LOCAL INCOME TAXATION IN THE UNITED STATES
WITH SPECIAL REFERENCE TO THE STATE OF OHIO

DISSERTATION

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**LOCAL INCOME TAXATION IN THE UNITED STATES WITH SPECIAL
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CHAPTER I

The State of Municipal Finance

One significant development in municipal finance during the past decade has been the marked expansion of local, particularly municipal, non-property taxation. Local governments have explored much new ground as is indicated by the levy of income, sales, use and a variety of other non-property taxes in marked contrast to previous reliance on property taxation as a primary and almost exclusive revenue source. This phenomenon results from local attempts at solution of the much mooted "financial plight" of cities.

American cities, generally, have found traditional revenue sources inadequate during the past two decades. One result has been continuing pressure for increased aid in the form of shared taxes and grants-in-aid from higher levels of government. Another result has been the development of non-property taxation. Revenue inadequacy has resulted from a number of factors most of which are well known to the tax student, the administrative specialist and, in a perhaps less choate formulation, the the taxpaying citizen. They may be enumerated as follows: (1) the increase in services desired rendered at the local level; (2) the increasing cost of both standard and additional municipal functions; (3) the inadequate yield of traditional property taxation; (4) the general continuance of state legislative and judicial limitations on the fiscal initiative of the state's municipal "creatures." It should also

be noted that either a "garrison economy" or a war economy accentuates this problem by increasing the cost of goods and services that cities must buy. Also either military preparedness programs or actual mobilization cause significant labor force movement and variation in industrial activity which increases expenditure needs in some localities without relation to tax capacity.

In addition to these generally applicable causes of insufficient municipal revenues, the peculiar revenue problems of the metropolitan city must be recognized. Decentralization of urban areas characterized by "blight" at the core and obsolete boundaries of central cities surrounded by dormitory suburbs leads to a marked difference between a desirable level of expenditures and available revenue from traditional sources.¹ It may also be noted that per capita cost of government is greater in large cities than in small cities and tends to increase in each population bracket.²

1 Manvel, Allen D., "Contrasting Effects of Population Growth on State and Local Government Finance," Proceedings of the Forty First National Conference of the National Tax Association, Sacramento, California, 1948, p. 421 at 423; hereinafter cited as 1948 proceedings, N.T.A.

2 U.S. Bureau of the Census, Governmental Finances in the United States, 1942, U.S. Summary, Washington, D. C., 1945, p. 8; This tendency was formulated in a more general way by Professor Adolph Wagner of Germany in 1893 as follows:

"Comprehensive comparisons of different countries and different times show that, among progressive peoples, with which alone we are concerned, an increase regularly takes place in the activity of both the central and the local governments. This increase is both extensive and intensive; the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely. In this way the economic needs of the people, to an increasing extent and in a more satisfactory fashion, are satisfied by the central and local governments. The clear proof of this is found in the statistics which show the increased needs of central governments and local political units."

"Grundlegung der politischen Oekonomie," Bk. VI, ch. 3 (third edition, 1893) quoted in Charles J. Bullock, "Selected Readings in Public Finance," Third Edition, Boston: Ginn and Company, 1924, 32.

While tax men are not medicine men and while no complete solution to the urban city's problems can be expected solely from any purely fiscal program, this condition needs to be considered in any evaluation of developments in local non-property taxation. As a result of inadequate local revenues, stemming from the above causes, many local governments have been living a hand to mouth existence for some years. Eight years ago, the Treasury Department's Special Committee on Intergovernmental Fiscal Relations composed of Professors Harold M. Groves, Luther Gulick and Mabel Newcomer state the problem as follows: "What is needed, apparently, is some new source of local revenue which will (1) not overlap existing Federal and State taxes, (2) enable the localities to tap their own resources without running hat in hand to central governments, (3) cover all or a vast majority of the interested citizenry, and (4) not be regressive. Much of the vitality of local government in the United States depends upon the development (discovery and utilization) of such a source."³

With the problem so stated and criteria advanced for evaluation of municipal experimentation with non-property taxation, a need exists for both factual study and analytical appraisal of the individual taxes utilized by experimenting municipalities from the viewpoint of the operation of individual taxes and from the standpoint of where, if at all, such taxes belong in the tax structure of recent origin,--the local income tax.

³ Federal, State and Local Governmental Fiscal Relations, 78th Congress, 1st Session, Senate Document 69, 1943, p. 8, 11.

It may be noted at the outset that however much the individual attempts to suppress his personal psychological orientation, it is still quite likely to materially affect, consciously or unconsciously, his analysis. Therefore, it is perhaps proper, for the sake of the record, for the writer to note that he is convinced, perhaps partly as an "act of faith," in the value of continued federalism and in the quite substantial value of healthy local government characterized by a high degree of local citizen participation in the local solution of local problems. For in the unitary state, the problems of local finance can hardly bulk large or be more than mere matters of variable administrative technique. In this connection it may not be inappropriate to quote the view of the late Henry C. Simons, "Democratic process is an invention of local bodies. It has been extended upward and may be extended gradually toward world organization. In any case, modern democracy rests upon free, responsible local government and will never be stronger than this foundation."⁴ If one accepts this viewpoint, even in part, then, despite the preeminent problems of federal fiscal policy, investigation of fiscal trends within the complex matrix of local government assumes basic significance and justifies renewed emphasis.

PROPOSED SOLUTIONS OF CITY FINANCIAL PROBLEMS

Much has been written concerning the alleged "financial plight" of cities for it is no longer a new problem. However,

⁴ Simons, Henry C., "Introduction, A Political Credo," in Economic Policy for a Free Society, Chicago: University Of Chicago Press, 1948, p. 13.

generally, it has tended to become more intense and require definite action. Many varying proposals have been put forth; in fact, certain of these may be considered virtually traditional responses to the problem. They may be enumerated, in brief, as follows: (1) centralization, or the assumption of functions previously local by either state or national government; (2) reallocation of functions, which would seem to imply both an upward and downward reassignment of governmental duties but which may be merely synonymous with centralization; (3) shared taxes, whereby revenue from a particular tax collected by either state or local government is shared on the basis of some predetermined apportionment formula; (4) grants-in-aid, whereby a higher level of government makes payments which are unrelated to their revenue source to local government with or without strings attached; (5) separation of sources of revenue for the three levels of government. To these five traditional responses may be added a potentially fruitful sixth possibility,--broadening the local revenue base through the utilization, to a more or less limited extent, of types of taxation already levied at either or both state and federal levels. It is in exactly this area, since there is obviously a limitation of revenue sources, that much of municipal non-property experimentation has occurred.

Considering these six proposals in brief for the purpose of delimiting the scope of the problem to be considered later as the principal subject of this study, it may be noted that in all probability no single proposal or program will provide a complete

solution to either the problems of all municipalities of a particular type or to those of all cities as a group. Municipal revenue problems vary and so must valid solutions thereto.

PROPOSALS INVOLVING STRUCTURAL CHANGE

The first two of the above-mentioned six proposals involve structural changes in the framework of government. While shifting of functions and governmental reorganization are needed in the local government area, particularly with respect to metropolitan centers, the rate of structural change is so slow that only the most confirmed optimist would hope to find a short run solution to municipal revenue problems in proposals for structural change which move rather in terms of geologic time. Certainly it is desirable to replace multitudinous overlapping and/or coterminous local units with a single local government. It should be noted however that at the county level this does not always provide a complete solution--witness the continuing problems of Philadelphia (to be considered in more detail later) where the City of Philadelphia and the Philadelphia School District are the only units within the county; nor has the fact that the City and County of Denver are a single entity absolved that governmental unit from the impact of increased revenue need.⁵

Moreover, it is at least to be questioned whether passing functions upward in the hierarchy of government results of

⁵ Smith, Kenneth L., "Some Aspects of Denver's Fiscal Problem," 1948, Proceedings, N.T.A., p. 4.

necessity in either increased economy or efficiency.⁶ Such changes also may result in the sacrifice of nonmensural, noneconomic values. While hardly susceptible of empirical verification other than in terms of comparative history, many will agree that it is in the long term interest of the citizen that activities be administered and financed at the lowest level of government consistent with efficiency.⁷

SHARED TAXES AND GRANTS-IN-AID

Turning to the third traditional response noted above, it is submitted that shared taxes are inadequate as the sole solution to the problem of municipal revenue needs. Clearly, returning some definite percentage of a given tax to local government may give it more revenue in prosperous times than tax sharing would do in periods of depression when municipal expenditure needs are greatest. It can hardly be assumed that state revenues largely dependent upon sales and gross receipts taxation, 59% of state revenues came from this source in fiscal 1950,⁸ will have a high degree of stability or that resultant distributions to local government would be uniformly stable. In addition, undue reliance upon shared taxes may involve a sacrifice of local fiscal independence. It must be noted that while the State retains the

⁶ Cf. eg. Simons, Henry C., Op. cit., p. 14.

⁷ Chatters, Carl H., "Priorities and Balance in Municipal Finance," 1948 Proceedings, N.T.A., p. 8.

⁸ U.S. Bureau of the Census, Sources of State Tax Revenue in 1950 (State Finances: 1950, No. 5), Washington, D. C., November, 1950, p. 2, Table I).

right of discretionary revocation and controls the method of apportionment, either legislatively or administratively, it can quite definitely call the tune of municipal expenditures. Moreover, uniformly shared taxes do little to equalize differentials in tax capacity; shared tax programs all too frequently cause plump municipal purses to bulge still further while leaving the lean ones relatively little better off than before the distribution. With shared taxes, it is too often a case of "to him that hath shall be given." The New York Moore Commission found in effect that thirty years experience in that state with shared taxes had produced a patchwork system of complex hodge-podge.⁹

It should be noted that in 1946, the State of New York abandoned the system of shared taxes that had been previously in effect. Under legislation enacted in 1946 based upon the recommendations of the Moore Commission, New York local governments now receive per capita grants in lieu of shared taxes. For the fiscal year ending March 31, 1950, 59.15 per cent of New York revenue went to its Local Government Assistance Fund in comparison with 40.85 per cent which went to the State Purposes Fund.¹⁰ That such a shift was made after careful consideration points up the defects in tax sharing previously noted.

Turning to the subject of Grants-in-Aid, analytically aids

⁹ State of New York. Report of the Commission on Municipal Revenues and Reduction of Real Estate Taxes, Albany, 1946, pp. 18-19.

¹⁰ The New York State and Local Tax System, 1949, Research and Statistics Bureau, State Tax Commission, New York, Albany, Revised December 20, 1949., p. 5.

may be considered a diluted form of centralization as compared with direct expenditure and control by the granting level of government. Grants may be considered as both a means of tax relief and as a technique of expenditure coordination by the higher governmental unit. Perhaps the most significant objective of a system of grants is the attainment of a desirable minima in the levels of service provided by the grantee governmental units with variable revenue resources within the federal framework. This is particularly appropriate where the functions subsidized are of general interest and can be evaluated by the central granting unit. In addition, it has been suggested by tax students that grants make possible a wider application of the ability to pay principle and permit a combination of the efficiency of centralized tax administration and the benefits of local administration of certain functions.¹¹

Grants are frequently criticized on the ground that they encourage expenditure extravagance; that they weaken local responsibility, reduce local autonomy and postpone desirable structural and reorganizational change at the local level.¹² Moreover, the use of grants poses a difficult problem of allocation and, in the absence of any definitive theory of allocation or reliable index of need, leaves the distribution at best with a formula which ignores some local variation in both tax resources and expenditure needs and at worst leaves the

¹¹ "Federal, State and Local Fiscal Relations," op. cit., p. 166.

¹² Ibid.

problem all too frequently to be solved by the competing pressures of local governments with variable bargaining power at the legislative drafting table. A minimum per capita grant, such as was adopted in New York, from the State to local government designed to provide a rough minimum service level, while imperfect, is perhaps a partial solution.

Total aid payments received by the 397 cities having 1940 populations of 25,000 or over increased 65.3% from 1942 to 1948, and 15.2% from 1947 to 1948.¹³ Such a percentage increase points up the tendency of local government to follow a policy of mendicant supplication toward higher levels of government with wider revenue sources to draw on. In this connection, it is noteworthy that slightly over one-fifth (20.2%) of the revenue received in 1949 by the 397 cities having 1940 populations over 25,000, was "aid received from other governments."¹⁴

Even though a certain further increase in state aid to local government may be inevitable, it must be borne in mind that a constantly increasing state contribution to local government suggests a concomitant decrease in effective local self-government. Local government fiscally dependent upon distributions from the state (or Federal Government) would, in all probability, have the independence of a minor child whose allowance can be cut at any

¹³ U.S. Bureau of the Census, Compendium of City Government Finances in 1948, (City Finances 1948, No. 2) Washington, D. C., 1950, p. 5, Table I.

¹⁴ U.S. Bureau of the Census: Summary of City Government Finances in 1949, (City Finances, 1949, No. 1) Washington, D.C., October, 1950., p. 5, Table 2.

time by a parent.

SEPARATION OF SOURCES

The fifth traditional response, separation of sources of revenue lies at the opposite pole from grants-in-aid and suggests fiscal independence for each level of government by careful demarcation of revenue sources, assigning them to particular levels of government and placing "No Trespassing" signs thereon. Separation of sources may result from either the operation of Constitutional limitations or the forbearance of higher levels of government. During the early national period in the United States an operative separation of sources existed in American public finance and was not an inappropriate solution. Federal revenues were derived except during emergencies from customs, proceeds of land sales and excises. Local government revenues arose, in the main, from general property taxation. While the trend of events and the widening scope of government have resulted in widening and overlapping taxation at all three governmental levels, many still desire the elegant simplicity of separated sources. For example, the Joint Committee of the American Bar Association, The National Tax Association and the National Association of Tax Administrators has proposed separation of sources on a wider scale. This conclusion stems quite naturally from the basic assumptions of that group, as follows:

" 1. Any solution must preserve, and not impair, the sovereign powers of both the federal and state governments.

2. In general, each grade of government should support its

functions from its own independent revenues.

3. In general, the governments of whatever grade which raise particular tax revenues should control their expenditures.

4. The primary purpose of taxation ^{is} the raising of revenue and its use for regulation should be limited to those instances where such use is clearly warranted."¹⁵ The general viewpoint of this group, representative of those most familiar with the effects of current tax trends is worthy of inclusion as follows, "The consequences of tax coordination by federal revenue controls would be the further strengthening of the federal government and the further weakening of the states. We realize that fundamental and popular centralizing forces have been at work since the founding of our democracy which have demanded an extension of federal authority. It is our earnest conviction, however, that if the trend toward increasing centralization is not substantially diminished, the survival of our democracy will be gravely endangered."¹⁶ Carl Chatters has suggested that the Federal government abandon admissions and all excise taxes whose yield, when federally administered, is low compared to cost of collection and which can

¹⁵ "The Coordination of Federal, State and Local Taxation", Report of Joint Committee of the American Bar Association, National Tax Association, and National Association of Tax Administrators, (1947); p. 5. Also noted in "Report of the Committee on Coordination of Federal, State and Local Taxes," Revenue Administration, 1947, Chicago, Federation of Tax Administrators, 1948, p. 12.

¹⁶ Ibid., p. 11.

be administered at the local level."¹⁷

As a practical matter, there appears little immediate likelihood of sufficient abandonment of sources to provide a solution to the municipal revenue problem. This statement should not be construed to deprecate the very real contribution that state abandonment has made to the possibility of self-help by municipalities willing to help themselves. Witness for example, the abandonment¹⁸ to its cities of admissions taxation by the State of Ohio. Even so, in the opinion of the writer, given our complex present tax structure and the possibility of continuing pressure for more revenue on all grades of government, separation will probably be inadequate. Moreover, it should be noted that only by Constitutional limitation could a separation be permanently effectuated and it is certainly questionable as to the desirability of introducing such an element of rigidity into the system. Comment on separation of sources as a solution has varied from the cautious comments of Professor Buehler that separation would be no panacea¹⁸ to the caustic acidity of Professor Louis Shere with reference to the "hoary and bankrupt separation of sources."¹⁹ It is noteworthy that the Groves, Gulick, Newcomer Committee begins its summary of the topic with the observation, "If a separation of sources is

¹⁷ Chatters, Carl H., "Priorities and Balance in Municipal Finance," 1948 Proceedings, N.T.A., p. 8 et seq.

¹⁸ Buehler, Alfred G., "Federal Grants in Aid v. Separate Revenue Sources," 1949, Proceedings, N.T.A., p. 384.

¹⁹ Shere, Louis, "An Economist's Viewpoint on Tax Policy," The Annals of the American Academy of Political and Social Science 266 (November, 1949), p. 169.

deemed still within the realm of feasibility . . ."20 The Committee further notes that only Brazil of the principal federal governments has adopted complete separation of sources; the Brazilian Constitution of 1937 delimits the field.

Aside from the above mentioned traditional separation, another aspect of separation of sources is division of a particular tax between different levying units. Thus, the Federal government could retain upper bracket income taxation and turn taxation of lower brackets over to the state or local governments. Another possibility would be Federal retention of the surtax and turning the normal tax over to the lower governmental units. This hardly seems likely in the foreseeable future and comes so close to the so-called "tax supplement" concept that it will be considered later in connection with coordination possibilities and the position of local income taxation in the tax system as a whole.

Having considered the five principal traditional responses to the problem of municipal revenue inadequacy and having noted defects in each of them plus little likelihood that they will provide a solution consistent with the maintenance of local autonomy, it is desirable to look further. Particularly if the maintenance of at least residual local autonomy is posited as desirable, the sixth possibility,--multiple utilization of the same sources, deserves consideration. This proposal quite naturally offends both those who favor the elegant simplicity of traditional separation of sources and those who regard multiple taxation as a retrogression not justified by reality.

20 Federal, State and Local Fiscal Relations, op. cit., page. 153.

In any event, no matter what the point of view, it seems apparent that the question of to what extent, if at all, state or local functional independence should be turned over to higher governmental levels will not be finally decided with any great rapidity. Meanwhile, municipal revenue needs have grown and along with the development of aid has come experimentation with non-property taxation,--involving in many instances overlapping taxes previously levied by either or both the Federal and state governments. It is quite simply a case where the fiscal need has caused action while structural change and tax coordination have lagged as a result of a number of causes including institutional inertia. To enumerate all the municipal tax experiments attempted in the past two decades would require a long listing. Generally, there has been an expansion of local amusement taxes, local consumption taxes, local business licenses and gross receipts taxation, and local income taxes.²¹ In short, there has been quite a substantial search for the new revenue source desired by the Groves, Gulick, Newcomer Committee²² without, however, a great deal of consideration of the four desirable characteristics noted by that group. One of these developments, not new in the history of public finance²³ but new to the American experience is:

²¹ Cf., Hillhouse, A. M., and Magelssen, Muriel, "Where Cities Get Their Money," Chicago, Municipal Finance Officers Association, 1945; id. 1947 Supplement; Miner B. Phillipps, 1949 Supplement.

²² Cf. supra p. 3.

²³ Buck, A. E., "Municipal Finance," 11 Encyclopedia of the Social Sciences 98 at 99, 100.

the increasing use of income taxation at the local level.

Aside from obtaining increased aid payments, municipalities may increase their revenues, chiefly, by the following means: (1) increasing the yield from property taxation; (2) increasing income from non-tax sources, particularly municipal public service enterprises; and (3) obtaining added revenue from non-property taxation. Property tax revenues, which in 1949 accounted for 53.4% of the general revenue of the 397 cities having 1940 populations of over 25,000,²⁴ can in all probability, be increased to a certain extent by improved administration, more realistic assessment, and a more stringent policy with respect to exemptions. Even so, many states still have either constitutional or statutory tax limitations. Where local law permits voted tax levies outside the limitation the electorate has frequently failed to approve outside levies, particularly those for current operating expenses. This tendency to disapprove additional levies complicates flexible utilization of the property tax even where the actual tax rate may exceed the limitation, as it frequently does in Ohio. It would appear over-optimistic to assume that the municipal revenue problem can be solved solely by a rejuvenation of the property tax.

NEW REVENUE SOURCES

One partial solution to the municipal revenue problem may be found in new revenue sources. It would appear that if coupled with an adequate state aid program a development of such local taxes

²⁴ U.S. Bureau of the Census, Summary of City Government Finances in 1949, op. cit., p. 5.

would provide at least a temporary solution to the problem. In this connection, it is noteworthy that in 1946, the State of New York enacted permissive legislation allowing counties and cities having populations over 100,000 to levy the following taxes: (1) a retail sales tax of not more than 2%; (2) a tax on the ownership of motor vehicles; (3) a 3% tax on restaurant meals and drinks over \$1.00; (4) a 5% admissions tax; (5) a license tax on vending machines; (6) a 1% gross receipts tax; (7) a 5% tax on the occupancy of hotel rooms.²⁵ Thus, New York has attempted a solution of local fiscal problems through a combination of grants allocated on the basis of population and of permissive local taxation. The State of Pennsylvania adopted permissive legislation allowing local governments wider tax powers on June 25, 1947.²⁶ Ohio vacated the admissions tax field in favor of its municipalities and returned certain intangible property taxes to localities. These changes are symptomatic of developments in this area. This trend has met with mixed reactions. One viewpoint contra is that vehemently expressed by Professor Louis Shere,

"Local governments, and to some extent the states too, are hard pressed for revenue to match their costly functions. Federal grants are flowing in growing volume to the states and are spilling over state barriers in the direct channels to local governments. After a period of substantial growth, state grants and shared taxes are encountering resistance at both the giving and receiving ends. The financial responsibilities for expanding governmental costs are being thrown back in large measure to the local units of government. The states are implementing this policy by endowing their subdivisions with new taxing powers which, however, do not encompass the

²⁵ Chapman, Alger B., "State and Local Fiscal Relations," Revenue Administration, 1947, op. cit., p. 28.

²⁶ Act 481.

relaxation of property tax limitation.

Thus under enormous financial pressure and gross misguidance, a big step backward was taken in intergovernmental fiscal relations and reform of the American tax system. Thousands of **local** units of government have enacted many more thousands of undesirable consumption and miscellaneous business and other taxes. Problems of tax compliance and administration, of tax barriers, tax migration, and multiple taxation, of equity, of market and incentive efforts, and of flexible fiscal policy, all loom more than proportionately larger in the bigger three-deep tax model of the post-war period than in the two deep model of prewar days.

The retrogressive policies now being pursued in intergovernmental fiscal relations are unbelievable. They are overwhelmingly naive and dangerous, politically and economically. They are sponsored by proclaimed friends of home rule and state's rights but it would be difficult to conceive plans fundamentally less compatible with either, unless it be the hoary and bankrupt separation of sources, the extreme opposite of the current duplication of state and federal taxes. Either approach leads to failure, and failure ironically leads to centralization, the bogey from which the unimaginative plans seek to escape."²⁷

This comment appears to rely upon several tacit presuppositions, --that multiple taxation is an evil per se; that grants-in-aid may be a complete solution to local government fiscal problems; that the tax structure of a federal polity can achieve structural simplicity in a complex interdependent economy characterized by wide variations in both tax capacity and expenditure needs. These presuppositions appear unrealistic and in error unless the major premise of the unimportance of local government financial responsibility for at least a significant portion of both expenditure and revenue raising be accepted. Such acceptance appears inconsistent with the proposition that democratic local government must maintain reasonable financial independence in order to survive in its present form; otherwise, it would become a mere administrative

²⁷ Shere, Louis, "An Economist's Viewpoint on Tax Policy," op. cit., p. 169.

adjunct of centralized government. Centralism may be acceptable in some quarters, however, it by no means follows that it is the inevitable result of the use of local non-property taxation.

By way of contrast to Professor Shere's vehemence, one Municipal Finance Officer, Carl C. Tillman of Toledo, Ohio made this statement with respect to the Toledo solution to the municipal revenue problem:

"A municipal income tax measure, properly conceived could provide for all maturing bonded indebtedness, meet the operating costs of certain services and facilities, such as health, recreation, etc., which are for the use of all residents and finance the proper maintenance of all thoroughfares. The particular needs of each individual community would indicate what preferential use would be made of this particular revenue. If the measure is conscientiously conceived, all factors taken into consideration and the rate set to accomplish what is required, it will place the finances of the city on a sound basis, make the income tax the primary source of revenue instead of a supplement to the real estate tax, afford definite relief to the real estate taxpayer, and make possible the elimination of many, if not all, of the stopgap measures of the past."²⁸

Another Municipal Finance Officer has stated that, "After 35 years in Municipal Finance work in this city, I am convinced that the Municipal income tax is the solution of the Municipal financial problems in Ohio."²⁹

These statements which could, of course, be multiplied many times, present a reasonably clear cut split in opinion. In all probability, truth lies in the middle ground; the writer reserves further comment until later.

The dilemma has been aptly stated by C. Emory Glander, former Tax Commissioner of Ohio, as follows, "To confine local governments

²⁸ Tillman, Carl C., "Municipal Income Taxation Problems," 1949 Proceedings, N.T.A., p. 304 at p. 307.

²⁹ Letter to the writer, dated July 19, 1950 from E. E. Hagerman, Director of Finance, City of Dayton, Ohio.

to exclusive reliance on their own tax resources is to doom certain areas to substandard existence and to multiply taxpayer compliance problems. To permit unlimited extension of governmental grants-in-aid is to destroy local financial independence, upon which the integrity and strength of local government are unquestionably dependent."³⁰

Finding a satisfactory middle path involves careful consideration of the new local non-property taxes that have been developed. This study will consider one of such taxes, the local income tax, in terms of how it measures up to the criteria advanced by the Groves, Gulick, Newcomer Committee and how it fits into the middle area of reality between the two undesirable extremes above-mentioned. In the writer's opinion, of all the non-property taxes suitable for local use there are but three that would be fiscally adequate with reasonably low costs of administration,--a city or county retail sales tax; a gross receipts tax upon all persons and entities engaged in business for gain or profit within a local jurisdiction, and (3) a local income tax. This conclusion has been suggested by others.³¹ It is proposed to consider here one of these, the local income tax, with particular reference to the State of Ohio.

³⁰ Glander, C. Emory, "New Types of Municipal Non-Property Tax Revenues," The National Tax Journal, Vol. III, No. 2, June, 1950, pp. 97-103 at 103.

³¹ For example cf., Burke, Robert Granville, "A Discussion of Local Revenue Problems with Some Oblique References to the Art of Taxation," 1948 Proceedings, N.T.A., p. 25.

CHAPTER II

THE MUNICIPAL TAXING POWER AND LOCAL INCOME TAXATION

In order to delineate the framework within which municipal authority can exercise its limited fiscal initiative, it is necessary to consider what taxing powers are held by municipal corporations. The beginnings of municipal organization and hence of the rules regulating municipal action are lost in antiquity. However, the scope of this inquiry does not go beyond the municipal taxing power as it exists in present-day American municipalities. Primary attention will be given to rules affecting Ohio municipalities since the Ohio experience in the local income tax field is of primary importance in this study.

Dillon's definition of a municipal corporation is, as follows:

"A municipal corporation, in its strict and proper sense, is the body politic and corporate constituted by the incorporation of the inhabitants of a city or town for the purposes of local government thereof. Municipal corporations as they exist in this country are bodies politic and corporate of the general character above described, established by law partly as an agency of the State to assist in the civil government of the country, but chiefly to regulate and administer the local or internal affairs of the city, town, or district which is incorporated."¹

Being analytically merely a sub-category of the corporation, municipal corporations, in general, have only such powers as are directly or by implication granted to them by the State. It should always be borne in mind when considering the scope open to local government fiscal action that the State's sovereignty is

¹ Dillon, *Municipal Corporations* 58 (5th ed., 1911).

paramount. It is true that there has been a minor cross-current in American municipal law suggesting the existence of an "inherent right of local self-government" but this has had small impact on the dominant rule of state supremacy.² The general rule is that local governmental powers depend upon a grant either from the legislature or from the state constitution directly.

While it is a well settled general rule of law that the sovereign power of taxation is incapable of delegation there is an equally well recognized exception to this rule in the case of political subdivisions.³ Accordingly, in the main, a municipality has only such powers and privileges with respect to revenue or taxation as are conferred by law.⁴

It is not proposed to examine here the taxing authority delegated by each of the forty-eight states of the Union to their respective municipalities in detail; the general situation will be ~~indicated~~ indicated and the situation in Ohio will be noted in more detail. In some states, the levy of taxes to finance ordinary corporate affairs incidental to the existence of the organized

² See Judge Wanamker dissenting in *State ex rel. Toledo v. Lynch*, 88 Ohio St. 71, 125, 102 N.E. 670 (1913); Fordham, Jefferson B., and Asher, Joe F., "Home Rule Powers in Theory and Practice," 9 Ohio St. L.J. 18 (1948); and generally McBain, Howard L., "The Law and Practice of Municipal Home Rule," New York, 1916.

³ 38 American Jurisprudence, Municipal Corporations, 69.

⁴ 15 MCQUILLAN, Municipal Corporations 9 (3rd ed., Smith, 1950), noting *Ashton v. Cameron County Water Imp. District No. 1*, 298 U.S. 513, 80 L. Ed. 1309, 56 S.Ct. 892, rehearing denied 299 U.S. 619, 81 L.Ed. 457, 57 S.Ct. 5.

municipal corporation is considered a local matter controlled by home-rule city charter provisions rather than general law.⁵

Obviously, the home-rule charter provisions of the constitutions of the several states authorizing such charters and the charters themselves, differ considerably with the result that no general rule can be laid down as to the power of the legislature over taxation in home rule municipalities.

CALIFORNIA CITY TAX POWERS

An example of the liberal approach is afforded by the rule of the State of California. Article XI, Section 6 of the California Constitution, adopted in 1914, provided that cities or town by creating new charters or amending existing charters could become empowered "to make and enforce all laws and regulations in respect to municipal affairs,"--with respect to all other matters charter cities were and are subject to general laws.⁶ Thus as to "municipal

⁵ MCQUILLAN, op. cit. supra. 21.

⁶ Cf. 24 California Jurisprudence, Taxation, Sec. 33, p. 51 et seq. Note, however, that a city operating under some form other than a freeholders charter in California must derive its taxing power, if at all, from a specific legislative grant of power rather than from the Constitution directly as in the case of California charter cities,--accordingly for the non-charter city, what the Legislature has given, it can, likewise, take away. Cf. also McQuillan, op. cit. 21,n59 citing Re Braun, 141 Cal.204, 210, 74 Pac. 780 (1903).

For an excellent discussion of the present variety in the organization of California municipalities see: Report of Senate Interim Committee on State and Local Taxation, Part Two, "State and Local Government Finance in California," (California Legislature, January, 1947), page 267 et seq.

The 1914 version of Section 6, Article XI, California Const. reads: "Cities and towns hereafter organized under charters framed and adopted by authority of this (continued on p. 24.)

affairs," freeholders charter cities derive their powers directly from the Constitution and not from a legislative grant of power. This constitutional grant of power has been construed to include the right to levy taxes by a city for revenue purposes, such levy being held to be a municipal affair.⁷ Thus, as has been pointed out by Professor McGoldrick, California has adopted the most extreme form of home rule as regards the municipal taxing power by accepting taxation as an inherent power of local self-government,-- a purely local matter not subject to control by the legislature for charter cities.⁸ This California highwater mark of fiscal home rule is more or less in accord with the philosophy implicit in the statement of Mr. Justice Field in United States v. New Orleans to

6 (continued from p. 23.) Constitution are hereby empowered, and cities and towns heretofore organized by authority of this Constitution may amend their charters in the manner authorized by this Constitution so as to become likewise empowered hereunder, to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in their several charters, and in respect to other matters they shall be subject to and controlled by general laws."

