

BEST METHODS OF MUNICIPAL TAXATION.<sup>1</sup>

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Although the subject under discussion is city taxation, it is impossible to consider the city apart from its relation to state government. It would not be difficult to devise a system of city taxation if the city stood alone, but unfortunately our cities are bound by constitutional limitations and systems of taxation which require uniformity throughout the state in which the cities are situated. It would be useless, therefore, to suggest reforms in city taxation without pointing out the obstacles that must be removed before the reforms can be adopted.

## STATE CONSTITUTIONS THE MOST SERIOUS OBSTACLE TO REFORM.

The most serious obstacle to reform is to be found in the constitutions of the states, which, as a rule, require the uniform and equal taxation of all property, save such as is specifically exempted by the constitution itself. Such a provision exists in the constitutions of twenty-five states, and, strange as it may seem, those constitutions which most offend against the true standard of constitution building are those which have been most recently adopted. The constitutions of eight states only are at all satisfactory in respect to the provisions regarding taxation, and with one exception these states are among the original thirteen. Those who framed these constitutions did not deem it necessary to bind their legislatures and subsequent generations to an inflexible system, but permitted their sons to increase in wisdom, as in wealth, and change their methods of taxations as conditions changed and learning grew. These eight states deserve to be placed on record to furnish an example for the rest of the Union. They are as follows: Alabama, Connecticut, Delaware, Massachusetts, New Hampshire, New York, Rhode Island and Vermont.

## LEGISLATURE SHOULD BE FREE TO ADOPT NEW METHODS.

I think it is too obvious to require argument that the legislatures of our states should be as free to adopt new methods of taxation as that manufacturers should be free to adopt new machinery. Constitutions in which are embodied a mass of statute law are as bad an example of the exercise of despotic power as the edict of an emperor or the ukase of the czar. Emerson, or some other great man, has said that "There is no law to prevent a man from growing wiser," but the constitutions of thirty-seven states decree that the voters of those states shall remain in primitive ignorance. To achieve improvement we must have power

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to change, and the first step which must be made in these thirty-seven states is to remove the constitutional restrictions upon the power of the Legislature to adopt improved methods of taxation.

#### STATE EQUALIZATION AN OBSTACLE TO IMPROVED TAXATION.

The second obstacle which must be removed before we can amend municipal taxation is the method at present in vogue in the great majority of the states for raising state revenue. Assessment and taxation are uniform throughout these states and a tax is levied for state purposes on all property throughout the state on the assessment made in each tax district by local officials. You are all familiar with the fact that the assessors in every tax district endeavor to shift the burden to other tax districts by the under assessment of property in their own district. This leads to interminable friction and jealousy, and in some states a state board has been created with power to equalize these assessments to distribute fairly the burden of state taxation. This plan has done little more than aggravate existing friction, and, so long as human nature remains as it is, we can hope for no better results from this plan.

Not only is this system bad in itself, but it binds every tax district in the state to a uniform system, which is almost as serious a bar to progress as restrictions imposed by a constitution. In every state there are differences of character between the various tax districts greater than the difference between the condition of Ohio and New York in the year 1800 and the year 1900. There are cities where population is dense and property has taken on manifold forms, and there are sparsely settled towns and villages, as primitive as any which existed before the revolution. To insist that such communities shall be bound to one system is almost inevitably to impose upon the progressive the will of the most backward.

#### STATE REVENUES DERIVED FROM SPECIFIC TAXES.

To avoid the imposition of a state tax upon property, as assessed by local officials, some states obtain their revenues from specific taxes levied upon certain selected forms of property. These taxes, being imposed at an unvarying rate, sometimes produce too much revenue, which the legislatures promptly squander, or produce too little, and proper expenditures have to be curtailed or the state is forced to borrow. All three of these difficulties have been met in recent years by the states of Connecticut, New Jersey and Pennsylvania. In times of excessive revenue the legislatures acquire habits of extravagance, and in times of deficit the business community, especially in cities, lives in daily dread that some new and oppressive tax will be laid to fill the coffers of the state. The system is utterly without flexibility and does more damage than the mischief which it was designed to remedy.

