

Vol. VI, No. 2

February 15, 1935



University of Arizona Bulletin

SOCIAL SCIENCE BULLETIN No. 8

ARIZONA TAX PROBLEMS

By

WARREN A. ROBERTS

PUBLISHED BY

University of Arizona

TUCSON, ARIZONA

University of Arizona Bulletin

Vol. VI, No. 2

February 15, 1935

HOMER LEROY SHANTZ, Ph.D., Sc.D.....President of the University

PUBLICATIONS COMMITTEE

C. Z. LESHER, *Chairman*; G. M. BUTLER; P. S. BURGESS; R. J. LEONARD;
M. P. VOSSKUHLE; R. H. GJELSNESS; H. A. PRAEGER, *Editor*.

DEPARTMENT OF ECONOMICS, SOCIOLOGY, AND BUSINESS ADMINISTRATION

E. J. BROWN, Ph.D.....Professor of Economics and Business
Administration; Head of the Department
R. M. HOWARD, M.S.....Professor of Accounting
R. C. PARNELL, B.A., LL.B.....Lecturer in Business Law
F. A. CONRAD, Ph.D. Associate Professor of Sociology
A. B. SCHMIDT, M.A.....Associate Professor of Economics
E. G. WOOD, Ph.D.....Associate Professor of Economics
and Business Administration
GEO. F. HERRICK, M.B.A.....Associate Professor of Business
Administration
L. R. GRAY, M.B.A.....Assistant Professor of Economics
W. A. ROBERTS, Ph.D.....Assistant Professor of Economics
R. A. HARVILL, Ph.D.....Assistant Professor of Economics
S. J. WANOUS, M.A.....Assistant Professor of Business Administration
MABLE COX.....Retail Specialist

STATEMENT OF MAILING PRIVILEGE

The University of Arizona Bulletin is issued semi-quarterly.
Entered as second-class mail matter June 18, 1921, at the office at
Tucson, Arizona, under the Act of August 24, 1912. Acceptance for
mailing at special rate of postage provided for in Section 1103, Act
of October 2, 1917, authorized June 29, 1921.

Vol. VI, No. 2

February 15, 1935



University of Arizona Bulletin

SOCIAL SCIENCE BULLETIN No. 8

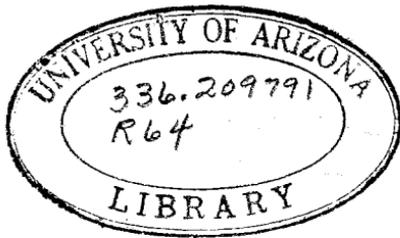
RC
2095
R6

ARIZONA TAX PROBLEMS

By

WARREN A. ROBERTS

PUBLISHED BY
University of Arizona
TUCSON, ARIZONA
Twenty-five cents



FOREWORD

Most of the following discussion is reprinted from material published in *The Arizona Producer* during November, December, and January. The purpose of those articles was two-fold; to assemble in convenient form information that might be useful to those interested in the financial problems of Arizona, and to show the need for attention to certain issues now neglected. The effort has been not so much to lay down a practical program for the State as to draw from the experience of other states to show the general direction of modern progress in the field of Public Finance. Due to the breadth of the subject and the desire to be brief, each article attempts to use only what appears to be the most significant of the data available.

It has long been recognized that the function of a university staff, with regard to problems in Public Finance, is to furnish information. It is the purpose of this pamphlet not to defend any theory or to propose any tax measure, but merely to fulfill a part of that function.

WARREN A. ROBERTS.

ARIZONA TAX PROBLEMS

THE PRESENT TAX BURDEN

There is a large amount of information on Public Finance that ought to be made available each year to interested taxpayers. Some of this information lies in Arizona reports, some in the findings of tax-surveys in other states and some in recent discussions by authorities in the field. The best means of presenting such material is through an exhaustive financial survey by the State; but, because such studies are expensive, they are made only rarely. The following articles are written in belief that of equal importance to the voter would be more frequent presentation of information already at hand. The attempt will be made to give the material in somewhat the same manner as would a state survey, though, due to lack of space, the treatment of each problem must be brief.

A financial survey in Arizona would no doubt start with a discussion of the weight of the property tax burden as compared with other states, the trend over the last fifteen years, and possible remedies for such a condition as we now face.

No analysis of the property tax burden ought to try to tell, of course, whether or not taxes are too high. Eric Englund, of the federal Bureau of Agricultural Economics, concluded a radio address last year by saying:

No individual is competent to say how high or low taxes will be or ought to be. In a democracy the people ultimately determine how much they will spend for improvements and services in their community. Fundamentally, they alone can determine how high taxes will be.

Nevertheless, because most people would like to know whether their own taxes are higher or lower than those elsewhere, the U. S. Department of Agriculture has made an effort to compare the farm tax burden in different states. In a document entitled *The Farmer's Tax Problem*, issued in 1933, it presented two studies to Congress. In one of these it

estimated the tax rate on each hundred dollars of actual value of property by states and geographic divisions. It estimated that in 1933 the United States average of real estate taxes per hundred dollars of actual value was **\$1.50**. The average in the eight mountain states, including Idaho, Montana, Utah, Colorado, New Mexico, Wyoming and Arizona, was higher—**\$1.65**. The average for Arizona was **\$1.49**—10 per cent less than the average for the Mountain States and slightly less than the average for the United States as a whole.

