to be used as food for human consumption or sold in the regular course of business
Iowa	Fertilizer
Louisiana	Fertilizer when sold directly to farmers
Mississippi	Fertilizer and seed used in growing agricultural products for market
Missouri	Feed for livestock or poultry to be sold ultimately in processed form or at retail; seeds, limestone and fertilizer used in creating foodstuffs to be sold at retail
North Carolina	Commercial fertilizer on which the inspection tax has been paid, and lime and land plaster used for agricultural purposes
Ohio	Feed and seed
Wyoming	Seed and fertilizer, the products from which are to be sold; and feeds for use in feeding livestock or poultry for marketing purposes

determine his tax liability, the farmer must keep an account of the amount of produce he consumes himself, the amount he sells for resale, and the amount he sells to the ultimate consumer. As a result, it is difficult to collect the tax on sales to farmers for home consumption and sales by farmers direct to consumers.

2. Other exemptions

In addition to exclusions from the retail sales tax of sales for resale and sales of certain goods which enter into the cost of products ultimately to be sold at retail, there are specific exemptions from tax of certain commodities.

State tax administrators indicate that the exemption of specific commodities or classes of commodities, or of sales to specified classes of buyers, make it difficult if not impossible to collect the entire amount of taxes for which taxpayers are liable. These difficulties arise in large part from the failure of retailers to keep accounting records or where records are kept, failure to segregate sales on the basis of classes of goods or buyers.

a. Necessities

When objections are raised to sales taxes on the ground of their regressiveness, the proponents may counter with the suggestion that the exemption of necessities (essential foods, low-priced clothing, fuel, and medicine) will reduce the regressiveness. Because of the administrative difficulties involved and because of the loss of revenue that would result, few States have extended exemption to the so-called necessities. 1/ At present, three States, California, North Carolina, and Ohio, have general food exemptions ("food for human consumption off the premises where sold"); 2/ and West Virginia allows taxpayers an exemption of 50 cents from the purchase price of food products. 3/ Other States which at one time had limited food exemptions have repealed them. 4/ Only one State, North Carolina, exempts medicine, and it restricts the exemption to medicine sold on prescription of physicians or compounded by druggists. 5/

1/ Louisiana's first sales tax (Luxury Sales Tax of 1936) exempted from tax a large number of "necessities" including foods, farm implements, common household utilities, and shoes and clothing selling for less than \$3. The Act proved difficult to enforce and was repealed in 1938. (Neil H. Jacoby in Retail Sales Taxation, p. 197.)

2/ New York City also has a broad food exemption. The Illinois electorate defeated at the November, 1942 election a proposed constitutional amendment which would have permitted the legislature to exempt food sales from the sales tax.

3/ The present exemption was adopted in 1943. It applies to sales of bread, pastries, eggs, butter, flour, milk, coffee, tea, chocolate, cocoa, nuts, fruits, groceries, vegetables and meats as food products for human consumption when the total retail price of any or all of such food products does not exceed fifty cents when purchased as any one continuing transaction. It does not apply to sales of these products by hotels and restaurants. The previous law excluded from tax sales of specified food items: bread, butter, eggs, flour and milk.

4/ Among these are: Alabama, Arkansas, and Washington. North Carolina shifted from a specific exemption to a blanket exemption in 1941.

5/ New York City exempts medicine (and eyeglasses) sold upon a physician's prescription.

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The administration of a general food exemption has required not only the listing of the general classes of food items exempt, but also the detailing by trademark name of certain items which are to be regarded as food and certain ones which are not. Examination of the California regulations, for example, reveals lengthy supplements to the regulations composed of trademark names which have been added to the original list of general classes of items which are to be included in or excluded from food products. For instance, the Battle Creek Food Company's "Spinach Concentrate" is not considered a food, while its "Zo Flakes" is so considered. The Ohio Department of Taxation declares that as a general guide it has followed the average person's definition and the meaning this average person attributes to the term "food." The experience of the Department, however, indicates that persons are not agreed as to the definition of food and that many questions have arisen which required the expansion of the regulations.

Prior to the 1943 revision, West Virginia's food exemption was limited to a few specified food items: bread, butter, eggs, flour and milk. At first glance this exemption appears to be so specific that few difficulties would arise in connection with its administration. Upon closer observation, however, this is found not to be true. Bread, for example, is defined in the law to mean "all bakery products made from wheat flour, whole wheat flour, and rye flour with a sugar content of less than 10%." An interpretative bulletin issued by the Tax Commission stated that loaf bread, pan rolls and buns were exempt when made from the ingredients mentioned in the law. ^{1/} A supplement to this bulletin stated that the list of tax-exempt commodities did not include "quite a number of yeast raised bakery products such as cinnamon rolls, cinnamon buns, coffee cakes, doughnuts, etc." ^{2/} It is clear that bakers would not always find it easy to distinguish between taxable and nontaxable items under such a definition, and that they would have the additional problems of keeping their records so as to disclose separate accounting for sales of taxable and nontaxable goods. ^{3/}

b. Articles and services already taxed

Articles already subject to special excise taxes are frequently exempted from the general sales tax. A few States (Iowa, Kansas, North Dakota, and Utah) have blanket exemptions of sales already subject to special excises. ^{4/} These exemptions are effective only when the general sales taxes are less than the special excises; if the excises are less, the buyer must pay the difference.

^{1/} Bulletin 9, issued June 14, 1941.

^{2/} Supplement A to Bulletin 9, issued June 25, 1941.

^{3/} An amendment adopted in 1943 substituted for this exemption a flat 50 cents exemption from the purchase price of food products. (See footnote 3 on preceding page.)

^{4/} Iowa does not confine the credit to cases in which the other tax is an excise, but permits a credit for any special tax "whether in the form of a license tax, stamp tax or otherwise." In Utah, the sale of beer is specifically excluded from the blanket exemption.

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In some cases the exemption from sales tax applies only to articles which are subject to excise taxes above certain rates. Colorado exempts commodities subject to State excise or on which the Federal excise exceeds 12½ percent of the sale price; 1/ and Wyoming exempts articles subject to a State excise in excess of 5 percent or to a Federal excise of more than 20 percent. 2/

Gasoline is exempt from the sales taxes in all but a few States. Other commodities commonly exempted on this basis are tobacco and alcoholic beverages. 3/ At least three States (Illinois, Indiana, and Michigan) make no provision for exemption of articles already taxed.

c. Casual sales

Casual and occasional sales not a part of or not in the course of one's trade or business are not taxable in most States either because they have been excluded from the definition of retail sales or have been specifically exempted. State administrative rulings have set up as a test of engaging in business whether there is "a systematic recurrence and continuity of such sales." This exemption is justified on the basis that the costs involved in collecting a tax on isolated transactions would be disproportionate to the amount of revenue raised.

d. Sales to or by specified groups

(1) Sales to or by governments

Approximately half the States exempt sales to themselves and most of these also exempt sales to their local subdivisions. 4/

Sales made directly to the United States Government are at present generally exempt from State sales taxes when payment is made direct from the United States Treasury. It appears that under the retail privilege form of sales tax in which the tax is technically levied upon the

1/ These include gasoline, cigarettes, tobacco, liquor, and beer. Cigars are not exempt.