All the states raise some money by specific taxes; many have inheritance taxes, many have taxes on corporations. Some have special taxes for the use of the state, imposed upon railroads, among these being the

state of Connecticut, which has a model system of railroad taxation. Some of these taxes are extremely bad and some few are good, but we can well afford to leave them all undisturbed for the present and devote our attention to the consideration of a really good system of raising so much revenue for state purposes, as the state may need over and above what it now derives from these fixed taxes.

#### A REALLY GOOD SYSTEM OF RAISING STATE REVENUE.

Such a system has been devised and was for the first time proposed in the state of New York two years ago. The plan is simple, flexible and has a tendency to fix responsibility and check extravagance. It is really the application to political divisions of the principle of income taxation without the inquisitorial features which render the tax upon private incomes obnoxious to many. This method is simply to apportion the state tax to the several counties of the state in accordance with local revenue. For example, if a state requires a million dollars and the total of local revenue is ten million dollars, each county is required to pay to the state 10 per cent as much as its own local revenue; if a county and the towns within it are extravagant it will pay more state tax than if it is economical. The board which apportions the state tax will have merely ministerial functions and the apportionment will be based upon a sum in proportion. There is no more opportunity for friction between counties and, to a certain extent, any locality can determine whether its share of state taxes shall be large or small.

#### INDORSEMENT OF MINNESOTA TAX COMMISSION.

The New York bill for the apportionment of state taxes and for local option in taxation, which I have described, was indorsed by the New York Chamber of Commerce and many commercial and labor organizations. It attracted the attention of the Minnesota Tax Commission, which reported to the Legislature on the tenth of last month. The commission refers to the bill as the "Purdy Bill," but I can only claim so much credit as may be due me for putting the plan before the country. The theory of apportioning state taxes on the basis of local revenue was first suggested to me by Benjamin Doblin of New York, about 1897. In October, 1899, I read to the State Commerce Convention of New York, a paper prepared by Allen Ripley Foote, who was unable to be present. In this paper Mr. Foote made the same suggestion, and he has since told me that the idea came to him as early as 1894.

The Minnesota Tax Commission says: "What is a proper basis whereby the amount of revenue for state purposes to be contributed by a given county may be ascertained? Neither population nor territorial area would perhaps afford a just basis.

Perhaps the least objectionable one is that which received the indorsement of the Chamber of Commerce of New York and known as the "Purdy Method." A bill was introduced into the Legislature of New York at its last session, whereby it was sought to put that method into actual operation as a part of the revenue system of the state, but the bill failed to become a law.

The Purdy system, in brief, is this: The whole

amount of revenue raised by taxation, aside from assessments for local improvements, is made the denominator and the amount of revenue so raised in any county is made the numerator of a fraction which determines the amount of revenue for state purposes to be contributed by the county. In other words, the total amount of money necessary to be raised for state purposes for a given year is apportioned among the respective counties of the state, according to the fractions so obtained.

That system went further and provided that the local governing bodies might declare what property should be free from taxation, or subject to taxation, at a reduced rate. That system also contemplates its application to each county as well as to the state. Taxes for state and county purposes may be apportioned to the various municipalities and townships in a manner similar to that provided for the apportionment of the state tax among counties.

It is asserted that from so general an adoption of the system the friction now existing between counties, with respect to the state tax, and between the political divisions of a county with respect to county taxes, would be wholly eliminated. This would be so, because the amount of the assessment of property in one township would concern no other township in the state. Great stress was placed upon the fact that, under such a measure, the principle of local option in taxation could be applied.