The second study gave us an even more favorable position. In this the Department of Agriculture attempted to find the percentage of gross rent required for real-estate taxes on cash-rented farms. This was intended to show, as nearly as possible, the relation of taxes to farm income. The average for the United States as a whole was **21.9** per cent. The average for the eight Mountain States was only a trifle lower—**21.6** per cent. The tax in Arizona was estimated to be the lowest in the Mountain States and third from the lowest in the United States—**16.7** per cent.

Of these two studies the first would appear to be a better estimate of the weight of the property tax in Arizona. The gross rent of farms in Arizona is probably high in relation to the value of those farms, due in part to the expense of irrigation; and the net income from farming is probably indicated better by farm values than by gross rent. Even so, taxes in Arizona seem to be somewhat less than the average in the United States and considerably lower than in her sister states of the Mountain region.

Another method of analyzing the weight of the tax burden is to make a historical comparison. In the ten years from 1920 to 1930, property taxes per capita rose in Arizona from \$46.20 to \$49.78, or about 8 per cent. Between 1929 (the peak year) and 1933, property taxes were reduced¹ from \$21,679,358 to \$16,693,874, or about 25 per cent. The state property tax was reduced 36 per cent, local property taxes 20 per cent. Part of the reduction, however, was due to the use of sales, income and luxury taxes which produced in 1933 a total of \$2,061,323. Of this, \$82,653.93 went for administration of

¹ Table 26, Eleventh Biennial Report of the State Tax Commission of Arizona. Data upon tax yields since 1932 was secured by correspondence with the Commission.

these taxes and \$736,345 for relief funds. Of the remainder, \$988,169 went into the State general fund and \$254,191 to county funds. If these last two items are considered to have supplemented the property tax, it should be said that the State tax was reduced by 21 per cent and local taxes by 18 per cent.

It is true, nevertheless, that taxes may be lower than elsewhere and lower than fifteen years ago and still be too high. It was estimated by the National Industrial Conference Board that while state and local taxes took only 4.5 per cent of the national income in 1913, they took 6.7 per cent in 1926 and 9.6 per cent in 1930. Certainly they took even more in 1933. It is estimated by the *Bond Buyer*, New York, that on June 1, 1934, there were in default 2,361 municipal bonds, notes, certificates of indebtedness, etc.² These included counties, cities, towns, and school, reclamation, drainage and special assessment districts. In Arizona there were 23 of these defaults; in California there were 109; in Florida, 330. On the other hand, in all of New England there was only one.

² Data collected by correspondence.

SHOCK ABSORBERS IN A REVENUE SYSTEM

NORMALCY AND DISTRESS

It is recognized that the problem of oppressive property tax burdens ought to be approached through two principles. The first is that the real difficulty has to do, not with the tax burden of normal times, but with the tax burden of the depression. So long as we can trust the wisdom of a democracy we must assume that property owners will not vote higher taxes in normal times than they can pay in normal times. We cannot assume, however, that they will not vote higher expenditures in good times than they can bear in a depression; and public expenditures tend notoriously to be a fixed cost of doing business. It is the impact of normal taxes on subnormal incomes that does the damage to the property owner.

The second principle is that the use of new forms of revenue, such as the income tax or the sales tax, does not necessarily lighten the depression tax burden. Just as the State of Arizona was fortunate, in 1930, that she had only a nominal bonded indebtedness, so she was fortunate that none of the new taxes had been put into effect before the depression, and the two million dollars of extra revenue came just at the time when property owners were most in need of help.

To illustrate the point involved, let us assume that these taxes had been used in Arizona in 1929 and had yielded, in that year, four million dollars. Would 1929 **property** taxes have been four million dollars lower than they were? Experience says not. In a democracy voters try to push public expenditures up to that point at which the sacrifice of the last tax dollar just about equals the benefit from the last dollar of public expenditure. They say to themselves, "Will the proposed new paving be worth the money to the community, or won't it?" and if the paving seems worth the expense it is voted. Experience has indicated that where the dollars come more easily, as from some new tax source, they will be spent more easily.

The probability is, therefore, that total 1929 expenditures would have been somewhat higher if Arizona had been receiving this four million dollars extra taxes. The legislature's problem in, say, 1933, would then have been a difficult one. The customary four million dollars of supplementary revenue would have shrunk to two million and the legislature would have faced the problem of making up, not just the shrinkage in the property tax revenue, but that of the income, luxury and sales taxes as well. These supplementary forms of revenue, instead of throwing an additional two million dollars into State and local coffers, to supplement the property tax, would have yielded two million less than normal, and the problem of State and local budgeting would have been more difficult than it has actually been.

Modern science of public finance is pointing all over the United States to this great principle—that the problem is to lighten the tax burden of depression years, and any tax system which tends to make the tax burden of good times lighter, but that of hard times heavier, is working to the disadvantage of the property owner. It encourages extravagance in good times and leaves no elasticity in the tax system for a depression.