There are at present 54 1914 Freeholders Charter Cities in California plus the City and County of San Francisco. The local taxing powers of other municipalities can be determined solely by reference to powers created in (1) pre-1879 special charters, (2) charters granted under the 1896 California Constitution, (3) the General Law applicable to Fifth and Sixth Class cities.

7 West Coast Adver. Co. v. City and County of San Francisco, 14 Cal. 2d. 516, 95 Pac.2d.138 (1939). Pre-1914 Charter cities which included tax powers in their charters are also covered. Cf. Re. Braun, 141 Cal. 204., 74 Pac.780 (1903).

8 McGoldrick, Joseph D., "The Law and Practice of Municipal Home Rule, 1916-1930," New York, 1933, p. 341; Cf. also Morton v. Broderick, 118 Cal. 474, 50 Pac. 644 (1897).

the effect that, "A municipality without the powers of taxation would be a body without life, incapable of acting and serving no useful purpose."⁹

Under this rule, California charter cities thus have power to levy local income taxes without regard to any necessity for legislative approval or to any limiting doctrine similar to the Ohio pre-emption doctrine.¹⁰ However, local supplementary taxation in California has taken the form of city sales taxes rather than city income taxes. As of January 1, 1949, 122 California municipalities were levying city sales taxes with an estimated total yield of \$27,900,000.¹¹ Despite this alternative sales tax development at the local level, city income taxes have been under consideration recently in the California cities of San Francisco, Richmond, Los Angeles and San Diego but in each of these cases the idea has been discarded.¹²

⁹ 98 U.S. 381, 393, 25 L.Ed. 225 (1878).

¹⁰ *Infra.* p. .

¹¹ Welch, Ronald B., "More City Sales Taxes," A Supplement to "City Sales Taxes in California," State Board of Equalization, Division of Research and Statistics, Sacramento, California, 1949, p. 1.

¹² Letter to the writer from Mr. Richard Carpenter, General Counsel, League of California Cities, Berkeley, California, dated January 30, 1951. While California has a double-decked sales tax structure, double decker income taxation appears inappropriate to date. Mr. Carpenter comments as follows: "As you know, California has a state income tax, and to pile a local income tax on the state income tax would make the tenure in office of the person voting such a levy rather short. While tenure in office is only one of the measures of political success, at least it is one, and for this reason few, if any, local legislative bodies will give serious consideration to an income tax at the local level."

Thus, the California cities which possess the most unrestricted powers of local taxation have shied away from local income taxation thus far.

The California rule is a minority one. In other jurisdictions, it is the rule that taxation is a state rather than a municipal affair and that state policy controls regardless of whether or not a particular city has adopted a home-rule charter.¹³ With respect to Ohio, McQuillan comments that, "Although under the home rule provisions of the Ohio Constitution, municipalities of that state may 'exercise all the powers of local self-government' they do not possess unrestricted power as to taxation for local or municipal purposes, since taxation has always been recognized as a power of sovereignty, inherent in the state."¹⁴ The Ohio rule will be discussed in more detail later.¹⁵ It may be noted at this point, however, that the Ohio rule is virtually the opposite of the California home-rule doctrine.¹⁶

GENERAL LIMITATIONS ON CITY TAXING POWER

It is elementary that municipal taxes are invalid if they violate constitutional provisions as to due process or deny persons equal protection of the laws. However, the rules resulting from interpretation of constitutional limitations of this type are not

¹³ Cf. Note, 106 A.L.R. 1202.

¹⁴ 16 McQuillan 23, citing State v. Slusser, 75 O.App. 141, 61 N.E. 2d.318, aff'd 144 Ohio St. 123, 56 N.E.2d.239, State v. Cooper, 97 Ohio St. 86, 119 N.E. 253.

¹⁵ Infra. p.34 .

¹⁶ McGoldrick, op. cit., p. 342.

peculiar to the field of municipal taxation and need not be labored here. It may also be noted that the general rule that taxes must be levied for a public purpose is, of course, applicable to municipal taxation.¹⁷ It is interesting to note Dillon's Comment on "public purpose,"--"A public use or purpose is of the essence of a tax. Theoretically, the taxpayer is compensated for the taxes he pays in the protection afforded to him and his property by the government which imposes the tax, but the substantial foundation of the power is political, civil, or governmental necessity (emphasis added), and the taxes are largely, if not wholly, as Mr. Mill insists, sacrifices for the public good, 'equality of sacrifice' being the rule dictated by justice."¹⁸ One might add that an even broader concept of taxation was suggested by Mr. Justice O. W. Holmes, Jr. to the effect

¹⁷ 16 McQuillan 52; Magano Co. v. Hamilton, 292 U.S. 40, 78 L.Ed. 1109, 54 S.Ct. 599; Cleveland v. Ruple, 130 Ohio St. 465, 200 N.E. 507.

¹⁸ Dillon, op. cit. 2312; Apparently Dillon is referring to John Stuart Mill, "Principles of Political Economy," Book V, Chapter II, (Hadley Ed.) 308, as follows: "As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all; which, it must be observed, is the mode by which the least sacrifice is occasioned on the whole. If any one bears less than his share, and the alleviation of the one, is not, on the average, so great a good to him, as the increased pressure upon the other is an evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice." Thus, Mill was in favor of proportional taxation. For a more recent discussion of theoretical bases for distribution of the burden of taxation see Hugh Dalton, "Principles of Public Finance," (12th ed.) London: Routledge and Sons, Ltd. 1943, page 86 et seq. The practical problem of whether or not proportional taxation at the local level is appropriate from a policy standpoint will be considered infra., Chapter X.

that taxes are the price paid for civilization.

Without elaborating on the various theories of the apportionment of the burden of taxation at this point, it may be noted that there need be little relation between the tax levied and benefit conferred today.¹⁹

TRIAL OF INCOME TAX IN ST. LOUIS, MISSOURI

The problem of a municipality in attempting to develop a new tax source is illustrated by the experience of the City of St. Louis. Under a rather broad tax provision in its charter, St. Louis levied a municipal income tax effective August 1, 1946. The Missouri Court invalidated the tax on the ground that both the state Constitution and the state legislature had failed to grant any such taxing power to the City.²⁰ The Court noted the Ohio presumption in favor of the municipality unless barred by either general law or the operation of the so-called Ohio pre-emption doctrine but held that the applicable rule in Missouri was contra, as follows, "But under Art. X, Sec. 1, Const. Mo. 1945 and 1875, the taxing power is exercised solely by the General Assembly except when it grants the power to municipalities."²¹

¹⁹ Morton Salt Co. v. City of South Hutchinson, 159 F.2d.897.

²⁰ Carter Carburetor Co. v. City of St. Louis, 356 Mo. 646, 203 S.W. (2d) 438, (1947).

²¹ 356 Mo. 646 at 660; Mo. Const. (1945) Art.X,Sec.1, referred to by the Court, reads as follows:

"The taxing power may be exercised by the General Assembly for state purposes, and by the counties and other political subdivisions under power granted to them by the General Assembly for county, municipal and other corporate purposes." The wording of Mo. Const. (1875) Art X, Sec.1 (continued on p. 29)

Accordingly, the first St. Louis income tax was invalidated in 1947. This result indicates the very real limitations on municipal action in the tax field and suggests that locally operative solutions to the problem of inadequate local revenue must be carefully made with adequate consideration of the legal limitations on municipal action that are involved. Of course, the problem can in most cases be solved by the enactment of permissive legislation. This was done in Missouri by the passage of legislation giving express authority for the levy of the St. Louis income tax.²² St. Louis adopted a second income tax ordinance enacting a $\frac{1}{2}$ of 1% city income tax on July 27, 1948, effective September 1, 1948.²³ This tax yielded approximately eight million dollars of revenue during its first full year of operation; the Earnings Tax Department was composed of only eight employees,-- million dollar a year tax collectors.²⁴ It may be noted that St. Louis has dropped from the ranks of income tax levying municipalities. The "earnings tax" levied in 1948 expired by its own terms July 17, 1950. Provision for levy of the tax at a rate of not in excess of one per cent was defeated by the electorate.²⁵

²¹ (continued from p. 28.) is similar with the single exception that "municipal corporations" is used in place of "political subdivisions."

²² Mo. Rev. Stat. Ann. Secs. 7780.4-7780.12 (Supp. 1949).

²³ City of St. Louis Ordinance No. 44678.

²⁴ Letter to the writer from R. E. Gruner, Collector of Revenue, City of St. Louis, dated October 25, 1950.

²⁵ Taxes, 28 (November, 1950) p. 1058.

In connection with the problem of municipal taxing power, it has been suggested by some observers of the tax scene that local income taxation has tended to develop in jurisdictions where there is no state income tax.²⁶ While, as indicated in the note, such observations may be premature generalizations, they do suggest the problem facing municipal governments in search of new revenue sources. In the absence of state grants of power, municipalities, with the exception of the peripheral case of California charter cities, do not have the taxing power requisite for concurrent levy of non-property taxes that are being levied by their sovereign state. Such being the case, municipal finance officers, city councils and citizens generally must perforce look elsewhere for a solution to inadequate revenues. Their solution conventionally takes one of two forms as follows: (1) a request for more money from the State in the form of either shared taxes or additional grants; or (2) the imposition of a tax which is permitted by the State or at least not pre-empted by it. That the first solution is a continuing one is

²⁶ Cf. Eg., Lindholm, Richard W., "Public Finance and Fiscal Policy," New York: Pitman, 1950, p. 696.,--"The tendency to separate the revenue sources of the state and local governments does not appear to be based on any more scientific basis than that either the income or sales tax has been usurped by the state government and the local governments utilize the tax not used by the state." Certain comment is appropriate. First, parenthetically, from a legal standpoint, States do not usurp taxing authority from their subordinate municipalities in the typical American pattern. Secondly, while the above statement is, perhaps, valid with respect to Ohio and Pennsylvania, it does not apply to California where both states and cities levy sales taxes and where both state and local government could levy an income tax simultaneously if they so elected. Similarly, the brief St. Louis experience does not fit the above comment. Neither does the situation in Kentucky where the state levies an income tax and the City of Louisville levies an income tax disguised as an occupational excise to satisfy the requirements of legal formalism.

indicated by the recently proposed legislative program of Ohio municipalities which are seeking an increase in the Ohio local government fund from \$18,000,000 to \$24,000,000.²⁷ The second solution of new local taxes is at best a difficult one. The case of St. Louis is illustrative of how the power-gap at the local level complicates attempts at local solutions of revenue shortages by means of the levy of new taxes. Even where the legal framework permits local tax action by making appropriate grants of power, the lines of causation determining the selection of one local tax rather than another are complex. Local reactions vary. For example, the City and County of San Francisco recently rejected the income tax as a local revenue source. A proposal for a city income tax with a maximum rate of 1% on incomes of over \$4,000 was shelved by the Board of Supervisors Finance Committee by a three to one vote.²⁸ To what extent the fact that the State of California levies a personal income tax affected this decision is at best problematical, --or, for that matter, why sales taxes at the local level are considered politically appropriate while income taxes are not.

Local initiative in the tax field is, in the main, based upon taxing power derived either from permissive legislation or from the operation of legal rules which permit municipal taxes of types not levied by the State. A third possibility exists, that of broader home-rule power based upon constitutional provisions as indicated by the California rule. However, experience in this third

²⁷ The Columbus Dispatch, December 9, 1950, p. 12, c.1.

²⁸ Taxes, 28 (October, 1950) p. 901.

category indicates a rather spotty development. In essence, aside from a grant of really permanent local tax autonomy, power must come either from a positive legislative grant which may of course be withdrawn whenever the wisdom of the legislature directs or from the operation of judicial interpretation which operates to delimit the area of permissible local tax selection in the absence of legislative action. The marked variety of results obtained in forty-eight state jurisdictions is of course disturbing to those desirous of a standardized solution in local taxation. Such uniformity is not to be expected, in the writer's opinion, in view of the variety of municipal circumstances and the further variety of jurisdictional rulings. It is at least questionable as to whether uniformity is desirable when need varies. Indicative of the variation in state rulings are the state cases classifying the income tax. The variety is considerable.²⁹ Although there is authority to the contrary, income taxes may be classified as excise taxes.³⁰ Conversely, it has been held that an income tax is an assessment against the taxpayer's personal income and hence is neither an excise nor a property tax.³¹ Whatever the tax be denominated, if proper delegated authority exists, it may be levied. If levied, it must be uniform in operation and non-discriminatory. Exemptions may or may not be allowed depending upon

²⁹ 16 McQuillan, op. cit. Sec. 44.193, p. 487 and cases cited therein.

³⁰ Carter Carburetor Corp. v. City of St. Louis, 356 Mo. 646, 203 S.W. 2d.438.

³¹ Owen v. Fletcher Saving and Trust Co., (continued on p. 33.)

the jurisdiction.³²

It may be noted that where Constitutional provisions prevent the levy of income tax of the "earnings type" as such, the same end may be accomplished by the levy of an occupational license tax or a franchise tax measured in terms of wages, salaries or business profits. This is the basis for the Louisville, Kentucky tax.³³

Aside from the St. Louis experiment mentioned above and the occupational excise taxes levied by Louisville and Paducah, Kentucky,³⁴ greatest utilization of local income taxation has come in the two states of Pennsylvania and Ohio. Philadelphia levied such a tax in 1939 which became operative in 1940 and, with the passage of enabling legislation, her example was followed by Scranton, Altoona, Erie, Johnstown and approximately 226 other local taxing jurisdictions in the state.³⁵ In Ohio, Toledo, Dayton, Columbus, Youngstown, Warren and Springfield have adopted this type of tax.³⁶ Washington, D. C. levies an income tax enacted

31 (continued from p. 32.) 99 Ind. App. 365, 189 N.E. 173,177.

32 Cf. eg. McPherson v. Fisher, 153 Ore. 615, 23 Pac 2d. 913 (exemptions permitted); but see contra, Butcher v. Philadelphia, 333 Pa. 497 (1938); Dole v. Philadelphia, 337 Pa. 375, 11 A.2d. 163 (exemption in Philadelphia tax invalidated as violation of the "uniformity clause" in Pennsylvania State Constitution.).

33 Louisville Ord. No. 112 (1948) approved in Louisville v. Sebree et al, 308 Ky. 420, 214 S.W.2d.248 (1948); Cf. Ch. IV infra.

34 Cf. Chapter IV, infra.,p.84

35 Cf. Chapter III, infra.,p.49,79.

36 The Ohio development is considered in Chapters V-VIII.

by the Congress.³⁷

From the standpoint of municipal taxing power, the Pennsylvania taxes are authorized by broad permissive legislation enacted by the State Legislature.³⁸ This legislation will be considered in greater detail later.³⁹

MUNICIPAL TAXING POWER IN OHIO

Municipal taxing power in Ohio is derived from the so-called Home Rule Amendment of the Constitution and from the operation of the pre-emption doctrine. Since this study is chiefly concerned with the Ohio development, the Ohio situation will be considered in some detail.

In 1912, Ohio adopted the Home Rule Amendment of its Constitution. Section 3 of Article XVIII reads:

"Municipalities shall have authority to exercise all powers of local self-government and to enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws."

Those favoring a large degree of operative home rule have been less than satisfied with the rather restrictive interpretation of this section by the Ohio Supreme Court.⁴⁰ It is noteworthy that judicial determination that municipal taxing power stems from the

³⁷ Cf. Appendix V.

³⁸ P.L. 45, 53 Pa. State, Ann. 4613 (Philadelphia); Act 481 (1947) as amended by Act 246 (1949) (as to other Pennsylvania local governments).

³⁹ Cf. Chapter III, *infra*. p. 63.

⁴⁰ Fordham, Jefferson B., and Asher, Joe F., "Home Rule Powers in Theory and Practice," 9 Ohio St. L.J. 18 (1948); Seasongood, Murray, "Cincinnati and Home Rule," *Id.* 98.

1912 Home Rule Amendment, Section 3, Art. XVIII, Ohio Constitution, and the most significant limitation on the exercise of that power are to be found in the opinion of the Ohio Supreme Court in the case of Zielonka v. Carrel.⁴¹ The Carrel case held that the taxing power of an Ohio municipality, after the enactment of the 1912 Amendment, stems from the constitutional grant of power rather than from any permissive action on the part of the General Assembly. Prior to the Home Rule Amendment, the situation in Ohio was otherwise. Even after 1912, the power of the legislature must not be minimized for Section 6, Art. XII provides for restriction of municipal taxing power by legislature action.⁴²

The Carrel case arose from the levy of an occupational excise tax by the City of Cincinnati on, among others, osteopathic physicians. One taxpayer of this class tendered the tax due to the city auditor who, purportedly for the purpose of providing a basis for a test case, refused to accept the tax tendered. The city law officer then brought an action to compel the auditor to accept the offered payment in order to test the validity of the levy. The Court noted that an "income tax," in Ohio at least, is an "excise tax,"⁴³ and that a tax on occupations is an excise;⁴⁴

⁴¹ 99 Ohio St. 220, 124 N.E. 134 (1919).

⁴² Ohio Const. Art. XII, Sec. 6,--"The general assembly shall provide for the organization of cities and incorporated villages, by general laws; and restrict their power of taxation, assessment, borrowing money, contracting debts and loaning their credit, so as to prevent the abuse of such power."

⁴³ 99 Ohio St. 220, 224

⁴⁴ 99 Ohio St. 220, 225

that the General Assembly has power to levy such a tax by virtue of Sec. 1, Art. II, Ohio Constitution. The court held that the grant to municipalities of "all powers of local self-government" included the taxing power in the following pointed statement,—" There can be no doubt that the grant of authority to exercise all powers of local government includes the power of taxation, for without this power local government in cities could not exist for a day."⁴⁵ The Carrel case is notable not merely for the holding that municipal taxing power flows from the Constitution but also for the establishment in Ohio of the judicial doctrine of pre-emption.

Paragraph 2 of the syllabus of the Carrel case, which under the Ohio rule is not merely an editorial summary but rather is the law of the case, reads as follows: "Under the grant of power of local self-government provided in Section 3, Article XVIII of the State Constitution, the city of Cincinnati as long as the State of Ohio through its General Assembly does not lay an occupational tax on business, trades, vocations, and professions followed in the state, may raise revenue for local purposes through the instrumentality of occupational taxes."⁴⁶ Thus while in one breath the Court seemingly widened the area for local taxation in the next it presented the pre-emption doctrine preventing a concurrent levy of a tax levied by the State.⁴⁷ Thus, local taxation could only exist

⁴⁵ 99 Ohio St. 220.

⁴⁶ 99 Ohio St. 220, Syl. 2.

⁴⁷ Reference with respect to the evolution of the pre-emption doctrine in Ohio must be made to the very able article by C. Emory Glander and Addison E. Dewey, "Municipal Taxation, A Study (cont. on p.37.)

on the basis of state sufferance. A careful reading of the opinion in the Carrel case fails to reveal to any material extent the source of the Court's inspiration in the enunciation of this doctrine. It was a period in which the concept of "separation of sources" was much discussed.⁴⁸ From the opinion, there appears to be no concrete evidence as to what part, if any, current discussion of this topic had on the decision. Logically, the conclusion can result from the interpretation of the sovereignty concept mentioned in the decision, in other words that if the sovereignty of the state in taxing matters is paramount, then a simultaneous similar use of the same power would amount to a derogation of that of the state and hence should be struck down. In the opinion of the writer, while perhaps legally sound reasoning, this is rather sterile rationalization for interdicting concurrent levy of the same tax by both state and local authorities given a suitable tax and non-confiscatory rates. However, the Court has continued to follow the doctrine announced in the Carrel case down to the present.⁴⁹ In the next two cases which were based upon the pre-emption theory enunciated in the Carrel case, Globe Security and Loan Co. v. Carrel,⁵⁰

⁴⁷ (continued from p. 36.) of the Pre-emption Doctrine," 9 Ohio St. 1.J. 72, (1948).

⁴⁸ Adams, T. S., "Separation of State and Local Revenues," The Annals of the American Academy of Political and Social Science, 58 (March, 1915) p. 132.

⁴⁹ Cf. eg., the latest holding in Youngstown Municipal Ry. Co. v. Youngstown, 154 Ohio St. 311, No. 32202, December 6, 1950; 22 Ohio Bar No. 36 at p. 311, (December 11, 1950).

⁵⁰ 106 Ohio St. 32, 138 N.E. 364 (1922).

and in Marion Foundry Co. v. Landes,⁵¹ the court applied the Carrel doctrine without giving any additional information explaining or rationalizing the pre-emption rule. The next case in the line is that of City of Cincinnati v. American Telephone and Telegraph Co.; the opinion given was applicable to three cases which were considered together by the Court, City of Cincinnati v. American Telephone and Telegraph Co., v. The Norfolk and Western Ry. Co., v. The Western Union Co.⁵² The syllabus reads as follows:

"1. Sections 5483, 5485, and 5486, respectively, lay an occupational tax upon telephone companies, telegraphy companies, and railroad companies.

2. The power granted to the municipality by Section 3, Article XVIII of the Constitution of the State of Ohio, to lay an occupation tax in the exercise of its powers of local self-government, does not extend to fields within such municipality which have already been occupied by the state."

Thus, the court again followed the pre-emption rule. It is noteworthy that the court cast about for some explanation of the Carrel rule pointing out that it might have been based upon one of the following three concepts: (1)

a rule analogous to that governing the problem of interstate commerce whereby the states may act until Congress does but that as soon as Congress does act state action is precluded;

(2) that the passage of a state taxing statute is a general law and that a local taxing ordinance in the same general area would be in conflict with a general law and hence be in excess of the powers of local government granted to Ohio municipalities;

(3) that under Section 6, Article XIII, Ohio Constitution, the passage of a state taxing statute operates as a restriction of the taxing power of municipalities.

⁵¹ 112 Ohio St. 166, 147 N.E. 302 (1925).

⁵² 112 Ohio St. 493, 147 N.E. 806 (1925).

Having thus noted the multiple rationalizations possible for the Carrel rule, the Court went on to say that such now was the well-settled rule in Ohio. The rule was followed in the subsequent cases of Firestone v. City of Cambridge⁵³ (holding that a municipality could not levy an excise tax based upon the privilege of driving an automobile on its streets in view of the fact that the General Assembly has pre-empted the field of taxation by levying a similar tax), and in Cincinnati v. Oil Works Co.⁵⁴ (holding that a municipality could not levy an excise tax on gasoline station operators since the field had been pre-empted). In the Firestone case, the Court concluded that the regulatory power granted to the General Assembly by Section 13, Article XVIII, Ohio Constitution⁵⁵ could be exercised either directly or by implication; also the court concluded that a provision for sharing the revenue derived from a state levied tax with local government was indicative of an intent to pre-empt the field.

A succinct epitome of the Ohio pre-emption doctrine prior to the decision in Haefner, v. City of Youngstown⁵⁶ is given by Messrs. Glander and Dewey as follows:⁵⁷

⁵³ 113 Ohio St. 57, 148 N.E. 470 (1925).

⁵⁴ 123 Ohio St. 448, 175 N.E. 699 (1931).

⁵⁵ Ohio Constitution, Article XVIII, Sec. 13, is as follows: "Laws may be passed to limit the power of municipalities to levy taxes and incur debts for local purposes and may require reports from municipalities as to their financial condition and transactions, in such form as may be provided by law, and may provide for the examination of the vouchers, books and accounts of all municipal authorities, or of public undertakings conducted by such authorities."

⁵⁶ 147 Ohio St. 58, 68 N.E. (2d) 64 (1946). ⁵⁷ (cont. on p. 40.)

"1. The Ohio Supreme Court by adhering to the doctrine of the Carrel case has committed itself to the position that the taxing power of municipalities is derived from Section 3, Article XVIII of the Constitution known as the homerule amendment.

2. The General Assembly has the constitutional power under Section 13, Article XVIII of the Constitution to limit or restrict the taxing power of municipalities.

3. The General Assembly may limit municipal taxing power by express declaration or by implication where the state enters a given tax field.

4. A municipality may levy excise taxes as long as the State of Ohio, through its General Assembly, has not levied the same or a similar tax and thus pre-empted the field."

The main difference between the pre-emption doctrine at this stage and the rule enunciated in the Youngstown case is with respect to what state or local action constitutes pre-emption. Prior to the Youngstown case, taxes which pre-empted the field were taxes of the same type. Then came the decision of the Ohio Supreme Court in the case of Haefner v. Youngstown. The City of Youngstown enacted a tax ordinance levying a 2 1/4% tax on the net amount charged by public utilities, said tax to be added to the consumers bill and the charge for the utility service and the tax to be collected at the same time. This levy was invalidated by the Ohio Supreme Court under the pre-emption rule. The syllabus of the case is as follows:

"1. Taxation is an attribute and function of sovereignty.

2. The taxing power of the state is made specific as to excise taxes by Section 10, Article XII of the Constitution, which expressly authorizes the General Assembly to enact legislation providing for them.

3. Municipalities have power to levy excise taxes to raise revenue

for purely local purposes; but under Section 13, Article XVIII of the Constitution, such power may be limited by express statutory provision or by implication flowing from state legislation which pre-empts the field by levying the same or a similar excise tax. (Emphasis added)

4. By virtue of Section 5546-2, General Code, which has levied a retail sales tax, and Section 5483, General Code, which (supplemented by House Bill 196, 120 Ohio Laws 123) has provided for a tax on the gross receipts of utility companies, the state has pre-empted the field of taxation which includes, *inter alia*, receipts by utility companies from natural gas, electricity and water sold to consumers and local service and equipment furnished to telephone subscribers."

The court based its opinion on the fact that while public utility sales were exempted from the retail sales tax⁵⁸ they were subject to a state excise tax on their gross receipts.⁵⁹ The court concluded that this was indicative of an intent upon the part of the General Assembly to pre-empt the field. This was purely inferential on the part of the court which spoke as follows:

"Inferentially the whole legislative course shows an intent to avoid double taxation of receipts whether they come from sales proper or are the "gross receipts" of utilities that are subject to the excise tax under Section 5483.

We can conclude only that by levying the sales tax and the gross receipts tax the General Assembly has pre-empted the field of taxation which includes, *inter alia*, receipts by utility companies from natural gas, electricity and water sold to consumers and local service and equipment furnished to telephone subscribers. There is no disputed question of fact and, therefore as a matter of law, the

⁵⁸ G.C. 556422

⁵⁹ G.C. 5483

collection of the excise tax sought to be imposed by the ordinance should be restrained."⁶⁰

The Youngstown case amounted to a marked extension of the pre-emption doctrine in that in the previous cases the taxes at the state and local level had been similar in order for the rule to operate as a bar to local action. However, the Youngstown rule, to say the least, suggests that virtually any excise tax, other than a local income tax, levied by Ohio municipalities could well be invalidated by analogous reasoning. To date the Court has shown no disposition to narrow its ruling.⁶¹ Even so, the reasoning of the Court in the Youngstown case is open to question. The decision rests on the inference as to the intent of the legislative branch, a frail reed at best. While settled rules of interpretation rather than actual investigation are used in determining intent, it would seem rather circuitous reasoning to infer that exemption from a state tax evidences the intent to preclude municipal tax levies in a particular tax area not actually occupied by the state. Since the General Assembly exempted sales of utility services from the sales tax, the Court deduced a legislative intent to avoid duplicate taxation of sales; on that inference the Court deduces a further derivative intent to preclude local taxation of consumer's utility bills. This appears to be an inference on an inference, a rather dubious reasoning process which, it is submitted, could well be

⁶⁰ Ibid at p. 64.

⁶¹ Vide e.g. Youngstown Ry. Co. v. Youngstown, op. cit.

modified when opportunity presents itself to the Court. Judicial clarification of the legality of a condominium of state and municipal governments in the levy of excise taxes in the same field would be of material aid to local finance policy.

It is not surprising that municipalities have sought to have permissive legislation enacted by the General Assembly so as to afford a positive indication that its "intent" was not in accordance with the inference of the Court. However, this legislation has not been forthcoming from the legislative halls and even if it does will be questionable until such time as the Supreme Court of Ohio rules thereon and, if it does, holds that the General Assembly may authorize the concurrent levy of similar taxes, as the Court defines the term "similar," by both the state and the local government. Certainly, as Messers. Glander and Dewey have suggested⁶² it is desirable that legislative clarification be made with respect to this problem. As it now stands, the cities of Ohio are clearly barred from levying local sales taxes and the rule of Haefner v. Youngstown appears to bar them from the levy of gross receipts taxes with the possible exception of unincorporated business. Thus, localities here are relegated to the local income tax, whatever their preference may be, and/or to the admissions tax which the state has allowed them to utilize by vacating that tax field.

In this connection it may be noted that the concern about "constitutional pre-emption" of income taxation in Ohio resultant from the provisions of Section 8, Article XII, Ohio Constitution

⁶² 9 Ohio St., L.J. 83.

and the dicta of Nichols, C. J. in the Carrel case to the effect that a municipality could not levy an income tax in view of the constitutional provision⁶³ have been disposed of by the holding of the court in Angell v. City of Toledo⁶⁴ which validated the Toledo city income tax in the absence of state levy.

Judge Nichols in the Carrel case gave the following obiter dictum, "It may be said in this connection that it is clearly to be implied from the Constitution that municipalities are without power to levy an income or inheritance tax."⁶⁵ Judge Turner in the Toledo case disposed of this dictum, which had concerned some for fear that, as Nichols, C. J. felt, Article XII, Section 9, as interpreted, directly barred a local income levy by direct constitutional implication, by noting that, "No inheritance or income tax was before the court in that case nor are such objects mentioned in the syllabus of the case."⁶⁶

The Toledo case, a new landmark in Ohio tax law, merits detailed consideration. Plaintiff filed his petition attacking the validity of Ordinance No. 18046, adopted by the council of the City of Toledo on January 28, 1946 which levied the Toledo city income tax, and seeking to have the tax declared invalid and

⁶³ Ohio Constitution, Article XII, Sec. 9: "Not less than fifty per centum of the income and inheritance taxes that may be collected by the state shall be returned to the county, school district, city, village or township in which said income or inheritance tax originates, or to any of the same, as may be provided by law.

⁶⁴ 153 Ohio St. 179.

⁶⁵ 99 Ohio St. 220, 228.

⁶⁶ 153 Ohio St. 179, 181 (1950).

also to have his employer restrained from withholding the tax from plaintiff's wages. A demurrer to the petition was sustained by the Common Pleas Court and plaintiff elected not to plead over, so that the petition was dismissed. Appeal, after a motion for new trial was overruled, was perfected to the Court of Appeals which affirmed the Lucas County Common Pleas. The Supreme Court of Ohio allowed a motion to certify the record, and on March 8, 1950, in an opinion by the late Judge Turner, five Justices concurring in the Turner opinion, Taft, J. writing a separate concurring opinion, the Court affirmed the lower courts holding that the Toledo income tax was a valid exercise of the local taxing power. The syllabus is as follows:

"1. Ohio municipalities have the power to levy and collect income taxes in the absence of the pre-emption by the General Assembly of the field of income taxation and subject to the power of the General Assembly to limit the power of municipalities to levy taxes under Section 13 of Article XVIII or Section 6 of Article XII of the Ohio Constitution.