In the report of the committee of the Chamber of Commerce, touching the merits of the Purdy bill, it was, among other things, said: "Local option in taxation has been a satisfactory part of the tax system in New Zealand since 1896, and for a longer time has been enjoyed by British Columbia and the Northwestern Territories of Canada. In New Hampshire, South Carolina, Vermont and some other states towns have the power to exempt from taxation new industries for a term of years, and this power is freely exercised. In Pennsylvania and New Jersey mortgages are exempt from local taxation in some counties. Local option bills have passed one house in each of the following states: Ohio, Michigan, California and Colorado. In Washington such a bill passed both houses, but failed on reference to the people. Glasgow, in Scotland, and over 266 municipalities in Great Britain have recently petitioned Parliament for local taxing powers. The case in favor of local option was summed up by the late David A. Wells in the following letter, written in 1892:

"I am greatly in favor of the local option principle. It is in fact a novel method, practically educating the people in respect to the good and bad method of taxation; and not merely the local taxpayers of New York, but the whole country.

"As it is, the taxpayer is bound down to a system to which no elasticity can be given except by knavery or by perjury; it is contrary to the world's experience and the best judgment of those who have carefully studied the subject, and he has no incentive to reason for him-

self he feels he can't get the Legislature to pay any attention to his conclusions.

"With permission to experiment on a smaller sphere, as granted by the proposed bill, the taxpayer will take an interest in the subject and results will certainly be achieved to which a legislature will give attention, because the argument of mere theory can no longer be urged in opposition."

The Minnesota commission further says:

"Since the attempted enactment of the Purdy bill by the Legislature of New York a measure substantially of the same character was enacted at the last session of the Legislature of Oregon. Undoubtedly such a measure would give rise to a spirit of greater economy in local government, inasmuch as the proportionate amount of the state revenue to be paid by a given county would be determined by the ratio of its gross revenue, as above defined, to the aggregate amount of gross revenue raised in all the local subdivisions. \* \* \*

"No fact is more firmly impressed upon the mind of the commission than the necessity for an early amendment of Article 9 of the constitution of this state. Since the adoption of the original constitution great changes and developments have taken place in the industrial world. Both the subjects and the objects of taxation are in many respects different now from what they then were.

"Following industriously in the footsteps of other states in the formulation of its organic law, this state adopted the policy of depriving the Legislature of powers touching taxation which are essential to the natural growth and development of a revenue system. \* \* \* It should be left to a large extent to the political subdivisions of the state to determine for themselves the objects for which revenue is to be raised therein and the subjects from which it is to be exacted. \* \* \*

"It is believed that the bill amendatory of Article 9 of the constitution, framed by the commission and appearing in the appendix, will, without danger to the public welfare, restore to the Legislature necessary powers of which it is now unwisely deprived. Its provisions have been adopted after a careful study of the constitutions of many states and nearly every feature has been adopted from one or more of such constitutions."

The sections of the constitution as amended by the commission are so admirable that I quote them:

"Section 1. The power of taxation shall never be surrendered or suspended.

"Section 2. All taxes shall be uniform upon the same class of subjects within the territorial limits of the authority levying the taxes, and shall be levied and collected under general laws for public purposes.

"Section 3. The Legislature may by general laws provide for the apportionment to counties, of the amount of revenue to be raised therein for state purposes, and may in any law providing for such apportionment authorize counties to select the subjects upon which revenue is to be raised therein for state or county purposes, and to apportion such revenue among the

## LOCAL OPTION FOR CITIES.

With the adoption of this plan the way is open for every city to adopt its own system without disturbing the system of the state, and when every city can experiment and profit by the experience of other cities improvement would be certain and rapid. If change is made possible it is then worth while to consider what change will be profitable.

## EXAMPLE OF BOSTON.

The chief source of revenue is now and must of necessity remain the taxation of real property, and the first essential is equality of burden. To secure this we have examples to which we can turn and are no longer obliged to travel an unknown road. From the cities of Boston and St. Paul he that wills may learn the chief lessons of the assessment of real property. In Boston they have one assessor to every six thousand of population, which is about fifteen times the number we have in New York in proportion to our population. In Boston assessments are made annually and are required to be made in detail. The land and buildings are valued separately and the assessors make a detailed report, which would be of great interest to every one of you and serve as a model for similar work in any city of the country. As a still further improvement, in many of the Massachusetts towns assessments are published annually and every taxpayer has a convenient opportunity to study the assessments and determine for himself the justice with which they are made.