Several solutions have been brought forward—each open to some criticism, but all worth the attention of the taxpayer. (1) Indiana established a board of tax appeals to keep down the level of taxes in normal times, and other states have followed, with mediocre success, the same plan. (2) It has been suggested that the sales tax be reserved for hard times, as was done in Arizona, and be repealed during business recovery. (3) The New York special tax commission of 1932 suggested that part of the yield of the income tax in good times be impounded by investment in state bonds, and be spent when the state revenue tended, in hard times, to fail.³ A recent report on federal finances, by the National Industrial Conference Board, also considers the subject of the adaptation of the income tax to the problems of the business cycle.⁴ (4) From the standpoint of property owners the ideal use of the income tax would be to utilize

³ Report of the New York State Commission for the Revision of the Tax Laws. 1932. p. 18 ff.

⁴ Ch. IV, *Federal Finance 1923-1932*, National Industrial Conference Board.

the proceeds in the reduction of outstanding local bonds. This would not only remove the temptation to expand the functions of government, in good times, as the income tax yield expands, but would definitely lower the fixed burden of bonded indebtedness, and thereby allow local property taxes to be reduced more rapidly in hard times. The total charges for local debt service in Arizona in 1932 were probably at least six and a half million dollars, which means that in many localities they were at least a third of the local budget.

We need to adjust our tax systems to the fact that there are such things as depressions. We have been taught the lesson that the property tax burden cannot be reduced as fast as private income drops, in spite of effort to bring it down. In the first place, the charge for debt service cannot be reduced without public insolvency, and this often is at least a third of the local budget. Moreover, capital investments, such as roads and buildings must be repaired and kept in order or the original investment will be lost. In the third place, certain government services are as necessary in the depression as out of it—police and fire protection, courts, schools for children, certain administrative offices and the institutions for the criminal and insane must all be maintained. For all of these reasons the property owner is learning that in spite of strenuous efforts and the most alluring promises of political candidates, his tax burden will hurt more and will take more of his income in bad than in good times.

If as a matter of common sense, this condition were widely recognized, the representatives of the property holder would begin to prepare for hard times before they arrived. This preparation would entail two forms of legislation. It would, on the one hand, involve the curbing of normal debts and expenditures so that, even unreduced, they would be less of a burden upon farm and business property in hard times. On the other hand, it would involve the saving of the yield of supplementary forms of revenue in good times, so that it might be used during the next depression. This might entail either complete abstention from the sales tax during good times, or the investment of the proceeds of the income tax in bonds or some variation of both of these methods.

It is not to be expected of course, that so severe a depression as the present one will come often in any one generation, and there is no particular reason why a state should anticipate such a drop in price level as occurred after 1929. Neither is it true that the condition in Arizona is more serious than elsewhere. On the other hand, it is true that those states which suffered the most during the past depression were those that had been most improvident with their sources of tax revenue during good times. Assuming that the voters of a state will exercise some measure of judgment in matching normal public expenditures with normal private income, the real need of a state is for a tax system elastic enough to ease the burden of depression expenditures. This was done for Arizona by the sales, luxury and income taxes, but whether or not these new forms of revenue will serve the State as well in the next depression will depend upon the way they are used in the next few years.

FUTURE TAX REVENUES

What will the sales and income taxes yield when times are better? The question cannot be answered accurately, of course; but for the purpose of financial planning an intelligent guess is necessary, and a certain amount of light can be shed on it by the experience of other states.

Only one state, West Virginia, made use of a gross proceeds tax during pre-depression years. This tax yielded its greatest amount in 1927—\$4,076,143.19—and by 1932 the total return had shrunk to \$2,327,711.01.⁵ Thus it can be calculated that if conditions should ever again return to those of the twenties, the yield of the West Virginia tax would increase approximately 75 per cent. An increase of 75 per cent over our own collections of sales and luxury tax would bring the yield up from the present \$1,826,120 to a little over \$3,000,000. This figure is not conclusive, of course, but it is the best help that the experience of other states can give us.

When it comes to a forecast of the future yield of the income tax we are beset with too many figures.⁶ Between 1928 and 1932 the yield of the Arkansas income tax dropped

⁵ *West Virginia's Experience with the Sales Tax*, Gov. W. G. Conley, in *Current Problems in Public Finance*, New York University.

⁶ The following figures were derived by private correspondence.

from \$871,841 to \$98,453.78; North Dakota's dropped from \$657,164 to \$116,063; and New York, in spite of doubled rates raised only \$30,000,000 in 1932 as against \$83,000,000 in 1928-29. Thus, if times would reverse themselves, Arkansas might expect an increase of over 800 per cent in revenue, North Dakota of over 400 per cent, and New York might cut her rates in two and still expect an increase of 170 per cent.

On the other hand, other states, by revising their rates upwards during depression were able to avoid a very great drop in revenue. Thus, the yield of the 1928 Oklahoma tax (\$1,088,886.87) was cut nearly in two by 1930; but a change in rates raised the yield to over \$2,000,000 in 1931, and kept the yield well over the million dollar mark for 1932 and 1933. In Missouri the use of new rates in 1931 kept the yield from falling more than 28 per cent between the very best and the very worst years. In Wisconsin the use of a five-year average of private income, for the computation of taxes due, kept the state income tax rather steady, but proved very unpopular.