2. The state has not pre-empted the field of income taxation authorized by Sections 8 and 9 of Article XII of the Constitution and the General Assembly has not, under authority of Section 13 of Article XVIII or Section 6 of Article XIII of the Constitution, passed any law limiting the power of municipal corporations to levy and collect income taxes.

3. A municipal income--tax ordinance may provide for collection of the tax at the source.

4. Ordinance No. 18-46, enacted pursuant to the charter of the city of Toledo, January 28, 1946, is a valid enactment.

5. Section 6 of Ordinance No. 18-46 of the city of Toledo, providing for the collection at the source of the income tax assessed, commonly known as the pay-roll income tax ordinance is a valid enactment."

Thus, the Toledo tax was validated and in addition its

taxation of non-residents was also approved. In a relatively brief opinion (less than six pages), Judge Turner disposed of the Carrel dictum; noted that while the Federal government is a government of "enumerated powers," the state Constitution is a limitation of powers and that the General Assembly can enact any law not prevented by the Constitution; noted the Ohio Constitutional provisions mentioned in the syllabus and came to the conclusion that Toledo had the requisite power to levy the tax. It is noteworthy that the opinion stated, "In the interpretation of the Ohio Constitution an income tax is not to be treated as an excise tax."⁶⁷ The opinion briefly disposed of the arguments re: non-resident withholding by pointing out that plaintiff had derived benefit from the city of Toledo. "In other words, the city of Toledo does afford to plaintiff not only a place to work but a place to work protected (emphasis added) by the municipal government of Toledo."⁶⁸ It is significant that the opinion stated specifically that it was limited to answering in the affirmative the two questions: (1) "Has the city of Toledo the power to provide by its charter or ordinance for the assessment and collection of an income tax?," (2) If the municipality has the power to enact such legislation, may it impose such a tax upon non-residents who work and receive their pay in Toledo?." The concurring opinion of Judge Taft presages problems to come if Ohio municipalities attempt over-extension of income taxation. He stated that, in his opinion, paragraph 2 of the Toledo

⁶⁷ Ibid. 183.

⁶⁸ Ibid. at 185.

syllabus in mentioning "the field of income taxation" was too broad and opined that the holding, being limited to answering the two questions propounded, did not determine whether other state taxes pre-empted portions of the potential income tax field, particularly the state tax upon intangibles.⁶⁹ Thus, while Toledo got the green-light, there are caution signs ahead.

On the same day the Court held that the income tax levied by the City of Dayton, Ohio was invalid.⁷⁰ This was predicated entirely upon the Court's interpretation of the tax limitation in the Dayton City Charter (Sec. 171) which provided that any taxes levied outside the limiting section (which the City unsuccessfully contended applied only to ad valorem taxation) must be approved by a vote of the people. Since this was not done, the Dayton tax was struck down; while this holding posed difficulties for the Dayton administration, it was in accord with the general rule of construction that ambiguities in tax statutes are to be construed strictly against the government and in favor of the taxpayer.⁷¹

Thus, Ohio municipalities, severely restricted by the operation the ten mill limitation of Section 2, Art. XII, Ohio Constitution⁷² and the pre-emption doctrine, have a judicially approved means of
 69 Secs. 5638 and 5638-1 G.C.

70 Zimmer et al v. Hagerman, Director, 153 Ohio St. 187 (1950).

71 Ibid. 191.

72 Dargusch, Carlton S., and Hart, John N., "Ohio Tends Her Tax Limited Municipalities," National Municipal Review, Vol. 28, No. 7 (September, 1939), p. 519.

increasing local revenue by the levy of local income taxes without the need for permissive legislation by the General Assembly.

Alternatively, cities may obtain increased aid, may obtain state exit from particular tax fields, may obtain legislation denying the validity of judicial inferences as to some particular taxes and authorizing with subtle indirection concurrent levy of some taxes; however, all of these are prospective, the right to levy a local income tax in Ohio is a present right which has been utilized and merits consideration.

While this study is primarily concerned with local income taxation in Ohio, two non-Ohio tax situations will be covered in the next two chapters. The Philadelphia city income tax was the first such tax in the United States. Use of similar taxes by some 230 local governments in Pennsylvania marks the greatest use of this tax in any state. Accordingly, the Pennsylvania experience will be considered in Chapter III. Louisville, Kentucky affords an example of the value of city income taxation in providing a significant supplemental revenue source for a metropolitan city, its occupational license tax will be covered in Chapter IV.

CHAPTER III

LOCAL INCOME TAXATION IN PENNSYLVANIA

Philadelphia was the first municipality in the United States to levy and collect a local income tax.¹ By 1938, as a result of rising expenditure, the growth of city population, and the impact of the depression on property taxation, the city needed additional revenue. A retail sales tax, which produced \$6,793,614, in eight months at a rate of 2%, was adopted in 1938.² According to Professor Buehler, this tax was unpopular with both retailers and with organized labor and this public reaction furnished popular support for the adoption of the city income tax. In November, 1938, the Philadelphia City Council³ made its first attempt in this direction by enacting an income tax ordinance which exempted

¹ Local income taxation has been utilized in the past in Europe. Cf. Buck, A. E., "Municipal Finance," 11 Ency. Soc. Sc. 98; Municipal income taxes were levied by some municipalities in Canada, in particular in the metropolitan area of Montreal and in Nova Scotia prior to the Dominion Provincial agreements in 1942. Cf. Buck, A. E., Financing Canadian Government, Chicago, Illinois: Public Administration Service, 1949, p. 322 in this regard. New York City enacted a local income tax in 1934, which was to be 15% of the Federal income tax; however, due to opposition from state officials and fear of resultant tax migration, this tax was repealed prior to its effective date. McGoldrick, Joseph D., "Sources of Municipal Revenue," Municipal Finance, November, 1939, p. 13.

² Buehler, Alfred G., "The Income Tax as a Local Revenue," Bull. National Tax Association, 33 (November, 1947) 34.

³ It may be noted that the City of Philadelphia is unique among Pennsylvania local governments in that it is a consolidated city-county government and that the city government performs and provides for all local government functions other than schools. Cf. in this regard, Patterson, Robert J., "The First Class City of Philadelphia," Local Government Finances in Pennsylvania, Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg, 1945, p. 31

the first thousand dollars of income from the tax.⁴ The Pennsylvania Supreme Court sustained the ordinance under its severability clause but held that the exemption was a violation of the uniformity requirement of the state Constitution in a brief per curiam opinion.⁵ The ordinance was thereupon repealed.⁶

The Philadelphia Council adopted a second income tax ordinance on December 13, 1939,--"imposing a tax for general revenue purposes on salaries, wages, commissions and other compensation earned after January 1, 1940, by residents of Philadelphia, and on salaries, wages, commissions and other compensation earned after January 1, 1940, by non-residents of Philadelphia for work done or services performed or rendered in Philadelphia, and on net profits earned after January 1, 1939, of businesses, professions or other activities conducted by such residents, and on the net profits earned after January 1, 1939, of businesses, professions or other activities conducted in Philadelphia by non-residents; requiring the filing of returns and the giving of information by employers and those subject to said tax; imposing on employers the duty of collecting the tax at source; providing for the administration, collection and enforcement of the said tax; and imposing penalties."⁷

This ordinance was made possible by enabling legislation known as the Sterling Act passed by the Pennsylvania legislature in 1932,⁸ which authorized cities of the first or second class to levy taxes

⁴ Green, Robert McCay, et al, "The Philadelphia Income and Wage Tax," Municipalities and the Law in Action, National Institute of Municipal Law Officers, 1944, p. 148.

⁵ Butcher v. Philadelphia, 333 Pa. 497, 6 A. (2d) 298 (1938).

⁶ Green, Robert McCay, op. cit., p. 148.

⁷ Philadelphia Ordinance approved December 13, 1939 (page 656 of published Ordinances), as amended December 21, 1942 (page 601 of published Ordinances), as further amended March 31, 1949; as amended December 9, 1949; published by W. Frank Marshall, Receiver of Taxes, Philadelphia, Pennsylvania, 1946; supplements 1948, 1949. Hereinafter referred to herein as "Philadelphia Ord.

⁸ Pa. Stat. Ann. tit. 53, Sec. 4613, P.L. 45.

on persons, transactions, occupations, privileges, subjects and personal property within the limits of the city which are not subject to a state levy. Section 2 set the initial tax rate at $1\frac{1}{2}\%$. The rate was reduced to 1% effective January 1, 1943 for the wage tax and effective January 1, 1942 for the tax on net business profits. The rate was raised to $1\frac{1}{4}\%$ on earned income effective January 1, 1950, and on net profits effective January 1, 1949.⁹ It is noteworthy that recently further rate increase has been proposed; a $1/4\%$ increase which has been considered would bring in approximately eight million dollars additional revenue. However, reports suggest that any excessive increase may result in adverse legislative reaction at Harrisburg through amendment of the Sterling Act to exempt non-residents.¹⁰

PHILADELPHIA ORDINANCE PROVISIONS

Since Philadelphia is the prototype for most local income taxation in the United States, its ordinance merits detailed consideration. Section 3 requires an annual return on or before March 15th of the following year for calendar year taxpayers or seventy-five days after the close of the fiscal year for those not on a calendar year basis. Section 3 further provides that where all taxable income is subject to withholding at source the Receiver of Taxes may accept the employers return showing the amount deducted and withheld as the final return. This is permitted where the

⁹ Section 3 amending Section 2 of Philadelphia Ord., December 9, 1949.

¹⁰ The Wall Street Journal, November 22, 1950, p.1., c.1. Vol. CXXXVI, No. 121.

taxpayer has a single employer for the year and where the gross amount of compensation without adjustment for expenses has been used as the basis for withholding.¹¹ Following the decision in the Butcher case, previously referred to, no exemptions were allowed; no deductions against earned income were enacted and no attempt was made to tax capital gains. Collection at the source was provided for with a requirement for monthly collection and payment by employers to the Receiver of Taxes. It was further provided that the failure or omission by an employer to withhold and pay the tax did not relieve the employee from the payment of the tax.¹² This provision for monthly payment has been criticised as placing an undue burden on employers and generally in other cities a quarterly system of payment has been adopted.¹³ The March 31, 1948 Amended Income Tax Ordinance provided for quarterly rather than monthly payment of taxes withheld from payrolls.

Section 5 made it the duty of the Receiver of Taxes to collect the tax levied by the ordinance and to keep records of the amount so received. Section 6 charged the Receiver with enforcement of the tax; granted him the power to promulgate administrative regulations; granted him and his agents inquisitorial powers; and provided fines for the disclosure of information so obtained. Section 7 provided for an interest penalty on unpaid taxes of six per centum per

¹¹ Philadelphia Income Tax Regulations, 1946, Art. III, p. 34.
Hereinafter cited as Philadelphia Regs.

¹² Philadelphia Ord., Sec. 4.

¹³ Martin, James W., and Lockhart, Madelyn, "Operation of a Local Income Tax," Public Management, 32, No. 3 (March, 1950), p. 54.

annum with an additional penalty of 1/2 of 1% per month for the first six months of delinquency. Section 8 provided for the collection of unpaid taxes by the City Solicitor as civil debts. Section 9 provided for penalties up to thirty days imprisonment or \$100.00 fine for violations of the ordinance.

The limitations on municipal taxing power have already been discussed.¹⁴ Section 10 of the Ordinance indicates the realization of such limitations, as follows,--"This ordinance shall not apply to any person or property as to whom or which it is beyond the legal power of council to impose the tax or duties herein provided for."

The ordinance concludes with the customary separability clause.¹⁵

The brevity with which both the ordinance and the regulations issued by the Receiver of Taxes treat the problem of the determination of profits earned in Philadelphia is noteworthy. "If the taxpayer is a non-resident, only the amount of net profits applicable to the activities of the business in Philadelphia shall be subjected to tax. If the non-resident taxpayers' records do not disclose the actual net profits for the Philadelphia branch, office, store, or activity separately, then the basis of the allocation shall be disclosed in the return. If such basis of allocation is not deemed correct, in view of the known circumstances, the Receiver of Taxes will make a re-allocation based upon gross receipts or any basis or

¹⁴ Supra. p. 26.

¹⁵ Philadelphia Ord., Sec. 11.

bases, which shall, under the circumstances of the case, more accurately reflect the net profits."¹⁶

It is submitted that the allocation formula in the Ohio municipal income tax ordinances to be considered later represents a definite improvement in that business and professional men are not so dependent in the last analysis upon the administrative determination of the Receiver of Taxes.¹⁷

CONSTITUTIONALITY OF PHILADELPHIA INCOME TAX

The first important legal attack upon the second income tax ordinance was made by labor organizations in the case of Dole v. Philadelphia.¹⁸ Adverse contentions included, inter alia, that the City had no power to impose such a tax, that the distinction between wage-earners and businessmen was unwarranted; that the City could not compel employers to withhold the tax without compensation, that the provision for fine and/or imprisonment for non-payment was invalid; that the City could not delegate to the Receiver of Taxes the power to inspect books and records and that the City could not tax non-residents working in the City. The Pennsylvania Supreme Court rejected all contentions and upheld the lower court ruling validating the ordinance in its entirety, relying in part upon the authority never too clearly explained in the brief per curiam of the Butcher case.

Thus, the Pennsylvania Court in the Dole decision held that the 16 Philadelphia Regs. Art. II-7, p. 33.

17 Cf. Chapter V, p. 125ff; 147ff.

18 337 Pa. 375, 11 A. (2d) 163 (1940).

second Philadelphia income tax ordinance was constitutional; that the differentiation between income derived from salaries and wages and that derived from business net profits was a reasonable classification; that there was no violation of uniformity requirements resulting from the fact that those working outside the municipality were subject to withholding at source and those working outside the municipality must file returns. Subsequent to the Dole decision, the ordinance was attacked on a number of grounds;¹⁹ however, the validity of the taxation of earned income has been uniformly sustained by the courts. Although the City has been

¹⁹ Among the cases interpreting the ordinance are the following:

- (1) Michael Guerra v. City of Philadelphia, 30 Fed. Suppl. 791, noted, Green and Wernick, "The Philadelphia Income and Wage Tax," op. cit., 1944, p. 149,--valid levy on income of non-resident working in Philadelphia.
- (2) Stoudt v. Phila., 38 D & C 222, noted Green & Wernick, Ibid., holding that a tax on income is not a tax on its source; a tax on the wage of a railroad employee not an undue burden on interstate commerce.
- (3) Marson v. Phila., 342 Pa. 369, (1941) 21 A. (2d) 228, held City had power to tax the income of state employees although it did not have the power to require state agencies to withhold tax.
- (4) Phila. v. Schaller, 148 Pa. Super. 276, 25 A (2d) 406, (1942) cert. denied 87 L.ed.28, upheld right of City to collect tax from resident Federal employee employed at Philadelphia Navy Yard. Thus, the doctrine of limitation of powers has not been applied to bar collection of the tax from Federal and state employees.
- (5) Kiker v. Phila., 346 Pa. 624, 31 A. (2d) 289, 184 A.2d 88 L.ed. 28, (1943) sustained the right of the City to tax a non-resident employed in a federal area within the city.
- (6) Transeau v. Phila., CXIV Legal Intelligencer 81, 1946, noted in "Legal Problems Involving Act 481," Elizabeth Smedley, Dept. of Internal Affairs, Second Addition, Harrisburg, 1950, p. 12.,--holding that person having a legal residence in Philadelphia liable for tax even though owns home, and lives elsewhere, coming to City only to vote. No appellate review.
- (7) Philadelphia v. Westinghouse Elec. & Man. Co., 55 D. & C. 343, 1945, noted Smedley, Ibid., held that employer with main office outside city must comply with withholding (continued on p. 56.)

successful with respect to litigation of earned income cases, the problem of extending taxation to unearned income has not fared so well. In Pennsylvania Company v. Phila. et al,²⁰ the Pennsylvania Court upheld a regulation of the Receiver of Taxes which subjected income from the management of property to the city tax where persons were employed in such management and otherwise exempted such income. It should be noted that the Pennsylvania Company is a corporate trustee operating real estate as a mortgagee in possession or as a conservator of trust assets and as such was engaged in a business undertaking for profit. Moreover, the State of Pennsylvania imposes a tax of four mills on certain types of personal property including mortgages.²¹ It will be recalled that Philadelphia derived its income tax power from the Sterling Act which act limited such power to that not exercised by the State. The Supreme Court of Pennsylvania had previously held that a tax on income from property is a tax on property.²² Thus, the Receiver was skating on thin ice. However, the Court determined that the activity

19 (continued from p. 55.) requirements of ordinance and regulations for employees resident of city working outside where employer company maintains office in city being thus subject to the jurisdiction of the city council.

(8) Pennsylvania Company for Insurances on Lives and Granting Annuities v. Philadelphia, 346 Pa. 406, 31 A. (2d) 137, (1943) Philadelphia Income Tax Ordinance not construed as imposing double taxation; corporate trustee engaged in operating real estate subject to tax.

20 346 Pa. 406, 31 A. 2d 137, (1943).

21 P.L. 507, June 27, 1913, 72 P.S. 4821.

22 Kelly v. Kalodner, 320 Pa. 180, 181 Atl. 598 (1935).

of the taxpayer in the ownership and management of the mortgages was in the category of a trade or business and that the tax on the income therefrom was not a property tax. Thus, there was no conflict in the corporate trustee case between the city income tax and the state personal property tax. However, the flag warning against the taxation of unearned income was going up. In the first case of Murray et ux v. Philadelphia,²³ the Court invalidated administrative regulations whereby the taxability of income from rentals and security trading was to be determined by the number and size of transactions. It was presumed that a certain magnitude would be indicative that the taxpayer was engaged in that business and hence that the income was earned. This regulation was rejected by the Court as arbitrary and not determinative of the division between earned income and unearned income.²⁴

In December, 1949, the City of Philadelphia amended its income tax ordinance by increasing the rate to 1 1/4% as previously noted and extending the tax to unearned income.²⁵ In the second Murray case,²⁶ the court declared all of the amendments invalid with the exception of the rate increase. In particular, it held that a tax

23 363 Pa. 524 (1950).

24 Vide Breitinger v. Philadelphia, 363 Pa. 51 (1950), Plaintiff, an attorney, received certain income from real estate and from security transactions (5 sales per year); held that such income was not taxable as plaintiff was not in the business for gain but rather was merely managing and conserving his property. Contrast with the corporate trustee case above noted where the same actions done for gain resulted in taxable income.

25 Vide supra page 51.

26 Murray et ux v. Philadelphia, 364 Pa. 157, 71 A. 2d 280, 289 (1950).

on the income from real estate was a tax on the real estate itself and, since unauthorized by the Sterling Act, hence invalid. The Court further suggested that even if permitted by state enabling legislation such taxation would be invalid as violative of the uniformity requirements. While the question of whether it would be possible for Philadelphia to tax any form of unearned income has not yet been answered, it would appear that the prospect is not good.

PHILADELPHIA TAX: YIELD AND EFFECTS

Philadelphia was the only city in the United States to levy a municipal income tax from 1940 through 1945; its tax is a prototype for many of the similar taxes levied in other cities, particularly in Pennsylvania and Ohio, since 1945. Thus, the Philadelphia story merits consideration.

This tax has clearly met the requirements of fiscal adequacy as indicated in Table I. With respect to Table I, it should be noted that the initial yield was low relative to the following years as a result of litigation testing the validity of the ordinance and due to lack of compliance prior to determination of the legality of the tax. This was particularly true of state and federal employees, whose compliance with the impost was not obtained until 1942. The drop in yield from 1942 to 1943 was, of course, caused by the rate reduction. It will be noted that in 1945 the earned income tax accounted for 24.7% of the cities total^{re}/venue receipts. Since 1945, the Philadelphia income tax has accounted for more than 26% of city revenue receipts annually, -certainly a most

TABLE I

RATE, INCOME TAX YIELD, TOTAL REVENUE RECEIPTS AND INCOME TAX REVENUE AS A PERCENTAGE
OF TOTAL REVENUE RECEIPTS, CITY OF PHILADELPHIA, PENNSYLVANIA,
SELECTED YEARS, 1940-1950

(Income Tax Yield and Total Revenue Receipts in thousands of dollars)

<u>Year</u>	<u>Rate</u>	<u>Income Tax Yield</u>	<u>Total Revenue Receipts</u>	<u>Percentage of Total Revenue</u>
1940	1 1/2	\$14,807	---	17.7
1941	1 1/2	19,855	---	25.2
1942	1 1/2	24,762	---	30.4
1943	1	20,762	---	27.1
1944	1	22,315	---	26.7
1945	1	22,431	---	24.7
1946	1	25,215	90,626	27.8
1947	1	27,582	106,066	26.0
1948	1	31,167	111,611	27.9
1949	1	30,722	115,696	26.6
1950	1 1/4	37,543	126,026	29.8

SOURCE: 1940-1944, Hillhouse, A. M., "Where Cities Get Their Money," Municipal Finance Officers Association, 1945, p. 102; 1945, "Local Government Finance in Pennsylvania," Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg, p. 39; 1946-1950, Data furnished writer by Bureau of Municipal Affairs, Department of Internal Affairs, Harrisburg.

TABLE II

TOTAL REVENUE RECEIPTS, PERCENTAGE DISTRIBUTION OF TOTAL REVENUE
RECEIPTS, PER CAPITA AMOUNTS, BY TYPE OF MAJOR TAX CATEGORY,
CITY OF PHILADELPHIA, PENNSYLVANIA, 1945

(Revenue Receipts in thousands of dollars)

<u>Source</u>	<u>Revenue Receipts</u>	<u>Per cent of total revenue receipts</u>	<u>Per Capita Amount</u>
Property Taxes	\$46,220	51.0	23.932
Earned Income Tax	22,431	24.7	11.614
Sales and Gross Receipts Taxes	2,085	2.3	1.079
Miscellaneous	581	0.6	.301
Total Tax Revenue	71,316	78.7	36.926
Other Revenue Receipts	<u>19,310</u>	<u>21.3</u>	
Total Revenue Receipts	\$90,626	100.0	

SOURCE: "Local Government Finances in Pennsylvania," 1945,
Department of Internal Affairs, Harrisburg, 1945, p. 31.

significant supplement to conventional municipal financial sources. Table II shows the city revenue picture in 1945; taxes accounted for 78.7% of total city revenue receipts or \$36.926 per capita. Property taxes accounted for 51% of this amount, \$23.932 per capita. The city income tax was the second largest source of income, accounting for 24.7% of the total and for \$11.614 per capita. Certainly this tax meets the traditional requirement of fiscal adequacy.

Thus as a supplementary source of revenue the tax has met the test of time. Moreover, this tax provides an effective means of causing "daylight citizens" to contribute to the cost of operating the city within they earn their livelihood. It has been estimated that from 15% to 30% of the revenue from the Philadelphia tax comes from non-residents.²⁷ As to the cost of collection, in 1946, the City Income Tax Bureau had 207 employees, including a Special Deputy Receiver of Taxes, an officer manager, ten auditors, twenty-two investigators, clerks, stenographers and office personnel. The average salary was \$2,100.00. Total Bureau expenditure, including \$30,000.00 rental of office space, amounted to approximately \$ 460,000.00 or about 1.8% of tax collections.²⁸ This appears to be a reasonable cost of collection;²⁹ however, the question may

²⁷ Buehler, Alfred G., "The Income Tax as a Local Revenue," Bull. National Tax Association, 33, No. 2 (November, 1947), p.38.

²⁸ Buehler, op. cit., p. 37.

²⁹ Cf. Federal, State and Local Government Fiscal Relations, op. cit., p. 34 et seq.

be raised as whether such a low salary level may not operate to reduce the efficiency of the Bureau if not increased along with the general increase in the cost of living. From the standpoint of fiscal adequacy and cost of collection, the Philadelphia tax seems to fill the bill.

Doubts have been raised as to the feasibility of local income taxation on the ground that such taxes might cause tax migration. In this connection, the following statement is pertinent:

" Of all the types of taxes collected by the city, this Earned Income Tax has proven the easiest to collect and is second only to the Real Estate Tax as a revenue producer. The Philadelphia Real Estate Tax has proven relatively inflexible whereas the revenue from the Earned Income Tax rises in prosperous times and will fall sharply during depressions. From the point of view of city administration, the Earned Income Tax is ideally suited to present day business conditions while the less flexible Real Estate Tax will act as a buffer during the next business depression.

To our knowledge this tax has not caused any exodus of business establishments to surrounding communities nor has it blocked the location of any new industries within the Philadelphia area." (emphasis added)³⁰

Little concrete information is available on the problem of the cost of compliance with local income taxation. Economy of collection for the city may be due in part to the fact that a large percentage of revenue comes from withholding and it is difficult to obtain information on the cost of compliance by employers. In view of the multiple reporting duties of business to both state and Federal governments, the additional cost of compliance with city income taxes should not be unduly burdensome.

³⁰ Letter to the writer from Dr. Leonard A. Drake, Economist for the Chamber of Commerce of Philadelphia, dated August 16, 1950.

This problem will be considered later.³¹

The Philadelphia tax, as well as other examples of local income taxation considered in this study, should be clearly distinguished from the graduated net income tax levied by the Federal government. Local income taxation in general and the Philadelphia tax in particular are characterized by the following differences: local rates are flat rather than graduated; there are few exemptions; the tax applies to gross earned income of individuals; the tax is a net income tax only for unincorporated businesses and professions and for corporations where they are taxed, as in Ohio. Philadelphia and other Pennsylvania local governments do not tax corporate profits, that possibility having been pre-empted by the state.³²

While tax authorities have noted that the flat rate tax "violates the popular principle of ability to pay,"³³ the people of Philadelphia apparently have not regarded the city income tax as so burdensome or manifestly unjust as to justify remedial action at the ballot box. Further evaluation will be postponed until both the Pennsylvania and Ohio taxes have been considered.³⁴

ACT 481

Turning from the experience of the City of Philadelphia to that

³¹ Infra. p. 241.

³² Beck, Morris, "The Philadelphia Income Tax, A Solution to Municipal Financial Difficulties," Bull. National Tax Association, 33, No. 3 (1947), p. 84.

³³ Buehler, op. cit., p. 39.

³⁴ Cf. Chapter XI and X infra.

of Pennsylvania as a whole, the traditional policy of state limitation on local taxing authority was abruptly reversed when in 1947, the General Assembly enacted Act 481, the so-called "tax anything" or "home rule" tax law.³⁵ This act gave the Pennsylvania local tax structure a "new look" by permitting nearly 3600 political subdivisions,³⁶ other than the City of Philadelphia, which was already covered by the Sterling Act previously referred to, to impose taxes upon "any and all subjects of taxation" not levied upon by the state. No taxes were levied by the act; it was merely permissive. Specifically, local subdivisions were permitted to levy taxes on: (1) persons, (2) transactions, (3) occupations, (4) privileges, (5) subjects, (6) personal property located within such subdivisions. Limitations on the authority granted included: (1) Localities may not levy on items which are or later become subject to a state tax; (2) localities were prohibited from levying a tax on the gross receipts of any public utility whose rates are regulated by the Pennsylvania Public Utility Commission. (3) The following over-all limitation was included in Act 481 in the final paragraph of Section 1, as follows:

" The aggregate amount of taxes annually imposed by enactment of an 35 Act 481, approved June 25, 1947.

³⁶ The following subdivisions were authorized to levy such taxes by ordinance or resolution:

- Cities of the second class (Pittsburg)
- Cities of the second class A (Scranton)
- Cities of the third class (46)
- Boroughs (936)
- Towns (Bloomsburg)
- Townships of the first class (61)
- School districts of the second, third, fourth classes (2,542).

ordinance or resolution by any political subdivision under this section shall not exceed an amount equal to the product obtained by multiplying the total assessed valuation of real estate in such political subdivision at the time of such enactment by the maximum millage of tax thereon allowed by law."

Despite these limitations, this novel departure from the prevalent policy of contracting the area of fiscal home rule gave some 3600 of the 5200 Pennsylvania local government units the right to tax virtually anything not taxed by the state.³⁷ This act was followed by wholesale adoption of a great variety of local tax measures including local income taxes. On June 22, 1948, after Act 481 had been in effect about one year, 284 local governments were reported as enacting a total of 397 taxes under the Act. In February, 1949, these figures were up to 732 subdivisions and 915 taxes. At the time of the 1949 amendments to Act 481, the Pennsylvania Bureau of Municipal Affairs reported that 762 local governments had enacted 967 taxes under authority of the act. Because of the 1949 amendments, discussed later,³⁸ and adverse court decisions regarding severance taxes, the total number of "481" taxes declined to 906 as of March 17, 1950. Permitted taxes have continued to increase and, as of December 31, 1950, 1306 taxes were being levied as indicated in Table III. Thus, the number of "481" taxes continues to grow.³⁹ It should be noted

³⁷ "Act 481: Its First Two Years of Operation," Monthly Bulletin, Vol. 18, No. 3, p. 17, Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg, Feb. 1950.

³⁸ *Infra.* p. 71.

³⁹ Cf. "Taxes Levied Under Act 481," Mimeo issued by the Pennsylvania Department of Internal Affairs, February 1, 1949; Supplement issued February 17, 1950; Cf. also "Special Taxes Levied By (continued on p. 67.)"

TABLE III

NUMBER OF TAXES LEVIED BY PENNSYLVANIA LOCAL GOVERNMENTS UNDER ACT 481, BY TYPE OF TAX,
AS OF MAY 2, 1949, MARCH 17, 1950 AND DECEMBER 31, 1950

<u>Type of Tax</u>	<u>May 2, 1949</u>	<u>March 17, 1950</u>	<u>December 31, 1950</u>
Per Capita	252	293	506
Amusement	171	195	260
Income	161	190	230
Mechanical Devices	88	96	104
Deed Transfer	23	29	75
Miscellaneous	57	64	131
Total	<u>752</u>	<u>906</u>	<u>1306</u>

66.

SOURCE: Bureau of Municipal Affairs, Department of Internal Affairs, Commonwealth of Pennsylvania

that less than 1000 of the 3600 local governments with permissive authority have levied taxes under the act. The various types of local governments levying income taxes are indicated in Tables IV and V. It should be noted that Class 2A cities are those having populations of 135,000 but under 500,000 and that third class cities have populations under 135,000. Thus, numerically, most of the Pennsylvania local income taxes are levied by smaller urban centers and by school districts where utilization of this particular type of tax rests on much less firm ground than in the case of its use by large metropolitan centers because of the probable high cost of collection and compliance involved. It will be noted that only nine (9) cities are currently levying city income taxes under Act 481 as amended. Thus, including the City of Philadelphia, ten (10) cities are using the local income tax in Pennsylvania today. The balance of the 230 local income taxes are levied by various other units of local government. It has been estimated that about one-third of the population of the state is now covered by one or another of the local income taxes presently levied.⁴⁰

This condition at least raises the question as to the desirability of an alternative levy at the state level. However, such an alternative would mean a new tax levy regardless of local need as well as additional revenue apportionment problems. Rates

39 (continued from p. 65.) Local Governments of Pennsylvania, February, 1950, Department of Research and Statistics, Ohio Department of Taxation, March, 1950.