2/ These include gasoline, cigarettes, and tobacco.

3/ States in which both tobacco products and alcoholic beverages are exempt include: Alabama, Arkansas, Colorado, Iowa, Kansas, Ohio, Oklahoma, South Dakota, and Utah.

4/ Kansas specifies that the exemption applies only when sales to the political unit are for use in a governmental capacity. Sales are taxable when made to a department engaged in the business of selling tangible personal property at retail, or in furnishing any services subject to the sales tax.

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retailer, the States could constitutionally tax sales to the Federal Government. In fact, both California and Illinois (which employ the retailers' privilege type of sales tax) at one time provided by regulation for the taxation of sales to the United States Government. ^{1/} California subsequently amended the sales tax law to provide specifically for exemption of receipts from sales to the United States or any agency or instrumentality thereof except a corporate agency or a corporate instrumentality. ^{2/} Under an amendment adopted in 1943 the exemption was further extended to include sales to an incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States. ^{3/} Illinois revised its regulations in November 1941 to provide that sales of tangible personal property directly to the United States Government, its departments, agencies, and instrumentalities, do not fall within the measure of the tax. ^{4/}

^{1/} California's regulations provided: "The tax applies to receipts from sales of tangible personal property to the United States Government. Sales to such departments as the Treasury, Interior, Agriculture, War, Navy, Post Office, are sales to the United States Government" (Regulations 74, adopted January 24, 1939, effective April 1, 1939).

Illinois regulations issued July 1, 1941, provided that sales to the United States Government or any of its instrumentalities were subject to the sales tax. Receipts from sales by the United States Government were exempt. According to one authority, Illinois had taxed sales to the Federal Government since February 1, 1938. (Robert S. Ford and E. Fenton Shepard, "The Michigan Retail Sales and Use Taxes," p. 59.)

^{2/} Secs. 5(f) and 5.1 of the Retail Sales Tax Act, as amended in 1939.

Sec. 5(f) provided that the exemption should be retroactive. Regulations subsequently issued indicated taxable transactions by a detailed listing of the corporate agencies and corporate instrumentalities.

^{3/} Examples of such corporations are the Reconstruction Finance Corporation, the Defense Plant Corporation, the Defense Supplies Corporation, Metals Reserve Company, and the Rubber Reserve Company. "The tax applies to receipts from sales to corporate agencies and corporate instrumentalities of the United States not wholly owned by the United States or by a corporation [not] wholly owned by the United States. Examples of such corporations are: National Banks, Joint Stock Land Banks, Federal Reserve Banks, Federal Savings and Loan Associations, Federal Credit Unions, and Federal Land Banks." (Ruling 74)

^{4/} Illinois Rule No. 40, revised November 1, 1941. The Director of the Department of Finance explained the reason for this revision as follows, "The State of Illinois cooperated with the Federal Government in seeking a legal justification for permitting this exception, because, despite the financial loss which would be involved to the State of Illinois, it preferred to pursue a course which would enable the Federal Government to utilize the money involved for the purchase of additional planes, tanks, guns, and other implements of war." ("Wartime Fiscal Problems in Illinois," State Government, November 1942, p. 221.)

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Most of the States now tax sales to contractors operating under Federal cost-plus-fixed-fee contracts. ^{1/} The constitutional authority of the States to tax such sales was upheld by the United States Supreme Court in Alabama vs. King and Boozer. ^{2/}

With respect to the taxability of sales by the Federal Government or its instrumentalities under State sales taxes, it may be noted that the Buck Act, passed in 1940, removed the territorial immunity of transactions taking place on Federal reservations, but did not waive immunity so far as sales by the Federal Government or its instrumentalities are concerned. ^{3/}

^{1/} As of April 1942, only eight States allowed exemption to such sales (Arizona, New Mexico, Ohio, Oklahoma, South Dakota, Washington, West Virginia, Wyoming). Commerce Clearing House. State Tax Review, April 16, 1942, p. 1.

^{2/} 314 U. S. 1, November 10, 1941. The Court held that the contractor in cost-plus contracts was not an agent of the Government and consequently as purchaser of the materials used in such contracts was subject to the tax. The Court emphasized, however, that its decision was made in the absence of Congressional legislation "immunizing from State taxation" the contractors in question. Bills were subsequently introduced in the 77th Congress which provided for the exemption of war contracts from State and local sales taxes (by making contractors agents or instrumentalities of the United States) but these bills did not reach the point of being considered on the floor of either House. Hearings were held and two bills (H. R. 6995 and H. R. 6750) were reported favorably by the House Ways and Means Committee, but no further action was taken.

^{3/} "The provisions of ... this Act shall not be deemed to authorize the levy or collection of any tax on or from the United States or any instrumentality thereof, or the levy or collection of any tax with respect to sale, purchase, storage, or use of tangible personal property sold by the United States or any instrumentality thereof to any authorized purchaser," 54 Stat. 1060,

⁴ U.S.C.A., par. 15, 1940.

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(2) Sales to or by charitable and other nonprofit organizations

Twelve States grant exemption to religious, charitable, and in some cases other types of nonprofit organizations. 1/ The exemption is restricted in five cases to sales by such agencies and in the same number of instances to sales to such agencies. In two cases the exemption covers both sales by and sales to these groups. 2/

(3) Sales by farmers

Farmers selling their own produce are specifically exempt in about half of the States. 3/ This exemption is largely one of administrative expediency based on the difficulties involved in collecting the tax from numerous vendors whose sales are small and whose records are poor or nonexistent. In most cases, however, the exemption does not cover sales from an "established business" or a regular route even though made by the producer. 4/

In some States sales by farmers are exempt only if they fall in the category of casual sales. In South Dakota, a farmer may sell a horse ~~or~~ cow without securing a license and remitting the tax, but the exemption does not apply to "persons who are regularly engaged in the business of selling tangible personal property at retail such as a farmer who at regular intervals delivers his milk, cream, eggs, and poultry to city customers." 5/ Under Utah's regulations, a farmer is not required to take out a license merely because he sells a portion

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- 1/ There is a lack of uniformity in the various States as to exemptions of the respective types of organizations. For example, in a particular State, sales to charitable institutions may be exempt while sales to religious and educational institutions may be taxable.
- 2/ The exemption is usually contingent upon the entire proceeds of such sales being used exclusively for religious, charitable or educational purposes.
- 3/ These include: Alabama, Arizona, Arkansas, Louisiana, Mississippi, New Mexico, North Carolina, Oklahoma, Utah.
- 4/ Arkansas and Oklahoma provide that the exemption shall not apply to sales from an "established business." However, the farmer's sales are not taxable when he sells commodities produced on his farm through an "established business" located on the same farm.
- 5/ South Dakota Regulations, art. IV (6).