It is probable that in this latter group of states better times will result in lower rates, and in this way the yield of the income tax might be kept fairly level during good and bad times. Unless Arizona lowers her income tax rates when times are better, it appears possible that the yield may increase with that in North Dakota or Arkansas. The yield of the Arizona income tax to June 30, 1934, was \$235,202.89, and the expectation that the tax will eventually produce over a million dollars of revenue still does not seem unreasonable. This would mean a change in revenue yield of about that in North Dakota, a change of much less than that found in Arkansas, and little more than that found in New York. It seems possible that the income and sales taxes together might produce \$4,000,000 of revenue if, as and when conditions in Arizona again equal those of 1928.

LOCAL EXPENDITURE CONTROL

Approximately 81 per cent of the total property tax for 1932, and about 85 per cent for 1933 was spent by local governments. The subject of local finance deserves more attention than it generally receives, particularly in view of the large per cent of municipal taxes that goes to pay fixed charges. It has been pointed out before that Arizona was credited by the *Bond Buyer* with twenty-three defaults of municipal obligations on June 1, 1934. The "Indiana Plan" for the supervision of local expenditures and indebtedness has been so widely discussed, both here and in other states, that it seems desirable to explain the plan and to give the conclusions of its outstanding critics.

Briefly stated, the plan as used in Indiana since 1920 makes it possible for any ten persons in any taxing district to ask that a proposed tax rate or bond issue be reviewed by the state commission. If the commission finds evidence of fraud, or carelessness, or determines that for any other reason the expenditure is unnecessary, it can order the bond issue or tax rate reduced or eliminated. The plan has been used by Iowa and, with variations by certain other states. The best way to understand its workings is by illustration. Thus, one Indiana county proposed to issue bonds to the amount of \$570,000 to build a road. After the matter had been appealed by county taxpayers to the state commissioner, the contractor asked that the estimate be reduced by \$131,000. The commission then demanded that new bids be made, and the contract was signed for \$369,000—a saving to the county of \$201,000 on this contract alone. In another instance, the state commission found that a proposed local bridge, sponsored by county officers, was not even to be on a public highway. In the erection of eight school buildings in Indianapolis, the local board asked for a larger sum than certain taxpayers thought necessary. The commission, upon petition, reviewed the proposal and insisted that all plans and specifications be prepared with the assistance of its own engineers. Knowing that the contracts would be carefully scrutinized by the authorities, contractors submitted bids

which were \$456,000 less than the amount originally estimated and asked for by the local board.⁷

These illustrations do not prove, of course, that the plan is good. There have been many objections to the idea, and while some of them can be easily answered, others are more serious. The charge that the plan violates the so-called principle of "home-rule" is probably not so important. Arizona, for instance, has a state examiner for the audit of county accounts. Other objections to the plan have been:⁸

(1) It may result in collective irresponsibility, if the community becomes too dependent on the plan itself.

(2) Total reductions ordered by the Indiana Commission have averaged only \$1,490,000 a year; or only about 1.49 per cent of total local expenditures.

(3) The system is too spasmodic in operation, depending entirely upon objections from dissatisfied minorities. Only about 3-4 per cent of expenditures and indebtedness are reviewed annually.

(4) The facilities of the commission are too limited to permit it to ferret out much extravagance or to analyze costs.

The National Industrial Conference Board declared that the plan was good but that its positive accomplishment was "relatively small," and this conclusion appears to be held by most of the outstanding critics.

For the purpose of this discussion the problem does not so much concern the shortcomings of the plan as the possible lessons that fourteen years of experience with it might have for Arizona. Wylie Kirkpatrick, national authority on municipal finance, concluded a criticism of the "Indiana Plan" by suggesting that a state might create a budgetary review to aid the taxpayer and link him with the local budget. Thus the board of budgetary review should be in a position not only to examine the local budget for evidence of fraud, graft, waste and carelessness, but also to give to the taxpayer a brief statement of comparative per capita costs as

⁷ Frank G. Bates, *State Control of Local Finance in Indiana*. Am. Pol. Sc. Review, May, 1926.

⁸ Wylie Kirkpatrick, *Tax Control*, quoted by Mills and Starr, *Readings in Public Finance and Taxation*, 79 ff.

between different localities. In addition, such a review might supplement the detailed budget published in local newspapers by brief, concise, figures of the rate at which per capita costs are increasing. Finally, it might assemble and report comparative per capita debt figures for each locality and perhaps relate them to assessed or census valuation.

The need of the hour is to clarify government problems for the average taxpayer, and whatever will do that is worth while. Yearly publications of local budgets is a step in the right direction, but they are too complicated to mean much to the average man. A mass of naked statistics is rarely read. A budget review, to represent the taxpayer in ferreting out waste, graft and blunders, and at the same time to report in plain English the financial condition of the locality, might be well worth the money to the voter.