40 Research Memorandum, Pennsylvania State Chamber of Commerce, Harrisburg, April 29, 1950, p. 4.

and revenue derived from this source by the nine levying cities are indicated in Tables VI and VII.⁴¹

On November 26, 1947, the Supreme Court of Pennsylvania upheld the constitutionality of Act 481.⁴² The Court held that the title of the act was sufficient; that it did not involve an improper delegation of taxing power to local governmental units; that it was not local or special legislation; that it did not constitute a denial of due process; and that it did not violate uniformity requirements.

MULTIPLE TAXATION UNDER ACT 481

As to the problem of multiple taxation and intergovernmental tax and credit relations, Section 5 of original Act 481 set up two different methods of treating the question. First: Philadelphia was given special treatment by means of a provision that tax payments made under a levy made prior to the enactment of Act 481, "shall be credited to and allowed as a deduction from the liability of taxpayers for any like tax respectively--imposed by any political subdivision of this Commonwealth under the authority of this act."⁴³

It is to be noted that the City of Philadelphia was the only Pennsylvania local government levying a local income tax prior to the passage of Act 481. Thus, with reference to the Philadelphia area, a resident of any political subdivision outside Philadelphia

⁴¹ Cf. p. infra. p. 80.

⁴² English and McCormick Coal Co. v. School District of Robinson Township, 358 Pa. 45, 55 A. 2d 803 (1947).

⁴³ Section 5, Act 481.

TABLE IV

**INCOME TAXES ADOPTED UNDER ACT 481 BY TYPE OF POLITICAL
SUBDIVISION AS OF MARCH 17, 1950**

<u>Local Units</u>	<u>Income Tax</u>	<u>Total 481 Taxes</u>
Cities, Class 2	---	3
Cities, Class 2A	1	1
Cities, Class 3	8	63
Boroughs	44	272
Towns	---	1
Townships, Class 1	2	14
School Districts	<u>135</u>	<u>552</u>
Total	190	906

Source: Bureau of Municipal Affairs, Department of Internal Affairs, Commonwealth of Pennsylvania; Research Memorandum, Pennsylvania State Chamber of Commerce, Harrisburg, April 29, 1950.

TABLE V

**INCOME TAXES ADOPTED UNDER ACT 481 BY TYPE OF POLITICAL
SUBDIVISION AS OF DECEMBER 31, 1950**

<u>Local Units</u>	<u>Income Tax</u>	<u>Total 481 Taxes</u>
Cities	9	77
Boroughs	56	349
Townships	2	25
School Districts	<u>163</u>	<u>855</u>
Total	230	1306

Source: "Taxes Levied Under Act 481" Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg, 1950, p. xvi.

may deduct his Philadelphia tax from any tax levied by his local residence unit. Also, the taxes paid by a resident of Philadelphia to Philadelphia are deductible from any tax paid to any other local governmental unit. It is reported that as a result of this provision giving Philadelphia priority that no wage or income taxes have been levied by other local governmental units in the Philadelphia area.⁴⁴

Second: With respect to the relative priorities of residence versus the place where income is earned outside the special case of Philadelphia, Section 5 of Act 481 gives definite priority to the taxpayers place of residence.⁴⁵ Thus with respect to Philadelphia alone, Pennsylvania has given priority to the place where income is earned; elsewhere priority has been given to the place of the taxpayers residence.

The effect of this second and more general provision of Act 481 was to encourage reciprocal taxation. For if a particular municipality levied a local income tax, there was every incentive for adjacent "dormitory suburbs" to obtain for their coffers revenue which was being paid by their residents to the city which first

⁴⁴ Smedley, Elizabeth, "Legal Problems Involving Act 481," Second Edition, Department of Internal Affairs, Harrisburg, 1950, p. 15.

⁴⁵ The applicable portion of Section 5 reads as follows:
 "Payment of any tax on salaries, wages, commissions, other compensation or on net profits of businesses, professions or other activities to a political subdivision by residents thereof pursuant to an ordinance or resolution passed or adopted under authority of this act shall be credited to and allowed as a deduction from the liability of such persons for any other like tax respectively on salaries, wages, commissions, other compensation or on net profits of businesses, professions or other activities imposed by any other political subdivision of this Commonwealth under the authority of this act."

levied the tax.⁴⁶ This result when coupled with the levy of an income tax by a coterminous school district having the power to tax both residents and non-residents prior to the 1949 amendments to Act 481 made it possible for a given income-recipient to be subject to four local income taxes, a rather obviously undesirable duplication of taxation and tax administration.

ACT 481 MODIFIED: ACT 246

In 1949, the Pennsylvania legislature passed Act 246 amending Act 481. This amendment prohibited the imposition of certain taxes, established rate limitations for specific taxes, modified the overall limit on revenues to be collected annually, and made various other modifications in Act 481.⁴⁷

⁴⁶ Cf. Smedley, op. cit., p. 16.

⁴⁷ Section 1.A of Act 246 with the amending portions underlined reads as follows:

" "Delegation of Taxing Powers and Restrictions Thereon.--The
duly constituted authorities of the following political sub-
divisions: cities of the second class, cities of the second
class A, cities of the third class, boroughs, towns, townships
of the first class, school districts of the second class,
school districts of the third class and school districts of
the fourth class may, in their discretion, by ordinance or
resolution, for general revenue purposes, levy, assess and
collect or provide for the levying, assessment and collection
of such taxes on persons, transactions, occupations, privileges,
subjects and personal property within the limits of such
political subdivisions as they shall determine, except that such
local authorities shall not have authority by virtue of this
act (1) to levy, assess and collect or provide for the levying,
assessment and collection of any tax on a privilege, trans-
action, subject, occupation or personal property which is now
or does hereafter become subject to a State tax or license fee;
or (2) to levy, assess or collect a tax on the gross receipts
from utility service of any person or company whose rates and
services are fixed and regulated by the Pennsylvania Public
Utility Commission or on any public utility services rendered
by any such person or company or on any privilege or transaction

47 (continued.) involving the rendering of any such public utility service; or (3) except on sales of admission to places of amusement or on sales or other transfers of title or possession of property, to levy, assess or collect a tax on the privilege of employing such tangible property as is now or does hereafter become subject to a State tax; or (4) to levy, assess or collect a tax on goods and articles manufactured in such political subdivision or on the by-products of manufacture, or on minerals timber, natural resources and farm products produced in such political subdivision or on the preparation or processing thereof for use or market, or on any privilege, act or transaction related to the business of manufacturing, the production, preparation processing of minerals, timber and natural resources, or farm products by manufacturers, by producers and by farmers with respect to the goods, articles and products of their manufacture, production or growth, or on any privilege, act or transaction relating to the business of processing by-products of manufacture, or in the transportation, loading, unloading or dumping or storage of such goods, articles, products or by-products; (5) to levy, assess or collect a tax on salaries, wages, commissions, compensation and earned income of non-residents of the political subdivision; Provided, that this limitation (5) shall apply only to school districts of the second, third and fourth classes; (6) to levy, assess or collect a tax on personal property subject to taxation by counties or on personal property owned by persons, associations and corporations specifically exempted by law from taxation under the county personal property tax law; Provided that this limitation (6) shall not apply to cities of the second class."

* * *

Section 1 C reads as follows: " "Over-all Limit of Tax Revenues.-- The aggregate amount of taxes (annually) imposed by enactment of an ordinance or resolution by any political subdivision under this section and in effect during any fiscal year shall not exceed an amount equal to the product obtained by multiplying the total assessed valuation of real estate in such political subdivision at the time of said enactment by ten (10) mills in cases of cities of the second class, cities of the second class A, cities of the third class, boroughs, towns, and townships of the third class, and by fifteen mills (15) in cases of school districts of the second class, third class and fourth class."

* * *

Section 1 E reads, in part, as follows: "Limitations on Rates of Specific Taxes.-- No taxes shall be levied by any political subdivision on the following subjects exceeding the rates specified in

47 (concluded.) this subsection:

" (c) On wages, salaries, commissions and other earned income of individuals, 1%."*

* * *

The final paragraph of Section 1, E. reads as follows: "If at any time two political subdivisions shall impose any one of the above taxes on the same person, subject, business, transaction or privilege, located within both such political subdivisions, during the same year or part of the same year, under the authority of this act, then the tax levied by any political subdivision under the authority of this act shall, during the time such duplication of the tax exists, except as hereinafter otherwise provided, be one half of the rate as above limited, and such one-half rate shall become effective by virtue of the requirements of this act from the day such duplication becomes effective without any action on the part of the political subdivision imposing the tax under the authority of this act. It is the intent and purpose of this provision to limit rates of taxes referred to in this subsection so that the entire burden of one tax on a person, subject, business, transaction or privilege shall not exceed the limitations prescribed in this subsection: Provided, however, That any two political subdivisions which impose any of the above taxes on the same person, subject, business, transaction or privilege during the same year or part of the same year may agree among themselves that, instead of limiting their respective rates to one-half of the maximum rate herein provided, they will impose respectively different rates, the total of which shall not exceed the maximum rate as above permitted."

* * *

The second paragraph of Section 4 of Act 246 regarding joint agreements read as follows:

"Any political subdivisions imposing taxes under authority of this act are authorized to make joint agreements for the collection of such taxes or any of them. The same person or agency may be employed by two or more political subdivisions to collect taxes imposed by them under authority of this act."

Comment: Re Section 1. E (c), while the omission of "unearned income" may be only objected to on academic grounds since the decisions in the Murray cases, the question may arise as to whether a higher rate could be levied on the net profits of unincorporated businesses.

PROBLEMS UNDER ACT 481 AS AMENDED

In so far as local income taxation is concerned, Act 246 provided that school districts should not have authority to impose a tax on the earned income of nonresidents. It may be observed, parenthetically, that there appears to be, possibly through an error in legislative draftsmanship, no limitation on the taxation of net profits in the Act itself. In addition, a maximum rate of one per cent is prescribed and it is provided that the combined rate for coterminous local units shall not exceed the maximum one per cent rate prescribed by the Act. However, such subdivisions are granted the power to vary their rates by joint agreement provided that the total combined rate does not exceed one per cent. In addition, the Legislature has gone on record as permitting joint collection agreements and personnel. In addition, the 1949 amendments provided that certified copies of all ordinances and resolutions levying taxes under Act 481 as amended be sent to the Bureau of Municipal Affairs, Department of Internal Affairs, Commonwealth of Pennsylvania.⁴⁸ Thus, this state agency will have reasonable source of information and can provide necessary information to interested parties. A similar provision would be a desirable inclusion in any legislation of this type adopted in other states.

While the 1949 amendments eliminated school districts from part of the multiple tax area by restricting them to the taxation of residents, reciprocal taxation with its attendant problems of

⁴⁸ Section 1, F., Act 246.

administration for both tax authorities and employers charged with withholding responsibilities has become increasingly characteristic of Pennsylvania local government finance.

In this connection, the fact that a municipality and a coterminous school district may both impose an income tax under Act 481 as amended poses problems of priority and double taxation. In Glen Alden Coal Company v. Thomas,⁴⁹ the court ruled that levy of an income tax by both a school district and by the municipality did not constitute double taxation because the same tax is not imposed by the same authority upon the same subject matter. It was also held in the Glen Alden case that a taxpayer can claim as a credit any tax paid to either the municipality or the school district in which he lives against any tax liability due the municipality where he works. However, no credit may be claimed from the school district of residence for taxes paid to the municipality of residence or vice versa. It will be recalled that the 1949 amendment to Act 481 made definite and certain the fact that both school district and municipality may tax residents. Moreover, it makes it possible and attractive for school districts to levy taxes as soon as municipalities do by the provision which provides for splitting the maximum legal rate previously referred to above.

Another variant of the situation arising from multiple levying of income taxes arose in the case of Morgan v. Glen Alden Coal

⁴⁹ 165 Pa. Super. 199, 1949, noted in Smedley, op. cit. p. 17, and in 18 Dept. of Internal Affairs Bull. 24, February 1950.

Company⁵⁰ which involved a taxpayer who resided in a municipality which levied a 1% income tax and worked elsewhere subject to both a 1% municipal income tax and a 1% school district tax at the place of earnings. Having paid the tax due his place of residence, the taxpayer wanted to have his employer restrained from withholding the tax due where he worked. The court ruled that the employer should refund to the employee taxpayer an amount withheld equal to the tax the employee had paid to his place of residence. Likewise, the employee taxpayer was entitled to have the tax paid to his place of residence credited against the tax levied by both the municipality and the school district in which he worked. This sort of problem has been partially solved by restricting school district taxation to residents.

Thus, one of the most apparent problems resulting from multiple taxation is how to treat the taxpayer who lives in one taxing subdivision and works in another. Is he to pay both taxes and then claim a whole or partial refund from the subdivision where he works under the Pennsylvania system of giving priority to the place of residence? Should he pay the tax due his city of residence and merely file an information return where he works if he is not subject to withholding there? The first solution is at best clumsy and inconvenient; the second might be satisfactory for the self-employed not subject to withholding; however, since a large

⁵⁰ 165 Pa. Super. 203 (1949); noted in Smedley, op. cit. and in 18 Dept. Internal Affairs Bull. 24, op. cit.

majority of individual taxpayers are subject to withholding, it would appear that frequently the individual would have to pay his tax individually to the city of his residence and then attempt to obtain a refund from the city where he works and where his tax has been withheld by an employer subject to the jurisdiction of that local unit.

One possible solution would be for the various taxing districts in a particular area to establish a centralized system for collection, clearing and accounting. This would tend to simplify administration and possibly reduce costs. Miss Smedley notes that most districts which have established joint collection agencies have found the cost relatively low.⁵¹ Such joint ventures are legal under the 1949 amendments to Act 481. Competent authority has suggested, "The solution to this problem is in the establishment of a centralized accounting system for all local units with income taxes in a particular metropolitan area."⁵²

A unique arrangement was devised in the Sharon area where 14 political subdivisions have imposed income taxes in the vicinity. The cities, boroughs and school districts concerned hired a private accounting firm to handle the clearing work involved. Withholding is made from the wages of all employees regardless of residence and such amounts withheld are transmitted by the employer to the Receiver of Taxes of the political subdivision where the business or plant is located. The accounting firms prepare an allocation of

⁵¹ Smedley, op. cit. 16.

⁵² "Act 481: Its First Two Years of Operation," op. cit. p. 24.

moneys due to each participating governmental unit and an actual distribution between the various Receivers is made quarterly. This arrangement has made it unnecessary in most cases for employees subject to withholding to file returns has obviated the necessity for claims for refunds.⁵³

Another less attractive partial solution would be to permit large employers to break down their withholding records on the basis of employee residence when their labor force is drawn from a number of adjacent taxing jurisdictions. However, this would cover only a part of the taxpayers affected and in addition would mean in practice passing an operational governmental responsibility, the determination of legal residence, to a private agency or possibly to the taxpayer himself. This was tried in the Johnstown Pennsylvania area on the initiative of some employers; however, the city refused to accept the determinations of the private agencies. These various attempts at coordination of the unintegrated local income taxes levied by a multiplicity of Pennsylvania local governments represent the Pennsylvania development to date. The proponent of fiscal home rule can only hope that cooperative arrangements between levying units within the framework of Act 481 as amended will provide a sufficiently satisfactory solution; otherwise additional legislation more specifically delimiting the credit and sharing relationships of levying localities will presumably be forthcoming.

⁵³ "Pennsylvania's New Local Tax Law in Operation," Bulletin No. 123, Research Bureau, Pennsylvania State Chamber of Commerce, Harrisburg, 1948, p. 8.

It must be borne in mind that the payroll cost of compliance borne by the private employer can become excessive as a result of the withholding requirements of a multiplicity of local governments. This is perhaps one of the most telling criticisms of such taxation. It has been estimated that payroll costs of withholding have run as high as 12% of the tax collected in some cases as compared with a cost of compliance of 3.7% of the amount collected for social security purposes.⁵⁴ While these Jewel Tea Company figures may be partially discounted as special pleading, it must be realized that disguised costs borne either by businesses or passed on via an uncertain and variable shifting process obscure evaluation of such taxes and indicate that continuing efforts toward making reciprocal tax relationships simple, understandable and efficient are required. Otherwise, the alternative is all too clear, a continuing shift of revenue raising to the state or federal level with a correlative decrease in the area of effective home rule.

INCOME

SCOPE OF LOCAL/TAXATION IN PENNSYLVANIA

Little has been said herein concerning specific local income taxes in Pennsylvania other than that of Philadelphia. In the main, such taxes have followed the Philadelphia model. Table VI indicates the development for cities having populations over 10,000, other than Philadelphia. Table VII shows the ^{current} status of City income taxation in Pennsylvania.

⁵⁴ Homuth, H. G., "The Taxpayer Angle On Local Income Tax Administration," Income Tax Administration, Tax Institute Symposium, New York, 1948, p. 343.

TABLE VI

Pennsylvania Cities Levying Income Taxes, Rate, and Revenue, 1948.

<u>City</u>	<u>Rate</u>	<u>Revenue (a)</u>
<u>100,000 but under 250,000</u>		
Erie	1	----
Scranton	1	\$850.0
<u>50,000 but under 100,000</u>		
Altoona	1	----
Johnstown	1	500.0
<u>25,000 but under 50,000</u>		
Aliquippa	4/10	67.0
New Castle	1	----
Sharon	7/10	141.5 (b)
<u>10,000 but under 25,000</u>		
Canonsburg	1/2	30.0 (c)
Carbondale	1	----
Dunmore	1	
Jeanette	1/2	84.0
Monessen	1/2	119.0

a. in thousands.

b. 9 months.

c. 6 months.

TABLE VII

CITIES LEVYING LOCAL INCOME TAXES, EFFECTIVE DATES OF CITY INCOME TAXES, RATES AND CITY INCOME TAX REVENUE, STATE OF PENNSYLVANIA, 1949

<u>City</u>	<u>Effective Date</u>	<u>Rate (%)</u>	<u>1949 Revenue</u>
Altoona	2-1-49	1	\$ 652,701
Carbondale	1-1-49	1	114,998
Erie	1-1-49	1	1,462,920
Jeanette	4-1-48	$\frac{1}{2}$	138,985
Johnstown	3-4-48	1	860,457
Monessen	3-12-48	$\frac{1}{2}$	131,412
New Castle	12-15-48	.7	462,066
Scranton	2-20-48	1	1,138,348
Sharon	4-1-48	.7	392,536

SOURCE: "Taxes Levied Under Act 481," Department of Internal Affairs, Commonwealth of Pennsylvania, Harrisburg, December 31, 1950, pt. I, pp. 1-33.

Evaluation of local income taxation will be made later.⁵⁵ However, in brief summary, it may be pointed out that in so far as the Pennsylvania experience is concerned, the Philadelphia tax began largely as a depression expedient and has grown, assisted by preference granted in state enabling legislation, into a reasonably efficient metropolitan tax covering the entire metropolitan area of Philadelphia. As a solution to the financial problems of the modern urban metropolis, while no panacea, the income tax appears to be a valuable adjunct and supplement to traditional property taxation. However, as far as the plethora of local income taxes which have sprung up in other Pennsylvania local government units, the question may be at least raised as to whether such a tax is appropriate for small school districts. In this connection, it has been estimated that in some areas where school districts have levied income taxes more or less as "spite taxes" costs of collection will be as much as 29 per cent of the revenue yield.⁵⁶ There is little justification for such taxes at this level. However, it is reasonable to assume that such taxes can be levied and collected reasonably efficiently by cities of at least 10,000 or more provided that effective solutions to the problem of reciprocal taxation can be found. It is submitted that efficient tax administration goals would suggest that the power to levy such taxes be withdrawn from school districts and that if no satisfactory alternative method of meeting their financial needs

⁵⁵ Cf. Chapter X *infra*

⁵⁶ Kurtzman, D. H., "Local Income Tax Administration in Pennsylvania," Income Tax Administration, Tax Institute Symposium, New York, 1948, p. 312.

can be found that, at the option of the local school authorities, up to 50% of the amount of revenue derived from municipal income taxation be allocated to the appropriate school fund. It would appear that in this regard the need for legislative control of local government action supercedes in the interest of efficiency the prerequisites of home rule. Comment will be reserved on broader aspects of the evaluation of local income taxation.

CHAPTER IV

THE CASE OF LOUISVILLE, KENTUCKY

In addition to the utilization of local income taxation in Pennsylvania, local governments in Kentucky, Missouri, and Ohio have levied similar taxes. The experience of the City of St. Louis has been mentioned previously.¹ The Ohio experience will be treated in Chapters V-VIII.

In Kentucky, local governments have depended historically upon property taxation as the principal source of local revenue.² Revenues for the operation of local government in Kentucky in 1942 were derived from property taxes to the extent of 85.7% of total tax revenue.³ Professor Martin pointed out in his 1946 study that, "Occupational licenses and nonbusiness licenses and permits are the only other (than property taxation) substantially productive sources of tax revenue for cities of the second through the sixth classes."⁴ It should be noted that the classification of cities in Kentucky stems from Section 156 of the state Constitution.⁵

¹ Cf. Supra. p. 28.

² Martin, James W., "Kentucky City Finances," Bulletin of the Bureau of Business Research, College of Commerce, University of Kentucky, No. 12 and the Kentucky Municipal League, Lexington, 1946, p. 29.

³ Ibid., p. 28.

⁴ Ibid., p. 30.

⁵ Section 156, Ky. Const. establishes the following classification:

<u>Class</u>	<u>Population</u>
First Class City (continued p. 85.)	100,000 or more

This classification will prove significant in the consideration of the legal limitations imposed upon municipal revenue power in Kentucky. As has generally been the case in recent years, Kentucky local governments have found revenues inadequate.⁶ For the purposes of this study, however, the development of the occupational license tax of the first class city of Louisville will be given primary attention.

LIMITATIONS ON LOUISVILLE TAX POWERS

First, however, the constitutional and legal framework within which Kentucky municipalities can make revenue raising innovations must be considered. Constitutional provision for legislative delegation of certain taxing powers to municipalities is the basis for the present legal arrangements covering municipal taxation in both Louisville, the single city of the first class, and in Kentucky municipalities generally.⁷ In 1948, the Kentucky General

⁵ (continued from p. 84.)

Second Class City	20,000 or more but less than 100,000
Third Class City	8,000 or more but less than 20,000
Fourth Class City	3,000 or more but less than 8,000
Fifth Class City	1,000 or more but less than 3,000
Sixth Class City	less than 1,000

⁶ Martin, op. cit., p. 170.

⁷ Kentucky Const., Sec. 181, reads as follows:

"The General Assembly shall not impose taxes for the purpose of any county, city, town or other municipal corporation, but may by general laws, confer on the proper authorities thereof, respectively, the power to assess and collect such taxes. The General Assembly may, by general laws only, provide for the payment of license fees on franchises, stock used for breeding purposes, the various trades, occupations and professions, or a special or excise tax; and may by general laws, delegate the power to counties, towns, cities, and other municipal corporations, to impose and collect license fees on stock used for breeding purposes, on franchises, trades, (continued on p. 86.)

Assembly enacted legislation, known as K.R.S. 91.200, implementing this constitutional authorization with respect to cities of the first class (ie. Louisville.). This statute granted broad licensing powers to the City; provided that collection of taxes thereunder should be administered by the Commissioners of the Sinking Fund; provided that sinking fund requirements should have first call on revenues and that, after amortization requirements were met, any overage in revenue, up to an amount of \$3,000,000 should be paid into the city general fund.⁸ Thus, as of June 17, 1948,

7 (continued from p. 85.) occupations and professions."

Section 181 a reads as follows:

"The General Assembly shall not impose taxes for the purposes of any county, city, town or other municipal corporation, but may by general laws, confer on the proper authorities thereof, respectively, the power to assess and collect taxes. The General Assembly may, by general laws only, provide for the payment of license fees on franchises, stock used for breeding purposes, the various trades, occupations and professions, or a special or excise tax; and may by general laws, delegate the power to counties, towns, cities, and other municipal corporations, to impose and collect license fees on stock used for breeding purposes, on franchises, trades, occupations and professions. And the General Assembly, may by general law only, authorize cities or towns of any class to provide for taxation for municipal purposes on personal property, tangible or intangible, based on income, licenses or franchises, in lieu of an ad valorem tax thereon: Provided; cities of the first class shall not be authorized to omit the imposition of an ad valorem tax on such property of any steam railroad, street railway, ferry, bridge, gas, water, heating, telephone, telegraph, electric light or electric power company." (Adopted November 1903.)

8 Baldwin's Kentucky Revised Statutes Annotated; (hereinafter cited herein as K.R.S.), Section 91.200 (1948), reads as follows:

"City License taxes; disposition of license fees.

(1) The Board of Alderman of each city of the first class, in addition to levying ad valorem taxes, may by ordinance impose license fees on franchises, provide for licensing any business, trade, occupation or profession, and the using, holding or exhibiting of any animal, article or other thing, and fix in each case the license fee, except that no company that pays an(cont.)

Louisville had broad licensing powers; so broad in fact that a tax of the Philadelphia type could be levied as a licensing measure.

It may be noted that the Commonwealth of Kentucky has constitutional power to levy an income tax and does so levy.⁹

⁸ (continued from p. 86.) ad valorem tax and a franchise tax shall be required to pay a license tax, and no license tax shall be imposed upon or collected from any bank, trust company, combined bank and trust company, or combined bank, trust, banking and title insurance company organized and doing business in this state, or in other cases where the city is prohibited by statute from imposing a license tax.

(2) License fees shall be collected by the Commissioners of the Sinking Fund. All revenues from such taxes shall be paid to the secretary and treasurer of the Sinking Fund until income from all sources of the Sinking Fund shall be sufficient to pay the costs of administration and the interest charges for the current fiscal year, in addition to a sum sufficient to amortize the outstanding principal indebtedness on a yearly basis in accordance with regularly used amortization tables. Revenues remaining, after meeting the requirements of this section shall be paid into the general fund; provided, however, payments into the general fund shall be limited to three million dollars in any one fiscal year. Ad valorem taxes for the benefit of the sinking fund shall not be levied unless the income of the Sinking Fund is otherwise insufficient to meet such requirements.

(3) Licenses shall be issued and enforced on such terms and conditions as may be prescribed by ordinance." (Effective 6-17-48)

⁹ Kentucky Const. Sec. 174, reads as follows:

"All property whether owned by natural persons or corporations shall be taxed in proportion to its value, unless exempted by this Constitution; and all corporate property shall pay the same rate of taxation paid by individual property. Nothing in this Constitution shall be construed to prevent the General Assembly from providing for taxation based on income, licenses or franchises."

Commerce Clearing House State Tax Guide Service, p. 1603; rates are as follows:

Corporations	4% *
Individuals: **	
First \$3000	2
Next 1000	3

(continued on page 88.)

While Section 174 authorizes the Commonwealth to levy an income tax and such a tax is levied, it should be noted that Section 181 of the Kentucky Constitution does not list an income tax among those that may be delegated to municipal corporations. Thus, without amendment of the State Constitution, it would appear that local income taxation, under that title, would not be valid in Kentucky. In any event, no such delegation has been made.¹⁰

In this connection, it is significant how the analyst can sometimes predict and suggest things to come. In his 1946 study, Professor Martin in the course of discussing possible new sources of non-property tax revenue for Kentucky municipalities made this statement, "In general, however, Kentucky cities may impose occupational licenses almost without state restrictions and obviously these may take the form, as they do in many states, of excises measured by the volume of business carried on by the licensee or within constitutional limitations by the profit enjoyed from that business." (emphasis added)¹¹ Even more telling is his comment in the footnote under the above sentence, "Although a tax on incomes could probably not be imposed even if there were express legislative authority, there is no apparent reason why an excise

9 (continued from p. 87.)

Over \$5000

5

* 4½% for 1950-1951.

**Individual rate for over \$8000 is 6% for 1950-1951.

10 Paducah Automotive Trades Association et al v. City of Paducah, 307 Ky. 524, 211 S.W. 2d 660,666 (1948).

11 Martin, op. cit., p. 195.

measured by business income could not even now be imposed on Kentucky businesses under the guise of license taxes. It is entirely apparent that under certain circumstances such measures take on the essential characteristics of a license tax."¹²

LOUISVILLE OCCUPATIONAL LICENSE TAX

The possibility indicated by Professor Martin became reality when the City of Louisville (1940 population 319,077) levied an occupational license tax of 1% on payrolls and the net profits of businesses effective July 1, 1948 as a temporary levy to be in effect until 1950.¹³ This ordinance was reenacted May 24, 1950 effective July 1, 1950 for an indefinite period.¹⁴ In general this occupational license tax ordinance levies an annual license fee on both persons and on business entities for carrying on economic activity in the City measured in the case of persons by 1% of all salaries, wages, commissions, and other compensation and on business and professional income by 1% of net profits.¹⁵

¹² It might be added or of an income tax depending on whether form or substance is considered.

¹³ Louisville Ordinance No. 112, Series 1948.

¹⁴ Louisville Ordinance No. 83, Series 1950, issued as a part of "License Fee Regulations, 2d Edition., Commissioners of the Sinking Fund, City of Louisville, Kentucky, July, 1950; hereinafter cited as Louisville Ord. or Louisville Regs. as Appropriate.

¹⁵ Louisville Ord. Sec. 1 reads as follows:
That on and after July 1, 1950, every person, association, corporation or other entity engaged in any occupation, trade, profession, or other activity in the City shall pay into the Sinking Fund of the City for the purposes set forth under Section 91.200 of the Kentucky Revised Statutes as amended, an annual license fee for the privilege of engaging in said activities, which license fee shall be (continued on p. 90.)

It should be noted that the levying section makes no distinction on the basis of residence. All earned income or net profits, as the case may be, derived from economic activity in the City are taxable regardless of the residence of the "licensee"; in this respect, due to the form of the Louisville levy, residents are not taxed on income earned as a result of work done or services performed or net profits earned outside the city as would be the

15 (continued from p. 89.) measured by one per centum of (a) all salaries, wages, commissions and other compensations earned by every person in the City for work done or services performed or rendered in the City; and (b) the net profits of all businesses, professions or occupations from activities conducted in the City.

Where salaries, wages, commission and other compensations under (a) above are earned for work done or services performed or rendered both within and without the City, said license shall be measured by such part of the salaries, wages, commissions and other compensations as is earned as a result of work done or services performed or rendered in the City. Such license fee shall be computed by obtaining the percentage which the compensation for work performed or services rendered within the City bears to the total compensation earned.

The net profits of businesses and professions from activities conducted in the City under (b) above shall be computed as follows:

(a) Multiply the entire net profit from all sources by a business allocation percentage to be determined by--

1. Ascertaining the percentage which the gross receipts of the licensee from sales or services rendered within the City bears to the total gross receipts from sales or services rendered wherever made.

2. Ascertaining the percentage which the wages, salaries and other personal service compensation for the period covered by the report for services performed or rendered within the City bears to the total wages, salaries, and personal service compensation for such period for all the licensee's employees within and without the City.

3. Adding together the percentages determined in accordance within subparagraphs 1 and 2 above and dividing the total so obtained by 2."

case under the Philadelphia tax. In this connection, competent legal authority in Kentucky has suggested that such extra-territorial operation would be invalid under the licensing basis for the Louisville tax.¹⁶ Thus, the Louisville tax is primarily a tax based on source of income rather than partially on source and partially on residence as is the case with local income taxation in Pennsylvania and Ohio.

