CHAPTER VII

Tax Troubles

And the Solutions Which Are Being Developed
by the Interstate Commission
on Conflicting Taxation

Origin of Commission

The difficulties growing out of conflicts between the tax plans of the federal government and those of the states have been so urgent as to command the attention of the Chamber of Commerce of the United States, the American Bar Association, and numerous taxpayers' groups, as well as federal and state agencies themselves. Two years ago the American Legislators' Association, sensing the importance of this problem, called the first meeting of the Interstate Assembly. The entire convention was devoted to problems of overlapping taxation, and it was addressed by some of the outstanding tax experts of the country. The Assembly brought its deliberations to a close by setting up the Interstate Commission on Conflicting Taxation and instructing it to study problems of conflicting taxation and develop plans for alleviation or elimination of the evils inherent in the present situation.

Personnel of Commission

The Commission on Conflicting Taxation was appointed by the President of the Interstate Assembly and met shortly after the adjournment of that body. The Commission consisted of ten state representatives and seven state senators, seventeen in all. Senator Henry W. Toll, executive director of the American Legislators' Association was appointed secretary to the Commission. Thirteen states representing every geographic region were given places on the Commission. The first Commission is pictured on the opposite page.

The Commissioners in 1933

Senator Seabury C. Mastick, Chairman, New York.
Hon. William B. Belknap, Kentucky.
Hon. R. Beverley Herbert, South Carolina.
Hon. Anna J. Ike's, Illinois.
Judge Edward L. Leach, Rhode Island.
Senator William Lee Knowles, Colorado.
Senator Earl R. Lewis, Ohio.
Senator Ben G. Oneal, Texas.
Senator Henry Parkman, Jr., Massachusetts.
Senator Alvin Reis, Wisconsin.
Hon. Harry B. Riley, California.
Hon. Estes Snedecor, Oregon.
Hon. Mark Graves, New York.
Hon. Henry F. Long, Massachusetts.
Hon. Leon D. Metzger, Pennsylvania.
Hon. C. H. Morrissett, Virginia.
Senator Henry W. Toll, Secretary, Colorado.

Representatives R. Beverley Herbert and Estes Snedecor and Senator Alvin Reis retired from the Commission in December, 1934. Two of the vacancies have been filled by the appointment of Senator Harold M. Groves of Wisconsin and the Honorable A. H. Stone of Mississippi. For two years the Commission has been actively at work, with the assistance of a technical staff during most of the period.

Generally speaking, the work of the Commission includes research, informal deliberations which eventuate in definite recommendations for state or federal action, and negotiations to secure the utilization of plans which may be developed.
Early in 1933 the Commission secured the services of Clarence Heer of the University of North Carolina as Research Director for its staff. It also had the advice and assistance of the permanent staff of the American Legislators' Association. Mr. Heer served until the end of May, 1934. Beginning in the autumn of last year a larger staff has been developed under the direction of James W. Martin of the University of Kentucky.

Staff Reports Submitted

In addition to preparing numerous brief memoranda and articles for publication in "State Government" and elsewhere, the research staff has completed and submitted the following reports:

1. Need for Interstate Commission, March, 1933.
2. Elimination of Tax Conflicts, March, 1933.
3. Fiscal Coordination Through Inter-governmental Agreement, November, 1933.
7. Coordination of Federal and State Tobacco Taxation, April, 1934.

Some of these reports are merely memoranda summarizing available information as to particular subject matter, but others are substantial research reports. They have been prepared in each instance primarily for the information of the Commission rather than for use by the public.

Some Conclusions

The Commission has, as a result of conferences held at various times throughout the last two years, reached certain conclusions respecting the approach to a solution of the overlapping tax situation, which may be stated in the language of the Commission staff as follows:

Preliminary Recommendations: The Interstate Commission on Conflicting Taxation met with its technical staff at the admin-
After a canvass of the entire field of federal-state fiscal relationships, it was agreed that certain types of conflict as between the respective taxing systems of the federal government and of the states were so serious in their effects as to require immediate negotiations with a view to their removal. Accordingly the Commission unanimously adopted a report containing the recommendations as follows:

First. **Gasoline taxes.** Since Congress has declared that the federal tax on gasoline was levied only as a temporary expedient on account of the emergency, the Commission urges the federal government to relinquish this source of revenue for the exclusive use of the states at the end of the next federal fiscal year, namely June 30, 1934.

