

ESSAY ON TAXATION

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THE first step toward correct tax legislation is the study of the principles on which it depends. Without this we have no assurance that change is improvement. Before we began to find principle in medicine, the science, if it could be called a science, consisted of mere experiment. Tax legislation is passing through the same stage. Without seeking definite and ascertained principles, founded on equity, the law strikes now at this object and now at that, as a means of raising money. A. L. Chapin somewhat ludicrously says that "there is found to be an advantage in combining different systems of taxation so that the defects of one shall be balanced by the defects of another, while the advantages of all are secured." That is as though a doctor should say that the disadvantages of antipyrines, sudorifics, and sedatives are such that it has been found best to dose patients for every disease with a view to combining the advantages of all remedies. Yet, in taxing, such is the common procedure.

It is not wonderful, however, that taxation should be of so chaotic a character.¹ It originated either in simple robbery or extortion by chiefs and kings, or in the price of protection from robbery;² and so far as it has been controlled by any practical theory it has been the theory of the blackmailer or the bandit; that is, to prey upon its victims just to such an extent and in such ways as will leave them able to respond to further exactions. This is what we might call, after Colbert's famous saying, the goose-plucking system of taxation. It has been succeeded, in theory at least, by taxes imposed by the people themselves for their common needs. What, then, are these common needs for which we should pay in common?

¹"The systems for raising revenues in the different states by the national government grew up under the force of accident and circumstances rather than as the result of consideration and inquiry." — *From the Report of the Commissioners of 1871, to revise the Tax Laws of New York, by David A. Wells and Messrs. Dodge & Cuyler.*

²Blanqui: *Hist. of Pol. Econ. in Europe*; also Denslow's "Prin. of Econ. Phil.," Cassell, p. 452; Smith's "Wealth of Nations," Black & Tait's Ed., pp. 412-14.

Taxes are popularly supposed to be paid only for protection of life or property. This is erroneous.³

3 J. S. Mill's *Prin. of Pol. Econ.* Longman's G. R. & D.'s, People's Ed., p. 485.

Were they for protection only, those persons who demand most protection should pay the most; that is, orphans, women, lunatics, and the poor generally; while the city "tough," John L. Sullivan, or anybody else who feels quite competent to take care of himself with his hands, should not pay anything. The rich man does not need your protection. He can, and actually does, hire Pinkerton's detectives, or footmen, or watchmen, when he finds himself or his property in danger. Should he on that account be exempt?

Were taxes for protection, the owner of a ranch, which cannot be carried off, and which he is prepared to defend by the aid of his cowboys, should not pay any taxes. We find, in fact, in some communities such a state of society that, owing to the mild manners or religious feelings of the people, protection is unnecessary; while in some frontier towns every one protects himself or else a vigilance committee protects all who deserve it. Will anyone claim that in such cases no taxes could be fairly levied, or that, conversely, he who pays no taxes should have no protection? In old times taxes were based on some such theory, but that age has long passed by.

Taxes are not paid for protection, except in the same sense that the price of protection is paid in stamping a letter. They are a necessary condition of having roads, bridges, public justice, sewers, boards of health, commissioners of agriculture, water, police, lights, education, harbors, and the thousand and one privileges incident to civilized society.

Another popular theory is that men should contribute to the common burden according to their abilities — that a man should pay because he can. This is as fallacious as the last.⁴ Such a tax is a tax on abilities, and consequently a discouragement to large abilities.

4 "It must, therefore, be evident that equality of taxation cannot mean the taxing of people according to their means." — *H. Fawcett's Man. of Pol. Econ.*, 6th Ed., p. 518.

It also is based on the tribute theory and can be reduced to an absurdity; for only a comparatively small sum, say not over a hundred thousand dollars annually, is necessary to the comfort of even a very extravagant man; while the ordinary banker could spare little out of five thousand. The man who has a million a year, therefore, if he were to pay according to his ability, should be taxed nine hundred thousand, and the modest banker should go almost free. Nor is there any justice in such a levy; for a costly marble mansion with its usual furniture, demanding no more from the public than does a cheap wooden house, should be charged no more. Clearly taxes are not collected for that reason.

Taxes are collected because, when men gather together, it is found best to divide certain necessary work for the sake of economy and efficiency. It seems, therefore, that those who get the most benefit from this work should pay proportionately; that all should pay only for what they get.

Adam Smith was the first to attempt to formulate these truths upon which a tax system should be based. His canons may be described as those of Convenience, Economy, Certainty, and Equality. They leave out, however, the element of directness, with the benefits which admittedly flow from every man knowing for what he pays his money. They do not sufficiently consider the additions to the amount of taxes which are added by those who advance the tax and really act as collectors. The greater the number of hands through which the tax passes on its way from the real payer to the government, the greater the number of profits and expenses which will be taken out of the sum paid before the government gets it.

An examination of the leading authorities shows that, though variously expressed, Smith's maxims as far as they go, have "been generally concurred in by subsequent writers,"⁵ and that their application has been no less generally neglected.

