

New Trends In State and Local Taxes

by JONATHAN ROWE

States and localities are victims of their own splintered political geography. Wealth means mobility, and wealthy businesses and people threaten to move elsewhere at the slightest suggestion of heavier taxes. The tax burden remains--and grows--on the less well off, who stay put because they have to.

In recent years the total tax burden on people of modest means has been edging up toward that born by the rich, while the share of state and local taxes born by business has been declining. Nevertheless, some states and localities have made significant progress, including one or two major breakthroughs. This article can only touch some highlights, and suggest a way the federal government could free these units of their terror of business tax dodging and industrial flight.

Property Assessment Abuses

Taxes on property are still the mainstays of local revenue systems. Recent studies have laid to rest the absurd claim that property taxes are inherently regressive--to own property, after all, is to be rich--and people have started asking why these taxes have been regressive as presently applied. Activists began to "catch on" that many assessors were allocating the tax burden illegally and unfairly. Groups such as the Citizen

Action Program (CAP) in Chicago added millions of dollars to local assessment rolls by exposing the underassessment of major commercial and industrial taxpayers such as U.S. Steel. Studies in Boston, Philadelphia, New Haven, and other cities revealed blatant assessment discrimination against poor black neighborhoods. Houston City Controller Leonel Castillo was one of the first elected officials to see the revenue at stake. Under his muckraking research and prodding, Houston's assessment roll has grown by almost one-third in two years. Among those taking hefty increases were Senator Lloyd Benson and Nixon's Treasury Secretary John Connally, whose exclusive

neighborhoods assessors had skirted gingerly for years.

Failure to Assess Certain Properties

Other skeletons discovered in local property tax offices have included outright failure to assess large properties, generous appeals systems for the rich, and uncollected delinquencies. Also, homeowners have to pay their property taxes to their mortgage lender banks in advance without receiving interest. (Four states--Connecticut, Massachusetts, Maryland, and New York now require interest on these escrow accounts.)

Better administration is only half of the property tax reform agenda. Expanding the tax base is the other. Most promising is the restoring of "intangible property"--stocks and bonds--to the tax rolls. We could cut taxes on real estate by about one-third nationwide, according to Professor Lester Snyder of the University of Connecticut Law School, if we taxed intangibles at just one-fourth the rate applied to real estate. At the same time, we would stop favoring people who invest in paper stocks and bonds over those who invest in business equipment or homes. In theory, intangibles are still taxable in many states, but with a few exceptions, such as Ohio and Florida, assessors ignore them.

Connecticut and New Jersey recently enacted special taxes on the income arising from paper property; New Jersey expects to raise \$65 million from the tax this year. Massachusetts taxes unearned income (dividends etc.) at 9% while wages and salaries are taxed at only 5%.

"Classified" Property Taxes

Another important reform is the "classified" property tax, in which different types or "classes" of property are assessed or taxed at different rates. Washington D.C. recently joined the five or so states with classified systems; in D.C., commercial property will be taxed more heavily.

than residential. A problem with existing classified systems is that they do not distinguish between small businesses and large, poor homeowners and wealthy. The "Mom and Pop" store gets hit just as hard as the Safeway because both are "commercial." It might be better to classify properties according to value instead of type, with the higher-valued properties paying higher rates. Australia adopted such a progressive property tax early in this century to help break up large estate holdings.

City governments could do tenants a big favor by billing property taxes directly to the tenants, instead of to their landlord. Tenants pay the property taxes anyway in their rents, and with a direct-billing system the tenants would get the income tax deductions. They would no longer have to chase these deductions to a home in the suburbs. In New York City a tenant-billing proposal has already been prepared by the McKinsey Inc., consulting firm.

To the chagrin of tax reformers, sales taxes regularly score high in public opinion polls. Apparently, people prefer to be nickled and dimed to death than to pay taxes in lump sums. Sales taxes could be made immensely more fair by expanding this tax to include professional services--lawyers, and advertising agencies, for example--since these services are consumed in large measure by the wealthy. New Mexico is one of the few jurisdictions with a broad-based sales tax of this kind. Last year roughly 25% of its sales tax revenues--\$48 million--came from professional services.