Second. **Tobacco taxes.** Fourteen states now have taxes on tobacco, and many other states are seriously considering levying such taxes. If the states continue to impose additional levies on tobacco products, the return to the federal government from this source of revenue will be further diminished. Since any material increase in these taxes during a period of depression will decrease the amount of tobacco consumed, such increase will adversely affect the producer as well as the manufacturer. Accordingly this Commission recommends that no additional tobacco taxes be adopted by the states for revenue purposes.

Third. **Electrical energy taxes.** Since the conditions of the manufacture and distribution of electricity vary so widely from state to state, this Commission recommends that Congress should leave this source of revenue for the exclusive use of the states. The states have long depended on the taxation of electric utilities, whereas the federal government has just entered the field.

Fourth. **Beer taxes.** Congress has already levied a heavy tax on beer. Substantial additional taxes on this beverage, or heavy license taxes on its distributors, levied by the states or by their political subdivisions, will diminish the federal tax revenues. Therefore the Commission recommends that the states, municipalities, and other local units of government refrain from levying heavy taxes on beer, unless they impose such taxes for regulatory purposes.

Fifth. **General sales taxes.** At the present time the federal government imposes no general sales tax. Consequently the conflicts between federal taxes and the general sales taxes which are levied by states are relatively slight. This Commission believes that the subject of general sales taxes should be further explored by the Commission's research staff in the light of developments at the present legislative sessions. The Commission intends to issue a further report during the coming year, which will contain recommendations designed to prevent the threatened development of serious conflicts in this field.

Sixth. **Compacts between states.** The Commission recommends that states which have tax problems that cannot be satisfactorily adjusted without cooperative action should confer concerning the execution of interstate compacts. The Commission further recommends that Congress should facilitate such compacts by a general enabling and consenting act.

**Federal Cooperation**

A majority of the delegates to the Assembly voted on the question of negotiating with the appropriate federal agencies on the basis of the above recommendations and such negotiations were unanimously approved. A conference was next sought with representatives of the federal government. This conference was arranged through the cooperation of Senator Pat Harrison, Chairman of the Senate Committee on Finance.

An informal meeting was held in the Ways and Means Committee room of the Capitol Building in Washington on April 21 which marked a distinct innovation in legislative procedure. For the first time in the history of the country, a commission representing officially designated delegates of the various state legislatures conferred with a Congressional group to coordinate federal and state legislative action.
Congress was represented by Senator Pat Harrison of Mississippi; Representative Robert L. Doughton of North Carolina, Chairman of the Committee on Ways and Means of the House of Representatives; Representative Fred M. Vinson of Kentucky; Chairman of the House Ways and Means Subcommittee on Double Taxation; and Representative Frank Crowther, of New York, a member of the House Committee on Ways and Means. The Treasury Department sent Benjamin H. Bartholow, special assistant to the Secretary of the Treasury in matters of legislation; and the Department of Commerce designated Messrs., C. J. Hunkin ah^ Walter Jaeger as its representatives. The federal conferees also included L. H. Parker, Chief of Staff of the Joint Committee on Internal Revenue Taxation and C. F. Stam, Counsel for that committee.

The Interstate Assembly was represented by the members of the Interstate Commission on Conflicting Taxation.

Need of Machinery for Cooperation

In presenting the recommendations of the Interstate Commission, Chairman Mastick stressed the need for setting up machinery which would establish continuous contact between representatives of the federal government and of the states for the cooperative solution of their joint tax problems. Senator Harrison, in reply, said that he was in complete sympathy with the objectives of the Commission and in general agreement with its preliminary recommendations, especially the one relating to the repeal of the federal gasoline tax at the end of the next fiscal year. President Belknap of the Legislators' Association urged that the Senate Committee on Finance put itself on record with regard to the gasoline tax, and Senator Harrison agreed to cooperate toward that end.