5 Mill's Prin. of Pol. Econ., p. 483. See also Fawcett's Man. of Pol. Econ., 6th Ed., 1883, p. 516.

His principles have recently been formulated by a New York association, as follows; viz., —

1. The most direct taxation is the best, because it gives to the real payers of taxes a conscious and direct pecuniary interest in honest and economical government.

2. Mortgages and capital engaged in production or trade should be exempt from taxation because taxes on such capital tend to drive it away, to put a premium on dishonesty, and to discourage industry.

3. Real estate should bear the main burden of taxation, because such taxes can be most easily, cheaply, and certainly collected, and because they bear least heavily on the farmer and the worker.

These unite all the canons stated by Adam Smith, and, for a practical program, appear to meet every requirement.

The laws are stated by Henry George with axiomatic force, as follows : —

The best tax by which public revenues can be raised is evidently that which will closest conform to the following conditions: —

1. That it bear as lightly as possible on production, so as least to check the increase of the general fund from which taxes must be paid and the community maintained.

2. That it be easily and cheaply collected, and fall as directly as may be upon the ultimate payers, so as to take from the people as little as possible in addition to what it yields the government.

3. That it be certain, so as to give the least opportunity for tyranny or corruption on the part of officials, and the least temptation to lawbreaking and evasion on the part of the taxpayers.

4. That it bear equally, so as to give no citizens an advantage, or put any at a disadvantage, as compared with others.

From these premises Mr. George arrives at a very radical conclusion.

The proposed changes which seem to meet with the most general favor from conservative intellects are a graduated income tax, a tax upon inheritances or upon collateral inheritances, and a tax on land and on franchises. They should be carefully considered.

The income tax, although advocated by good authorities, seems to be more proper as a special or supplemental tax, where other sources of revenue fail,⁶ or for special demands like war.

6 "Direct taxes on incomes should be reserved as an extraordinary resource for great national emergencies."—*Laughlin's Mill's Prin. of Pol. Econ. Appleton, 1887, p. 556.*

It is open to three objections: —

First. That it is extremely difficult to collect fairly — so much so that in Germany, where that tax is heavy, the proverb runs, "The bigger the income, the bigger the thief." It is a tax which is more readily evaded by the very rich than by others, because it pays a rich man to employ the best counsel, to resort to artifices, or to remove his residence for the purpose of saving a considerable sum of money; while upon men of moderate circumstances, especially those on a salary or having a fairly definite professional income, it falls with redoubled weight.

Second. Even a graduated tax has not that justice which appears on its face. For a poor man with a large family to pay anything out of an income which barely supports him is more of a hardship than for a wealthy man, who has only himself to care for, to pay a large proportion of his superfluity. In order to impose anything like equal burdens, an income tax should be graduated with reference not only to the amount of income, but to the amount of necessary expenditures, and, consequently, with reference also to the social position of the individual. Thus, a butcher's foreman with fifteen hundred dollars a year, who lives as butcher's foremen and men of the laboring class usually do, would find a tax upon his income far less burdensome than the small merchant who makes fifteen hundred dollars' profit, but whose mode of living and dress, from the nature of his occupation, necessarily involves a much larger expenditure. But such graduation would be impossible.

Third. An income tax is paid, if paid at all, entirely out of savings. It tends to discourage frugality, and to undo the very work on which we have spent so much trouble in establishing a savings bank system. All proposals for a graduated income tax necessarily provide for the exemption of incomes under a certain amount, for it would not pay to collect a tax on a laborer's wages. If, in order to remedy this, its payment be made a condition of the suffrage, then, besides disfranchising many working-people, it opens a wide door for corruption; and, if not so constructed, such a system would exempt the greater part of the public from all share in the public burdens.

"It is to be feared, therefore, that the fairness which belongs to the principle of an income tax cannot be made to attach to it in practice." (J. S. Mill's "Prin. of Pol. Econ.," page 555.)⁷

7 For other objections see Fawcett's *Man. of Pol. Econ.*

Now, as to the inheritance tax: That is an occasional and uncertain duty, like the old aids, reliefs, and wardships; and the effect of it is, like that of other taxes on personal property, to drive away capital. The American colonies at Paris, Pau, Rome, and London are already sufficiently large for American interests. A tax on inheritances violates the canon that taxes should be assessed at the time when they can be most easily paid, since almost all estates are pressed for ready money, and one cannot pay taxes with a note or by hypothecating "cat-and-dog" securities, valuable as they may eventually prove to be.

The legacy duty falls mainly upon widows and orphans, and falls most heavily upon those of slender means, because it is more easily evaded by the rich. Being impersonal and infrequent, it interests no one in good government. It fosters extravagance and hinders the natural redistribution of vast estates, and that in increasing degree as it is made heavier on bequests to distant relatives. Nor does the fact that a legacy is possible merely by reason of law justify this toll, for the collection of a debt is also such an artificial power.

We must seek some more philosophic changes than these if we are to distribute the burdens equitably.