The only gesture made in this direction at the present time is the appointment of a so-called state examiner, and this gesture is inadequate for the following reasons:

(1) While we may have able examiners, there is no legal provision that insists that he have the necessary training.

(2) Only county audits are made. Towns, cities, school districts are a law unto themselves.

(3) The examiner has no power to take action if he does find something wrong.

(4) His purpose is not to analyze the budget at the time it is passed, nor to give information to the taxpayer, but merely to see if the budget is adhered to after it is adopted.

The Arizona taxpayer could be much better protected by law and much better informed than he is at the present time.

THE ADMINISTRATION OF THE PROPERTY TAX

INEQUALITIES OF ASSESSMENT

The weakest point in the tax system of Arizona, as in most other states, lies in the administration of the property tax. The tax system as a whole with its income tax, its property tax, the tax on retail sales and upon luxuries is much more equitable than it has ever been before. Yet approximately 89 per cent of the revenue is still raised by the property tax, and a loosely directed property assessment, such as we have in Arizona, will result in more inequities than all other taxes could correct.

If A's property is assessed at 30 per cent of its value, and B's at 60 per cent it is a matter of elementary arithmetic that A is paying relatively double the taxes paid by B; yet the probabilities are that this condition appears often. What recourse has A in this situation? Theoretically, he could appeal to the Board of Supervisors, thence to the Tax Commission and thence to the State courts, but normally he would do none of these things. In the first place he would not know of the inequality; in the second place he could not easily prove it if he did know; and in the third place he would hesitate to appear to be so unsocial a citizen as to complain about his assessment. Moreover, if the Board of Supervisors and the Tax Commission refuse an adjustment he has no recourse, under Arizona law, before State courts, unless he can prove that he is assessed at over 100 per cent of actual value—not matter what the assessment ratio on other property may be.⁹ Finally, no ordinary individual can afford to go to court, anyway. Such a privilege is reserved for the large corporations who can afford it. It ought to be more generally understood that inequitable assessments hurt the small property owner more than the large. In reality A is at the mercy of the assessment machinery of the state, and the state is therefore under moral obligation to protect him.

⁹ Section 3065, Revised Code of Arizona.

Many states, realizing this, are taking steps to compare assessments with actual values, and to arrange to correct the mistakes they find. Arizona has never made such a study, but the findings in other states indicate the probable conditions here. The results in other states, with methods like our own, show in all cases (1) striking inequalities in assessment, and (2) a general tendency to underassess valuable property and to overassess property of small value. Unless there has been more than ordinary attention to methods of assessment, it is usually found that property is assessed at anywhere from 10 to 200 per cent of actual sale value. One Rocky Mountain state found that while much grazing land was assessed at nearly 200 per cent of sale value, a certain prominent hotel, owned by an important politician was assessed at approximately 15 per cent of its value. West Virginia found some property assessed at 1500 per cent of actual value, and another piece assessed at 0.55 of 1 per cent of sale price.¹⁰ A study in Cook County, Illinois, made in 1926, showed the following condition:¹¹

Percentage of Appraised to Sale Value	Percentage in Group
1— 20%	24.7
21— 30%	31.7
31— 50%	33.7
51—100%	19.9

Thus, while 31.7 per cent of the property examined was assessed at 20 to 30 per cent of actual value, a quarter of the property was assessed at less than 20 per cent and a fifth of the property at over 50 per cent. The findings in other states, while not quite so startling, have shown much the same sort of inequities.

The tendency to discriminate against poor property and in favor of valuable property has been found wherever examination has been made. The disclosures in Indiana, for instance, were as follows:¹²

Actual Sale Value	Ratio of Assessed to True Value
Under \$500	47.49%
\$ 1,000 to \$ 2,500	42.86%
\$ 5,000 to \$ 10,000	37.08%
\$50,000 to \$100,000	26.81%

¹⁰ Jens P. Jensen, *Property Taxation in the United States*, Ch. XII.

¹¹ *Ibid.*

¹² *Ibid.*

This meant that the property of least value paid nearly twice the taxes, per dollar of actual value, as did the expensive property. Somewhat similar conditions were found in Kansas and Minnesota, where similar studies were made.

In order to impress upon the taxpayer and the state official the need for accuracy in assessments, such a study as those just discussed should probably be made in Arizona. Yet it is easier and less expensive merely to assume that conditions here are as found in other states where methods of administration are the same as our own. In administering the property tax, as in every other field, the state will go either forward or backward, and if a state is content to make no progress, the chances are that inequalities will become greater rather than less.

"SEPARATION OF SOURCE"

It has been suggested that the state forsake the property tax and leave the counties to their own inequities. Obviously, this is no answer to the problem. In the words of one of the latest and most authoritative works on the subject:

The inequalities in the assessment ratios do result in some inequalities in the state tax; but they are very much less than those that result in the local taxes. How irrational it is to argue for segregation of state sources . . . and to permit chaotic local assessments, such as are shown by the evidence to exist everywhere!¹³

The notion of separation of sources of state and local revenue has been given a set-back by the experience of California. State Comptroller Roy L. Riley, in an address to the National Tax Association in 1928, said, among other things:

As a result of separation of source we have degenerated into fifty-eight independent taxing units, without ability to make comparisons of any kind or nature . . . There are gross discriminations in local assessments that cannot well be avoided under the present system.