The first joint conference of federal and state legislators has already produced two tangible results. In its report of May 1, accompanying the bill to extend the federal gasoline tax for another year (H.R. 5040), the Senate Committee on Finance endorsed the recommendation of the Interstate Commission on Conflicting Taxation in the following language:

"Your committee is of the opinion that the gasoline tax should be reserved for the states after June 30, 1934."

Federal Machinery: A much more important result of the conference came on May 3, when the Senate Committee on Finance authorized its chairman Senator Pat Harrison to appoint a Subcommittee on Double Taxation to study federal and state taxation and the duplications existing therein, and to cooperate with the states in working out a plan by which the taxing system as a whole may be improved. Pursuant to this action, Senator Harrison appointed a committee consisting of Senator King, Chairman, and Senators Barkley, Byrd, Reed and La Follette.

It has long been obvious, but especially so since tax rates have been increased by the revenue act of 1932, that the taxation of the same object by the federal government and forty-eight different state governments results in many inequities. The elimination of a part of this duplicate taxation, and the more equitable distribution of our present heavy tax burden, would, without doubt, not only be welcomed by the public, but would also have a most beneficial effect on business.

The Joint Committee on Internal Revenue Taxation, through its staff, has been studying this subject for about three years, and considerable data in regard to it have been collected. A Subcommittee on Double Taxation was appointed by the Committee on Ways and Means of the House of Representatives. This committee has as its chairman Congressman Vinson of Kentucky, and it is still at work on this problem. At its request, the staff of the Joint Committee published a factual report on this subject: This report is comprehensive in its scope and describes practically all federal, state, and local taxes and the duplications existing therein. A tabulation based on the report can be found in Chapter III of this handbook.

The appointment of a Subcommittee on Double Taxation from the Senate Finance Committee means that both branches of Congress will include members who are thoroughly familiar with this subject, and who are able to cooperate with the states in proposing plans for the improvement of our taxing system.
It is hoped that the Interstate Commission on Conflicting Taxation and the double taxation committees of the Senate and House will provide the necessary machinery for improving our taxing system through joint effort. The dual character of our government makes it possible to accomplish more by cooperation than by direct legislation.

Centralization and Segregation

Various proposals to bring a measure of order into the present chaos of federal-state tax conflicts have recently been made to the Commission. These proposals may, in general, be grouped under two main heads, centralization and segregation. Centralization involves a surrender on the part of the states of the right to levy certain duplicated taxes in the administration of which the federal government enjoys a clear advantage. To make up for the resulting loss of state revenue it is variously suggested (1) that the federal government take over from the states certain duplicated taxes which they now perform, (2) that it make a more extensive application of the principle of federal grants-in-aid, and (3) that it return to the states a portion of the yields of certain of the surrendered taxes on a basis of origin of collections, or of population, or on other criteria. Another proposal in the general direction of centralization is the suggestion that the federal crediting device, by which state inheritance taxes may be used as an offset against payments due under the federal estate tax, be extended to other federal taxes.

Segregation in its extreme form involves a division of the tax field between the federal government and the states, each level of government keeping specific types of taxes for its-exclusive use.

The Commission has not committed itself unreservedly to either of the two lines of action which are described in the preceding paragraphs. Centralization would doubtless reduce the area of federal-state tax conflicts and would considerably simplify the administration of some types of taxes. The further extension of the principle of federal tax credits might remove the element of interstate competition in certain fields. Whether or not federal administration, coupled with a sharing of tax yields with the states, represents a desirable mode of procedure—in the case of taxes which neither the states nor the federal government can afford to surrender completely—is a question which the Commission felt should be given further study. In the meantime the Commissioners were impressed by the fact that whatever gains centralization might accomplish would have to be purchased by the states at the price of restrictions on their sovereign powers.