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of his crops, but if he establishes a place of business for the sale of his crops, such as a roadside stand, market, stall, or other store, and if, in addition to the sale of crops which he has produced, he sells products which he has purchased or otherwise acquired from a third party, he becomes a retailer and is subject to tax. ^{1/} West Virginia's regulations also exempt farmers who market their products through isolated sales, but if farmers market their own products or those of others to regular customers or market regularly to the extent that they are in competition with retail stores or markets, or display farm products on public or curb markets or any fixed place of business, they must collect the tax on their sales. ^{2/}

e. Size-of-sale exemptions

(1) Exemption of small businesses

Lump-sum exemptions of gross sales or gross receipts from State retail sales taxes are very exceptional. Of the States with single-stage taxes only Michigan has such an exemption, amounting to \$600 annually. All retailers, however, are required to file returns regardless of whether their sales are under or over \$50 a month. The Indiana gross income tax allows retailers a lump-sum exemption of \$3,000 per year and returns are required only of those who have gross sales in excess of this amount. ^{3/} Under Washington's gross income tax, persons whose gross operating income is less than \$600 for a bi-monthly period are exempt. ^{4/} If gross income exceeds the minimum exemption, however, the entire income is subject to tax. Persons claiming exemption under this provision may be required to file returns even though no tax is due.

(2) Exemption of small purchases

Small purchases (purchases below a fixed amount) are often exempt from State retail sales taxes in so far as the consumer is concerned, but usually the retailer is required to pay the tax on the total amount of sales including those on which he was not allowed to collect the tax. Louisiana is an exception to this rule. Under the present 1-percent tax, the bracket system provides for the exemption of sales of

^{1/} Utah Regulations, par. 38, September 1, 1939.

^{2/} West Virginia Supplement to Bulletin No. 5.

^{3/} Persons other than retailers are allowed an annual exemption of \$1,000.

^{4/} Prior to the 1941 amendment, the bi-monthly exemption was \$1,000 for retailers and \$400 for others.

24 cents or less, and the retailer is allowed to deduct receipts from such sales if he can substantiate the deduction by written records. 1/

New York City and Wyoming, which allow exemptions of small purchases, follow a different practice. Under Wyoming's law, consumers are not required to pay tax on purchases of 24 cents or less, and retailers are permitted a choice of either keeping detailed sales records of such sales in which case they return only 1-percent tax on them, or of not keeping such records and paying the regular 2-percent tax on total sales. New York City's schedule (under the present 1-percent tax) provides for the return of no tax on transactions involving less than 25 cents, but the vendor may separately state and collect the tax on these sales from consumers "if he finds it feasible to collect the tax at the rate of exactly 1 percent." A ruling interprets the provision as follows: for example, a vendor who has established a selling price of 24-3/4 cents may collect a tax of 1 percent, or approximately 1/4 cent, thus receiving from the customer an aggregate of price plus tax of 25 cents. 2/ When the vendor establishes a fractional price on sales less than 25 cents, his bills, advertising placards, or other records must show clearly a separate billing and collection of the tax. Furthermore, to avail themselves of the benefit of this ruling, taxpayers must notify the tax administrator in order that complications on future tax audits may be avoided.

IV. Measure of the tax or computation of taxable receipts

A. Gross sales or gross receipts

The measure of the State retail sales taxes is either the retailer's gross sales or his gross receipts. Gross receipts, as used in the sales tax laws, generally do not include the total sale price of credit sales but include only the actual amount of money collected by the retailer. Gross sales, on the other hand, include the total sale price of all sales made by the retailer, regardless of whether or not he receives full payment. 3/

1/ The bracket schedule adopted by the City of New Orleans for collecting the combined State and city tax (amounting to 3 percent) exempts sales of 12 cents or less and receipts from such sales are deductible if segregated in the records.

2/ Ruling of Special Deputy Comptroller, January 22, 1942.

3/ Adjustments are made in some States for bad debt losses, however.

In the majority of the States the gross sales basis is employed. The taxpayer reports the entire amount of sales, including credit sales, in the return for the period within which the sale is actually made. In seven States the use of this basis is mandatory. 1/ In five States the gross sales basis is used unless special permission is obtained from the administrator to defer payment of tax on credit sales. 2/ Three other States which employ the gross sales basis also permit gross receipts reporting of sales under conditional contracts where the payment period exceeds 60 days. 3/ In West Virginia, the tax on credit sales must be paid at the time of sale or within thirty days thereafter.

The gross receipts basis is the usual method of reporting in three States and permission must be obtained from the administrator to report on the gross sales basis. 4/ Four States make it optional with the retailer as to whether he is to report on a gross receipts or gross sales basis. 5/ The vendor must elect with his first return on which basis he will report. Having elected the method of making returns, all subsequent returns must be on the same basis until permission to change has been secured from the administrator.

A tendency has been noted on the part of the States to shift from a gross receipts to a gross sales basis. Of the seven States which now require that the tax be paid on a gross sales basis, three formerly allowed deferred payment of the tax on credit sales. 6/ The tendency to limit the privilege of deferring payment of the tax on credit sales appears to indicate that the States have had administrative difficulties with the gross receipts system of reporting. Gross receipts reporting, for example, complicates record-keeping with respect to the classification of taxable and nontaxable sales. Conditional sales contracts (under which transfers of possession of property take place but title is retained as security for the purchase price) also present special problems, particularly when the seller transfers his interest in the contract to a third person. The seller in such cases must either pay the tax upon the full sale price of the goods or keep a

1/ California, Louisiana, Michigan, Ohio, Oklahoma, Utah, and Washington.

2/ Arizona, Arkansas, Kansas, Mississippi, and North Carolina.

3/ Iowa, North Dakota, and South Dakota.

4/ Illinois, Indiana, and Missouri.

5/ Alabama, Colorado, New Mexico, and Wyoming.

6/ Furthermore, only one of these (Utah) allows adjustment for losses or bad debts. Ratchford, B. U., op. cit., p. 569.

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record of payments made thereafter on the contract in such a manner that the tax administrator can determine whether the full tax has been paid.

B. Adjustments of gross sales or gross receipts

1. Returned goods and repossessed property

If articles sold are returned and the sale entirely rescinded by refunding the entire purchase price, adjustment must be made since, in effect, no sale took place. Almost without exception, State sales tax laws and regulations specifically permit a deduction for credits or refunds for returned goods. The deduction is usually limited to returned goods for which the full purchase price is refunded and a few States specify that the amount of the tax also must be refunded.

Articles repossessed under conditional sales contracts, however, are not necessarily treated as returned goods. Under the usual rule, if the retailer's records are kept on an accrual basis so that he has previously included in his reported sales the total selling price of the property, he will be permitted to deduct the unpaid balance from gross sales reported in his next tax return. If he has included in his reported gross receipts only the amount of cash actually received from time sales of this kind, no credit will be allowed for the return of repossessed property. There are exceptions to the general rule, however. In some States, which require retailers to report on a gross sales basis, no deductions are allowed for unpaid balances on repossessed property. California, Louisiana, Michigan, and Oklahoma are among the States which follow this practice. ^{1/} The Michigan Supreme Court had held that the statutory provisions respecting refunds for returned goods do not apply to repossession of articles since there is no refund of the purchase price. ^{2/} Following this ruling the Michigan regulations were amended to provide that "credits or refunds for returned goods ... cover only such goods that are voluntarily returned for full exchange, refund of purchase price or full credit ... The term 'returned goods' does not include repossession or recapture of merchandise by legal process ..." ^{3/}

^{1/} Louisiana's regulations, after providing that retailers shall not deduct from their gross sales unpaid amounts on repossessed property, adds this statement, "Any dealer that is required to repossess articles ... will bear such losses himself." (Louisiana, Rule 56.)