The report of a Special Commission in California (1929) noted as follows:

Many of the advantages which its framers claimed for the system have failed of realization. It has not brought about an improvement in local assessments. It has not brought relief to real estate. It has not achieved stability of rates (i.e., of tax rates). It has not established a tolerable degree of equity in its

¹³ *Ibid*, p. 292.

apportionments of taxes among the classes of taxpayers or among individual taxpayers in a class

It has brought about rigidity where there should be elasticity, rendering it difficult to make changes in either rates or methods. It has been the direct cause of disputes which have had profound and unfortunate political consequences.¹⁴

It seems apparent that to take the state tax off of property, and, at the same time to deprive local governments of income from other sources, is not an answer to the problem.

It does no good, on the other hand, to blame the assessors or members of the Tax Commission. The fault lies with the system, and not with any individual or any group. I think it is probable that a complete survey of the Arizona property tax would find two of the most obvious faults to be (1) that the assessors have no complete, authoritative assessor's manual by which to standardize their work, and (2) that the members of the Tax Commission are elected rather than appointed and have not quite the necessary power over local assessors. The first of these faults can easily be rectified, but there seems to be little possibility of reform for the second and greater difficulty.

The New York State Tax Commission,¹⁵ in laying down a program for tax reform, emphasized as an important part of it the need of a good assessor's manual. Minnesota has developed one and other states are working along the same line. Such a manual is now in process of preparation by an outstanding assessment engineer in this State and the University hopes to publish it early this year. Although it is only an important detail in the general scheme of property tax administration we believe it to be one of the most practical steps toward an equitable tax system that can now be made.

The machinery of assessment of any state ought to be so well organized, directed and empowered that it could be trusted to operate justly and fairly without continuous watching. It is generally considered that the only type of organization that approaches this ideal is one in which the Tax Commission is appointed for a long enough period of time to feel relatively free from political pressure. It was

¹⁴ (p. 73) Quoted by Lutz. *The Georgia System of Revenue, Its Problems and Their Remedies*, 1930, (p. 31).

¹⁵ 1927 Report.

held by the Committee on a Model System of State and Local Taxation, of the National Tax Association that ". . . the members (of such commission) should be appointed, in classes, for terms of at least six years."

The election of a Tax Commission subjects the members thereof to too direct political pressure. Thus, during a recent campaign in which a member of the Tax Commission was up for reelection, an advertisement was inserted in a prominent paper criticizing that individual for voting to raise certain assessments. In my humble opinion such criticism of a commission of quasi-judicial powers and duties tends to be a travesty on democracy, and approaches corruption by political force. As a quasi-judicial body, the State Tax Commission ought to be able to feel that reappointment will be made upon the basis of judgment, courage and efficiency, rather than upon political reactions to their work.

While the present Tax Commission has some power over local assessors, it is telling no secrets to say that little of that power is used. It appears, superficially, at least, that the assessor is in at least as strong a political position as the Tax Commission, and influence is about as apt to flow from the assessor toward the commission as the other way.

Yet the situation in this State is not a simple one. The existence of a large amount of corporate property, including copper deposits, railroads, telephone and telegraph lines, probably makes the public unusually distrustful of appointed assessment officers; in spite of the fact that the persons primarily responsible for the present mine tax law were the first members of the Tax Commission, appointed by Governor Hunt. It seems doubtful if the espousal of a new method of choosing Tax Commissioners is apt to be productive of very important results.

If it is true that the present method must continue, the only way to better our condition will be to give continuous attention to methods of assessment, and to carry to the people some sort of report on the quality of the work done. This is not, of course, a satisfactory solution. It is, in fact, scarcely a solution at all. Yet, somehow or other, the property owner, with no information regarding comparative assessment ratios, misled by general underassessment and with no recourse in State courts against any except the

grossest inequalities, ought to be given some sort of protection. At the present time he appears to be in an almost helpless position.

THE INTANGIBLES TAX

The Intangibles Tax Law, just declared invalid by the Supreme Court of Arizona, presents a problem to the next legislature. The court's objections can easily be overcome by the passage of another law, but the economic desirability of the law is probably as debatable as it was two years ago. It is the purpose of this article to give, as briefly as possible, the reasons for and the arguments against such a tax, and to note the newest method of taxing income from intangibles.

In favor of the tax is the best possible reason—that it will probably raise some revenue. One way to estimate the amount of intangible property in a state is to see what per cent of estates, probated in the state and reported under the inheritance tax law, consists of intangibles. Of the property probated during the two years 1931 and 1932 stocks and bonds formed about 41 per cent and mortgages, notes, judgments and accounts receivable about 21 per cent. The indications are, therefore, that, partly due to the large amount of mining stocks in the State, about 60 per cent of property, by value, is intangible in character, and only about 40 per cent tangible. This is not far different however from that found in other states. Inasmuch as tangible property in Arizona was assessed at approximately \$578,440,000 during the years 1931-1932, it is possible to draw the conclusion that the value of intangibles in the State reaches three quarters of a billion dollars. This amount, if caught and taxed at four mills on the dollar (and it is generally considered that intangibles ought not to be taxed higher than that) would yield about three million dollars of revenue. It is in the hope of tapping this source of income that state legislatures are induced to pass laws taxing intangibles.