As the experience of California, Colorado, Massachusetts, and other states shows,⁸ to tax personal property in any form fully or fairly is utterly impracticable.⁹ The attempt results in an increase of nothing but perjury. If it could be done it would be disadvantageous, and it is now advocated by hardly any respectable authority. Even the attempt has recently been, to all intents, abandoned in Ohio. The tendency of enlightened law-making is to fix taxes mainly on real estate, and this better conforms to the canons. The quantity of real estate is substantially fixed, and its use indispensable, so that assessments on it cannot lessen its amount or impair the extent to which it is used. It cannot be carried away or concealed. It is open to the sight of all, and, though its valuation is not entirely free from difficulty, yet, since it is immovable from year to year, it can be more accurately appraised and more easily compared than any other property.

⁸ See Thomas G. Shearman's address before the Joint Committee of Taxation of the Ohio Legislature, Jan. 9, 1889.

⁹ See Julien T. Davies's address on "The Abolition of the Tax upon Personal Property," delivered Jan. 22, 1891.

Its value is determinable in advance of assessment; the tax is a first lien on the property, so that it has become proverbially certain, while the active interest of real estate owners in public expenditure testifies to the beneficent effect of its directness. As to the way in which this tax is distributed, the *New York Times* well remarked: "Everybody who pays rent, or who pays board to any one who pays rent, or who buys anything of any one who either owns or rents real estate, contributes his share toward the taxes that are collected from real estate. The landlord who directly pays the tax bills adds substantially the amount of his payment to the rent which he charges for the use of his house, and the amount of rent paid by the occupant affects the price of anything that he may sell, whether it is lodging, or board, or merchandise." (Editorial, May 19, 1891.)

This is too self-evident to need discussion. This tax is specially adapted to municipal wants, as the assessable value of real estate increases in direct proportion to wise municipal expenditures.

The practical difficulties in the way of its adoption are not serious. It is not difficult to show the farmer that the accompanying exemption of personal property would greatly lighten his burdens, because he knows that agricultural land is worth little in itself, and derives its value mainly from the stock, crops, machines, and capital employed upon it. The farmer feels the assessment of these things more severely than the trader, because he can less easily evade it.

Taxes on real estate are just, and are favored by intelligent real estate owners, because, although that part of the tax which falls on the value of the land alone is paid by the owner and cannot be charged over,¹⁰ these taxes encourage improvement, foster trade, and so increase the value of the land.

10 "A tax on rent would fall wholly on landlords, and could not be shifted to any class of consumers." — *Ricardo, Chap. X.*

Merchandise or houses can always be produced again at about the same price, but whatever increase comes from business and prosperity attaches only to the land, so that all eventually comes back to the owner of the soil.

The tax must be on real estate regardless of whether it is paid for or not. Were the propositions which commend themselves to many of our rural legislators carried out, namely, to tax the mortgage too, or to tax the land and allow the amount of any mortgages to be deducted from the assessed valuation, in the one case the amount of the tax on the mortgage would be charged over to the borrower, and in the other the city speculator would pay simply no real estate tax whatever, because he would cover up his land to its full value with mortgages held by his sister in Jersey City, his lawyer in Great Britain, or by somebody else so removed from state jurisdiction that, in accordance with the decisions of our United States courts, the property could not be reached for taxation.

Taxes on corporate or other franchises conferred by the government also comply with the conditions of the canons, for it is unreasonable that one man or body of men be given special privileges without making special compensation to the community. This applies equally to banking, insurance, railroad, and land companies. But the tax must be laid on the value of these privileges and not on the use of them, nor on the capital employed, nor on the receipts, else it will have all the disadvantages of other taxes on production and on capital. Such taxes are popular, and are generally recognized as specially adapted for state purposes, so much so that the Governor of New York recently expressed the hope and conviction that they would shortly be sufficient to defray all ordinary expenses.

The question of federal customs duties need hardly be considered here, since those who hold that the tariff is not a tax at all, but merely a means of fostering industry, believe that it should be gradually dispensed with when no longer needed; while those who believe that it is a tax contend that if sufficient revenue can be otherwise raised with less expense, greater certainty, and an equally general distribution, then, being subject to constant modification, it should gradually

disappear. In any case it has nothing to do with either state or municipal government, even if at present necessary for national purposes.

These, then, appear to be the needed scientific changes, — the steady concentration of all taxes for local purpose on local real estate,¹¹ and of taxes for other purposes upon franchises and upon the special powers of corporations.

11" Now, all this loss and confusion would be avoided if the corporations were assessed by the State Assessors, under a code to be wisely adjusted, so as to distribute taxation equitable, with reference to the means, condition, and purposes of the corporation; keeping the tax below the repelling and expelling point, and recognizing the claims of manufacturing and publishing corporations to consideration. The real estate interest would reap a substantial and material advantage in relief from the state tax, and corporations, when each class should be equitably and uniformly taxed, would cease to be the objects of jealousy and distrust." — *Letter xi. of Geo. H. Andrews on "The Future of New York" 1877.*