^{2/} Montgomery, Ward & Co. v. Fry, 277 Mich. 260, 269 N. W. 166 (1936); Rudolph Wurlitzer Co. v. State Board of Tax Administration, 281 Mich. 558, 275 N. W. 248 (1937).

^{3/} Michigan Regulations 16 (as amended March 1, 1940).

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California formerly permitted the seller to deduct from his gross receipts the unpaid amount of the sales price of a repossessed article, but under a recent opinion of the Attorney General it now is held that no deduction is allowed on repossessed property except where the entire consideration paid by the purchaser is refunded to him. ^{1/}

Missouri, which requires the payment of the sales tax on the full purchase price of article sold under conditional sales contracts, does not allow the seller to deduct from his sales tax return the unpaid balance due on repossessed property. However, at the end of the calendar year, if the seller's records are properly kept, he may determine his actual loss on such a transaction by subtracting the retail value of repossessed property from the balance due from the purchaser (excluding from the balance the unpaid interest, finance charges, insurance charges, and any other amount added to the original purchase price). Such loss may be deducted in the same manner as charged-off accounts.

2. Discounts

In arriving at the measure of the tax, credit usually may be taken under State sales taxes for readjustments in sales price, such as cash, trade, or quantity discounts, regardless of whether these discounts are taken at the time of purchase or subsequently. Utah, for example, permits the deduction of discounts even though readjustment of price has been made subsequent to the period in which the tax upon the sale is reported, but the credit is allowed only if a sworn statement is furnished that the readjustment actually has been made. In Ohio, however, only those discounts which are allowed at the time of the sale may be deducted; discounts which are allowed after the sale is made or upon the happening of an event at some future time, such as cash discounts, are not deductible.

3. Transportation, installation and service charges

Charges for certain services rendered in connection with sales of taxable articles may be excluded from taxable receipts. Principal charges of this kind are those made for transportation, installation, interest, and insurance.

Where contract prices include charges for transportation, installation, and service for a specified period, State sales taxes generally apply to the full contract price. In some States the right

^{1/} Opinion of Attorney General, N. S. 4195, April 9, 1942.

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to exclude transportation charges depends upon whether the charges are separately billed. ^{1/} Separate billing, however, may not operate to exclude transportation if the price is the same both at the sending and receiving points.

Some States allow the exclusion of transportation charges if the seller contracts to sell property at retail for a price f.o.b. origin, the title to pass at that point and the buyer to pay the transportation costs. The Illinois regulations provide that "whether or not transportation charges may be deducted by the seller ... does not depend upon the separate billing thereof, but depends on whether the seller assumes responsibility for payment of transportation to a designated place ..." ^{2/}

Installation charges are generally excluded if there is a separate billing of materials and services. In Illinois, however, if the seller is required to install the property in order to complete the sales contract, the installation charges must be included in taxable receipts. ^{3/} This rule applies in all instances where the installation is an incident to the sale of the goods, as in the case of nursery products, radios, carpets, signs, storage batteries, and gas or electric stoves.

4. Interest and carrying charges

In the majority of States, interest or finance charges on sales of tangible personal property under conditional sales contracts or other contracts providing for deferred payments of the purchase price are not considered a part of the selling price of such property if they are separately agreed upon and billed. However, distinction is made between interest charges and "penalties" such as amounts added to the selling price because of failure of the buyer to make an installment payment at the time specified in the agreement between the parties. Interest is deductible if separately billed, but "penalties" are considered a part of the selling price and are subject to tax.

^{1/} States which specifically require separate billing include among others: California, Iowa, Kansas, and North Dakota.

^{2/} Illinois Rules and Regulations (revised July 1, 1941), art. 3.

^{3/} Ibid.

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A few States, for example Louisiana and Mississippi, consider interest and carrying charges a part of the selling price and apply the tax to the entire credit price including such charges. ^{1/}

5. Taxes

In States imposing the tax on the consumer, the amount of tax collected by the seller from his purchasers is, of course, excluded from the measure of the tax. Furthermore, in most States imposing the tax on the seller, the amount of sales tax reimbursement collected by the seller is excluded from gross receipts or gross sales for sales tax purposes. In some cases taxpayers are required to keep their records so that sales receipts and tax receipts are segregated; otherwise tax must be paid on the combined amount. ^{2/} Michigan and Illinois have formulae for computing the tax which in effect permit deduction of the approximate amount of tax reimbursement from gross sales. In Michigan, the formula used for obtaining the amount of sales tax payable to the State where the 3-percent tax is included in the purchase price and reported in gross sales is to consider gross receipts as 103 percent of taxable receipts and pay the tax on 100 percent. In Illinois, the 2-percent tax rate is applied to 98 percent of gross receipts. ^{3/} Indiana, on the other hand, provides that any amount added and collected as tax must be considered an additional price received and must be included in taxable income.

With respect to specific excises levied by the Federal Government or by the States, some States provide that taxes shall not be deducted unless they are paid directly by the retailer. Federal manufacturers' excises, which attach at the time of sale by the manufacturer, are generally not deductible in computing gross sales or gross receipts for State sales tax purposes. New York City and Arkansas appear to be the only jurisdictions which permit the deduction of these excises and they must be separately stated in order to be deductible. ^{4/}

^{1/} Louisiana, Rule 27; Mississippi, Opinion of the Attorney General, May 20, 1941.

^{2/} For example, New Mexico (Ruling No. 39).

^{3/} Prior to a 1941 amendment of the Illinois sales tax law, retailers were required to pay a tax measured by gross receipts which included the amount of sales tax collected. Thus if a retailer added 3 cents (the rate imposed prior to the amendment) to a dollar article, his taxable receipts were \$1.03.

^{4/} Subsequent to the imposition in 1941 of the Federal retail sales taxes on cosmetics, furs, and jewelry, New York City amended its regulations to provide for the deduction of Federal excises (both retailers' and manufacturers') provided such taxes are separately listed. Under the manufacturers' taxes it will be difficult, if not impossible, in many cases, for the retailer to ascertain what portion of the manufacturer's price is attributable to the tax.

In some States, if the manufacturer sells directly to the consumer, the Federal manufacturers' excise tax may be excluded provided it is separately invoiced. ^{1/} The theory of this exclusion is that Federal excises attach when the title to the article sold passes from the manufacturer to the purchaser, and where the first purchaser is the ultimate user, State sales taxes usually attach at the same instant. Consequently, the Federal tax is considered not to be a part of the sales tax measure. Other States require the Federal manufacturers' excise taxes to be included in the State retail sales tax measure even though the sale is made to the ultimate user and the tax is listed separately. ^{2/}

In most States the Federal retailers' excises (on jewelry, furs, and toilet preparations) may be excluded from the selling price if they are separately billed or invoiced. Indiana, however, has held that these taxes must be included in the measure of the State tax. ^{3/}

States usually allow deductions of miscellaneous Federal excises, such as those on admissions and telephone and telegraph services, wherein the vendee is liable for the tax and the vendor acts as collecting agent for the Federal Government.