Yet it must be admitted that the intangibles tax has been the least satisfactory of all major forms of revenue. In the first place, the yield has always been disappointing.¹⁶ In Montana, a state with conditions somewhat similar to our own, money and credits are assessed at the rate of 7 per cent, as against a 30 per cent assessment for farm real estate, and

¹⁶ Jensen, *Op. Cit.*, Ch. VII.

the general property tax is put upon that assessment. The yield in normal times has varied from about \$175,000 to about \$200,000. Minnesota has been receiving, in good times, about a million and a quarter in revenue; but her population is seven times that of Arizona. Kentucky, with a population nearly the same as that of Minnesota, receives two and three quarter million dollars in good times. These states are some of the most successful. Connecticut, though a manufacturing center and considered to be a "creditor state," receives only half a million dollars, even in good times, and her population is approximately four times Arizona's.

But the fact that the yield is low is not a reasonable objection to the tax. Even a hundred and fifty thousand dollars of revenue is not to be scorned by a State like this. The present unpopularity of the tax is best explained by the report of the recent Colorado tax survey commission, which based its objection to the measure on the following grounds:

1. Not as much intangible property escapes as appears, because many intangibles are not and should not be taxable. Moreover, persons should always be allowed to deduct debts from taxable credits.
2. The American people would not stand for the inquisitorial methods necessary to enforce the intangibles tax, and, if they did, the owners would avoid the tax by buying tax-exempt securities.
3. The intangible property is not in itself productive, and therefore should not be taxed, even though it might represent productive and taxed property.
4. Lacking the effective enforcement methods, only a few groups will show their intangibles:
 - a. The very honest.
 - b. Those ignorant of the effect of the tax, or those accidentally caught.
 - c. The legally incompetent (widows, minors, etc., temporarily exposed by estates in the process of probation).
5. Lacking the correct enforcement methods the tax is not capitalized in the security and is not expected to

be paid. Therefore it is an undue burden on the ones caught.

The Committee of the National Tax Association on a Model System of State and Local Taxation¹⁷ recommended that because of its universal failure a state should do without a tax on intangibles if it had a personal income tax. On the other hand, because a tax on the *income* from intangibles is easier to enforce than a tax on their capital value, some members of the committee recommended the Oregon or South Carolina plan; whereby the state levies, in addition to the regular income tax, an additional tax on income from intangible property. It was suggested that this additional tax might be levied at such a rate as 3 per cent. Yet the committee repeatedly emphasized the fact that too heavy a tax on intangibles was not only unjust, but tended to drive out of a state the holders thereof. In no state is this objection more important than in Arizona, where much of the market for labor comes from the popularity of the State for winter visitors and health seekers.

The demand for the taxation of intangibles in this State appears too strong to be denied, and it is possible that the Oregon or South Carolina plan might be a good compromise. New Hampshire's tax on the income from intangibles has long been considered one of the most successful intangibles taxes in the United States. A tax on the income, rather than on the capital value of the security is usually much better enforced than a tax on capital value, and partly for that reason it is much more just.

Without a doubt, every state must consider as one of the important factors involved, the effect of any tax law upon the migration of individuals and wealth. This does not mean, however, that a state ought to fear to levy just taxes; for those who leave a community because they are unwilling to support government functions are probably no great loss to the state. The real issue is somewhat broader than this. Most people are willing to pay their full share of the cost of government, but in a revenue law such as the income tax or intangibles tax three precautions ought to be taken. In the first place the tax must be moderate and not confisca-

¹⁷ *Second Report on a Plan of a Model System of State and Local Taxation*, National Tax Association, (Phoenix, 1933) p. 30.

tory, and its administration must not be too inquisitorial. In the second place the demagogues must be kept from making it too apparently a class tax. (People dislike hearing that they are being taxed as exploiters of the poor. In the third place the tax must be so well administered that it is obviously enforced upon all. (A man ought not to feel that he must either be a "liar" and deny his wealth or a "sucker" and pay the tax. It has often been felt that the intangibles tax law has had this effect.)

— Our aim must be to take the golden eggs without scaring away the geese, and the matter calls for some degree of adroitness.

RECOMMENDATIONS

The records show that the tax system of the new State of Arizona, twenty years ago, was one of the best administered in the United States, and attracted nation-wide attention for a period of several years. To maintain such a standard, in the face of changing economic conditions, calls for a progressive spirit of dissatisfaction with existing methods. Many states find it disadvantageous to appoint a commission every few years, to look at the tax system with an impartial eye, and to report their findings and recommendations to the governor and the legislature. If a state does not do this it will find that many important matters are neglected because they are not politically exciting enough to bring before the people. The business of state and local governments is one of the most important single enterprises in the state, and it is not possible to keep track of all the important details by political discussion alone. Indeed, excitement over panaceas and cure-alls may lead public attention from more sober but more practical issues.