The ordinance provides for monthly withholding of tax due by the employer and quarterly payment to the Secretary-Treasurer of the Commissioners of the Sinking Fund. Louisville profited from the prior experience of Philadelphia and established, initially, a system of quarterly payment of taxes withheld by employers. In the same section, it is provided that non-compliance with withholding requirements by the employer does not avoid the liability of the employee for payment of the tax.¹⁷ Section 4 of the ordinance provides that each "licensee" shall file an annual return by the April 15 following the close of the calendar tax year or by the fifteenth day of the fourth month following the close of the tax year for those on a fiscal year basis; that such returns shall not be required from those whose entire taxable compensation is subject to withholding; that the Secretary-Treasurer of the Sinking Fund shall have the authority after written application by the taxpayer to extend the due date of the tax; subject, however, to interest at

¹⁶ Cf. Evans, Alvin E., "Opinion Respecting ExtraTerritorial Occupational Taxes," Appendix II in Kentucky City Finances, op. cit., p. 271.

¹⁷ Louisville ord., Sec. 3.

six per cent per annum until paid; that every person commencing a business shall deposit an initial license payment of \$10.00, same to be credited against his tax liability at the end of the tax period.

Section 5 provides that it shall be the duty of the Secretary-Treasurer to collect and receive the "license fees" under the ordinance and to keep records thereof. Section 6 charges the Secretary-Treasurer with the enforcement of the ordinance and empowers him to make regulations for the administration and collection of the tax. Section 7 authorizes the Secretary-Treasurer and his agents and employees to examine records and the like of both licensees and their employers for the purpose of determining their proper tax liability and gives these tax officials the power to examine under oath to the extent that a Notary Public has such powers. This section gives the Secretary the normal inquisitorial powers incident to tax collection and is similar to such provisions in local income tax ordinances in other jurisdictions. Section 8 notes that it is not the intention of the City to levy any occupational license fee prohibited by law. Section 9 provides that certain occupations require "special regulation" in addition to the regular license fee and sets specific additional fees.¹⁸

¹⁸ Louisville Ord. Section 9 provides for additional fees by type of business as follows:

(1) Amusement business:	\$100.00 per week
(2) Dance Halls:	62.00 per annum
(3) Pool Tables:	25.00 per table per annum
(4) Fortune Tellers:	1500.00 per annum
- (continued on p. 93.)

Section 10 provides that the information obtained by the Secretary-Treasurer and his agents and employees in the collection and administration of the tax shall be confidential and provides for a fine of \$100.00 or imprisonment for not more than ten (10) days for disclosure. However, the Secretary-Treasurer is authorized to exchange information with the Commissioner of Revenue of the State of Kentucky on a reciprocal basis; such information to maintain its privileged character. Section 11 provides that delinquent fees shall bear interest at 6% plus an additional penalty rate of $\frac{1}{2}$ of 1% per month until paid. Section 12 lists certain other licenses that are not revoked by the tax ordinance. Section 13 provides that insurance companies are not subject to the license tax. Section 14 provides for a fine of \$100.00 and costs for making a "knowingly" false, fraudulent or incomplete return. Section 15 contains the severability provision. Section 16 exempts domestic servants employed in private homes from the operation of the ordinance because of the great cost of administration. Section 17 exempts "the occupation of serving as

18 (continued from p. 92.)

(5) Itinerant Merchants	\$250.00	each stop
(6) Peddlers	10.00	per annum
(7) Taxicabs	30.00	per annum per taxicab
(8) Collection Agencies	62.00	per annum
(9) Detective Agencies	62.00	per annum
(10) Loan Companies	250.00	per annum
(11) Pawnbrokers	250.00	per annum
(12) Professional Bondsmen	250.00	per annum
(13) Auctioneers	25.00	per annum
(14) Rooming House*	10.00	per annum
(15) Game Tables	15.00	per annum

* More than 2 rooms for rent.

a duly ordained minister of religion" from the tax. Section 18 provides that churches or other eccleastical organizations need not withhold for such exempted persons. Section 19 provides that the ordinance become operative on July 1, 1950.

It is interesting to note that in exempting the clerical profession from the operation of the ordinance, Louisville was, evidently, profiting from the prior experience of Philadelphia. For in Philadelphia, the City lost a case testing the validity of treating amounts received by a Roman Catholic priest for performing sacraments as income from a profession.¹⁹ This holding treated such amounts as "gratuities" rather as earned income. This view has been criticised by Dean Fordham who would include such income under the category of tips.²⁰ While the Louisville tax includes "tips" as taxable income,²¹ it would appear that exemption of clerical income may avoid a troublesome and irritating collection problem; such provision may have been included to avoid one possible legal ground for objection to the ordinance.

CONSTITUTIONALITY OF LOUISVILLE TAX

The validity of the ordinance was soon tested in the courts and was upheld with only one judge dissenting.²² The court held,

¹⁹ Ross v. Philadelphia, 149 Pa. Super. 33, 25 A. 2d 834 (1942).

²⁰ Fordham et al, op. cit., p. 244.

²¹ Louisville Regs., Art. II-I, Sec. 1, e,1 (a)., cf. 149 Pa., Super, 33, op. cit.

²² City of Louisville et al v. Sebree et al, 308 Ky. 420, 214 S.W. 2d 248, (decided 8-6-48; rehearing denied 10-12-48).

in effect, that under the provisions of Article 181 of the Kentucky Constitution, the Kentucky General Assembly had authority to delegate authority to levy such taxes to the city authorities of, inter alia, the City of Louisville and that such delegation had been made.²³ The opinion further noted that Section 181 imposed no limitations on the "measure" of the tax. The court further held that Section 18, exempting clerical occupations from the operation of the tax, was not an essential violation of equality and uniformity requirements.

It should be noted that the court's decision sustained the validity of the ordinance as a license tax measured by income in much the same fashion that at an earlier date the Supreme Court of the United States sustained the validity of the Corporation Excise Tax of 1909.²⁴ However, the Kentucky court must have been well aware from the briefs and the argument that, as it said, "The principal storm center of the controversy is whether or not this ordinance imposes an income tax, the taxpayers arguments being that the city has no authority to levy such a tax. We need not pass upon the question of the existence or absence of that power."²⁵ It may be said that, while obviously well aware of the realities of substance, the Court through the utilization of the quaint though useful doctrine of subject and measure sustained the validity of the tax without passing upon the income tax questions,--

²³ Ibid., 214 S.W. 2d 248,, 252.

²⁴ Flint v. Stone Tracy Co., 220 U.S. 107 (1911).

²⁵ 214 S.W. 2d 248, 252.

so that the City of Louisville in form has an "occupational license tax" while in substance its levy may be considered as much an example of local income taxation as the Philadelphia tax.²⁶

Thus the Kentucky Court sustained the validity of the tax and also, incidentally the prediction of Professor Martin, previously referred to,²⁷ made some two years before. However, before giving too much emphasis to Professor Martin's predictive efficiency, it may be noted that Professor Martin and other members of the Bureau of Business Research of the University of Kentucky served as

²⁶ 214 S.W. 2d. 248 at 253 et seq. reads as follows:

"It is true the scheme of taxation embodies features characteristic of the familiar income taxes; particularly in the exaction of a percentage of the monetary proceeds of labor, services or business and in its administrative provisions. It is likewise distinguishable in this connection from the ordinary licensing laws since it does not provide for the issuance of certificates and it may be parenthetically noted that the Act of 1948, Senate Bill No. 62 repealed K.R.S. 91.220 which provided for such certificates to licensees. Lending weight to the taxpayers' argument that it is an income tax is the fact that the ordinance is closely patterned after an ordinance of the City of Philadelphia, which was intended to be and sustained by the courts as an income tax, that city having the power to impose it. Dole v. City of Philadelphia, 337 Pa. 375, 11 A. 2d 163. Also, after a somewhat similar ordinance of the City of St. Louis, modeled from the Philadelphia ordinance, which was regarded by the courts as a "species of income or excise tax," and held not to be within the charter power of that city which imposed it to imposing property taxes and true licenses. Carter Carburetor Corp. v. City of St. Louis, 356 Mo. 646, 203 S.W. 2d 438. In each of those ordinances the imposition was a withholding tax directly upon earnings or income derived from labor, services or business performed or done within the respective cities by either its residents or nonresidents. Both cases were decided upon the construction of the respective city charters. This Louisville ordinance lays the tax upon the privilege of working and conducting a business within the city, and only measures the value of the privilege by the amount of earnings or net profits." (Emphasis added)

²⁷ Supra. p. 88.

consultants in the formulation and drafting of the Louisville tax.²⁸

One other significant legal attack on the Louisville tax has so far been made in the Courts. As previously occurred in the case of the Philadelphia tax, Federal employees subject to the payroll tax sought to nullify its application to their group on the basis of the doctrine of absolute intergovernmental immunities stemming from the landmark case of McCulloch v. Maryland.²⁹

As might well have been expected, the Kentucky Court, after analyzing the later federal cases, held that the immunity of the Federal government from taxation by states and their political subdivisions does not extend to such governments officers and employees.³⁰

Thus, the Louisville tax was successful in withstanding its

²⁸ Martin, James W., "Payroll Tax; the Louisville Experience," Municipal Technical Advisory Service, Division of University Extension, The University of Tennessee, Knoxville, December, 1950, p. 3.

²⁹ 4 Wheat. 316, 4 L.Ed. 579, (U.S. 1819).

³⁰ Cook et al v. Commissioners of Sinking Fund of City of Louisville, 312 Ky. 1, 226 S.W. 2d 328, (decided January 17, 1950). The holding was epitomized in Syllabus 5 as follows: "Federal government employees are not immune from license fees imposed by city ordinance on all persons engaged in occupations, trades, professions or other activities in city for privilege of engaging in such activities, though measured by compensation paid them." The opinion considers the evolution of the intergovernmental immunities doctrine from the McCulloch case to Graves v. New York, 306 U.S. 466, 59 S. Ct. 595, 83 L.Ed. 927, 120 A.L.R. 1466. Of interest is the inclusion by the Kentucky Court of the following quotation from the concurring opinion of Frankfurter, J. in the Graves case (83 L.Ed. 927, 938): "All these doctrines of intergovernmental immunity have until recently been moving in the realm of what Lincoln called 'pernicious abstractions.' The web of unreality spun from Marshall's famous dictum was brushed away by one stroke of Mr. Justice Holmes's pen: 'The power to (continued on p. 98.)'"

second legal attack. Seemingly, the only other reported case dealing with the Louisville tax is one in which the City Director of Finance obtained a declaratory judgment approving barrowing in anticipation of quarterly revenues from the occupational license tax while same were in the hands of the employers under the withholding regulations but were not yet turned over to the Sinking Fund or by the Sinking Fund Commissioners to the City.³¹ The application of the doctrine of constructive receipt afforded the city a favorable solution to that problem.

30 (continued from p. 97.) tax is not the power to destroy while this Court sits.' (referring to Holmes's dissent in Panhandle Oil Co. v. Mississippi 277 U.S. 218, 223, 48 S.Ct. 451, 73 L.Ed. 857, 859, 56 A.L.R. 583.)

31 Meyers, City Director of Finance, v. City of Louisville, 310 Ky. 348, 220 S.W. 2d. 852 (May 20, 1949). Syl. 2 reads as follows: "Collections of occupational license tax by employers for fourth quarter of city's fiscal year were constructively received (emphasis added) by the city immediately on being withheld by employer, though they were not to be received by city actually until after close of fiscal year, and therefore barrowing of money by city against tax collections was not a violation of constitutional provisions limiting indebtedness without assent of two thirds of voters thereof nor statutory provision that city of first class should not barrow over limits of levy for the year." The Constitutional provision referred to above was Sec. 157, Ky. Const. which reads as follows: "No county, city, town, taxing district or other municipality, shall be authorized or permitted to become indebted in any manner or for any purpose, to an amount exceeding, in any year, the income and revenue provided for such year, without the assent of two thirds of the voters thereof voting at an election to be held for that purpose; and any indebtedness contracted in violation of this section shall be void."

Thus, while the Louisville tax has been subjected to legal attack in much the same fashion that the Philadelphia tax was tested at an earlier date, it has been, thus far, uniformly successful despite the constitutional limitations on income taxation in the State of Kentucky.

It should be noted that this tax follows the observable trend in local taxation of income in that it is limited to earned income. It differs, however, from local income taxes levied in Pennsylvania and Ohio in that its application is limited to income earned within the city without reference to residence or differentiation between residents and nonresidents. Thus, a resident of Louisville employed solely without the city would not be subject to the tax; whereas a nonresident employed within the city is subject to the occupational license tax. While this situation causes daylight citizens to contribute to the support of the city in which they earn their livelihood which is presumably a desirable result, it should be borne in mind that this is a result not of tax planning per se but rather of fitting a tax into the framework of legal limitations. Certainly, such limitations in the local tax field cause strange results when taxes are tailor-made to conform to rules. However, obviously, unless such conformity is effected, invalidation may result.

The yield of the tax surpassed estimates. In the fiscal year 1949, the occupational license tax brought in over \$4 million, of which \$3.9 million came from withholdings and over \$108 thousand from federal employees. The business tax yielded \$470,000.00 in

this period.³²

It will be recalled that the 1948 version of K.R.S. 91.200 placed a ceiling of three million dollars on the amount that the Commissioners of the Sinking Fund could transfer to the City of Louisville in any one year. This payment was made, being well covered by the total receipts of the Sinking Fund as indicated in Table VI.

CHANGED LEGISLATIVE LIMITATIONS

In 1950, the Kentucky legislature amended K.R.S. 21.900 in several important respects. First, it placed a one per cent rate limitation on the authority of Louisville, the lone Kentucky city of the first class, to levy its license tax.³³ Secondly, it limited the taxation of salaries, wages and other compensation and also taxes on net profits earned to such incomes resultant from activities within the city. Neither of these two legislative limitations changed the operation of the Louisville tax since it has only applied to incomes arising within the city regardless of residence and since the rate has not exceeded one per cent. However, both this latter provision and the rate limitation will serve to prevent any future changes of this type. Thirdly, the Sinking Fund was authorized to transfer amounts in excess of the three million dollars per year previously authorized, such amounts to be placed in a special fund entitled the "Special Capital Fund

³² Martin and Lockhart, Public Management, March, 1950, op. cit., p. 54-57.

³³ K.R.S. 91.200 (1) as amended, effective June 15, 1950.

Account."³⁴

In 1950, as indicated in Table VII, the Louisville occupational license tax yielded better than five million dollars; total Sinking Fund gross income being \$6,647,703.39, and its net income being \$4,903,459.93. Accordingly, in view of the amendment to K.R.S. 91.200 (2), the Sinking Fund transferred to the City of Louisville, three million dollars which was available for current operating expenditure by the city. In addition, after providing for the expenses of administering the Sinking Fund, interest and bond amortization requirements, the Sinking Fund transferred an additional \$1,078,435.14 to the so-called "Special Capital Improvement Fund" of the city.³⁵ This amount may be used only for capital improvements;

³⁴ K.R.S. 91.200 (2), effective June 15, 1950, reads as follows:
 "License fees or taxes shall be collected by the Commissioners of the Sinking Fund. The proceeds from such taxes shall be paid to the Secretary and Treasurer of the Sinking Fund until income from all sources of the Sinking Fund, including any surplus existing on the effective date of this Act, shall be sufficient to pay the cost of administration and the interest charges for the current fiscal year of the Sinking Fund, in addition to a sum sufficient to amortize the outstanding principal indebtedness of the city on a yearly basis in accordance with regularly used amortization tables. From revenues remaining, after meeting the foregoing requirements of this section, there shall be paid into the General Fund of the city ~~(on a yearly basis in accordance with regularly used amortization tables. From revenues remaining, after meeting the foregoing requirements of this section, there shall be paid into the General Fund of the City)~~ an amount not to exceed three million dollars (\$3,000,000) in any one fiscal year. Any surplus remaining after the Sinking Fund requirements hereinabove set forth have been met, and after the said payment of three million dollars (\$3,000,000) in any one fiscal year into the General Fund of the city has been made, shall be paid over to the city to be placed in an account to be designated the "Special Capital Fund Account" and expended for capital improvements as hereinafter defined, and for no other purpose. Provided, however, that at least eighty per cent (80%) of any payments into said "Special Capital Fund Account" (continued on p. 104.)

TABLE VI-A

SINKING FUND-CITY OF LOUISVILLE, KENTUCKY
STATEMENT OF INCOME AND EXPENSE-GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 1949.

INCOME:

Individual License Fees	\$4,038,859.34	
Net Profits License Fees	547,659.74	
License Fees	469,457.98	
Penalties and Interest	3,089.06	
Dividends on Louisville Water Co. Stock	817,000.00	
Property Taxes	5,268.33	
Interest on Investments	28,220.01	
Miscellaneous Income	<u>250.00</u>	
Total Income		\$5,909,804.46

EXPENSES:

Interest on City of Louisville Bonds	1,533,922.12	
Coupon and Bond Handling Fees	2,674.18	
Salaries	57,128.01	
Commissioners Fees	460.00	
Postage	1,926.08	
General Expense	36,960.70	
Supplies and Materials	2,338.29	
Printing	2,204.59	
Insurance and Bond Premiums	857.33	
Traveling	<u>296.97</u>	
Total Expenses		1,638,768.27
Net Income		<u>\$4,271,036.19</u>

Source: Annual Report, Commissioners of the Sinking Fund, of
Louisville, Kentucky, 1949, p. 15.

TABLE VII-A

SINKING FUND-CITY OF LOUISVILLE, KENTUCKY
STATEMENT OF INCOME AND EXPENSE-GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 1950

INCOME:

Individual License Fees	\$4,254,912.34
Net Profits License Fees	988,052.50
License Fees	515,510.97
Penalties and Interest	3,653.04
Dividends-Louisville WaterCo. Stock	850,000.00
Property Taxes	1,677.32
Interest on Investments	33,897.22
	<hr/>
Total Income	\$6,647,703.39

EXPENSES:

Interest on City of Louisville Bonds	\$1,617,168.43
Coupon and Bond Handling Fees	3,022.06
Salaries	73,064.01
Commissioners Fees	300.00
Postage	2,547.82
General Expense	41,131.02
Supplies and Materials	2,085.01
Printing	3,481.83
Insurance and Bond Premiums	850.57
Traveling	592.71
	<hr/>
Total Expenses	\$1,744,243.46
	<hr/>
Net Income	\$4,903,459.93

Source: Annual Report, Commissioners of the Sinking Fund of Louisville, Kentucky, 1950, p. 15.

eighty per cent of the 1950 distribution was ear-marked by the legislature for the acquisition of right-of-ways for streets and express ways. Presumably this limitation will not be applicable to future years and the city will be free to plan its own capital improvements expenditures from the new "Special Capital Improvement Fund."

As regards administration of the tax, Professor Martin has pointed out and suggested the necessity of correcting, the situation, which in the writer's opinion, is the most significant criticism of administration of the tax,--to 1950 no audits of returns have been made.³⁶ It is submitted that this obviously indicates lost revenue and, moreover, is unjust to those subject to withholding with no opportunity for partial evasion. If such a tax, and this comment is equally applicable to the entire field of local income taxation, is to meet minimal requirements of

³⁴ (continued from p. 101.) during the calendar year 1950 shall be used for paying the city's share of the cost of acquiring rights-of-way necessary to the establishment and improvement of major streets and express ways in the city the construction of which is to be paid in whole or in part from funds provided by the Commonwealth of Kentucky or the United States of America or either of them."

³⁵ Annual Report, Commissioners of the Sinking Fund of Louisville, Kentucky, 1950, p. 16; Letter to the writer from Mr. Thomas Graham, President of the Sinking Fund Commissioners, dated June 7, 1951 in which it is also stated that the cost of administration of the Sinking Fund for the year 1950 was 1.7% of revenues collected. Also cf. Wood, F. E., "The Louisville Story, A Century of Fiscal Integrity," A Report of the Sinking Fund Commission of Louisville, : Gibbs-Inman Co., 1951, p. 92 ff.

³⁶ Martin and Lockhart, op. cit., (1950) p. 54 et seq.

administrative justice and fair treatment, an effective auditing and enforcement program seems clearly indicated.

Aside from this comment, Professor Martin's optimistic evaluation of the tax is presumably valid, as follows:

"In the light of more than two years operation, the Louisville ordinance, enacted in a state which is still presumed to forbid city income taxes, has proved eminently successful in hurdling legal difficulties and producing sorely needed and really substantial revenue for the city. A careful study has indicated that, as far as the operation of this particular tax is concerned, there are no apparent gross inequities. Mayor Farnsley's re-election in a controversy centered basically on the wisdom of the tax leads the observer to believe that Louisville residents recognize its operation as generally fair.³⁷

TAX POWERS OF OTHER KENTUCKY CITIES

Until July 1, 1950, no other taxes comparable to that of Louisville were levied in Kentucky.³⁸ On that date, Paducah, Kentucky levied a payroll tax similar, in part, to the Louisville tax.³⁹ This development will be discussed shortly. First, however,

³⁷ Martin, James W., "Payroll Tax: the Louisville Experience," op. cit., p. 5.

³⁸ Letter to the writer from Mrs. Martha Shipp, Division of Research, Department of Revenue, Commonwealth of Kentucky, Frankfort, dated January 15, 1951.

³⁹ Letter to the writer from Mr. Henry Collins, City Treasurer, City of Paducah, Kentucky, dated January 18, 1951; Cf. Unnumbered Ordinance, City of Paducah, dated May 31, 1950; Commerce Clearing House, State Tax Guide Service, Par. 29-370, Report 225, dated January 9, 1951.

the taxing power of Kentucky cities, other than the first class city of Louisville, will be considered. It appear that Kentucky cities have the present legal right to levy taxes of the Louisville type or similar imposts as a result of the passage of K.R.S. 92.281 by the Kentucky General Assembly, effective June 17, 1948.⁴⁰ Thus, subject to the various limitations indicated, all Kentucky cities, regardless of their class, would appear to have substantially the same broad licensing power to levy what amounts to an income tax cast in the form of an occupational license tax. Referring to the limitations on such local taxing power contained in K.R.S. 92.281 , K.R.S. 91.200, giving bonded debt requirements first call on such revenues, is uniformly applicable to all Kentucky cities, class one through class six. It should be noted that the reference in K.R.S. 92.281 referring to K.R.S. 243.070 merely limits municipal

⁴⁰ K.R.S. 92.281 reads as follows:

"Power to Levy All Taxes Authorized by Const. Sec. 181 Exceptions.

(1) Cities of all classes are authorized to levy and collect any and all taxes provided for in Section 181 of the Constitution of the Commonwealth of Kentucky, and to use the revenues therefrom for such purposes as may be provided by the legislative body of the city.

(2) Nothing in this section shall be construed to repeal, amend or affect in any way the provisions of K.R.S. 243.070.

(3) This section shall not in any wise repeal, amend, affect or apply to any existing statute exempting property from local taxation or fixing a special rate on proper classification or imposing a State tax which is declared to be in lieu of all local taxation, nor shall it be construed to authorize a city to require any company that pays both an ad valorem tax and a franchise tax to pay a license tax.

(4) This section shall also be subject to the provisions of K.R.S. Sec. 91.200."

activity with respect to liquor licenses,⁴¹ no doubt, in accordance with basic Kentucky tradition.

PADUCAH OCCUPATIONAL LICENSE TAX I

The City of Paducah successfully levied an occupational license tax measured by gross receipts, effective July 1, 1948 prior to the adoption of K.R.S. 92.281. This local tax ordinance was successful against court attack.⁴² In the course of its opinion denying plaintiffs application for a temporary injunction, the court in the Paducah case gives a reasonably succinct statement of the law relative to the power of Kentucky cities, other than the first class city of Louisville, to levy license taxes, as follows:

"It is sufficient to say that it (referring to the Paducah gross receipts tax ordinance) classifies the various types of business and fixes the license taxes on the basis of gross receipts from the business. . . . Under authority of the above section (referring the Ky. Const. Sec. 181), the legislature by K.R.S. 84.190, which is the charter for cities of the second class, has extended this power to those cities in the following language, 'The general council may by ordinance: License, tax and regulate all trades, occupations and professions.', and by K.R.S. 92.200, concerning revenue and taxation of cities other than first class has again extended this powers to these cities in the following language: 'The legislative body of each city of the second to sixth class may impose license fees on stock used for breeding purposes, and on franchises, trades, occupations, and professions and may provide the collection of such fees.' . . . If language means anything,

⁴¹ K.R.S. Sec. 243.070 provides in effect that municipal liquor licenses may be issued subject to the following limitations:

- (1) malt beverage retailers license . . not over \$200.00
- (2) brewers license not over \$500.00
- (3) distillers license. not over \$500.00

⁴² Paducah Automotive Trades Assn. et al. v. City of Paducah, 307 Ky. 524, 211 S.W. 2d 660 (3-26-48).

it means that by these constitutional and statutory provisions, cities of the second class have been given plenary power to enact ordinances imposing license taxes on trades, occupations and professions such as has been done under the ordinance here involved, provided such license taxes are reasonable and are based upon proper classification."⁴³

Thus, the Paducah gross receipts tax cast in the form of an occupational license tax was validated under the broad delegation of power to local governments, just as the Louisville occupational license tax measured by payrolls and net profits has been validated earlier in the Sebree case. Evidently, Kentucky municipalities have a choice between the two taxes as long as the form of their enactment casts them in the approved form of license taxes.

It is interesting to note that in this Paducah case, plaintiff evidently relied upon the Missouri case invalidating the St. Louis payroll income tax in his argument that local authority did not exist. The Court rejected this contention and gave definite indication again that, as has been previously indicated with respect to the Louisville case, income taxation per se is not legal for Kentucky local governments.⁴⁴

⁴³ 211 S.W. 2d. 660 at 665 et seq.

⁴⁴ 211 S.W. 2d 660 at 666 contains the following comment:

"In the light of these authorities (the reporter does not enlighten us, merely noting 'citing many cases'), we do not deem it necessary to analyze or regard as of binding effect on us the case of Carter Carburetor Corp. v. City of St. Louis, Mo. Sup., 203 S.W. 2d 438 cited by plaintiffs. We know not the constitutional or statutory authority from which it springs nor the type of ordinance involved. However, from the quotations in plaintiffs brief, it appears to be a gross tax on salaries, wages and commissions. The court in its opinion, said it was not a license tax under the police power (such as we have at the case at bar) but that it was a species of income tax and that the General Assembly had never authorized municipalities to impose an income tax, just as our (continued on p. 109.)

The Paducah gross receipts tax, approved in the Automotive Trades Association case discussed above, levied license taxes based on gross receipts on persons engaged in various businesses in that City effective January 1, 1948. Wholesalers other than those selling food for human consumption, pay taxes ranging from \$150.00 on yearly gross receipts of from \$25,000 to \$300,000 to \$625 on gross receipts of \$1,250,000 and over. Wholesalers of food for human consumption pay taxes ranging from \$150.00 on yearly gross receipts of from \$25,000 to \$500,000 to \$375 on yearly gross receipts of \$1,250,000 and over. Retail merchants pay at rates ranging from \$15 on yearly gross receipts of not more than \$5,000 to an upper rate of \$2,500 on yearly gross receipts of \$1,250,000 or over. Returns and payment of the tax are required on or before March 15 of each tax year, except that the amount due may be paid in two installments at the taxpayers option.⁴⁵

While the schedules for this tax were formulated after some study of the relation of gross profits and gross receipts,⁴⁶ this tax is not an example of income taxation in the general sense of

⁴⁴ (continued from p. 108.) Kentucky General Assembly has made no such authorization to Kentucky cities. Nor do we deem it necessary at this time to analyze or quote from the cases from other jurisdictions cited by defendant upholding one or more of the features of the type of ordinance involved in this case."

⁴⁵ Commerce Clearing House, State Tax Guide Service, Para. 63-650, p. 3383.

⁴⁶ Letter to the writer, dated January 8, 1951, from Professor James W. Martin, Director of Bureau of Business Research, University of Kentucky.

that phrase⁴⁷ and detailed consideration will not be given it here.

PADUCAH OCCUPATIONAL LICENSE TAX II

While retaining its gross receipts tax on business, Paducah levied an additional payroll tax effective July 1, 1950. While this tax is formalized as a gross receipts tax, reference to the levying section and the definition of gross receipts, indicated below, demonstrate its marked similarity to the payroll income component of the Louisville occupational license tax.

Section 2 of the Paducah ordinance reads as follows:

"It shall be unlawful for any person to engage in or follow any trade, occupation, or profession within the city on or after the 1st day of July, 1950, without paying a license fee for the privilege of engaging in or following such trade, occupation or profession, which license fee shall be measured by one-half ($\frac{1}{2}$) of one per centum of the gross receipts of each such person."

The definitions of "trade, occupation or profession" and of "gross receipts" in Section 1 of the Paducah ordinance indicate clearly the fact that this new second Paducah tax is merely the payroll tax cast in yet another form.

Section 1 (b) reads as follows:

"The words, "trade, occupation and profession" shall mean and include the doing of any kind of work, the rendering of any kind of personal services, or the holding of any kind of position or job within the City of Paducah, Kentucky by any clerk, laborer, tradesman, manager, official, or other employee, including any non-resident of the City of Paducah, who is employed by any employer as defined in this section, where the relationship between the individual performing the services and the person for whom such services are rendered is, as to those services, the legal relationship of employer and employee, including also a partner of a firm or an officer of a firm or corporation if such partner or officer receives a salary for his personal service rendered in the business of such firm or corporation, but they shall not mean or

⁴⁷ Cf. U.S. Glue Co. v. Town of Oak Creek, 247 U.S. 321, 38 S. Ct. 499 (1918).

include domestic servants employed in private homes, or businesses, professions or occupations for which license fees are required to be paid under an ordinance adopted on December 23, 1947, as amended or, except a partner of a firm or an officer of a corporation, any person who is an employer within the meaning of this section."

Section 1 (f) reads as follows:

"The words "gross receipts" and "compensation" shall have the same meaning and both words shall mean and include the total gross amount of all salaries, wages, commissions, bonuses, or other money payments of any kind, or any other considerations having monetary value, which a person receives from, or is entitled to receive from or be given credit for by his employer for any work done or personal services rendered in any trade, occupation or profession, including any kind of deductions before "take home" pay is received, but the words "gross receipts" and "compensation" shall not mean or include amounts paid to traveling salesmen or other workers as allowance or reimbursement for traveling or other expenses incurred in the business of the employer, except as to the extent of the excess of such amounts over such expenses actually incurred and accounted for by the employee to his employer.

"The words "gross receipts" and "compensation" shall not mean or include gratuities and tips customarily received by an employee from persons other than his employer."

Thus, the new Paducah tax is similar to the Louisville tax only as to the payroll income tax. As to business taxation, Paducah has retained its earlier gross receipts license tax. Paducah is the only example that the writer has noted of this combination of a personal payroll income tax and a gross receipts business tax. It would seem that Kentucky municipalities have a choice of either a tax of the Louisville type or of the Paducah type. It is estimated that the Paducah tax will yield \$125,000 from business licenses and \$141,000 from this employees earnings tax in 1951.

These two developments represent the Kentucky experience to

⁴⁸ Letter to the writer from Mr. Henry Collins, City Treasurer of Paducah, dated January 18, 1951.

date. It may be reasonably expected that since the initial phase of legal testing is passed and since the majority of Kentucky cities have the right to levy such taxes that more adoptions of this form of local income taxation will follow to the extent that Kentucky municipalities search for additional sources of non-property tax revenue.