6. Bad debts

If retailers report on a cash basis, the tax on credit sales is paid as collections are received and no tax is paid on uncollectible accounts. Several of the States which permit the retailer to pay taxes on the basis of gross sales allow adjustment for worthless accounts. Such allowances present administrative problems (as for example, when an account represents both taxable and nontaxable sales) and constitute a loophole for evading the tax. Especially is this true in those States which merely require that the retailer shall have written off the losses on his books. In most cases the deduction is limited to accounts which have been charged off for income tax purposes. ^{4/} Of the seven States which require retailers to report on a gross sales basis, only one allows the deduction of bad debt losses.

^{1/} Arkansas, Illinois, Kansas, Michigan, Missouri, New Mexico, North Carolina, North Dakota, Oklahoma, South Dakota, and Wyoming (also New Orleans and New York City). Commerce Clearing House, State Tax Review, October 13, 1941, p. 1.

^{2/} Alabama, Arkansas, California, Colorado, Indiana, Mississippi, Utah, and Washington. Commerce Clearing House, State Tax Review, October 13, 1941, p. 1.

^{3/} Prior to 1943 California also held that Federal retailers' excises were not deductible, but a 1943 amendment provides that any tax (other than a manufacturers' or importers' excise tax) imposed by the Federal Government with respect to retail sales is deductible whether imposed upon the retailer or consumer.

^{4/} States which allow the deduction on this basis include: Colorado, Iowa, Missouri, North Carolina, North Dakota, South Dakota, and Utah.

7. Trade-ins

State practices vary widely with respect to the treatment of sales involving trade-ins. 1/ There are three methods of handling such sales. First, the value of the trade-ins may be allowed as a deduction from the sale price of the new article and the trade-in subjected to tax when sold. Second, the full sales price of the new article may be taxed and the trade-in exempted when sold. 2/ Third, both the allowance credit and the sale of the trade-in may be taxed.

A few States employ the first method and tax only the difference in value between the new and used article but subject the secondhand article to tax when it is resold. 3/ Kansas formerly employed the second method and exempted trade-ins when sold, but by a 1941 amendment shifted to the first method of permitting a deduction of the amount allowed for the trade-in.

In the rest of the States, practice is about equally divided between the second and the third methods. The Iowa law specifies that the deduction allowed for receipts from sales of trade-ins must not be in excess of the original value of such trade-ins. Special records must be kept, however, in order to take advantage of this exemption. The seller must keep a record of individual transactions showing the identity of the traded-in property, the date received and date sold, the names and addresses of the persons from whom acquired and to whom sold, and the exact trade-in and sale price. Perhaps because of the difficulties involved in administering such an exemption most States using the second method exclude the sale of the trade-in regardless of price. Frequently the exemption is allowed only when the trade-in has been accepted as part of the purchase price of new goods. 4/

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- 1/ For a discussion of the treatment of trade-ins under State sales taxes, see B. U. Hatchford, "Measure of Consumption Taxes," Law and Contemporary Problems, Summer 1941, pp. 571-573.
- 2/ The tax usually applies to new parts and accessories used in repairing or reconditioning the article traded in but, in some cases, these also are exempt.
- 3/ Among these States are: Colorado, Kansas, North Dakota, and West Virginia. North Dakota's regulations explain, however, that when property which is not subject to sales tax, such as livestock, is taken as part consideration of the purchase price of a taxable article, the purchaser will be required to pay sales tax on the full purchase price.
- 4/ Mississippi's exemption of sales of trade-ins has been construed to apply only "when articles of like kind are traded in on the purchase of a new similar article." (Letter from Attorney General for the State Tax Commission to Commerce Clearing House, May 28, 1941.)

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Thus, the tax applies to sales of used articles which have been accepted in trade for other used articles.

South Dakota follows the third method of taxing both the allowance credit and the sale of the trade-in, but a specific exemption is provided in the case of resale of used farm machinery taken in trade on the purchase of new farm machinery already taxed by the State.

A tendency has been noted for States to shift to the third method (which allows no exemption to trade-ins) probably as a result of unsatisfactory administrative experience with the others. ^{1/} The courts have denied that such treatment imposes double taxation. A Pennsylvania court held that "the tax is imposed on the purchaser, computed on the amount he has agreed to pay" and "in each instance the tax has been levied upon the particular transaction with the respective purchaser." ^{2/} The Colorado Supreme Court held that the tax covers each separate sale and that "there is no limit to the number of times a particular article of merchandise may be subject to a sales tax so long as it remains in the stream of commerce and goes through the regular channels of trade." ^{3/}

V. Tax rates

The rates which are applied to retail sales by the 23 sales tax States are distributed as follows: 16 States, 2 percent; ^{4/} ^{1/2} States, 3 percent; ^{5/} one State, 2-1/2 percent; ^{6/} and the States of Louisiana and Indiana, 1 percent and 1/2 of 1 percent, respectively. ^{7/} North Carolina levies a 3-percent rate, but the maximum tax that may be imposed upon the sale of a single article is \$15. Washington and West Virginia,

^{1/} Ratchford, B. U., op. cit., p. 572.

^{2/} City of Philadelphia v. Heinel Motors, 16 A. (2d) 761, 764 (Pa. Superior Ct. 1940).

^{3/} Bedford v. Hartman Bros., 104 Colo. 190, 194; 89 P. (2d) 584, 585.

^{4/} Alabama, Arizona, Arkansas, Colorado, Illinois, Iowa, Kansas, Mississippi, Missouri, New Mexico, North Dakota, Oklahoma, South Dakota, Utah, West Virginia, and Wyoming.

^{5/} Michigan, North Carolina, Ohio, and Washington.

^{6/} California. The rate was reduced in 1943 from 3 percent to 2-1/2 percent for the period July 1, 1943 to June 30, 1945.

^{7/} Louisiana's rate is 1 percent, but in addition the City of New Orleans levies a 2-percent tax. Indiana, which imposes a gross income tax, reduced the rate applicable to retailers from 1 percent to 1/2 of 1 percent on January 1, 1942.

which are included in the 3-percent and 2-percent groups, respectively, also impose on retailers business and occupation taxes based on gross receipts from retail sales. 1/

With few exceptions, the 18 States imposing the single-stage form of sales tax apply a uniform rate to sales of all types of property. 2/ Alabama applies a lower rate (1/2 of 1 percent instead of the regular 2 percent) to sales of automobiles. The Wyoming law which provides that no tax is to be collected by the vendor from the purchaser on sales of 24 cents or less allows the retailer to pay a reduced rate (1 percent instead of the regular 2-percent rate) on all sales of 24 cents or less, provided he keeps detailed segregated records of all such sales. If he elects not to keep such records, he must pay a 2-percent tax on his total sales.

With a view to reducing the regressive effects of a sales tax, it has been suggested that lower rates be applied to sales of necessities such as "essential" foods and low-cost clothing, and higher rates to sales of "luxury" meals and clothing (defined as those selling for more than a minimum amount), theater tickets, liquor, etc. The States have levied special excises on "luxury" items, but little attempt has been made to introduce differentiation into the general sales tax. New York City has had some experience with differential rates under the sales tax. In 1938, the rate of tax was increased to 3 percent on restaurant meals selling for more than \$1, 3/ liquors, and public utility services, while the regular rate remained at 2 percent. The existence of surplus revenues in 1941 made possible a reduction of the tax to 1 percent on all types of sales.