A logical program: On the other hand, the Commission is faced with the problem of finding an immediate and complete program of segregation which will adequately satisfy the respective revenue requirements of the federal government and the states, and at the same time prove fair to the taxpayer. It is inclined to believe that the most promising course of action would be to take each of the various forms of duplicated taxes and consider it separately. After determining what seems to be the logical solution with respect to each specific tax, it would then be necessary to go over the entire program and devise some method or methods for adjusting any discrepancies between the assigned resources and revenue needs. A program of this kind might ultimately call for some centrally administered, state-shared taxes; but in the case of many taxes the remedy for the present evils of dual federal-state administration appears to be segregation.

The Commission was well aware of the fact that no constitutional means exist which could be utilized to make agreements binding on either the legislatures of the states or on the Congress. It is believed, however, that the taxpayers of the country—to whom both the Congress and the state legislatures are answerable—will supply all the binding force that is needed. It is the taxpayers who are the chief sufferers from the present welter of federal-state tax conflicts, and if a fair adjustment of some of these conflicts can be arrived at through the method proposed, it seems probable that the taxpayers of the nation will exert pressure to make such adjustments effective.

The recommendations which the Commission put forward as a basis for negotiations rest on a few general propositions concerning which there can be little disagreement.
They are:
(1) That under any scheme of coordination between the respective tax systems of the federal government and the states, there will be certain specific types of taxes which make suitable sources of state revenue. On the other hand, certain taxes are more suitable to the federal government than they are to the states.
(2) That other things being equal, a given type of tax should be administered by the particular level of government which can best perform this task effectively.
(3) That in view of the fact that the states and their subdivisions are compelled to carry the larger share of the country's governmental costs, and in view of the smaller range of non-property taxes which the states are in a position to administer effectively, the federal government refrain as far as possible from utilizing taxes upon which the states have come to depend and which they can administer efficiently.

Recommendations on Liquor Taxation

Recommendations concerning the taxation of alcoholic beverages were adopted by the Interstate Commission on Conflicting Taxation at its meeting in Washington, D. C., November 10 and 11, 1933. The recommendations were as follows:

RESOLVED, That it is the sense and the recommendation of the Interstate Commission on Conflicting Taxation:

1. That the social implications of the repeal of the Eighteenth Amendment greatly outweigh in importance the revenue aspects of repeal.
2. That the taxes on alcoholic liquors, as well as the taxes and license fees upon the traffic in such liquors, should be so devised as to promote temperance, and at the same time to discourage illicit trafficking in such beverages.
3. That there is grave danger that if both the federal and the state governments, without regard to each other, impose taxes or other imposts on these commodities, or upon the traffic in them, the combined load of taxation will become so heavy as to defeat the foregoing objectives.
4. That volume taxes, or so-called gallonage taxes, whether direct or indirect, should be imposed upon liquor by the federal government only, and only at a moderate rate.
5. That the rate of the volume tax should in no event exceed three dollars per gallon on spirituous liquors, and that the rate of taxes on beverages of lower alcoholic content should be correspondingly lower.
6. That of the combined gross revenue from the liquor traffic, derived by the federal and state governments from all sources, one-half should inure to the benefit of the states and their localities, and the remaining half should be retained by the federal government.
7. That in applying the principle which is stated in the preceding paragraph, in the case of those states which adopt the state stores plan, or other form of state liquor monopoly, there should be substituted for gross revenue as defined in that paragraph, the actual profit derived from state liquor transactions.
8. That the federal government should ascertain its total gross revenue from the liquor traffic derived from all sources, and divide that amount by the total population in all of the wet areas in the United States, thus establishing the federal per capita. Similarly each state should ascertain its total gross revenue, including both state and local proceeds, and divide that amount by the total population in all of the wet areas in the state, thus establishing the state per capita. In the case of each state, the state per capita and the federal per capita should then be added, thus establishing the combined per capita for that state. The state's minimum share should be one-half of the combined per capita. Accordingly, the federal government should make payments to each state which contains wet areas, in accordance with the following formula:

\[ \text{Ascertained one-half of the combined per capita.} \]

\[ \text{Subtract from that amount the state per capita.} \]

Multiply the difference by the number of the total population in all of the wet areas in the state, this arriving at the amount to be paid by the federal government to the state.
9. That revenues from spirituous liquors which are sold for medicinal purposes should not be included in the foregoing computations, but should be separately handled, in accordance with the above stated principles, but in accordance with the method stated in the following paragraph.