CHAPTER V

THE TOLEDO EXPERIENCE

On January 28, 1946, the City of Toledo, Ohio, after quite lengthy consideration of how to solve its revenue needs, adopted an income tax ordinance on the Philadelphia model, which levied a one per cent tax effective March 1, 1946.¹ Toledo's financial difficulties, which led to its income tax adoption, stemmed from a number of sources, including: (1) the impact of the State Constitutional tax limitation,² (2) the failure of Toledo citizens to authorize levies outside the abovementioned property tax limitations; (3) the eating away of "inside millage" available for general city operations by refunding municipal bonds at maturity.³

¹ Ord. 18-46.

² Ohio Const., Art. XII, Sec. 2, (15 mill limitation effective January 1, 1931; 10 mill limitation effective January 1, 1934.)

³ The ten-mill tax limitation of Article XII, section 2, Ohio Constitution, which became effective January 1, 1934, generally reduced property tax revenue available for municipal operations as compared with revenue under the pre-existing fifteen mill tax limitation. It may be noted that bonds issued refunding bonds issued prior to the adoption of the limitation are not subject to the tax limit. Cf. State ex rel The Ohio National Bank v. Village of Hudson, 134 Ohio St. 150 (1938). However, where money intended for retirement of bonds issued within the ten-mill limitation was made available for current operating expenses by refunding "inside bonds," the debt service requirements for such refunders became a preferred obligation on the "inside millage" for subsequent years and, accordingly, reduced the free millage within the ten mill limit which otherwise would have been available for operating expenses. Thus cities that postponed their problem by refunding inside bonds found their difficulties multiplied in later years. Such was the case in Toledo.

The Toledo City Manager's 1945 Budget Message is indicative of the city's financial situation at the beginning of 1945.⁴ His statement reads in part as follows:

"There is an increase in the expenditure side of the budget over previous years, which is attributable entirely to increased costs of materials and supplies and to authorized higher wage scales.

The budget provides for no general increase in personnel over 1944, and provides for no new services.

The operating resources, referring specifically to the General Fund, will be derived, as has been the case in the past several years, from:

- (1) Normal tax collection sources;
- (2) Continued, stop-gap, deficit financing-
 - (a) Refunding,
 - (b) Transfers from special funds as balances appear to be available;
- (3) Allocation of taxes and receipts collected by the State;
- (4) Miscellaneous license fees, rentals, inspection fees, service charges, and other revenues collected directly by the City;
- (5) Working capital carried over from 1944.

The budget as submitted shows General Fund resources anticipated for 1945 of \$3,503,613, and estimated expenditures for 1945 of \$3,703,431. These estimates as submitted indicate an anticipated General Fund deficit of approximately \$200,000. Such deficit can be met or overcome by one or more of the following factors:

- (a) Underrun in expenditures;
- (b) Tax collections in excess of anticipated amounts;
- (c) Increased allocations of State collected taxes distributed for local operating uses;
- (d) New sources of revenue as yet undetermined.

When the 1944 budget was submitted, a similar situation confronted us, and that budget also indicated a substantial deficit Through your authorization the Citizens Finance Committee was appointed. It has been continually at work and will shortly report to you and the citizens of Toledo.

I am confident that the report of the Committee will, in its general tenor, agree that Toledo should be a progressive, soundly financed community, and that the report will recommend a pattern for the financing of municipal operations and the future development of the City. The act of placing Toledo's municipal government back on a sound financial basis is the foundation on which all future planning for this City must rest.⁵

Thus was the Toledo picture delineated and subsequent

⁴ The Toledo City Journal, 30, No. 2 (January 13, 1945), p. 9.

⁵ Ibid.

developments were to make the fourth recommendation, new sources of municipal revenue, the solution for the City.⁶

CITIZENS FINANCE COMMITTEE REPORT

The Citizens Finance Committee referred to by City Manager George M. Schoonmaker in his 1945 Budget Message was created by City Council on April 26, 1943. Originally, the Committee was organized with a view to drafting an amendment to the City Charter which would permit a higher real estate tax rate, however, it gradually came to consider the wider problem of additional sources

⁶ It is noteworthy that similar comments had been presented in Budget messages in prior years, as follows:

1940 Budget: "Some means must be found during the year to assure adequate future resources and eliminate any necessity for deficit financing and place the City on a pay as you go basis."

1941 Budget: "... a plan of long range financing must be worked out and presented to the people with such clarity and vigor that it will meet with acceptance, thereby precluding once and for all the resort to expediciencies for financing the operating needs of the City."

1942 Budget: "The pernicious futility of the procedure followed has been obvious to all; City officials have pointed to the need for a solution and have recommended programs, all of which require that the people, the final source of revenue, make available the funds required to furnish municipal services of the level needed and desired by these same citizens of the City of Toledo."

1943 Budget: "We have all realized and it has been pointed out in the annual budget messages to Council and the public for the past several years, that tax revenues as they have and do exist are inadequate to provide the funds necessary to operate the City government, retire the bonded debt and pay off the heavy poor and work relief expenditures of the depression years."

1944 Budget: "However, the depressing picture of continued refunding of the inside debt; continued inadequacy of finances for the maintenance of regularly established services; the lack of available resources for the replacement of worn out equipment, and the construction of much needed improvements remain a problem without prospect of current solution unless the cooperation of the State Legislature and the tax paying public can be obtained."

The above quotations are given in The Toledo City Journal, 30, No. 2, p. 10.

of revenue.⁷ On June 21, 1945, the Committee submitted its report and recommendations to the City Manager.⁸ The report noted the character of the city's financial situation and public reaction thereto as follows:

"There has been considerable confusion in the public's mind by past predictions of financial disaster which somehow never seems to catch up with us in a form the average citizen feels. The nearest approach to it is that all kindergarten training in our public schools has been stopped, our school term shortened and teachers put on part-time salaries in certain years. Still the connection between that fact and the financial policies of Toledo is not sufficiently real to bring about the necessary action.

Further confusion has been caused by each Council's policy of not operating on a balanced budget of expense and revenue (rather than expense and cash) and the newspaper reports which have discussed the budget as unbalanced one day and mysteriously balanced the next. It is no wonder the public concludes that it should vote down every tax levy so long as Council can vote increased expenses in major amounts without even a hint of the source of revenues to meet them and apparently get by through some magic of city financing. Like all magic, the answer is simple when you know it.

. . . . We pay for just what we get; if we have more expense than income we go in debt and finally we have to pay up. Simply stated, Toledo has found the cash to meet expenses by going in debt. It has not balanced revenue and expense. The statement of the problem is equally simple. We have several millions of debts to pay. We should decide how long that method of financing is to be permitted to continue--when and how are we going to pay up?

Cash has been found to pay operating expenses by refunding some \$7,000,000 of debts inside the 10 mill limitation. There remains a total of inside principal outstanding of \$6,369,645.

The amount of this debt is now such that there is no revenue left in the budget to reduce the debt after paying the interest and the present operating expenses of the city."⁹

⁷ Cf. Peelle, Harold Mitchell, "The Municipal Income Tax in Toledo and Columbus, Ohio," Unpublished Master's Thesis of The Ohio State University, 1949, p. 17 et seq. in this regard and for a detailed coverage of the adoption of the Toledo tax and the events leading thereto.

⁸ "Report of Citizens Finance Committee of the City of Toledo," Frank H. Adams, Chairman, Supplement to (continued on p. 117.)

Another indication of the financial condition of the city is shown in TABLE VIII which contrasts the Toledo property tax levies for 1930 and 1944.

As indicated, free inside millage available for current city operation decreased from 4.49 to 2.59 during the fourteen years between 1930 and 1944; total city millage was reduced from 11.43 to 8.75, a decrease of 2.68 mills with a resultant decrease in collections of \$2,206,000.¹⁰ Further, it will be noted that there is a complete absence of outside levies for operations by 1944. The data indicates the substantial impact of the tax limitation and failure of the electorate to approve outside levies on the revenues of the City.¹¹

⁸ (continued from p. 116.) The Toledo City Journal, Issue of September 15, 1945. Hereinafter cited as "1945 Citizens Finance Committee Report."

⁹ Ibid., p. 1-A et seq.

¹⁰ The 1930 Toledo City tax duplicate was \$578,858,070. See Annual Report, The Tax commission of Ohio, 1930, Cleveland: Consolidated Press and Printing Co., p. 241.; The 1944 duplicate was \$479,707,815. See "Final Report of City Auditor of Toledo, Ohio, 1949," Supplement to The Toledo City Journal, Issue of May 20, 1950.

¹¹ Treatment of the Ohio Constitutional tax limitation is beyond the scope of this study. Reference is made to: Dargusch, Carlton S., and Hart, John N., "Ohio Tends Her Tax Limited Localities," National Municipal Review, Vol. 28, No. 7; Cf. also the line of Ohio cases interpreting the limitation: State ex rel City of Portsmouth v. Kountz, Mayor, 129 Ohio St. 272, 194 N.E. 869, 97 A.L.R. 1099 (1935); State ex rel Ohio National Bank v. Parma, 130 Ohio St. 396 (1936); State ex rel Alden Corp. v. Solon, 132 Ohio St. 362 (1937); State ex rel Ohio National Bank v. Hudson, 134 Ohio St. 150 (1938).

TABLE VIII
COMPARISON OF TAX LEVIES AND COLLECTIONS, 1930 and 1944, CITY OF
TOLEDO, TOLEDO SCHOOL DISTRICT AND LUCAS COUNTY, OHIO
(Levy in mills; collection in thousands)

<u>CITY</u>	<u>1930 Levy</u>	<u>1930 Collection</u>	<u>1944 Levy</u>	<u>1944 Collection</u>
"Inside"				
Operating	4.49	\$ 2,591	2.59	\$ 2,001
Debt	2.09	1,206	1.86	
"Outside"				
Operating	1.752	1,011		
Debt	3.098	1,788	4.3	2,389
<u>Total City</u>	<u>11.43</u>	<u>6,596</u>	<u>8.75</u>	<u>4,390</u>
<u>SCHOOLS</u>				
"Inside"				
Operating	5.37	3,184	3.40	1,782
Debt	.05	30	.18	60
"Outside"				
Operating	2.7	1,601	2.00	1,050
Debt	1.8	1,067	2.10	1,092
<u>Total Schools</u>	<u>9.92</u>	<u>5,882</u>	<u>7.68</u>	<u>3,984</u>
<u>COUNTY</u>				
"Inside"				
Operating	2.78	1,913	1.97	1,182
Debt	.22	133		
"Outside"				
Operating	1.1	737	.30	188
Debt	1.1	766	.50	369
<u>Total County</u>	<u>5.2</u>	<u>3,549</u>	<u>2.77</u>	<u>1,739</u>
State of Ohio	.45	304		
Grand Total	27.00	\$16,331	19.20	\$10,113

SOURCE: Report of Citizens Finance Committee, 1945, p. 8B.

The Toledo situation was plain,--revenues were inadequate for debt service and minimal service standards. The Committee made two general recommendations as follows:

"1. The citizens of Toledo and Council should vote additional taxes to carry out the financial program as recommended.

2. Council should give sufficient evidence of its adoption of a policy of operating on a budget basis, with expenses balanced by revenue, to justify the confidence of the citizens of Toledo in providing increased revenues."¹²

With respect to the problem of additional revenues, the Committee felt that, in the absence of enabling legislation by the State, recourse might be had to one or more of the following: (1) General Property tax (2) Public utility service tax; (3) payroll tax.¹³ While the policy recommendations amounted to proposing increased real estate levies and the adoption of a public utility service tax, it is significant to note the comments on the income tax, as follows:

"A payroll tax was given extensive consideration but it is not recommended for adoption at this time. It was considered from two viewpoints in particular:

1. A way of obtaining tax sharing for the operation of the city or urban center from those who work, conduct business and use many city facilities daily but pay no direct tax for its support, and

2. As a means of financing public improvements by those gainfully employed.

Major reasons for not recommending adoption of a payroll tax centered around the following points.

The legal right of the city to levy such a tax is not clearly established. Although there are contentions that the power exists and that the public would not be required to register its approval or disapproval at the polls, no city in Ohio has enacted such a tax. In fact, Philadelphia and perhaps one or two small cities are pioneers in the field. Philadelphia justifies its enactment of this tax primarily upon dire necessity and the fact that in normal

¹² 1945 Citizens Finance Committee Report, p. 3-A.

¹³ Ibid., p. 7-A.

times it has approximately a million daily commuters to its business and industrial center. With a residential population of approximately two million, a situation exists which is much more serious than in the Toledo area. Bills to repeal the Philadelphia tax were just recently killed in a committee of the State Legislature because the sponsors proposed no adequate alternative source of revenue.

Objections were presented to adding more deductions from gross pay of employees, particularly at a time when reconversion will be taking place.

Possible effect upon the 'tried and tested' wage rates were discussed in relation to attitudes toward take-home-pay as compared with total earnings. These points were related, in turn, to the future expansion of Toledo and the possibility of attracting new business and new industry to settle in the community and add to the employment level.

Finally, it was estimated that one per cent payroll tax such as exists in Philadelphia would increase revenues beyond any need that has as yet been established. Estimates of possible revenues ranged from two to three-and-a half million dollars annually.

The result was that the consensus of the Committee was to adhere to proven methods as nearly as possible."¹⁴

Thus, the payroll income tax, despite the successful experience of the City of Philadelphia, was rejected as it has been earlier in 1943.¹⁵ The Committee proposed a more conventional solution. The portion of the Committee recommendations applicable to municipal revenue is indicated, as follows:

1. Recommendation for charter amendment to permit increase of the levy for general city operations from 4.45 mills to 6.00 mills for the period 1946-1950. It was estimated that this would provide approximately \$3,339,000 for operations. Operating revenue needs for the period were estimated at \$5,375,000; however, the balance was expected to be derived from distributions of state sales tax revenues.
2. Recommendation for the enactment of a 5% tax on gross utility bills, the revenues therefrom, estimated to yield \$700,000 per annum, to be earmarked for inside debt service charges and inside debt retirement. It was assumed that such a tax would permit retirement of inside debt by 1958.

¹⁴ 1945 Citizens Finance Committee Report, p. 11-B.

¹⁵ Cf. The Toledo City Journal, 30, No. 49, p. 509,522 for draft ordinance of local income tax which was discussed but not adopted by the Toledo City Council in March, 1943.

3. Levy of .7 mills for three years to provide approximately \$992,000 to meet general fund requirements for city equipment.
4. An additional .3 levy to cover bond financing of \$2,145,000 for "essential" city improvements.
5. Additional levies for county purposes (.14 mills); for retirement of library bonds (.17 mills); for deferred maintenance and replacements for school system (.41 mills).¹⁶

ADDITIONAL PROPERTY LEVIES REJECTED; INCOME TAX ADOPTED

As result of the Committee proposals, nine proposed property tax levies were submitted to Toledo voters in November, 1945.; the utility tax having been tabled by City Council. None passed.¹⁷ It was thus evident that if revenues were to be increased, alternative nonproperty revenue sources must be utilized. Evidently, the utility tax was rejected on the theory that the revenue derived therefrom would be insufficient to cover "inside" debt requirements and would make no contribution to current operating expenses; it was tabled by Council.¹⁸ Interest turned to the income tax measure which had been rejected in 1943. After much consideration, Ordinance 18-46 was passed January 28, 1946 by a 7 to 2 vote, to go into effect March 1, 1946.

Opposition to the new tax was voiced shortly after its adoption by the Toledo Political Action Committee of the C.I.O. and referendum petitions were filed with the Clerk of Council as soon as the tax went into effect. In opposition to the C.I.O activity, a civic committee headed by Vice-Mayor DiSalle, which was

¹⁶ 1945 Citizens Finance Committee Report, p. 3-B.

¹⁷ Cf. Peelle, op. cit., p. 28, 29, 30 for a discussion of the campaign and election.

¹⁸ The Toledo City Journal, 30, p. 513 (December 8, 1945).

supported by the Toledo officials of the American Federation of Labor, took on the job of "selling" the tax to the electorate.¹⁹ It would appear that C.I.O. opposition to local income taxation is virtually a standard reaction and that A.F.L. support is likewise to be expected.²⁰ The ordinance was upheld at the election held April 11, 1946, a majority of the votes cast favoring adoption. Toledo had its income tax.

ALLOCATION OF INCOME TAX REVENUE

Before considering the tax provisions of the Ordinance, it is noteworthy that it provided a basic plan for the allocation of revenues.

The expenditure allocation set up in Section 14 of the Tax ordinance provided a "five year plan" for the City as indicated in Table IX. It will be observed that the Toledo plan provided for the application of 31.2% of estimated revenues for retirement and service of debt inside the ten mill limitation as provided for in Section 14-2 of the Ordinance and for 19.5% for outside debt service under the provisions of Sec. 14-7 of the Ordinance. Thus, for the five year period, the Toledo plan provided for the application of 50.7% of income tax revenues to debt reduction. The total corporate debt of the City of Toledo as of January 1, 1946 was \$20,165,002.23, of which \$6,942,712.79 was debt inside the

¹⁹ Cf. Peelle, op. cit., p. 43; Gregg, Ronald E., "Payroll Tax Boon to Toledo," National Municipal Review, 38 (April, 1949), p. 164.

²⁰ Roesken, Edward, "Municipal Income, Sales and Use Taxes," Taxes 24, p. 972.

10-mill limitation.²¹ The proposed expenditure plan implementing the provisions of Section 14 of the Ordinance provided in effect for liquidation of 100% of the city's inside debt and 80% of the entire city debt, leaving at the end of the five year period a net debt of \$4,113,220 of which none would be inside the ten mill limitation.²²

It will be noted from the table that \$800,000 per year was planned for expenditure for operations, this amounting to 18.0% of estimated income tax revenues over the five year period. 12.4% was to be devoted to capital improvements and 9.2% was to be allocated to the Stabilization Fund established by Section 14-6 of the Ordinance for the purpose of reducing the city millage in order that other subdivisions, in particular the Toledo City School District, might benefit therefrom to the extent of the millage freed from city use.²³ Thus, while the adoption of the

21 Schoonmaker, George N., City Manager, "Income Tax Long Range Program," The Toledo City Journal, 31, No. 42 (October 19, 1946), p. 581.

22 Ibid., p. 582.

23 Ord. 18-46, Sec. 14-6 reads as follows:
"Each year there shall be paid into the Stabilization Revenue Fund the balance collected under this tax, not to exceed \$480,000, or whatever sum shall be equal to the revenue raised by one mill of the real estate tax levy.

When the Stabilization Reserve Fund reaches an amount equal to a mill levy, the Council of the City of Toledo shall release to the Lucas County Budget Commission one mill, or such portion thereof as has been placed in the Stabilization Reserve Fund, in order that the Budget Commission may make such mill or fraction thereof available to the County of Lucas and Board of Education of the City of Toledo.

The sum set aside in the Stabilization Reserve Fund shall be placed in the General Fund to replace the mill levy or portion thereof that has been released."

TABLE IX

THE TOLEDO OHIO INCOME TAX PLAN; PROPOSED ALLOCATION OF FUNDS AND ESTIMATES OF
REVENUE UNDER TOLEDO ORDINANCE NO. 18-46 FOR THE PERIOD 1946-1950 AS OF OCTOBER 8, 1946

<u>Year</u>	<u>Administration</u>	<u>Inside Debt Service</u>	<u>Operations</u>	<u>Deferred Maintenance & New Equipment</u>	<u>Capital Improvements</u>	<u>Stabilization Fund</u>	<u>Outside Debt</u>	<u>Estimated Revenue(a)</u>
1946	\$137,400	\$1,388,543	\$800,000	\$250,000	\$550,000	\$124,057	\$	\$3,250
1947	194,500	1,388,543	800,000	250,000	550,000	480,000	336,957	4,000
1948	194,500	1,388,543	800,000	250,000	550,000	480,000	1,336,957	5,000
1949	194,500	1,388,543	800,000	250,000	550,000	480,000	1,336,957	5,000
1950	194,500	1,388,543	800,000	250,000	550,000	480,000	1,336,957	5,000
Total	\$915,400	\$6,942,615	\$4,000,000	\$1,250,000	\$2,750,000	\$2,750,000	\$2,044,057	\$22,250
Percentage	4.1%	31.2%	18.0%	5.6%	12.4%	9.2%	19.5%	100%
Required by								
Ord. Sec.	14-1	14-2	14-3	14-4	14-5	14-6	14-7	

(a) Estimated Revenue in thousands

SOURCE: The Toledo City Journal, 31, No. 42 (October 19, 1946), p. 583.

tax was an emergency measure, the City of Toledo went into the experiment with a carefully planned expenditure program designed to improve the city's financial status. It may be pointed out that without adequate expenditure programming no utilization of new revenue sources will be a solution to local finance problems.

PROVISIONS OF ORDINANCE 18-46

Turning to the provisions of Ordinance 18-46, Section 1 reads as follows:

"To provide funds for the purpose of retirement of certain debt, general municipal operations, deferred maintenance and capital improvements of the City of Toledo there be and is hereby levied a sum in the nature of an excise tax for the privileges defined in each of the respective sections of this ordinance."

Section 2 provides the customary set of definitions for use in connection with the balance of the ordinance. It may be noted that in this definitional section, the definition of resident is grounded completely upon the legal concept of "domicile" rather than by indicating any real indicia of what is to be considered determinative of residence. Thus, as defined, residence rests in part at least upon the nebulous intent of the individual. Section 3 imposes the 1% tax and provided a formula for the allocation of net profits resultant from work done or services performed in the City.²⁴

²⁴ Ord. 18-46, Sec. 3, reads as follows:

"An annual tax for the purposes specified in Section 1 hereof shall be imposed at a rate of one per cent (1%) per annum upon the following:

- (1) On all salaries, wages, commissions and other compensation earned after March 1, 1946 by residents of the City of Toledo.
- (2) On all salaries, wages, commissions (continued on p. 126.)

It will be noted that the Ordinance in reality levies two distinct taxes; one on all earned income of residents and on that part of earned income of non-residents resultant from work done or services performed in the City; a second tax is levied on all the "net profits" earned by businesses, professions or other activity conducted by residents and on the part of "net profits" resultant from such activity within Toledo by non-residents; and on

24 (continued from p. 125.) and other compensation earned after March 1, 1946 by non-residents of the City of Toledo for work done or services performed or rendered in the City of Toledo.

(3) On the net profits earned after March 1, 1946 of all businesses, professions, or other activities conducted by residents of the City of Toledo.

(4) On the net profits earned after March 1, 1947, of all businesses, professions, or other activities conducted in the City of Toledo by non-residents.

(5) On the net profits earned after March 1, 1946 by all corporations having their principal office and place of business in the City of Toledo, or an office or place of business in the City of Toledo, said tax being levied on such part of the net profits as is earned by such corporations as a result of work done or services performed or rendered and business or other activities conducted in the City of Toledo.

The portion of the entire net profits of a taxpayer to be allocated as having been made within the City of Toledo may be determined as follows:

a- Multiply the entire net profit by a business allocation percentage to be determined by-

1. Ascertaining the percentage which the average value of the taxpayers real and tangible personal property within the city during the period covered by its report bears to the average value of all the taxpayers real and tangible personal property wherever situated during such period.

2. Ascertaining the percentage which the gross receipts of the taxpayer from sales within the City of Toledo, plus the gross credits or charges for work done and performed or services rendered in the City of Toledo bears to the total gross receipts from sales wherever made plus the total gross credits or charges for work done and performed or services rendered.

3. Ascertaining the percentage which the (continued on p. 127.)

corporations on the same basis.²⁵ It will be noted that profits are allocated to Toledo and hence determined to be subject to the tax on the basis of three percentages based upon property, gross

²⁴ (continued from p. 126.) total wages, salaries and other personal service compensation, similarly computed during such period of employees within the city, except general executive officers, bears to the total wages, salaries and other personal service compensation similarly computed, during such period of all the taxpayer's employees within and without the city, except general executive officers; and

4. Adding together the percentages determined in accordance with subparagraphs 1, 2 and 3 above, or such of the aforesaid percentages as shall be applicable to the particular taxpayer's business, and dividing the total so obtained by the number of percentages used in deriving said total.

b- Provided, however, that in the event a just and equitable result cannot be obtained by the use of the factors contained herein, the Board of Review shall have the authority to substitute factors calculated to effect a fair and proper allocation."

²⁵ It may be noted that in Section 2 of the Ordinance, the following definitions are set out:

"Association"- A partnership, limited partnership, or any other form of unincorporated enterprise owned by two or more persons.

"Business"- An enterprise, activity, profession, or undertaking of any nature conducted for profit or ordinarily conducted for profit, whether by an individual, co-partnership, association or any other entity.

"Corporation"- A corporation or joint stock association organized under the laws of the United States, the State of Ohio, or any other state, territory, or foreign country or dependency."

It might be pointed out that Massachusetts trusts and Ohio land trusts, etc., might well be included specifically rather than by implication. This, however, is quite a natural difficulty in drafting an income tax in "Reader's Digest" form.

Art. I-1 (b), Toledo Income Tax Regulations gives a more complete definition of Business, as follows:

"The term "Business" means an enterprise, activity, profession, trade or undertaking of any nature conducted for profit or ordinarily conducted for profit, whether by an individual, co-partnership, association or any other entity; but the ordinary administration of a decedent's estate by the executor or administrator, and the mere custody, supervision and management of trust property under a passive trust, whether inter vivos or (cont.)

receipts and payrolls as set up in the business allocation formula in Sec. 3 (5) a. This is similar to the so-called Massachusetts formula used in the state income taxation field, which formula has been characterized as one of the most satisfactory methods of making such allocations.²⁶

Note should be taken of the provision of Section 3 (5) b which provides that the Board of Review, composed of the City Director of Law, the Director of Finance and the City Auditor,²⁷ may, in its discretion, substitute other factors in the formula. Thus, the Board is empowered to increase or decrease the taxable basis of taxpayers subject to the formula without reference to any standard other than "fairness." While it would appear that this provision is included to cover cases where the formula would be inequitable, it is submitted that there is virtually no administrative standard set up for the guidance of the Board,--a far cry from administrative fact finding. The constitutionality of this provision has been questioned by writers but as far as can be presently ascertained

²⁵ (continued from p. 127) testamentary, unaccompanied by the actual operation of a 'business' as herein defined, shall not be construed as the operation of a 'business'."

Section 2 of the Ordinance defines Net Profits as follows:
 "The net gain from the operation of a business, profession, or enterprise, after provision for all costs and expenses incurred in the conduct thereof, either paid or incurred in accordance with the accounting system used and without deduction of taxes based on income."

²⁶ Cf. Blakey, Roy G., and Johnson, Violet, "State Income Taxes," Chicago: Commerce Clearing House, 1942, p. 65 et seq.; Cf. also Schultz, William J., and Harris, C. Lowell, "American Public Finance," Fifth Edition, New York: Prentice Hall, 1949, p. 453.

²⁷ Ord. 18-46, Sec. 13.

there has been no litigation of this point.²⁸

Section 4 provides that the tax should be first levied on the remaining part of the 1946 tax year, making provision for taxpayers on a fiscal year basis by providing that the tax would be applicable to that portion of the fiscal year after March 1, 1946, the effective date of the tax.

and
Sections 5, 6, 7 provided for annual returns due on March 15 of the following year; for collection at the source by employers with monthly remittance of taxes withheld to the City, except that in hardship cases the Commissioner of Taxation is authorized to establish a different payment period;²⁹ that the tax while held by the employer prior to remittance to the Commissioner of Taxation is to be deemed a trust fund; and for declarations of estimated income by taxpayers whose income is not subject to withholding provisions on or before March 15 of each year and permitting the use of estimate figures utilized by the taxpayer for federal income tax purposes subject to modifications so as to only state income taxable under the ordinance; and providing for quarterly payments on the estimate in a fashion similar to that provided for by federal income tax regulations.

Section 8 of the Ordinance directs the Commissioner of Taxation to collect the tax; to keep adequate records, and charges the Commissioner with enforcement of the provisions of the

²⁸ Frieberg, Albert M. (of the Cincinnati Bar), "The Toledo Income Tax," 32 Ohio Opinions 332.

²⁹ Toledo Regs. Art. IV-2.

Ordinance; and gives him the power to make regulations and rules for administration and enforcement. Section 9 grants inquisitorial power to the Commissioner of Taxation to examine books and records and to examine taxpayers under oath concerning income subject to the tax and to compel the production of books and records and the attendance of witnesses. It is further provided that refusal of such examination shall be deemed a violation of the ordinance. It further provides that such information gained as a result of examination of returns, records or individuals shall be confidential and provides penalties for divulging such information up to \$500.00 fine or six months imprisonment or both.

Section 10 provides that delinquent taxes shall bear interest at six per cent per annum and that in addition a penalty shall be assessed of one-half of one per cent of the amount due for each month of the first six months of nonpayment.

Section 11 provided that unpaid taxes plus penalties and interest thereon should be recoverable by suit as other debts of like amount are recoverable.

Section 12 provided penalties for violations ~~for~~, non-filing and non-compliance with the terms of the ordinance by treating such actions as misdemeanors and further provided for a maximum fine of \$100.00 or imprisonment for **sixty** days or both.

Section 13 established a Board of Review, composed of the Director of Law, as Chairman, the Director of Finance and the City Auditor, and required that all rules and regulations adopted by the Commissioner of Taxation be approved by this Board prior to

becoming effective.

Section 13 further established the Board of Review as an appellate reviewing authority to hear and affirm, modify or reverse rulings made by the Commissioner of Taxation in administration of the ordinance provisions.- The section also included a provision requiring that such appeals be perfected within 20 days after the announcement of the ruling or decision by the Commissioner.³⁰

Section 14 of Ordinance 18-46 established the allocation of funds derived from the tax as previously discussed. Section 15 provided that the ordinance should not apply to any person or entity that it was beyond the power of the City to tax and for separability of provisions of the ordinance in the event that any part thereof was declared unconstitutional. Section 16 provided that the ordinance should remain in effect until December 31, 1950 and thereafter for the purpose of collecting back taxes until such taxes were collected. Section 17 declared that the ordinance was an emergency measure so as to permit it to go into effect immediately. Such were, in brief, the provisions of the first Toledo income tax ordinance.

ADMINISTRATION OF TOLEDO TAX

As previously mentioned, Section 8 of the Ordinance provides

³⁰ Toledo Regs. Art. X-1 and X-2 provide in substance that the Board may act upon a majority vote of its three members; that the public may be excluded from hearings; that the ordinance provisions relating to the confidential character of tax data shall be applicable to proceeding before the Board; that a record be kept of its transactions and that procedural rules adopted by the Board be filed in the Office of the Clerk of Council and that such rules be available to the public upon request.

for a Commissioner of Taxation charged with administration of the city income tax; this official heads the Division of Income Taxation. The organization of this Division has been progressively modified during the first five years of the tax. Chart I shows an outline of the personnel set-up of the Division, which at the end of 1950 included 70 employees.³¹

As presently operating, this organization, in addition to collection of the tax, gives a "pre-audit" to all returns filed. In addition, special audits are given to questionable returns. According to Mr. Tillman, from 30 to 40% of all returns are audited. It must be observed in this regard that personnel limitations control to a certain extent. However, on the basis of a 30-40% audit program, Toledo would appear to be considerably ahead of other Ohio municipalities in this matter.³² Most of the special audits have resulted in office adjustments and payment rather than litigation.