Under the multiple-stage taxes different rates apply at the manufacturing, wholesale, and retail levels, and differentiation also exists in rates applied to various types of transactions at the same level. Variations from the general rate at the retail level are indicated in Table 5.

VI. Provisions relating to shifting

State retail sales taxes are imposed either upon the privilege of engaging in the business of selling at retail or upon the retail

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- 1/ The low-rate business and occupational tax becoming effective in Seattle in July 1943 also applies to gross receipts from retail sales.
 - 2/ Multiple rates are subject to the objections mentioned in connection with exemptions, (see page 15, section 2), namely, that they require sales records which separate sales by classes of goods.
 - 3/ Included in the price of the meal were cover, minimum, entertainment, or other charges made to patrons.

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Table 5. Differential retail rates under multiple-stage taxes

State	General retail rate (percent)	Special rates at retail level (percent)
Arizona	2%	Transportation, public utility services, printing, advertising, contractors, sales by restaurants and similar establishments, 1%
Indiana	1/2 ^{1/}	Display advertising, 1/4 of 1%; admissions, personal and professional services, sales of capital assets (including real estate and intangibles), storage, and utility charges; sales of all tangible personal property which do not constitute wholesale sales or selling at retail by retail merchants, 1% ^{1/}
Mississippi	2	Automobiles, fluid milk, contractors, gas and electricity for industrial use, 1%
New Mexico	2	Automobiles, 1%
West Virginia	1/2	Public utilities, 1%-4%; contractors, 2%

^{1/} Prior to a 1941 amendment, effective January 1, 1942, Indiana's rate was 1 percent on all gross income, except that received from wholesale sales and from display advertising which was taxable at 1/4 of 1 percent. The amendment reduced the rate on retail sales by retail merchants to 1/2 of 1 percent. The 1/4 of 1 percent rate was retained on wholesale sales and display advertising, and industrial processing was classified under that rate. All other receipts are taxable at 1 percent.

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sale transaction. 1/ Practice in the States is about equally divided between these two forms of tax. Under the retail privilege tax, the retailer is primarily liable for payment of the tax, but in most cases either mandatory or permissive provisions for shifting the tax are found in the law or regulations. Of the 11 States 2/ which impose retailers' privilege taxes, four (Alabama, Kansas, Mississippi, and West Virginia) specifically require that the tax be passed on, and at least two others (North Carolina and South Dakota) specifically permit the retailer to add the tax to price. California provides that the tax shall be collected by the retailer from the consumer "in so far as it can be done."

In the States which impose the tax upon the sale rather than upon the retailer, the retailer is directed to collect the tax from the consumer. 3/ Methods of shifting the tax are the same regardless of whether the tax is levied on the retailer or on the consumer.

The States have attempted to frame methods of collection whereby retailers will recover approximately the amount they must pay the State. On many individual sales it is difficult, if not impossible, to collect the exact percentage specified in the law. In order to facilitate the collection of the tax, most of the States have adopted a bracket system for adding the tax to prices. The schedule is

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- 1/ Prior to passage of the Revenue Act of 1942, the Bureau of Internal Revenue distinguished for purposes of the computation of the Federal income tax between State sales taxes which were levied on the retailer and those which were levied directly on the consumer. In general, if the legal incidence of the tax was upon the retailer, the consumer was not permitted to deduct the amount of the tax from gross income in computing net income, even though reimbursement for the tax was separately stated and collected from him. The Revenue Act of 1942, however, provides that all State retail sales taxes, if separately stated, are deductible.
- 2/ Alabama, Arizona, California, Illinois, Kansas, Michigan, Mississippi, New Mexico, North Carolina, South Dakota, and West Virginia.
- 3/ Arkansas regulations state that failure for any reason to collect the tax from the consumer will forfeit the seller's permit and make him liable for tax. (Arkansas Regulations, art. 1.) Colorado regulations declare "the tax is in reality imposed upon the purchaser, and the duty is imposed directly upon the one making the sale, under penalty of misdemeanor, to add the tax ... in so far as practicable, to the sale price." (Colorado Regulations 1.)

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prescribed by statute in Ohio and West Virginia; 1/ in fifteen States it has been prescribed by administrative authority; 2/ in at least four of the remaining States, retailers' associations have voluntarily adopted a schedule. 3/

The bracket system involves the specifying of the amount to be collected on sales of various sizes. While the system is simple enough in its operation, it does not provide for collection of the exact amount of tax. Underpayment or overpayment of the tax results. Under low rate taxes, it is common practice to exempt small sales in order to avoid collection of a tax far in excess of the rate provided by law. These exemptions sometimes extend as far as all transactions involving 25 cents. Since most States collect the tax on total sales (allowing the retailer no deduction for small sales), the retailer may be forced to absorb the tax on some portion of his receipts derived from small sales, but through the operation of the bracket system he may be able to compensate himself by collecting more than the amount of tax on other sales.

1/ The West Virginia statute provides that the retailer shall collect a tax of 2 percent of gross receipts, but the tax payable by the purchaser is to be computed under the following schedule (also set up by statute): on sales below 6 cents, no tax; from 6 cents to 50 cents, 1 cent tax; from 51 cents to \$1, 2 cents tax; on each 50 cents or fraction thereof in excess of \$1, one cent. It may be noted that under this schedule the purchaser will be paying in excess of 2 percent. The statute requires the retailer to remit to the State the entire amount collected even though it is in excess of 2 percent of gross proceeds. Ohio's statute sets up a bracket schedule under which the tax is collected by means of prepaid tax receipts. If the amount of tax collected from purchasers by means of prepaid tax receipts does not equal 3 percent of his gross receipts from retail sales, the retailer must pay the difference. Furthermore, if the retailer has collected tax in excess of 3 percent of such gross receipts and has not canceled tax receipts in the proper amount, the excess must be remitted.

2/ Alabama, Arizona, Arkansas, Colorado, Kansas, Louisiana, Mississippi, Missouri, North Carolina, North Dakota, Oklahoma, South Dakota, Utah, Washington, and Wyoming.

3/ California, Illinois, Iowa, and Michigan.