10. In the case of each state, the federal government should compute the amount of revenue which the federal government derives, by taxation and licensing, from the sale of liquors for medicinal purposes in that state, and also the amount which the state derives from such licensing and sales, total the two amounts, and pay to the state such amount as will give it not less than one-half of the total.

Recommendations on Gas Taxes

The staff of the Interstate Commission on Conflicting Taxation has also made a very complete study of the gasoline taxes in the 48 states. The report of this study was filed with the Congressional Ways and Means Committee by Chairman Seabury C. Mastick in January, 1934. It is the opinion of the Interstate Commission on Conflicting Taxation that gasoline taxes should be definitely left to the states. An article from State Government of January, 1934, is reprinted in part:

"As is well known the gasoline tax is the most important single source of state revenue. Taking the country as a whole, state governments derived 24 per cent of their total tax receipts from this source in 1931. In a number of states, the relative reliance placed on the gasoline tax is considerably greater than this. Thus, gasoline tax collections represented roughly 40 per cent of the state tax revenues of Georgia, Tennessee, and Texas in 1931, and about 33 per cent in North Carolina and South Carolina during the same year.

"Acting on the assumption that they could rely on the gasoline tax as a certain and stable source of revenue, and that the federal government would not attempt to enter this field, the states and their subdivisions have made a vast investment in motor highways.

"State and local highway bonds outstanding at the present time, excluding those for city streets, aggregate in the neighborhood of $3,000,000,000. These bonds were sold to the public largely on the security of the gasoline tax and motor vehicle licenses which are the main sources of highway revenues. In 1931, state highway bonds outstanding totaled $1,227,000,000, and in that year about 56 per cent of all state highway revenue was supplied by the gasoline tax.

"A decline in state gasoline tax collections will not only reduce the amounts available for the construction and maintenance of state highways, but will also impair the ability of state and local governments to meet interest and amortization charges on highway bonds. Only about 10 per cent of the total state gasoline tax collections for the country as a whole is used to meet debt-service charges on highway bonds. This, however, is an average figure which conceals the precarious situation of a number of states which have gone heavily into debt to match federal-aid highway funds and which have been counting on an undiminished flow of gasoline tax revenues to support their highway bond issues. In West Virginia, 83 per cent of all state gasoline tax collections is devoted to debt-service charges on highway bonds. The corresponding ratio for Arkansas is 65 per cent; for South Carolina, 58 per cent; for North Carolina, 49 per cent; for Florida, 43 per cent.

"In 1932 state gasoline tax collections registered a decline for the first time in their history, dropping from $536,000,000 in 1931 to $513,000,000 in 1932. This represented a loss of $23,000,000, or 4.3 per cent. Although there may have been no causal connection, it is significant that this decline coincided with the federal invasion of the gasoline-tax field with its excise tax of 1 cent per gallon.

"The immediate cause for the decline in state gasoline tax collections was a falling off in the consumption of motor fuel. The average reduction in consumption for the country as a whole between 1931 and 1932 was 7.5 per cent. For individual states the reductions ranged from less than 1 per cent in New Hampshire to 22 per cent in Arkansas. A serious aspect of this situation is the fact that some of the most precipitous declines in consumption have taken place in states in which the gasoline tax..."
TAX TROUBLES

is most heavily relied upon for highway maintenance and construction, and to meet interest and principal payments on highway bonds.

"In Arkansas where motor-fuel consumption dropped 22 per cent between 1931 and 1932, approximately 65 per cent of the proceeds of the gasoline tax is required for highway debt service charges. In South Carolina where consumption dropped 15 per cent, about 58 per cent of the proceeds of the gasoline tax is required for debt service. Mississippi relies on the gasoline tax for 94 per cent of all of its state highway revenues, and gasoline consumption in this state declined by over 16 per cent between 1931 and 1932. In New Mexico where the gasoline tax supplies 75 per cent of all state highway revenues, the consumption of gasoline has fallen off by 18 per cent.