In the matter of legal enforcement, the City of Toledo has elected as a matter of policy to use criminal rather than civil procedure in income tax cases.³³ To February, 1951, some 317 enforcement cases have been instituted by the City Income Tax Division.³⁴ Virtually all of these have either been decided in favor

31 Interview with Mr. C. C. Tillman, Tax Commissioner of City of Toledo.

32 Cf. infra. Ch. VI, p.163 Ch. VII, p.186 Ch. VIII, p. 200.

33 It may be noted that this policy is similar to Columbus and differs from that of Springfield. Ch. VI, p.172 infra; and Ch. VII, p.188 infra.

34 Interview with Mr. E. N. Goodyear, Attorney, Income Tax Division.

of the city or dismissed after payment of the tax. The number of cases should not be taken as an index of the effect of this type of enforcement as it would appear that gratuitous newspaper publicity of income tax convictions operates to produce additional compliance making the city income tax office the day after several convictions are announced seem like March 15. To date, according to Mr. Goodyear, no enforcement cases have been brought by the City against corporate taxpayers, adjustments having been made by conference rather than litigation.

As to legal questions arising from the incidence of the income allocation formula, only one appeal has been made to the Board of Review established by the Ordinance to date. It was denied by the Board. No appeals have been taken from the Board or by-passing the Board to the Civil courts. This is in line with the experience of other Ohio municipalities levying income taxes. Under Ordinance 18-46, it is estimated that about half of affected tax-payers have used the allocation formula; the other half using separate accounting.

As to other litigation of the tax, the landmark case of Angell v. Toledo has already been discussed at length in Chapter 2. There is presently pending in the Lucas County Court of Appeals an appeal from a judgment of the Lucas County Common Pleas Court affirming a judgment of the Municipal Court of Toledo holding that the Statute of Limitation does not apply to non-payment of the Toledo tax on the theory that such non-payment is a continuing offense so that the statute does not run. No decision has been rendered to

CHART I

PERSONNEL CHART
DIVISION OF TAXATION
CITY OF TOLEDO, OHIO

ADMINISTRATIVE

- 1 Commissioner: Duties prescribed by Ord. 18-46;
- 1 Secretary: Secretarial duties
- 1 Stenographer: Stenographic duties.

LEGAL DEPARTMENT

- 1 Attorney-Deputy Commissioner:
Handles legal matters, in charge during Commissioner's absence;
- 1 Secretarial stenographer: Secretarial.

CASHIER

- 1 Chief Cashier: Responsible for all cash received;
- 3 Asst. Cashier: Receive income taxes and issue receipts.

AUDITOR

- 1 Chief Auditor: In charge of department;
- 1 Secretarial Stenographer: Secretarial.

INVESTIGATIONS

- 1 Supervisor: Supervisory;
- 1 Sr. Stenographer: Stenographic;
- 4 Internal Auditors: Letters, etc.;
- 4 Investigators and collectors:
Field check on potential taxpayers, evaders and changes in ownership;
- 4 Clerk-Typists: Clerical, typing;

AUDIT

- 1 Asst. Chief Auditor: Supervisory;
- 1 Sr. Stenographer: Stenographic;
- 10 Field Auditors: Audit returns, books;
- 4 Internal Auditors: Internal audits, etc.;

BOOKKEEPING

- 1 Bookkeeping supervisor: In charge;
- 4 Machine operators: Posting accounts;
- 1 Clerk-typist: Sorting, filing, typing.

GENERAL OFFICE

- 1 Addressograph supervisor: Supervisory;
- 1 Stenographers: Stenographic;
- 4 Clerk-typists: Clerical, typing;
- 1 Mail supervisor: Handling mail;
- 2 File-Record clerks: Filing;
- 1 Stockkeeper: Handling supplies.

CONFIDENTIAL FILES

- 1 File Supervisor: Supervisory;
- 2 File-Record clerks: Filing.
- 1 Comp. operator

ADDRESSOGRAPH

- 1 Operator: Operate addressograph;
- 1 Clerk-typist: Assist operator.

date to the writer's knowledge.

In addition, several finance and small loan companies have contended that the Toledo tax is not applicable to them on the theory that the State of Ohio has pre-empted the field of taxation of such companies by levying a tax on shareholders of a dealer in intangibles under the Ohio Personal Property Tax Law.³⁵ The Commissioner, and on appeal the Board of Review, have taken the position that the state tax is a property tax measured by income and that Toledo tax is, as decided in the Angell case, an income and not a property tax, so that taxing the net profit of a dealer in intangibles does not conflict with nor has it been preempted by the state tax. The decision of the Board of Review has not been appealed to the Courts. The decision of the Board of Review, with the names of the companies omitted out of deference to the confidential provisions of the ordinance is included verbatim in Appendix II.

While there will doubtless be continued litigation of various particular questions under the tax, the "power question" was settled in favor of the City in the Angell case and it is a valid tax.³⁶

TOLEDO TAX: YIELD AND RESULTS

Turning to consideration of the results of the Toledo income tax levy, the Toledo Citizen's Committee prepared a report covering

³⁵ G. C. 5414-1 et seq.

³⁶ Angell v. City of Toledo et al, 153 Ohio St. 179, 91 N.E. 2d 250 (1950).

the period from March 1, 1946 through December 31, 1948,--the first three calendar years during which the tax was collected.³⁷ During this period, the City collected a total of \$14,191,919. In addition, payments made during the first four months of 1949 related to taxable income for the 1948 tax year amounted to an additional \$1,794,627. Thus, during the period covered by the Committee Report, Toledo received total revenue amounting to the sum of \$15,986,546. from its income tax.³⁸ The expenditure program established by Section 14 of Ordinance 18-46 has already been discussed.³⁹ The actual allocation of revenue for the period in accordance with the five year program is indicated in Table X.

This Table indicates the results of utilization of the tax for the period covered. It will be noted that the cost of collection of the tax for the period was only 2.9% of total revenue collected,--certainly a reasonable cost figure. The total cost of \$457,416 was expended as follows: salaries and wages, \$322,583; rent and utilities, \$86,253; supplies, \$48,580.⁴⁰ Cost of collection in relation to total revenue would seem to indicate efficient administration. However, it must be observed that approximately 70% of this revenue was derived from taxes withheld from payrolls by employers and that a taxpayer without non-payroll income need not

³⁷ "Three Year Report, City Income Tax", Report of Toledo Citizens Committee, The Toledo City Journal, 34 No. 36, (September 3, 1949) p. 822-824.

³⁸ Ibid.

³⁹ Cf. supra. p. 122.

⁴⁰ Ibid., p. 822.

TABLE X

EXPENDITURE ALLOCATION OF INCOME TAX REVENUE AND PERCENTAGE DISTRIBUTION BY TYPE OF EXPENDITURE, CITY OF TOLEDO, OHIO
MARCH 1, 1946 to DECEMBER 31, 1948

<u>Type of Expenditure</u>	<u>Revenue Allocated</u>	<u>Per cent of Total Revenue</u>
Cost of Collection	\$ 457,416	2.9
Inside Debt Service	4,165,629 (b)	26.1
Operations	2,400,000	15.0
Deferred Maintenance & New Equipment Purchases	750,000	4.7
Capital Improvements	1,650,000	10.3
Stabilization Fund	1,440,000	9.0
Outside Debt Service	5,123,501 (b)	32.0
Total	<u>\$15,986,546 (a)</u>	<u>100.0</u>

(a) Total includes \$1,794,627. of 1948 tax collected in 1949.

(b) \$3,016,708 of amounts shown as allocated to debt service invested in U.S. Government and City of Toledo securities pending maturity dates of noncallable city bonds. Figures shown do not include \$7,754 interest income on such investment.

SOURCE: The Toledo City Journal, 34, No. 36 (September 3, 1949), p. 824.

file a separate return; this operates to reduce the cost of collection.⁴¹

It will be recalled that Section 14 of the Ordinance provided for the allocation of \$1,388,543 per year to the service and retirement of "inside" debt; this was done each year with a resultant allocation of \$4,165,629 or 26.1% of revenues collected. Note that as originally estimated revenues for the three year were to be \$12,250,000,⁴² whereas actual collections amounted to \$15,986,546. A comparison of the percentages breakdown of the original estimates and the actual allocations that developed indicate that in each case, with the exception of the percentage applicable to "outside debt," percentages of revenue actually expended or allocated are greater than the initial estimates. This is merely another way of saying that revenue exceeded expectations and as a result of a fixed expenditure formula limiting the amount applicable to current operations, the planned amounts of the five year plan were covered and that a surplus accrued which under Section 14 was allocated to "outside" debt.

Mr. Ronald E. Gregg, executive secretary of the Toledo Municipal League, has suggested three main reasons for the shortness of the initial tax estimates, in substance as follows:

- (1) original "official guesses" were deliberately conservative;
- (2) postwar employment in Toledo surpassed the wartime peak; (3) the

⁴¹ Gregg, Ronald E., "Payroll Tax Boon To Toledo," National Municipal Review, 38, No. 4 (April, 1949), p. 164.

⁴² Cf. Table IX, p. 124, supra.

wage and profit level increased.⁴³

As a result of this largely unanticipated high yield, it was possible for the City to allocate a total of \$5,123,501 (32.0% of total collections) to retirement of outside debt, whereas originally it had been anticipated that only \$4,347,828 would be available for this purpose for the entire five year period, 1946-1950. It should be noted that the amount allocated was not spent due to the unfortunate fact that the municipal bonds issued by the City of Toledo to be serviced from general taxation contain no call feature; however, this surplus over the original estimates is available for redemption as the bonds mature. The last of these bonds do not mature until 1976. Meanwhile, amounts designated for this purpose are placed in a special investment fund which, it is estimated, will eventually earn about \$575,000.⁴⁴

While the debt retirement program has worked out better than originally anticipated, it must also be noted that the rising price level has caused a reduction in the real value of the amounts allocated for capital improvements,--so that the \$550,000 designated for such expenditures has not purchased all that was originally planned. The rigid provisions of Section 14 required that surplus be used for debt retirement. It is not surprising that as operating costs mounted city officials began to look for ways and means of tapping the lucrative income tax for more operating revenues. It was the opinion of council that any change in Section 14 must be

⁴³ Gregg, op. cit., p. 164.

⁴⁴ Ibid.

submitted to the electorate. A number of proposals were considered.⁴⁵

A compromise version was agreed upon by Council and submitted to the voters, November 2, 1948, with a modified expenditure program substantially as follows:

- (1) Cost of administration of the tax.
- (2) An amount sufficient to pay off all "Inside debt" (\$2,777,086).
- (3) The surplus accrued 1946-1948 of \$2,545,000 for "outsidedebt" payment.
- (4) Annually: Up to \$800,000 for garbage and rubbish collections.
 " " 350,000 for public health expenditure.
 " " 360,000 for the University of Toledo.
 " " 200,000 for recreation program.
 " " 125,000 for operation.
- (5) \$250,000 for Deferred Maintenance and Equipment Replacements.
- (6) Set Stabilization Fund at \$510,000 per year.
- (7) Allocate excess for the years 1949 and 1950 above the above stipulated amounts for improvements.⁴⁶

This proposal was defeated at the polls; the original limitations were sustained.⁴⁷ However, the need continued for some addition to operating revenues. An amendment to Section 14 was placed on the ballot and approved by the electorate on November 8, 1949, which reads as follows:

"8. After sufficient moneys have been placed in the Bond Retire-

⁴⁵ Cf. Peelle op. cit., p. 106 et seq.

The Toledo City Journal, 33, No. 18, p. 329, contains a suggested amendment to Section 14 which is indicative of the trend in the consideration of the change by Council.

⁴⁶ "Payroll Tax Amendment," Toledo Municipal News, 2, No. 8 (July, 19, 1948), p. 2.

⁴⁷ Gregg, op. cit., p. 166.

ment Fund to retire the outstanding general bonded indebtedness, the balance of the funds collected under the provisions of this ordinance shall be appropriated by the Council of the City of Toledo as follows:

(a) The sum of \$1,375,000 to the General Fund . . . to eliminate the 1948 and 1949 deficits in said fund and to provide for a balanced budget for the year 1950.

(b) Any balance over the requirements of (a) hereof to the Capital Improvement Fund of the City of Toledo."48

Thus the citizens of Toledo placed primary emphasis upon debt retirement but permitted utilization of excess revenues for operations. The following Report indicates the Toledo picture to July 31, 1950.

CITY MANAGER'S REPORT OF CITY INCOME TAX AS OF JULY 31, 1950

1946 Receipts

Estimated Collections - 10 mos.	\$4,000,000	
Total Actual Receipts		\$4,051,809
Receipts in Excess of Estimate		\$ 51,809

Allocations and Appropriations-1946

Total Allocations	4,051,809	
Total Appropriations		3,233,761
Unappropriated Balance		818,048

1947 Receipts

Estimated Collection	5,000,000	
Total Actual Receipts		5,657,002
Receipts in Excess of Estimate		657,002

Allocations and Appropriations-1947

Total Allocations	5,657,002	
Total Appropriations		3,610,266
Unappropriated Balance-1947 Tax		2,046,736

1948 Receipts

Estimated Collection	6,250,000	
Actual Receipts to Date		6,277,735
Receipts in Excess of Estimate		27,735

Allocations and Appropriations-1948

Total Allocations	6,250,000	
Total Appropriations		3,689,313
Unappropriated Balance of 1948 Tax		2,588,422

1949 Receipts

Estimated Collection	6,000,000	
Actual Receipts to Date		5,962,853
Balance of Estimate to Be Collected		37.147

Allocations and Appropriations-1949

Total Allocations	5,962,853	
Total Appropriations		3,716,802
Unappropriated Balance 1949 Tax		2,246,051

1950 Receipts

Estimated Collection	6,000,000	
Actual Receipts to Date		2,473,161
Balance of Estimate to be Collected		3,526,839

Allocations and Appropriations-1950

Administration	\$ 278,335	278,335	
Inside Debt	1,388,543	1,388,543	
Operation	2,175,000	2,175,000	
Deferred Maintenance	250,000	250,000	
Capital Improvement	550,000	550,000	
Stabilization Fund	480,000	480,000	
Bond Retirement Fund	878,122		878,122
Total	6,000,000	5,121,878	878,122

SOURCE: 35 The Toledo City Journal (No. 33) 824, (August 19, 1950.).

143.

TABLE XI

TOTAL INCOME TAX REVENUE, CITY OF TOLEDO, OHIO, ANNUALLY,
1946-1950*

<u>Year</u>	<u>Revenue</u>
1946	\$ 4,051,808.72
1947	5,657,002.04
1948	6,277,734.71
1949	5,962,852.59
1950	<u>4,513,634.70</u>
Total	\$24,463,032.76

* Data for year tax levied; tax books closed April 30th
of year following; 1950 total to December 31, 1950.

SOURCE: Tax Commissioner, City of Toledo, Ohio.

The above recapitulation of income tax receipts in the City Manager's Report and the total collected annually indicated in Table XI together with the 1950 allocations of income tax revenue give an overall picture of the very material assistance that this revenue source is affording Toledo city financing. It will be observed that the 1950 allocations show an increased amount for operations in comparison to the original \$800,000. per annum originally established as an operations expenditure ceiling. Such an increase appears more than justified in view of the general increase in prices that has and is occurring.

CITY MILLAGE TRANSFERRED TO SCHOOL DISTRICT

Toledo has, as a result of five years of city income taxation and careful expenditure, made provision for its debt, improved current services and reduced its dependence upon the real property tax. The City has reduced its real property tax millage freeing one mill annually which has been taken over by the Toledo ¹ City School District. Table XII shows the change in the composition of the real estate tax rate in Toledo for the five year period of the tax. It will be observed that the total tax rate applicable to Toledo real estate has not dropped. On the contrary, it has increased from 19 mills for the collection year 1946, based on the 1945 tax duplicate, to a total of 20 mills for the collection year 1950 based on the 1949 tax duplicate. However, the city portion of the total has decreased from 8.65 mills for the collection year 1946 to 3.45 mills for the collection years 1949 and 1950. This reduction has permitted the county budget commission to allocate additional millage to the school district and generally has reduced the pressure on the real

estate tax in a period of rising prices and increasing governmental costs. The county rate has increased by 1.2 mills and the school rate by 5.0 mills, while the city rate has decreased by 5.2 mills from 1945 to 1949.

It has been noted by Mr. Ronald Anderson, the City Finance Director, that as Toledo City services have improved, adjacent communities have given consideration to the desirability of being annexed to the City of Toledo. Mr. Anderson has suggested that the operation of the city income tax has provided a stimulus for annexation and extension of the legal boundaries of the city to cover its economic area.⁴⁹ It should be noted that the Pennsylvania experience does not show the suggested trend, yet if as a by-product of the tax metropolitan organization is improved that will be so much to the good. It may be further suggested that the reciprocity provisions contained in the new Toledo tax ordinance, to be discussed shortly, may encourage levy of income taxes by adjacent localities rather than provide a stimulus to annexation.⁵⁰

Comparative evaluation of income taxes at the city level will be considered in Chapter X. However, with respect to the first five years of the Toledo experience, the epitomization of its achievements prepared by Mr. Gregg is worthy of note:

" . . . several points merit enumeration:

⁴⁹ Anderson, Ronald T., "Income Tax Aids Annexation," National Municipal Review, 38 (October, 1949), p. 443.

⁵⁰ Toledo Ordinance 689-50, enacted November 29, 1950, effective January 1, 1951, printed by The Toledo Commission of Publicity and Efficiency, December, 1950, in particular Section 15.

TABLE XII

**TAX LEVIES, CITY OF TOLEDO, OHIO, TOLEDO SCHOOL DISTRICT,
AND LUCAS COUNTY, OHIO, ANNUALLY 1946-1950.**

Duplicate Collection Year	1945 1946	1946 1947	1947 1948	1948 1949	1949 1950
<u>Levies-Mills</u>					
County					
Debt	.8	.5	.5	.5	1.5
Operating	<u>1.97</u>	<u>2.33</u>	<u>2.47</u>	<u>2.47</u>	<u>2.47</u>
Total County	<u>2.77</u>	<u>2.83</u>	<u>2.97</u>	<u>2.97</u>	<u>3.97</u>
City					
Debt	6.06	4.2	3.4	-0-	-0-
Operating	<u>2.59</u>	<u>4.15</u>	<u>3.45</u>	<u>3.45</u>	<u>3.45</u>
Total City	<u>8.65</u>	<u>8.35</u>	<u>6.85</u>	<u>3.45</u>	<u>3.45</u>
Schools					
Debt	2.0	1.8	1.8	1.2	3.2
Operating	<u>5.28</u>	<u>6.82</u>	<u>9.38</u>	<u>9.38</u>	<u>9.38</u>
Total Schools	<u>7.58</u>	<u>8.62</u>	<u>11.18</u>	<u>10.58</u>	<u>12.58</u>
Total-All Levies.	19.00	19.8	21.0	17.0	20.0

SOURCE: "Financial Report of The City Auditor, Toledo, Ohio for the Year Ended December 31, 1949," Published as a Supplement to The Toledo City Journal of May 20, 1959, p. 22; Data for 1950 collection year furnished by Mr. C. D. Eisenman, Deputy Auditor, City of Toledo.

1. Toledo faced the postwar period with a **comprehensive** five-year fiscal program produced by citizen-public official cooperation to restore city services from depression and wartime ailments.

2. When other methods failed, they together--but independent of outside aid--pioneered a new method.

3. The near clean up of backed up property maintenance, restoration of adequate city service level, reduction of net general indebtedness to nothing, and addition of overdue public improvements on a pay as you go basis is a salutary program that stands in favorable contrast to the experience of most cities during this period.

4. The extra elimination of more than \$14,000,000 of debts, large reduction of city property taxes, reestablishment of city equipment and properties and limitation of new improvements to the more essential obtainable on a pay as you go basis, and reasonable employee pay during a period of inflation is a starter to the counter-inflationary public spending policies talked about for 25 years but too seldom applied. The payroll income tax is working in Toledo.⁵¹ (Emphasis added)

ORDINANCE 689-50

The first five years of city income taxation in the City of Toledo, Ohio have been considered and, on balance, the tax has changed the city financial situation from that of the typical "plight" to that of a solvent going concern. On November 29, 1950, the City Council committed Toledo to another five years of such taxation by enacting Ordinance No. 689-50, to be effective January 1, 1951 levying a 1% tax for the five year period ending December 31, 1955. It is estimated by city officials that the tax will yield approximately \$6,480,000 in 1951.⁵²

The drafting of the new ordinance reflects the experience of five years of tax administration and contains many changes and

⁵¹ Gregg, op. cit., p. 180.

⁵² The Toledo City Journal, 36, No. 6, (February 10, 1951) p. 117.

improvements. In the opinion of the writer, the new Toledo ordinance is the best local income tax ordinance that he has seen. In view of this fact and since this is the latest major Ohio city income tax ordinance it is given in its entirety in Appendix I. Comparative consideration of ordinance provisions will be treated in Chapter IX. Accordingly, only the most significant provisions of the new Toledo Ordinance will be mentioned. The definitions in Section 2 of Ordinance 689-50 are expanded and in addition separate definitions are provided for "non-resident individuals" and for "non-resident unincorporated business entity." In addition, the new ordinance taxes both unincorporated and corporate business entities on profits arising from Toledo transactions whether or not a place of business is maintained in the City.⁵³ The new ordinance provides additional explanation of the income allocation formula by adding that the property value in the formula shall be the "basis used for federal income tax purposes."⁵⁴ Also an additional section is added to clarify the determination of the sales percentage in the income allocation formula by stipulating in more detail what sales shall be considered to have occurred "within the city."⁵⁵ Furthermore, the new ordinance provides that with the exception of net income from finance, investment or construction activities which may be determined by separate accounting, all taxpayers shall allocate income, when necessary,

⁵³ Ord. 689-50, Sec. 3 (3) a; 3.(4)a; 3(5).

⁵⁴ Sec. 3(6) (a) 1.

⁵⁵ Sec. 3(6) (a), (1)-(3).

as having been made within the City by means of the formula rather than by separate accounting.⁵⁶

Taking recognition of the lengthy process of determination of Federal Income tax liability in many cases, the new Toledo ordinance provides that where there is a final determination of Federal income tax liability which affects Toledo income tax liability, the taxpayer shall file an amended return within 90 days after the Federal determination.⁵⁷ Section 10 of the new Ordinance provides stiffer penalties for delinquent taxes in addition to 6% per annum, -- 1% a month for the first 3 months of delinquency; 5% if the tax is paid during the next three months; and 10% if paid later than six months after due. It is provided, however, that where a return is filed in good faith and the Commissioner makes an additional assessment or when additional tax becomes due as a result of a Federal Income tax adjustment or adjudication, this penalty provision shall not be applicable.⁵⁸ Section 11 contains a new provision in the nature of a Statute of Limitations in that except in fraud cases or where a "substantial portion of income subject to this tax" has been omitted, no additional assessment is to be made after three years from the time the tax payment was made, except where the taxpayer has executed a waiver of the Federal statute of limitations, the period during which the Commissioner may make an additional assessment is to be

⁵⁶ Sec. 3, 6 and 3, 6 (a).

⁵⁷ Ord. 689-50, Sec. 5.

⁵⁸ Ord. 689-50, Sec. 10.

three years from the time of the determination of the federal tax liability. Section 13, dealing with the Board of Review extends the time for appeals from the Commissioner from the 20 days provided for in Ordinance 18-46 to 90 days and sets up the right of an aggrieved taxpayer to appeal from a determination of the Board of Review to a court of competent jurisdiction with 90 days after a determination by the Board. This is in all probability an example of surplusage for in all probability such taxpayer would have such right in any event and it is at least questionable as to whether the 90 day provision of the ordinance limiting the time of appeal would be controlling except as a predicate for claiming laches.

ALLOCATION OF REVENUE UNDER SECOND TAX ORDINANCE

More significant is Section 14 which deals with the allocation of funds. After payment of costs of collection and administration, \$100,000 per annum or part of that amount is to be appropriated to the city General Fund; the next \$250,000 per annum is to go for Maintenance of New Equipment; then an amount equal to one mill is to go to the Stabilization Fund and one mill is to be released to the County Budget Commission for use of Lucas County and the Board of Education of the City of Toledo. Moving down the priority list, the next \$350,000 per annum is to be appropriated to the Trustees of the University for capital improvements and the balance is to go to the City Capital Improvement Fund. However, not to be outdone by the escalator clauses in currently much mooted collective bargaining agreements, the Toledo city fathers have

thoughtfully provided, "recognizing the instability of conditions," that for each one point increase in the "BLS Consumers Price Index" during certain base periods stipulated in the Ordinance, \$100,000 shall be appropriated to the General Fund. Toledo officials do not intend to be caught in the second five year period of their income tax with shortages in operating funds and surpluses for debt retirement.

RECIPROCITY PROVISIONS ADOPTED

Also, Section 15 of the new ordinance provides an answer to the problem of multiple local income taxation by establishing reciprocity provisions. Non-residents subject to two local income taxes are permitted to deduct from their Toledo tax liability up to fifty per cent of the total Toledo tax for like taxes paid to their city of residence. This deduction is subject to the provision that the other city must include in its levying ordinance a similar provision. In addition to this reciprocal deduction for non-residents, Section 15 provides that residents of Toledo subject to a local income tax on earned income earned outside Toledo may deduct from the Toledo tax the tax paid outside to the extent of the Toledo tax attributable to such earnings. This provision is analogous to that included in the second Dayton ordinance.⁵⁹ Thus Toledo, without any action by the State of Ohio, has provided an equitable means of handling the problem of multiple territorial local income taxation. This problem will be discussed on a comparative bases in Chapter IX.

⁵⁹ Dayton Ord. No. 16922, Sec. 17

It would appear that the Toledo income tax is working and that it is a reasonably satisfactory supplemental means of solving the financial problems of a large urban center.

CHAPTER VI

THE CITY INCOME TAX OF COLUMBUS, OHIO

After utilization of local income taxation by Toledo, Ohio had demonstrated that such a tax could be levied and collected with a reasonable degree of success in Ohio, Councilman Henry Koontz and Auditor R. P. Barthalow of the City of Columbus made a study of the Toledo tax with a view to its adoption by the City of Columbus and submitted a report on the subject to the Columbus City Council on November 13, 1947.¹ This report analyzed the Toledo experience with local income taxation and recommended that in the event Columbus adopted the tax that the following deviations from the Toledo system be made, as follows: (1) that employers be required to submit quarterly rather than monthly withholding returns and payment of taxes rather than monthly withholding returns as had been the original practice under both the Toledo and the Philadelphia taxes,--it being felt that monthly reporting and payment was an unnecessary hardship on reporting employers; (2) that the penalty for delinquent and unpaid taxes be raised from the Toledo rate of $\frac{1}{2}$ of 1% for each month of delinquency in addition to the basic penalty rate of 6% per annum to a higher penalty rate by adding the following after the comma in the fifth line of Section 10 of Toledo Ordinance No. 18-46: "and the taxpayer upon whom said taxes are imposed shall be liable in addition

¹ Barthalow, R. P., and Koontz, Henry, "Report to the Mayor and City Council of Columbus, Ohio," unpublished mimeo, 1947, Files of City Auditor of Columbus, Ohio

thereto, to a penalty of five per cent of the amount of unpaid tax for the first full month or fraction of month of delinquency in the payment of tax; a penalty of ten per cent of the unpaid tax for the second full month or fraction of month of delinquency in the payment of the tax and a penalty of fifteen per cent per month or fraction of month of delinquency per month or fraction of month of delinquency in the payment of the tax for the next four months the tax was due and unpaid,"²-certainly a stiff penalty recommendation; (3) the Barthalow Report further suggested that, While the Toledo ordinance provided for a Board of Review composed of the Director of Law, the Director of Finance and the City Auditor, it would be desirable on a comparable Board in Columbus to include the City Attorney, a member of the City Council Finance or Judiciary Committee, and a representative citizen not connected with the City in any other official capacity to be appointed by the Mayor and to be compensated on a per diem basis. The report concluded that, "At the present time, we recommend no further changes be made for a Columbus ordinance."

While city officials originally considered the levy of a one (1) per cent income tax on the Toledo model with the above exceptions, it would seemed that support for the proposal appeared more available for a $\frac{1}{2}$ of 1% levy,² there being some feeling that the City should set its proposed tax rate in terms of expenditure needs rather than adopting a 1%^{tax}/rate and tailoring spending to utilize all of the resulting revenues. It should be noted that

² Cf. Peelle, H. M., op. cit., p. 47 et seq, particularly at 64.

this time, the City had several notable outstanding General Fund obligations including approximately \$1,387,000 due on back pay claims of city employees resultant from withholdings of pay during the period from February 1, 1931 to February 28, 1937; an estimated amount for settling some 115 stream pollution suits resulting from damage to the property rights of downstream riparian owners by improperly treated Columbus sewage of from \$70,000 to \$120,000; also approximately \$200,000 due the public employee retirement system funds.³

ADOPTION OF COLUMBUS INCOME TAX

The Columbus City Income Tax, Ordinance No. 658-47,⁴ was enacted November 28, 1947, to be effective January 1, 1948 and to continue in effect until December 31, 1952. Section 2 of the Ordinance, which levies the tax, reads as follows:

"To provide funds for the purposes of the retirement of certain debt, general municipal operations, deferred maintenance and capital improvements of the City of Columbus, there ~~be~~ and hereby is levied a tax at a rate of one half ($\frac{1}{2}$) of one (1) per centum per annum upon the following:

- (1) On all salaries, wages and other personal service compensation earned after January 1, 1948 by residents of the City of Columbus.
- (2) On all salaries, wages and other personal service compensation earned after January 1, 1948, by nonresidents of the City of Columbus for work done or services performed or rendered in the City of Columbus.
- (3) On the net profits earned after January 1, 1948, of all unincorporated businesses, professions or other activities conducted by residents of the City of Columbus.

³ Ibid., p. 58; also information in files of Citizens Research, Inc., 50 E. Broad Street, Columbus, Ohio.

⁴ "City of Columbus, Ohio, Income Tax Regulations and Ordinance No. 658-47; Regulations Promulgated by the City Auditor and Approved (cont.)"

(4) On the net profits earned after January 1, 1948 of all unincorporated businesses, professions, or other activities conducted in the City of Columbus by nonresidents.

(5) On the net profits earned after January 1, 1948 by all corporations having their principal place of business in the city of Columbus or an office or place of business in the city of Columbus, said tax being levied on such part of the net profits as is earned by such corporations as a result of work done or services performed or rendered and business and other activities conducted in the city of Columbus.

(6) On that portion of the gross receipts of non profit organization engaged in business activities similar to those in which profit corporations and other taxpayers under this ordinance are engaged, remaining after the deduction of 1. all costs and expenses of doing business, including reserves for depreciation and bad debts and 2. patronage dividends paid in cash within ninety days after the close of the taxpayer's calendar or fiscal year with respect to which such refunds are made.

For the purposes of sub paragraph 6, the term "non-profit organizations" means corporations, associations and other similar organizations including, ~~but~~ not by way of limitation, corporations organized under authority of Section 10186-1 to 10186-30 both inclusive of the General Code of Ohio.

The portion of the entire net profits of a taxpayer to be allocated as having been made within the city of Columbus, may, in the absence of actual⁵ records thereof, be determined as follows:

(a) Multiply the entire net profit by a business allocation percentage to be determined by-

1. Ascertaining the percentage which the average value of the taxpayers real and tangible personal property within the city during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period.