The sales tax on food has become a rallying point for tax reformers and food activists, and since 1971 the tax has been repealed in eight states, most recently Washington, D.C. and Michigan. Poor people must spend a larger portion of their earnings on food than do the rich, making the food tax highly regressive. Complete repeal may not be the best answer however. An exemption for a basic amount of food might be the answer. New Mexico has taken a different route. That state guarantees that the combined burden of all state and local taxes will never exceed a set percentage of the taxpayer's income, thus targeting relief to those tax-

payers who really need it. (In other states such "circuit breaker" relief is confined to property taxes.)

A few states have closed income tax loopholes--California and Maryland beat Congress in repealing the oil depletion allowance--but the trend remains toward more loopholes not less. Some of the biggest hide under the skirts of a hot number called "federal conformity." If the states conform their income taxes to the federal code, the argument goes, life will be easier for both taxpayers and administrators. But when states adopt the loophole-ridden federal tax laws, their revenues drop. Wisconsin lost about \$16 million the first year when it went just part-way to the federal model in 1965, and more recently, revenues fell by some \$12 million in Utah when it made the shift in 1973.

Multi-State Corporations

States willing to entrust their tax systems, to people like Senate Finance Committee Chairman Russell Long (D-La.) responsible for the present unfair Federal tax system, get what they deserve.

A little-noted loophole has been lax income tax enforcement against large multi-state corporations. Some corporations juggle their books to shift their income from high-tax states to low-tax states, or to overseas subsidiaries. Sometimes they do not even file returns. States such as California with effective out-of-state audit programs have taken in between eight and fifteen dollars in new revenue for every dollar in audit expense. Progressive tax administrators from 22 states, including California, have joined the Boulder, Colorado-based Multistate Tax Commission (MTC), which audits multistate corporations on behalf of its members. (See P&T Vol. III, No. 11). Businesses lobby state legislators furiously to keep them from joining MTC, and a group of the nation's largest corporations, led by U.S. Steel, has tied up the group in expensive litigation.

Loopholes are "Incentives"

Hard times and chronic business flights have made state lawmakers vulnerable to pressures for special business tax loopholes and "incentives". Numerous studies, in-

cluding one by the U.S. Advisory Commission on Intergovernmental Relations, have questioned the effectiveness of these. MIT economist Bennett Harrison found in a study for the Massachusetts State Legislature that "job creation" tax incentives costing the state \$66 million per year had produced no new jobs.

These tax incentives do not work well for two reasons. First, taxes are not all that important in where businesses locate. And second, when one state enacts incentives its neighbors usually follow suit. The net result: business pays less all around and every one else pays more.

Within a metropolitan area taxes can affect where businesses locate, though taxes are not the only reason firms flee the city to the lower-taxed suburbs. Here the seven-county Minneapolis-St. Paul Twin Cities region scored probably the greatest breakthrough in state and local taxes of the last twenty years. Led largely by the Minneapolis-based Citizens League, these counties agreed to share all increases in their commercial and industrial tax bases. No matter where in the area a business locates all the counties would get a portion of the new revenue. This would end the self-destructive tax undercutting between the counties and enable them to base land-use decisions on something other than the need to attract new industry. School-financing inequities would be lessened, and the fiscal excuse for zoning out poor people would be reduced.

The center cities and poorer suburbs have gained substantially from this tax-sharing plan. Minneapolis gained over \$9 million in assessed valuation last year--almost 60% over its own assessment growth--and the gain this year could be double that amount.

Businesses can still threaten to leave a state, however. Without alternative sources of jobs and revenues, few legislators dare call their bluff. Protection against such tax blackmail could come from Congress. And it would be simple to do. Congress could enact a special tax on large businesses and industries, against which all state and local

taxes would be allowed as a credit. These businesses would pay this minimum state and local tax no matter where they moved, and the incentive to go tax bargain hunting would be less. Congress used exactly this approach to protect other states when Florida and Nevada tried to attract retirees by abolishing their estate and inheritance taxes in the 1920s.

Where to start? The first step toward fairer state and local taxes is to find out how much we are spending now on tax breaks for the unneeded. These breaks persist largely because people are not aware how much revenue is lost, and because the tax expenditures are not subjected to annual budget review along with other budget items. Both the federal government and the state of California now prepare tax expenditure budgets, showing how much each tax preference cost the taxpayers each year in foregone revenues.

Tax reform, you see, is really a way of cutting out wasteful government expenditures--tax expenditures. ■

Jon Rowe's new book
Tax Reform Handbook
is published by Pantheon, 1976

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