"It is not claimed that the decline in gasoline consumption was caused "by the imposition of the federal excise tax on gasoline. It is maintained, however, that the federal tax prevents needy states from readjusting their tax rates to the new level of gasoline consumption and thus, not only jeopardizes the adequate maintenance of expensive highways, but undermines the safety of many millions of highway bonds which were sold to the public on the assumption that the gasoline tax would be reserved to the states.

"For many years, the average service-station price of gasoline steadily declined. In 1921 it was 26 cents per gallon, exclusive of tax. In 1932 it was a little over 13 cents per gallon. This decline in service-station price more than offset the effects of steadily rising rates of gasoline taxation. With the advent of the N.R.A., however, the price of gasoline has gone up, and should the efforts of the federal government to restore a measure of prosperity to the oil industry succeed, the federal excise tax on gasoline will be so much more severe.

"In addition to threatening the safety of three billion dollars worth of state and local highway bonds, the federal excise tax on gasoline hampers needed efforts in the direction of general property-tax relief. Most important of all it prevents municipalities, which all over the country are rapidly going bankrupt, from sharing in a source of revenue to which they are justly entitled.

"There is at present a desperate hunt for new sources of municipal revenue to stave off impending bankruptcies. Since the cities furnish the highway facilities on which half of the motor fuel of the country is consumed, they are justly entitled to a larger share of gasoline tax collections. But as long as the federal government remains in the gasoline-tax field, few if any states are in a position to do justice to their cities in this regard.

"It is realized that the need of the federal government for revenue is acute. The situation of the states and municipalities, however, is even more desperate. The credit of the federal government is unimpaired. States and localities find it almost impossible to borrow and there have been widespread defaults in municipal bonds. The possible sources of federal taxation are numerous and varied, compared to those of the states and municipalities.

"In imposing a gasoline tax, the federal government weakens the security underlying 4½ billions of city, street, and rural highway bonds. It prevents the states from relieving the overburdened property taxpayer by transferring a larger share of the cost of rural highways to motor vehicle users. Finally, it prevents the states from stemming the rising tide of municipal bankruptcies by allocating to their municipalities the share of the gasoline tax to which they are justly entitled."

Boston Conference

At its conference in Boston, September 30th and October 1, 1934, the Commission developed rather definite plans for activity during the current year. These plans contemplated, in the first place, careful investigation of the overlapping levies of the federal government and the states in the field of death taxation, sales taxation (in the event the federal government should impose a sales tax), and income taxation; both corporation and individual. It was the opinion of the Commission, after extensive deliberation, that the most promising approach in the field of death and income taxation inhered in the further development of the credit plan utilized most effectively thus far in the case of the federal estate tax, as provided in the Revenue Act of 1926. In developing this plan of approach,
the Commission expressed a definite preference for the crediting device as compared with the plan of federal administration which has been vigorously urged in some circles.

In the second place, the Commission has developed plans for a more unified view of the entire situation than has hitherto characterized its activities. Heretofore, investigations of particular tax measures have been made. In the future the consequences of each adjustment on the entire situation will be examined before the Commission acts.

In the third place, the Commission is hoping early in 1935 to offer recommendations respecting all of the more troublesome conflicts, so that a comprehensive program of action will be available. These recommendations, if they materialize, will be presented to the Interstate Assembly and, if approved, will become the official program of the Commission. This of course does not mean that the Commission will refuse in the future to make modifications in the program. It means rather that the Commission will have arrived at a provisional general solution of federal-state conflicts which it can officially advocate.

Thus far negotiations with representatives of the legislative and executive branches of the federal government have been confined largely to the field of gasoline and liquor taxation. Informal conference between the leaders in the House, Senate, and administrative branches of the federal government and members of the Commission has been the method by which most negotiations have been conducted. In addition to such informal conferences, contacts have been made with official finance leaders in Congress and in the administration by letter, by wire, and by direct personal discussion. It is anticipated that, if present plans are completely worked out, more extensive negotiations will be made with these representatives of the federal government and with the legislative and administrative agencies in the various states.