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Nine of the States 1/ minimize tax rate variations by the use of tokens in fractional-cent denominations of one, two, or five mills. Under low rates, such as those imposed by the States, tokens serve to eliminate inequity in applying the sales tax to small purchases. The use of tokens generally has been favored by merchants whose business is made up in large part of small sales. 2/ Consumers in some cases have objected to the nuisance aspects of tokens. A few States which once used tokens have discontinued them. Illinois issued tokens during the first year the sales tax was in effect (1933-1934), but took no action to enforce their use. Consumers and retailers did not become accustomed to them and a few months after their introduction they fell into disuse. 3/ Kansas repealed its statutory provision for tokens in 1939. Louisiana employed tokens under the former sales tax (which was repealed in 1940), but the sales tax law enacted in 1942 provides for collection of the tax in accordance with a bracket schedule adopted by the administrative agency. 4/

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- 1/ Alabama, Arizona, Colorado, Mississippi, Missouri, New Mexico, Oklahoma, Utah, and Washington. The administrative agency in at least four other States (Arkansas, North Carolina, South Dakota, and Wyoming) has statutory authorization to issue tokens but has not made use of this authority.
- 2/ For a discussion of the attitude of tax administrators and consumers toward the use of tokens, see Joseph W. Huston and John R. Berryman, "Collection and Enforcement of State Consumption Excise Taxes," Law and Contemporary Problems, Summer 1941, p. 520.
- 3/ Jacoby, Neil H., Retail Sales Taxation, p. 312.
- 4/ Subsequent to the enactment of the State sales tax of 1 percent, the City of New Orleans (which imposes a 2-percent tax) adopted an integrated bracket system which applies to sales that are taxed by both the city and the State. Of the total amount collected under the integrated method two-thirds is remitted to the city and one-third to the State. In the event that a sale is taxed by the City of New Orleans and not by the State, the tax is collected under a schedule applicable only to the New Orleans tax.

VII. Administrative provisionsA. Allowances to retailers for collecting the tax

Retailers act as sales tax collecting agents for the State either as a matter of law or of practice. The work of collecting, recording and paying the tax imposes a considerable burden upon the retailers. ^{1/} Eight States reimburse the retailer by permitting him to retain a certain percentage of the tax. In some cases the retailer receives the allowance only if the tax is paid promptly. Table 6 indicates allowances granted in the various States.

Table 6. Allowances for collecting the tax

State	Allowance - percent of tax
Alabama	3%
Arkansas	2
Colorado	5
Louisiana	2
Missouri	3
North Carolina	3
Ohio	3 ^{a/}
Oklahoma	3

^{a/} Ohio's reimbursement is in the form of a 3-percent discount on the purchase of prepaid tax receipts. The retailer is required to give the consumer a stamp which is torn in half so as to cancel it. In order to encourage the consumer to demand his tax receipts an amendment adopted in 1939 provided that the State would redeem canceled stamps at 3 percent of their face value when presented by charitable and certain other organizations in amounts representing taxes of \$100 or more. Under an amendment adopted in 1943, agents appointed by the treasurer of the State for the sale of prepaid tax receipts receive an amount not to exceed 1 percent of the proceeds of sales and the county treasurer may retain for use of the general fund of the county 1 percent of the proceeds of sales.

^{1/} See Shoup, Carl, "The Experience of Retailers under New York City's Sales Tax," National Tax Association Bulletin 30, 110 (1936). Shoup found that every store investigated reported an increase in accounting costs because of the tax and many estimated the extra cost at from 5 to 10 percent of the tax collected.

In other States retailers are not compensated for the cost of collecting the tax except in so far as they are able to collect more than the legal rate of tax as a result of the operation of the bracket system. Some States, however, have specific provisions requiring that any such excess be paid to the State. ^{1/}

B. Returns

The States require frequent reports and payments of the retail sales tax. State practice with respect to frequency of filing returns is indicated in Table 7.

Fourteen States require monthly returns, but six of these permit quarterly returns if tax liability is less than an indicated amount per month. Three States require bi-monthly returns and four require quarterly returns. Ohio, which uses a system of prepaid tax receipts, requires a semi-annual return. In addition to periodical returns, accompanied by tax payments, six States require an annual return which recapitulates tax liability.

In a recent study the Illinois Department of Finance examined the advantages and disadvantages of various filing periods for the purpose of determining the desirability of changing from a monthly to a quarterly sales tax return period. ^{2/} It found no overwhelming advantage favoring either particular period of return. The longer periods of return afford greater opportunities to decrease administrative office expenses or to divert these potential savings into expenditures on field auditing. On the other hand, infrequent return periods make it more difficult to collect the tax in case of bankruptcies and removal of businesses to other States. Also, the longer a taxing agency allows liability to run, the more difficult it is to enforce payment.

California and Iowa have attempted to combine the advantages of quarterly returns and those of monthly returns by requiring quarterly returns but permitting the sales tax administrator to require monthly returns of individual taxpayers if necessary. It was noted in this connection by the Illinois study that of the 202,852 active permits in California as of January 31, 1942, as many as 38,398 (or 18.9 percent) were required to file on a monthly basis. ^{3/}

^{1/} See section on "Provisions relating to shifting."

^{2/} Criz, Maurice, "Quarterly Retailers' Occupation Tax Returns for Illinois," National Tax Association Bulletin, November 1942, pp. 38-43.

^{3/} Reported in a letter from DeWitt W. Kreuger, Chief, Division of Research and Statistics, California State Board of Equalization, dated March 3, 1942, to Maurice Criz.

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Table 7. Frequency of filing returns

Monthly	Monthly; quarterly if tax small ^{1/}	Bi-monthly
Arizona	Alabama (\$10)	South Dakota
Arkansas	Colorado (\$20)	Utah
Illinois	Mississippi (\$10)	Washington
Kansas	Oklahoma (\$ 5)	
Louisiana	West Virginia (\$10)	
Michigan	Wyoming (\$10)	
Missouri		
New Mexico		
North Carolina		

Quarterly	Semi-annual	Annual, in addition to monthly or quarterly
California ^{2/}	Ohio	Alabama
Indiana ^{3/}		Arizona
Iowa ^{2/}		Indiana
North Dakota		Michigan
		Mississippi
		Missouri

^{1/} Minimum liabilities to be reported monthly shown in parenthesis.

^{2/} Administrator may require returns on other than a quarterly basis.

^{3/} When tax is not in excess of \$10 for a quarter, taxpayer may file annual return.

C. Licenses

To facilitate administration, most States license all taxpayers. Three States require that the license be renewed annually, one requiring no fee, one a fee of \$1, and the other \$2.50. Seventeen States issue permanent licenses, six requiring no fee and the others requiring fees ranging from 50 cents to \$2. No license is required in three States. License requirements in the various States are indicated in Table 8.

The licensing device is used as an instrument of enforcing tax compliance and is particularly effective if the administrator has authority to revoke licenses in case of noncompliance. Approximately two-thirds of the State sales tax laws contain a revocation provision. The typical provision states that the administrator "may, on a reasonable notice and after full hearing, revoke the license of any person found to have violated any provision of the Act." ^{1/} Some administrators have found the threat of license revocation a very effective means of enforcing payment of delinquencies. ^{2/}

D. Bonds

The requirement of a bond to guarantee payment of tax is a protective device found in many State motor fuel and liquor tax and in some tobacco tax acts. A recent study of methods of collecting and enforcing consumer taxes indicates, however, that none of the State retail sales tax laws contains a mandatory provision for posting security, although some of them have discretionary bonding provisions under which the administrator may require the posting of a bond or other security when he has reason to believe that such action is necessary to avoid default. ^{3/}

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- ^{1/} The Ohio law specifically provides that an appeal may be taken to the common pleas court of the county and the judgment of the common pleas court may be reviewed upon proceedings in error in the court of appeals. Either court may suspend the order of revocation pending hearings in the courts.
- ^{2/} The Utah Tax Commission, for example, cites delinquent taxpayers to appear and show reason why their license should not be revoked. Those who fail to reply are notified that their license will be revoked 10 days after the receipt of the notice. If at the end of this period they have not made payment, they are visited by a member of the field force. It is estimated that 60 percent of the delinquent accounts are paid upon receipt of the first notice, 90 percent of those remaining pay upon receipt of second notice that revocation will follow; and practically all the remainder pay at the time of the field contact. (Fifth Biennial Report of the State Tax Commission of Utah, 1939-40.)
- ^{3/} Huston, Joseph W. and John R. Berryman, "Collection and Enforcement of State Consumption Excise Taxes," Law and Contemporary Problems, Summer 1941, pp. 508-509.