## EXAMPLE OF ST. PAUL.

Much may be learned also from the method successfully adopted in St. Paul in 1896, which was devised by Mr. W. A. Somers, for ascertaining the value of land. Although this is simple in itself it would take too long to describe it in detail. It is sufficient to say that committees of citizens are called in to assist the assessors by fixing the value of normal inside lots and corner lots on each square; also the proportionate value of lots of less or greater depth. From this decision the assessor determines the assessed value of any lot by a simple mathematical calculation. The St. Paul plan worked so well that it withstood all attacks by other cities before the board of equalization of the state of Minnesota.

## LICENSES A SOURCE OF REVENUE.

A second source of revenue is licenses, which are granted pursuant to police power. But as the revenue from this source is unimportant, and a description of the subject is somewhat outside the field of taxation, I shall not discuss it.

## FRANCHISES MAY OR MAY NOT BE A SOURCE OF REVENUE.

The third source of revenue is public franchises. This involves the question of public ownership and operation, which is beyond the subject assigned me. It may be well to point out, however, that there are, broadly speaking, three ways of dealing with public franchises. They may be owned and operated by the municipality. They may be leased to the party which bid the lowest rate of fare and best service. While this method yields no direct revenue to the municipality revenue will come in

directly from the increase in the value of land due to the population attracted by cheap public services. The third method is by taxing franchises, their value being determined according to the rule laid down by the State Board of Equalization of Illinois, and approved by the United States Supreme Court in the state railroad tax cases reported in 92 U. S. This method of valuation is substantially that which has long been embodied in the statutes of Connecticut for the taxation of steam railroads. The value of the franchise is determined by deducting the value of the plant from the total assets of the corporation, which are ascertained by adding together the market value of the corporate securities.

## IMPOSSIBILITY OF ASSESSING PERSONAL PROPERTY.

The fourth source from which revenue can be derived is the taxation of personal property, but the efforts of two thousand years, and perhaps many thousand more, have failed to result in any method of assessment which has ever proved satisfactory. If I should denounce the attempts to tax personal property as they deserve I should be considered prejudiced, and I therefore quote from the reports of commissions in several states, which you can examine for yourselves. In 1870 the New York assessors said in their report: "The general property tax is a reproach to the state, an outrage upon the public, a disgrace to the civilization of the nineteenth century, and worthy only of an age of mental and moral darkness and degradation when the only equal rights were those of the equal robber." A commission composed of two Republicans and two Democrats reported in Ohio in 1893 that "The system as it is actually administered results in debauching the moral sense. It is a school of perjury. It sends large amounts of property into hiding. It drives capital in large quantities from the state. Worst of all, it imposes unjust burdens upon various classes in the community; upon the farmer in the country, all of whose property is taxed because it is tangible; upon the man who is scrupulously honest, and upon the guardian and executor, whose accounts are matters of public record." In West Virginia a commission reported in 1884 and said: "Things have come to such a condition in West Virginia that, as regards paying taxes on this class of property, it is almost as voluntary and is considered pretty much in the same light as donations to the neighboring church or Sunday-school."

I have referred to the excellent system in Massachusetts of assessing real property, but the experience of Massachusetts in regard to the assessment of personal property is the same as elsewhere. The able commission which reported in 1897 said that "The taxation of personal property in the form of securities and investments is thus a failure. It is impracticable, uncertain, not proportional to means as between individuals, grossly unequal in different parts of the state. The experience of Massachusetts in this regard is the same as that of the other states in the Union."

## DEFECTIVE RESULTS OF ATTEMPTS TO TAX PERSONAL PROPERTY.

Although this is the testimony of able commissions in

widely separated states; it may seem extravagant, and I therefore give you a few of the actual results. In Cincinnati, Ohio, in 1866, over seventeen million dollars' worth of intangible personal property was assessed; in 1896 less than one-third as much, only a little over five millions. The amount of money on deposit in Cleveland banks in 1896 was about seventy million dollars, and there was returned for taxation \$1,741,129. There was on deposit in the banks throughout the state about \$190,000,000, and of this \$140,000,000 was in the five city counties. The city counties returned for taxation about five million dollars in money, while the remainder of the state returned twenty-nine million dollars out of sixty million. The whole amount of stocks and bonds returned in the whole state was about seven millions, while thirty years before it was over twelve millions.