Besides the general problems, touched upon above, there are a number of smaller details in the administrative provisions of the present law that call for correction. Two of these were brought out in the recent bank tax cases. In the first place, the only protection against unjust and discriminatory overassessment given by the Arizona Courts is protection against assessment at over 100 per cent of value. Even though all other property be assessed at 40 per cent of value, and one man's property be assessed at 100 per cent of value, he has no appeal from the decision of the County Board of Supervisors or the Tax Commission, to a State Court.¹⁸ Inasmuch as most property in the State is assessed at 40 to 50 per cent of actual value it is apparent that there is no adequate protection against unfair county or State "equalization."

A second weakness is the fact that there is no provision in Arizona law that a man, believing himself overtaxed,

¹⁸ *Revised Code of Arizona*, Section 3065.

may pay those taxes "under protest" and, if the courts uphold his case, easily regain the illegal tax.¹⁹ If an unfair tax is paid under protest in Arizona the only recourse of the payer is to sue and obtain judgment against every government unit to which the tax ultimately went. The result has been that a large taxpayer, about to commence suit on his taxes, has a good excuse for refusing to pay them, and several counties were therefore embarrassed by lack of income during the most difficult of the last few years. The same difficulty may face those who paid taxes under the intangibles tax measure just declared unconstitutional by the Supreme Court. At this writing it appears that they may have to sue to regain those taxes.

Another illustration of the need of some revision of the financial code is the disagreement among counties over the interpretation of Sections 787 and 788 (Revised Code) pertaining to the registry and payments of warrants. It is the belief of several in the field that the group of laws pertaining to local warrants and local budgets should be entirely re-written.

It has been said that the preceding discussion has been made with two ends in view; to gather together certain information that might be useful to those interested in the financial problems in Arizona, and to show the need for further study of certain important matters in the financial program of the State. The effort has been made to draw some conclusions from the information accessible at the present time, but most of the topics call for more complete treatment and more adequate information than is now available.

Because of the amount of tax reform now being undertaken by other states and because of the amount of interest now manifest throughout the State of Arizona, the time seems ripe for the appointment of a small commission to study and report upon the general tax system of the State. Among other things, there should be considered:

1. **A long-time plan for State and local revenue**, and the extent to which State and local governments might acquire a more elastic revenue system by the **conserva-**

¹⁹ Appellees brief, Southern Arizona Bank and Trust Company vs. Pima County.

tion of sources of income and the avoidance of or reduction of indebtedness.

2. **The experiences of other states with methods of expenditure control and of budget review, and possible methods of improvement of our present inadequate system of State examination of local budgets.**
3. **The present method of property tax administration, and means by which it might be improved.** It should be possible to pay a tax under protest and easily regain it if the tax is found illegal. There should be some protection in State courts against unfair assessments. Local budget laws should be carefully reviewed.
4. **Possible savings that might be made by county consolidation, and by centralization of administration.** Particular attention might be paid to the 1931 program of North Carolina, whereby highways, schools and local debts were all centralized in the hands of the state government.
5. **Possible savings to be made by further centralization of the purchase of materials and supplies.**
6. **The administration of the inheritance, income, sales and intangible taxes.**

Just as a business or professional man, in studying the most advanced methods in his field, may find much that he cannot use, so such a commission may be able to form practical suggestions on but a part of the issues to be considered. Nevertheless, those issues need study and it would be a waste of the time of the legislature to consider most of them without more information at hand.

It is the personal opinion of the writer that the best type of commission for this purpose would be one composed of representative business men, who are willing to give part of their time and attention to such State problems. The subordinates they choose should, however, be hired by the State, and to them would fall the burden of collecting the necessary information and of the clerical work. In this way the report bears the stamp of practical men of affairs,

and the State benefits from the expression of the business man's point of view.

But whether or not the commission be of this sort, the need for some such study seems apparent. Every political campaign witnesses a waste of time and money in arguments that could easily be settled with a little research. The need is suggested not only by the amount of work now being done in other states, but also by the accumulation of problems here. Such a study as here proposed if its suggestions are followed might easily place the State of Arizona again among those states with the most progressive financial programs.

UNIVERSITY OF ARIZONA PUBLICATIONS

Agricultural Experiment Station Publications

General Bulletins
Technical Bulletins
Annual Reports

Agricultural Extension Service Publications

Agricultural Extension Circulars
Annual Reports

University of Arizona Record

Loan Play Library Announcement
Summer Session Announcement
University Announcement of Courses
Moving Pictures and Slides Announcement
Financial Report of the Board of Regents
Correspondence Courses Announcement

University of Arizona Bulletin

Arizona Bureau of Mines Bulletins
Humanities Bulletins
Biological Science Bulletins
Physical Science Bulletins
Social Science Bulletins
Fine Arts Bulletins
General Bulletins

Copies of the above publications may be obtained by request to the Director of the Mailing Bureau, University of Arizona, Tucson, Arizona. A charge of twenty-five cents is made for the University of Arizona Announcement of Courses, and a nominal charge is made for University of Arizona Bulletins.