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Table 8. License requirements under
State retail sales taxes

				Annual			
No license				No fee	\$1	\$2	\$2.50
Indiana	Utah	Michigan	Colorado				
Missouri							
West Virginia							
Permanent							
No fee				50¢	\$1	\$2	
Alabama	Iowa	Arizona	Wyoming				
Arkansas	North Dakota	California					
Illinois	South Dakota	Mississippi					
Kansas		New Mexico					
Louisiana		North Carolina					
Oklahoma		Ohio					
		Washington					

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VIII. Revenue importance

If unemployment compensation taxes are excluded, general sales taxes are the second largest source of State revenues. They rank next in importance to motor fuel taxes and exceed by far the aggregate collections from both corporate and individual income taxes. In the fiscal year 1942, sales tax collections amounted to \$629 million which represented one-sixth of total State tax revenues (excluding unemployment compensation taxes) and one-third of the tax revenues of the States which have sales taxes. The relative importance of the sales tax in the tax structure of individual States is indicated in Table 9. The proportion of total revenues derived from the retail sales tax ranges from 18 percent in Alabama to 45 percent in Michigan. Some of the States with broader scope taxes, such as Washington and West Virginia, received even larger portions of their revenues from sales taxes.

Table 10 shows collections from State general sales and use taxes for the fiscal years 1939 - 1943. The Bureau of the Census estimates State sales tax collections as \$665 million in 1943 compared to \$629 million in 1942.

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Table 9. Revenue importance of State sales taxes,
fiscal year 1942

State	Tax collections (In thousands of dollars)			Sales tax as a percent of total taxes	
	Sales tax	Total taxes		Including:	Excluding:
		unemployment compensation	unemployment compensation	unemployment compensation	unemploy- ment com- pensation
Alabama	\$ 9,311	\$ 62,287	\$ 51,643	14.9%	18.0%
Arizona	5,340	26,574	23,765	20.1	22.5
Arkansas	8,042	45,822	40,879	17.6	19.7
California	134,321	436,137	333,475	30.8	40.3
Colorado	10,277	43,727	38,484	23.5	26.7
Illinois	85,589	320,802	230,869	26.7	37.1
Indiana	33,601	124,397	95,701	27.0	35.1
Iowa	21,190	80,139	70,870	26.4	29.9
Kansas	13,110	49,502	44,411	26.5	29.5
Louisiana ^{1/}	-	-	-	-	-
Michigan	82,728	251,153	183,902	32.9	45.0
Mississippi	9,907	46,415	42,379	21.3	23.4
Missouri	29,514	106,005	82,670	27.8	35.7
New Mexico	5,193	19,937	18,299	26.0	28.4
North Carolina	15,663	112,808	99,018	13.9	15.8
North Dakota	4,382	19,449	18,546	22.5	23.6
Ohio	64,411	301,448	228,494	21.4	28.2
Oklahoma	14,070	80,291	73,537	17.5	19.1
South Dakota	3,650	15,543	14,859	23.5	24.6
Utah	5,324	24,022	20,511	22.2	26.0
Washington	40,248 ^{2/}	105,891	90,124	38.0	44.7
West Virginia	30,961 ^{2/}	67,594	56,788	45.8	54.5
Wyoming	2,094	8,641	7,386	24.2	28.4
Total	\$628,926	\$2,348,584	\$1,866,610	26.8%	33.7%

Source: Bureau of the Census, State Tax Collections in 1942, July 1943.
Percentages computed.

- ^{1/} The Louisiana sales tax was repealed in 1940 and reenacted on September 1, 1942.
^{2/} Includes collections from both the retail sales tax and the business and occupation tax.

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Table 10. Collections from State general sales taxes and use taxes, 1939-1943 ^{1/}

(In thousands of dollars)

States	1939	1940	1941	1942	1943
Alabama	\$ 5,890	\$ 7,756	\$ 9,311 ^{2/}	\$ 9,311 ^{2/}	\$13,427 ^{6/}
Arizona	3,568	4,010	4,403	5,340	6,179
Arkansas	4,988	5,514	6,152	8,042	9,193
California	87,910	93,780	110,372	134,321	137,295
Colorado	7,191	8,810	9,416	10,277	11,706
Illinois	81,517	90,818	101,761	85,589	79,492
Indiana	19,982	23,538	25,873	33,601	34,117
Iowa	15,858	16,858	17,992	21,190	20,636
Kansas	9,728	10,080	11,189	13,110	14,554
Louisiana	5,489	7,473	4,991 ^{4/}	^{4/}	6,063
Michigan	51,488	60,374	73,632	82,728	86,163
Mississippi	6,065	6,743	7,407	9,907	13,164
Missouri	22,332	23,019	29,514 ^{5/}	29,514 ^{5/}	31,168
New Mexico	3,454	4,198	4,265	5,193	5,895
North Carolina	10,998	12,208	14,247	15,663	^{7/}
North Dakota	2,751	3,099	3,364	4,382	4,314
Ohio	46,105	50,985	64,411 ^{5/}	64,411 ^{5/}	59,851
Oklahoma	10,706	10,952	11,788	14,070	16,028
South Dakota	3,810	4,504	5,014	3,650	3,876
Utah	3,613	4,199	4,542	5,324	6,756
Washington	16,381	20,689	24,364	40,248	48,598
West Virginia	20,630	18,608	20,874	30,961	^{7/}
Wyoming	1,870	1,961	2,094 ^{2/}	2,094 ^{2/}	2,439
Total	\$ 442,324 ^{2/}	\$ 490,176 ^{2/}	\$ 566,976 ^{2/}	\$ 628,926 ^{2/}	\$ 614,897 ^{8/}

Source: Bureau of the Census, State Tax Collections, 1939-1943.

- ^{1/} Includes collections from (1) general sales taxes applicable to retail, wholesale, or manufacturing sales, (2) use and compensating taxes, (3) gross income and gross receipts taxes which have the characteristics of general sales taxes.
- ^{2/} Totals reported by the Bureau of the Census have been adjusted to exclude delinquent collections from repealed taxes in certain States not listed here.
- ^{3/} Data for fiscal year ending September 30, 1941.
- ^{4/} The Louisiana sales tax was repealed as of December 31, 1940, but was reenacted on September 1, 1942.
- ^{5/} Data for fiscal year ending December 31, 1941.
- ^{6/} Data for fiscal year ending September 30, 1942.
- ^{7/} Data not yet available.
- ^{8/} Incomplete. The Bureau of the Census estimates total collections to be \$665,000,000 (August 1943).