#### IMPRACTICABILITY OF PRACTICAL MEN.

If so-called practical men were really practical the taxation of personal property would have been abandoned long ago. The difficulty is that many of them are wedded to the theory that, in order to be equal, taxation must be equally imposed on all property. Never was theory more unjust in its application or more absurd in its foundation. It probably grew out of another theory that taxation should be proportioned to ability to pay, for which poor Adam Smith is often held responsible, although what he really said was that ability to pay was the most convenient test of the amount of benefit received from taxation, which is the true basis for its imposition. The theory that equality demands the equal taxation of all property is grounded in absolute ignorance of the laws of incidence and presupposes that the man who pays the tax collector is inevitably the man who bears the burden of the tax. Nothing could be further from the truth, as everyone must admit who considers the operation of any tax save that upon monopoly.

#### TAXATION ON MORTGAGES AND EVIDENCES OF DEBT PAID BY BORROWERS.

There are still many in the rural districts who insist that mortgages must be taxed because the lender of money is rich, and utterly ignore the fact that the laws of nature inevitably force the payment of the tax by the borrower. It is interesting to note that in a case arising in the city of Charleston, in an opinion written by Chief Justice Marshall generations ago, the Supreme Court of the United States decided that the borrower pays the tax and refused to permit the city of Charleston to impose a tax on the obligations of the United States.

The same rule applies to the taxation of any evidence of debt. Money always seeks the best return, and if taxed it flies to more hospitable places. The supply being decreased, the price which can be obtained for its use rises until the return is equal to that which can be obtained elsewhere.

#### TAXATION OF PRODUCTS OF LABOR FALLS ON CONSUMERS.

In many of the Southern and New England states

the advantage of untaxed machinery is apparently appreciated to some extent, for new industries are offered exemption for a term of years, but this is a very partial and crude application of a true principle. If machinery is taxed or goods or any other product of labor, the tax inevitably falls upon the consumer of the goods and the theory of equality is quite destroyed.

#### A TRUE THEORY OF TAXATION.

Thirty years ago a landowner of Tennessee, in a letter to Governor Brown, laid down the true theory, which he said should be emblazoned in letters of gold on the walls of every legislative hall: "Never tax anything that could or would come to you, or that could or would run away." The application of this principle will relieve the great mass of the people of the burden of indirect taxation, which they pay in the increased prices of the necessities of life. Lower prices will increase consumption, the demand for goods will be greater and wages will tend to rise. A burden will be lifted which profits no one, least of all the owners of real estate, who are supposed to be relieved. The owner of real estate is, of all men, the most deeply interested in an increase of population and the general prosperity of the community in which his property is situated. Land has value in proportion to the amount of personal property placed upon it, and it is only by attracting personal property and population that the real estate owner can prosper.

The labor unions of the country understand this better than most of our citizens, and, although they are sometimes credited with antagonism to capital, they have again and again demanded the abolition of taxes which burden production and trade. The voters of our cities, if freed from the impracticable restrictions imposed upon them, would quickly free themselves from a system of taxation which debauches character, robs the widow and the orphan, hampers production and helps to make the rich richer and the poor poorer.

#### RÉSUMÉ.

In conclusion, I will sum up what seems to me ought to be done, nay, must be done, to improve the condition of our cities.

Abolish all constitutional restrictions upon the power of the Legislature to regulate taxation. Do away with the necessity of uniform state taxation by apportioning state and county taxes in proportion to city and town revenue. Give every city the right to formulate its own system of taxation. Assess real estate annually, stating the value of land and improvements separately and publish the assessments.

When this is done I do not say that perfection will be attained, but the way will be cleared for such further reforms of state and municipal taxation as experience will have then proven to be wise and prudent. Every city will be an object lesson to every other city, and with the possibility of improvement improvement will be sure. Who shall set a limit to the perfection that may be attained when taxation is a vital issue at every local election and every city is a debating society?