2. Ascertaining the percentage which the gross receipts of the taxpayer derived from business within the city of Columbus during the period covered by the report bear to the total gross receipts wherever derived.

⁴ (continued from p. 155.) by the Board of Appeals," November 8, 1948, p. 18; hereinafter cited herein as "Cols. Ord." or "Cols. Regs." as appropriate.

⁵ Emphasis added by the writer.

3. Ascertaining the percentage which the total wages, salaries and other personal service compensation during the period covered by its report of employees within the city, except general executive officers, bears to the total wages, salaries and other personal service compensation of taxpayer's employees within and without the city, except general executive officers; and

4. Adding together the percentages determined in accordance with subparagraphs 1, 2 and 3 above, or such of the aforesaid percentages as shall be applicable to the particular taxpayer's business, and dividing the total so obtained by the number of percentages used in deriving said total.

(b) Provided, however, that in the event a just and equitable result cannot be obtained by the use of the factors contained herein, the Board of Appeals shall have the authority to substitute factors calculated to effect a fair and proper allocation."⁶

COMPARISON OF TOLEDO AND COLUMBUS INCOME TAXES

The ordinance as adopted by the City of Columbus followed the Toledo pattern very closely.⁷ The main differences between the taxes of the two cities are as follows:

- (1) The rate differential, Toledo - 1%; Columbus - $\frac{1}{2}$ of 1%.
- (2) The taxing under the Columbus ordinance of the net receipts of non-profit organizations including, "but not by way of limitation,"⁸ corporations organized under G.C. 10186-1 to 10186-30., generally known as the Ohio cooperative marketing act. Thus, cooperatives are covered by the Columbus City Income Tax. The tax base for such organizations is gross receipts less costs and expenses and those patronage dividends paid within ninety days after the close of the tax year.
- (3) While under the Toledo tax, the allocation formula is applicable and permissible whether or not the taxpayers books show a better basis for allocation;⁹ under the Columbus ordinance, the allocation formula is appropriate only where actual records do not afford a basis for the breakdown of net profits subject to the tax. In this connection, it is noteworthy that to date no appeals to the Board of Review from the incidence of the formula have been made under the Columbus tax.¹⁰

⁶ Cols. Ord. Sec. 2.

⁷ For a meticulous, painstaking, word for word comparison of the two ordinances, cf. Peele, op. cit. supra., p. 75 et seq.
(continued on p. 158.)

- (4) The provision for quarterly reports¹¹ of withholding by employers rather than monthly withholding reports as originally provided by the Toledo Ordinance.¹²
- (5) The Columbus ordinance provides affirmatively that while information obtained as a result of the administration of the tax is confidential and disclosure is subject to penalty, copies of tax returns may be furnished to the U.S. Bureau of Internal Revenue.¹³
- (6) The Columbus ordinance provides for a tentative assessment of tax due in cases of nonpayment and provides that proof of mailing an assessment notice to the last known address of the taxpayer shall be presumptive proof of the receipt of notice by the addressee. After receipt, actual or presumed, the taxpayer is allowed twenty days to file a protest; if no protest is made within the prescribed period, the proposed assessment becomes final and the final assessment must be served on the taxpayer by mail; after which the taxpayer has thirty days to appeal to the Board of Appeals.¹⁴ This provision spells out the procedural rules for taxpayers' remedies in much greater detail than is done in the Toledo ordinance.
- (7) Section 14 of the Columbus ordinance sets up a Board of
8 Columbus Ord. Sec. 2 (6).
- 9 Toledo Ord. Sec. 3 (5-a).; Toledo Regs. Art. II-6 (1).
Ordinance 689-50, Sec. 3-6 provides that the income allocation formula is mandatory with the exception of income from finance, investment, or construction activities in which cases separate accounting is required.
- 10 Interview with Mr. D. S. Swisher, Chief, Income Tax Division, City of Columbus, Ohio, February 6, 1951.
- 11 Columbus Ord. Sec. 5.
- 12 The City of Toledo shifted to a quarterly withholding report system by adopting Ord. 234-46, July 15, 1946.
- 13 Columbus Ord., Sec. 10.
- 14 Columbus Ord., Sec. 9.

Appeals consisting of a citizen of Columbus who is Chairman of the Board and is appointed by the Mayor, the City Treasurer and the City Attorney. This Board acts as an appellate reviewing authority. It passes on appeals from the assessments made by the City Auditor; must approve tax regulations prior to their becoming effective; and is authorized to hear and determine appeals from the incidence of the income allocation formula. There is no citizen representation on the Toledo Board.

(8) In addition, the Columbus ordinance provides for the specific exemption of certain types of income from the tax. Section 16 of the Ordinance reads as follows:

- "1. Funds received from local, state or federal government because of service in the Armed Forces of the United States by the person rendering such service or as a result of another person rendering such service.
2. Poor relief, old age pensions or similar payments including disability payments received from local, state or federal governments, or charitable, religious or educational organizations.
3. Pensions, disability benefits, annuities or gratuities from whatever source derived.
4. Dues, contributions and similar payments received by charitable, religious, educational organizations or labor unions, trade associations, lodges and similar organizations.
5. Receipts from casual sales and seasonal or casual entertainment, amusements and sports events and health and welfare activities conducted by bona fide charitable, religious and educational organizations and associations.
6. Personal earnings of all persons under eighteen (18) years of age." This provision seems justified on both equitable and administrative grounds. It should also be noted that income from intangible property subject as it is to taxation by the State of

Ohio is not included in the definition of net profits earned.¹⁵

(9) Perhaps the most significant difference between the Toledo ordinance and the Columbus ordinance lies in the distinctly different provisions for the allocation and expenditures of income tax revenue. While the City of Toledo established a rigid system of expenditure priorities on a five year basis in its first tax ordinance,¹⁶ the correlative provisions of the Columbus ordinance are noteworthy for their vagueness and flexibility.¹⁷ There is no firm preconceived expenditure pattern in the Columbus ordinance; there is nothing to prevent City Council from making token appropriations for the various past due items and for deferred maintenance purposes and then appropriating the balance of income tax revenue to the General Revenue Fund. This being the case, Section 15 may

15 Columbus Regs. Art. II-10 (1).

16 Toledo Ord. Sec. 14; Cf. p. 122 supra.

17 Columbus Ord. Sec. 15 reads as follows:

"Allocation of Funds. The funds collected under the provisions of this ordinance shall be applied for the following purposes, and in the following order, to-wit:

1. Such part thereof as shall be necessary to defray all costs of collecting the taxes levied by this ordinance and the cost of administering and enforcing the provisions hereof.
2. Such part as Council may from time to time appropriate for the settlement and compromise of city employees back pay
3. Such part as Council may from time to time appropriate for the ~~settlement~~ repair and maintenance of the streets.
4. Such portion of the revenues which Council does not appropriate for the above purposes shall be placed in the General Revenue Fund for the purposes thereof.
5. Such part as Council may declare as surplus shall be placed in a Capital Improvement Fund.

2. (cont.) claims and pollution suits brought against the city.

be regarded as lip service rather than as an expression of a positive expenditure program. However, if dissatisfaction with expenditure policy exists the basic remedy remains at the ballot box.

After adoption of the income tax by City Council and approval by the Mayor on November 28, 1947, referendum petitions were circulated under CIO sponsorship and were filed in January, 1948;¹⁸ a special election was held June 8, 1948. It will be noted that the tax had been in process of collection for sometime by the date of this election and that presumably the novelty and perhaps the initial irritation of the levy had become somewhat blunted by time. Mr. Peele has analysed the pro-tax newspaper publicity in some detail in his study of the Columbus tax and has noted that it was uniformly in favor of adoption.¹⁹ The tax was approved by a 58.8% majority.²⁰ Accordingly, Columbus had its tax, being the second large Ohio municipality to adopt this type of local non-property tax.

On July 12, 1948, the Columbus City Council provided for a separate "Income Tax Fund."²¹ This tardy enactment complied with the provision of General Code 5625-9 which requires political subdivisions including municipalities to establish a separate fund for each class of revenue derived from a source other than the

¹⁸ G.C. 4427-12

¹⁹ Peele, Op. cit., p. 71-73.

²⁰ "Referendum Vote," The Columbus Citizen, June 9, 1948, p. 1. It will be noted, parenthetically, that "58%" is one figure that crops out in conversations with Columbus city officials. (continued on p. 162.)

general property tax. Having thus complied with the requirement for a special fund, Council proceeded to appropriate from the fund so established. The pertinent portion of Ordinance Number 593-48, also passed July 12, 1948, also passed July 12, 1948, reads as follows:²²

"Section 1. That City council deems it necessary to allocate and does hereby allocate from said income tax funds the amounts designated for the purposes set forth hereinbelow:

1. The sum of \$23,721 for the purpose of defraying the cost of collecting, administering and enforcing the said income tax during the year 1948.

2. The sum of \$1000.00 for the settlement and compromise of city employees' back pay claims and the sum of \$35,000.00 for the settlement and compromise of pollution suits brought against the city. (Emphasis added.)

3. The sum of \$1000.00 for the repair and maintenance of streets.

Section 2. That the sums hereinabove allocated from said income tax funds are hereby appropriated to the General Fund for the purpose of paying said amounts, and there is hereby further appropriated the sum of \$1,814,279.00 to the General Fund for the purposes thereof."

This ordinance indicates the extreme flexibility of Section 15 of the Columbus Tax Ordinance; allocation of funds in only token amounts satisfies the vague expression of expenditure priorities. Thus, the balance of income tax revenue goes into the General Fund and is not necessarily expended for the expressed objectives of the ordinance as passed. With expenditure priorities vitiated so easily, it is a simple matter to utilize income tax revenue for current operations rather than allocating it to clearing up back claims against the city. The experience of the City of Toledo

²¹ Cols. Ord. No. 592-48, 21, ~~Cols. Ord.~~, The (Columbus, Ohio) City Bulletin, 33, No. 8 (July 17, 1948), p. 397.

²² Cols. Ord. 593-48, Ibid., p. 397.

which was directed by a firm mandatory expenditure plan for the first five years of city income taxation indicates, from a practical standpoint, a better solution which puts first priorities first.²³ When city income taxes are initiated in response to an accumulation of back claims, the Columbus experience as evidenced by this ordinance would appear to indicate the desirability of including a rigid expenditure plan in the ordinance.

COLUMBUS TAX: REVENUE YIELD AND ADMINISTRATION

As a revenue measure, the Columbus city income tax, like similar levies in Philadelphia, Toledo and elsewhere, has been an efficient revenue producer. Table XIII indicates the annual yield for the period from 1948 through 1950 and the relation of income tax revenue to General Fund Revenue Receipts. As the tax is administered in Columbus, no attempt is made to classify income tax revenue with respect to the year the income upon which the tax is levied is earned or accrues and the year the tax liability accrues,--city records merely indicate revenue received in the year in which it is received by the City, so that as a result, revenue data in Tables and Schedules concerning Columbus can give no information as to the tax derived from total taxable income of any particular year, unless it be assumed that the overlap between the year in which tax liability accrues and the year in which payment is made is substantially equal from year to year.

In any event, the yield from the tax has been substantial.

²³ Cf. Chapter V, supra. p. 122

Schedules 1 and 2 give a more detailed picture of revenue receipts and indicate, as might be expected, that the largest single source of income tax revenue is employee withholding. Schedule 1 also indicates that disbursements, differing from the Toledo practice, have been made chiefly to the General Revenue Fund.

Schedule 3 shows the number of taxpayers by type. Unfortunately, the number of individual taxpayers paying under the withholding provisions of the ordinance is not available. City officials have not taken the time or money to break down employers reports so as to obtain the exact number of individuals paying the wage tax. Any such figure would be little better than a rough estimate due to labor turnover and constantly changing employment; however, it is unfortunate that this data is not available so as to afford some indication of compliance.

Table XIV indicates the administrative and collection costs of the Columbus income tax. It will be observed that in all three years that the tax has been collected to date, costs of collection have been in excess of 4% of the revenue yield of the tax. The figures for 1948 and 1949 may be discounted as being affected by the cost of organizing and also by uncertainty as to the validity of the levy. If it is assumed that the 1950 figures give an accurate indication of the cost of collection, it would appear that the Columbus tax is a rather high cost one. 4.778% is rather high even though not unreasonable. However, it must be recalled that Toledo, levying a 1% rather than the $\frac{1}{2}$ of 1% rate of the Columbus tax, has a cost of collection of

TABLE XIII

INCOME TAX REVENUE, TOTAL GENERAL FUND REVENUE RECEIPTS, AND INCOME TAX REVENUE AS A PERCENTAGE OF TOTAL GENERAL FUND REVENUE RECEIPTS, CITY OF COLUMBUS, OHIO, ANNUALLY, 1948-1950

(revenue in thousands of dollars)

<u>Year</u>	<u>Income Tax Revenue</u>	<u>Total General Fund Revenue Receipts</u>	<u>Income Tax Revenue As A Percentage Of Total General Fund Revenue Receipts</u>
1948	\$2,074	\$6,143	33.76
1949	3,067	7,178	42.72
1950	3,053	7,490	40.76

SOURCE: Annual Reports, City Auditor, City of Columbus, Ohio, 1948-1950.

TABLE XIV

INCOME TAX REVENUE, INCOME TAX ADMINISTRATIVE COSTS, INCOME TAX ADMINISTRATIVE COST AS A PERCENTAGE OF INCOME TAX REVENUE, CITY OF COLUMBUS, OHIO, ANNUALLY, 1948-1950

<u>Year</u>	<u>Income Tax Revenue</u>	<u>Income Tax Administrative Cost</u>	<u>Administrative Cost as a Percentage of Income Tax Revenue</u>
1948	\$2,073,555.79	\$ 85,563.46	4.126
1949	3,067,205.38	135,259.06	4.409
1950	3,052,992.28	145,875.42	4.778

SOURCE: Annual Reports, City Auditor, City of Columbus, Ohio, 1948, 1950; Administrative Cost Data furnished by Mr. R. P. Barthalow, City Auditor.

SCHEDULE 1

RECEIPTS AND DISBURSEMENTS-1948 and 1949

	<u>1948</u>	<u>1949</u>
Balance December 31, 1948		\$ 19,476.56

RECEIPTS

D1 Payments with Declarations	\$ 312,375.58	\$ 309,778.48
Q1 Quarterly Payments on Declarations	389,299.68	362,112.22
IR Annual Information Returns		213,616.53
W1 Withholding Returns	1,352,125.16	1,950,669.55
BRF Fiscal Year Returns	11,145.58	228,376.04
TOTAL NET RECEIPTS	\$2,072,946.00	\$3,054,552.82

REFUNDS BASED ON:

D1 Payments with Declarations	391.65	14.27
IR Annual Information Returns		33.40
Q1 Quarterly Information Returns	209.70	184.33
W1 Withholding Returns	8.44	452.46
Miscellaneous		11,968.10

TOTAL REFUNDS	\$ 609.79	\$ 12,652.56
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TOTAL RECEIPTS	\$2,073,555.79	\$3,067,205.56
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TOTAL RECEIPTS & BALANCE	\$2,073,555.79	\$3,086,681.94
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DISBURSEMENTS

To General Fund for Street Repair	\$ 1,000.00	1,000.00
General Fund for Judgments	35,000.00	45,000.00
General Fund for Administration and Collection of Tax	23,721.00	16,750.00
General Fund	1,992,748.44	2,745,250.00
Refund of Revenue		822.57

TOTAL DISBURSEMENTS	\$2,815,822.57
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BALANCE, DECEMBER 31, 1949	\$ 270,859.37
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SOURCE: Annual Report of City Auditor of Columbus, Ohio, 1949, p. 18, Sch. 2.

SCHEDULE 2

CITY INCOME TAX COLLECTIONS BY TYPE OF PAYMENT, COLUMBUS, OHIO,
1950

RR Forms of Corporations-Partnerships Joint Ventures & Fiduciaries	\$ 174,633.35
IR Forms of Individual Proprietorships, Individual Professionals and all other Individuals with taxable income not subject to withholding	258,501.46
DI Forms; Advance Payments of Estimated Tax from all classifications of taxpayers with income not subject to withholding	304,394.49
W-1 Forms: Tax withheld by Employers from employees compensation	2,015,192.73
Q-1 Forms Collections by statements from all classifications of taxpayers with income not subject to withholding.	233,457.54
Total	<hr/> \$2,986,179.57

Revenue to December 7, 1950.

SOURCE: Letter Report of City Auditor to City Council; December 7,
1950.

SCHEDULE 3

**NUMBER OF TAXPAYERS BY TYPE OF TAXPAYER SUBMITTING COLUMBUS CITY
INCOME TAX RETURNS AS OF DECEMBER 7, 1950
AND AS OF APRIL 15, 1951**

Corporations	2,397	2,480
Partnerships, Joint Ventures and Fiduciaries	2,031	2,214
Individual Proprietorships, Individual Professionals, and all other Individuals with income not subject to withholding	70,249	60,419
Employers Withholding Returns	10,524*	9,621
TOTAL	85,201	74,734

* Information not available as to number of employees paying tax under withholding provisions of the Ordinance.

SOURCE: Letter Report of City Auditor to City Council of Columbus, Ohio, December 7, 1950; 1951 information furnished by City Auditor.

2.9%,²⁴ and that Louisville, Kentucky has a cost of collection rate of 1.7%,²⁵--thus, noting that part of the increased Columbus cost may be due to maintenance of substantially the same organizational set-up as would be required for a higher rate tax, current cost appears rather high.

1950 cost of collection expenditures included \$122,500 for salaries, \$19,500 for supplies, \$13,500 for equipment as the principal cost items.²⁶ At present, the Columbus Income Tax Division is composed of forty-eight employees,²⁷ including the following:

<u>Position</u>	<u>Employees</u>
Chief of Section	1
Assistant to Chief	1
Field Auditors	4
Office Auditors	4
Investigators	7

The balance of the employees are clerical personnel.

Schedule 4 indicates the current salary schedule applicable to these employees and to certain other selected city employees.

It is questionable if salaries at levels established by the Ordinance which established this salary schedule will attract and hold satisfactory personnel. Problems of this type are certainly not peculiar to the City of Columbus; currently city officials are

²⁴ Cf. Chapter V, *supra.*, p. 136.

²⁵ Letter to the writer from Mr. Thomas Graham, President, Commissioners of the Sinking Fund of the City of Louisville, Kentucky, dated June 17, 1951.

²⁶ Data furnished by Mr. R. P. Barthalow, Interview, February 7, 1951.

²⁷ Information furnished by Mr. D. S. Swisher, (continued p. 171.)

SCHEDULE 4

**SALARY SCHEDULE FOR EMPLOYEES INCOME TAX DIVISION CITY OF COLUMBUS,
OHIO AND FOR CERTAIN SELECTED OTHER EMPLOYEES, CITY OF COLUMBUS,
OHIO, ESTABLISHED BY ORDINANCE 65-51, EFFECTIVE JANUARY 1, 1951**

<u>Title</u>	<u>MONTHLY SALARY</u>		
	<u>First Year</u>	<u>Second Year</u>	<u>Third Year</u>
Chief, Division of Income Tax	\$367.00	\$383.00	\$400.00
Assistant to Chief	306.00	317.00	328.00
Field Auditor	273.00	284.00	295.00
Investigator	251.00	257.00	268.00
Office Auditor	225.00	235.00	245.00
Senior Processor	220.00	230.00	240.00
Processor	180.00	190.00	200.00
Clerk (rate per hour)	1.15	1.15	1.15
Unskilled Labor (rate per hour)	1.09	1.09	1.09
Switchboard Operator	295.00	304.00	313.00
Senior Legal Stenographer	235.00	245.00	255.00
Patrolman	282.00	287.00	300.00
Golf Pro-Golf Course Manager	328.00	339.00	350.00
Garbage Furnace Operator	246.00	251.00	257.00
Assistant City Attorney	380.00	398.00	417.00

SOURCE: Ordinance 65-51, passed January 23, 1951, effective January 1, 1951, The (Columbus, Ohio) City Bulletin, 36, No. 5 (February 3, 1951), p. 67.

of the opinion that present salaries are adequate. In the face of the increased demand for trained personnel resulting from the current defense effort, this opinion may prove over-optimistic. In addition, referring to Schedule 4, the question may at least be raised as to whether an office auditor is worth less than a switchboard operator or for that matter the city golf "pro" or the garbage furnace operator?

Turning to the subject of administration and compliance, it has been estimated that presently there is about 80% compliance on the part of individuals and corporations subject to the tax.²⁸ It should be noted that individual taxpayers subject to withholding of the tax from earned income have little opportunity for evasion.

While the Income Tax Division has instituted no formalized audit program, returns are given a preliminary audit for arithmetical errors and obvious commissions prior to posting to individual ledger cards. In the period, 1948-1949, a sample of 12,000 individual returns were audited, the principal operational result being a number of informal adjustments. According to D. S. Swisher, about 50% of corporate returns are audited currently. Presumably the audit program will be expanded as time goes on.

As far as prosecutions are concerned, 37 affidavits have been filed to the end of 1950. Of these 37 suits, 14 were filed against employers for failure to remit taxes withheld from employee earnings. In the 14 cases against remiss employers, the city obtained judgments in 13 cases. The remaining case was dismissed as the
27 (continued from p. 169.) Chief, Columbus Income Tax Division.
28 Confidential source.

judgments in 13 cases. The remaining case was dismissed as the defendant had withheld as an individual employer and then subsequently incorporated and paid the withheld tax to the City as a corporation. The City did not note this fact until the enforcement hearing, at which time, when the facts became apparent, dismissal was requested.²⁹

The City has instituted 23 actions of a criminal nature (misdemeanor) against individual taxpayers for failure to file returns and has obtained 23 convictions. It is submitted that this a rather minute enforcement program even considering the practical problems including the maintenance of political standing and goodwill for the incumbent administration at City Hall.

Several aspects of the collection and enforcement problem are cited in the following extract from a report of Mr. R. P. Barthalow, Columbus City Auditor to the City Council, as follows:

"Since August 31st (1950) we have obtained approximately 2000 delinquent returns from individuals. A large percentage of these delinquent returns were obtained during the month of August at which time the Criminal Division of the Municipal Court was giving accurate and full consideration to the evidence presented in each case where it had been necessary to file affidavits for the arrest of persistent and wilful violators of the income tax ordinance. We feel that since October 1st such impartial consideration has not been forthcoming and as a result, our efforts to impartially administer the provisions of the income tax ordinance in fairness to all taxpayers has been seriously handicapped and many thousands of dollars of delinquent income tax money which should have been collected still remain outstanding. ~~These delinquent taxes will eventually be collected still remain outstanding.~~ These delinquent taxes will eventually be collected but at an increased and unnecessary high administrative cost to the city.

Section 11 of the income tax ordinance provides for a penalty of

²⁹ Information furnished by Mr. D. S. Swisher.

10% of the amount of unpaid tax and the assertion of interest on such unpaid tax at the rate of one-half of one per cent per month.

Section 13 of the ordinance provides for a fine of not more than \$100.00 against those taxpayers who shall have been found guilty for a first offense of wilfully failing, neglecting or refusing to pay the tax.

It is quite evident that in adopting the aforementioned section of the ordinance it was the purpose of Council to penalize all taxpayers who failed to timely pay their Columbus Income Tax obligations by the assertion of penalty and interest and to see to it that those taxpayers who wilfully failed, neglected or refused to pay the tax would, upon conviction, be subject to fine.

It is no pleasant duty for an official to have to file affidavits against taxpayers for wilful refusal to comply with the provisions of the income tax ordinance and certainly such procedure should never be resorted to until all other reasonable means to collect the delinquent tax have failed. However, Council has imposed upon the City Auditor the responsibility to impartially administer the Columbus Income Tax Ordinance and if the City Auditor should fail to make every effort to collect delinquent tax, he must then be adjudged remiss in his duty and unfair to those thousands of Columbus Income Tax payers who pay their income tax when it is due.

Council has likewise imposed certain duties upon the judges of the Municipal Court in connection with the provisions of the Columbus Income Tax and any judge who sits in judgment on income tax violators must be measured by the same yard stick as is the City Auditor.

At no time has the Columbus Income Tax Division resorted to the filing of affidavits for the arrest of income tax violators until every possible effort has been made to collect the delinquent tax. When these efforts have been exhausted, the affidavits for arrests have been filed.

During the third quarterly term of the Criminal Division of the Municipal Court with Judge Fred Donnally on the bench, the Columbus Income Tax Division filed affidavits for the arrest of eight persons who were alleged to have wilfully violated the provisions of the income tax ordinance.

Seven of these persons were found guilty by the Court. One of the seven was fined \$100.00 and costs, and the fine and costs were paid by the defendant. Five of the defendants were fined \$25.00 and costs and in four of the cases the fines and costs were paid. In one case we recommended suspension of the fine for the reason

that evidence was introduced to show that the defendant had been ill during all of the time of delinquency and unable to attend to business. One defendant was never apprehended by the police for the reason that he had left the city for parts unknown.

In view of the fines which were asserted by the Court and collection made of these fines, it is quite evident that the Court gave due consideration to the evidence presented in each case.

After these convictions were obtained, several hundred delinquent taxpayers voluntarily submitted returns and immediately made payment of the tax shown to be due thereon. These collections were made without unnecessary administrative costs to the city.

During the present term of the Criminal Division of the Municipal Court starting October 2nd and with another judge on the bench, sixteen persons have come before him charged with wilfully violating the provisions of the Columbus Income Tax ordinance. In each case we have proven our charge and this is best evidenced by the fact that in each instance the Court has imposed a fine of \$25.00 and costs but then suspended both the fine and the costs.

In rendering these decisions the Judge announced from the bench that when any taxpayer who came into court and presented receipts showing that he had paid his delinquent tax subsequent to the filing of the affidavit for his arrest because of wilful violation of the income tax ordinance, no fine would be collected from him, even though he were found guilty of the violation. This statement was made by the Court after evidence had been presented showing that in one instance the income tax division had three times mailed delinquent notices to the defendant and that upon five separate occasions an investigator for the division had called upon the defendant at his place of business endeavoring to make collection of the delinquent tax and thus avoid the necessity of prosecution. The evidence also showed that the defendant had used abusive language to the investigator and had positively refused to comply with the provisions of the law.

This announced policy by the Court of refusing to fine a delinquent taxpayer against whom it had been necessary to file an affidavit in order to make collection of delinquent tax and irrespective of all the surrounding circumstances, has, in my opinion, seriously impeded income tax collections. In some instances delinquent taxpayers have taken the attitude that they would withhold their payments of the income tax until such time as they were brought into court and that then any fine which might be imposed upon them by the Court would be suspended.

If this attitude on the part of the court is to be continued, a successful administration of the Columbus Income Tax would be an

impossibility. The only incentive that income taxpayers would have to pay their income tax when due would be that of good citizenship and the full realization of their moral and civic responsibilities.

Under the present circumstances no more affidavits for the arrest of persistent income tax violators will be filed until after January 1, 1951."³⁰

This rather lengthy statement indicates a continuing enforcement problem, particularly in view of the psychological impact of a few convictions upon the behavior of delinquent taxpayers. One can understand the view of the Court that suspended sentences predicated upon compliance with the tax are fair; on the other hand, one can equally well appreciate the Auditor's point that such action has an adverse effect upon compliance. As in most such conflicts, the middle ground is the proper solution. Currently, with a different Judge on the bench, this problem has been much reduced.³¹ It would appear that a more vigorous program on the part of the Income Tax Division, the Assistant City Attorney in charge of income tax prosecutions and reasonable appreciation on the part of the Court of the problems implicit in the situation, might yield better tax compliance. It is to be noted that under prevailing Columbus procedure, criminal type prosecutions are the prevailing enforcement technique. While civil suits are more time consuming, such action is a possible alternative.³²

In summary, it may be pointed out that the Columbus tax is

³⁰ Letter Report of R. P. Barthalow, City Auditor to City Council, December 7, 1950.

³¹ Interview with Mr. R. P. Barthalow, June 11, 1951.

³² On the Springfield procedure, cf. Chapter VII, p. 188.

substantially similar to other city income taxes; that it has resulted in substantial increases to city revenue, which increases have been allocated principally to general operations of city government; that the cost of collection while not unreasonable is relatively high; and finally, that enforcement to date leaves something to be desired. Further evaluation will be postponed until Chapter X.

CHAPTER VII

THE CITY INCOME TAX OF SPRINGFIELD, OHIO

The City of Springfield, Ohio adopted a 1% income tax, similar in both form and substance to those previously discussed and modeled in the main upon the ordinances of Toledo and Columbus,¹ on May 24, 1948 for a five year period. The effective date of the ordinance was June 24, 1948; it levied a tax on the earned income of individuals and upon the net profits of corporations, associations and businesses earned after June 30, 1948.² The moving force for adoption of this form of local taxation appears to have resulted from unpaid bills and overdrafts on operating funds. The following statement by former City Auditor Mark O. Armstrong indicates the "financial plight" of the City of Springfield prior to the adoption of its local income tax:

" . . . I wish to point out our financial plight before the enactment of our Income Tax Ordinance, effective as of July 1, 1948:

- (1) Improper but necessary overdrafts, if the City were to function at all, together with unpaid bills which were years past maturity amounted to substantially more than \$800,000.00 as of June 30, 1948. Some indication of the situation is the fact that on said date, the entire cash resources of the City amounted to only \$184,000.00, whereas, the definitely earmarked Water Works Fund (independently) of all other expenditure restricted funds carried a book balance of over \$350,000.00.

¹ Interview with Mr. Mark O. Armstrong, then City Auditor of Springfield, Ohio, February 8, 1951.

² Springfield Ordinance No. 4741, published in "The Springfield (O.) Sun," May 27, 1948. It may be noted that, contrary to the prevailing practice of issuing printed (continued on p. 178.)

- (2) The personnel complement of the Police and Fire Departments, each consisted of 66 members as of June 30, 1948. According to federal standards, each should have consisted of 110 members.
- (3) Trash collection was completely suspended.
- (4) City parks and recreation activities were virtually at a standstill.
- (5) Police and Fire Department equipment had not had any replacements for many years.
- (6) Street and Sewer Cleaning and Maintenance equipment ranged from 8 to 10 years of age.
- (7) Every municipal activity, both operative and administrative, was materially curtailed in scope.
- (8) There had not been a major paving, sewer, sidewalk or similar improvement for several years, due mainly to the inability of the City to finance its minimum legal share.
- (9) Salaries and wages were wholly incommensurate with those paid in private enterprise, with the result that **turn-over** in personnel was extraordinarily high with respect to both operating and administrative employees."³

This statement presents the situation prior to the adoption of the tax.

PROVISIONS OF SPRINGFIELD INCOME TAX ORDINANCE

Turning to the provisions of Ordinance 4741, it, in the main, follows the pattern previously developed by Toledo and Columbus and for that reason will not be elaborated upon. It differs from the ordinances of those two cities in that a separate income tax fund is provided for specifically in the ordinance itself.⁴ It

² (continued from p. 177.) pamphlet form tax ordinances and regulations in the form of page extracts from local newspapers.

³ Extract from statement enclosed with letter from City Auditor Mark O. Armstrong to the writer, dated August 19, 1950.
(continued on p. 179.)

will be recalled that in the case of Columbus, a separate ordinance was passed after the tax was adopted establishing a separate income tax fund.⁵ More significant is the inclusion in the Springfield tax ordinance of an "exclusion" from taxable income of \$1040.00 per annum.⁶ This was, according to city officials, a concession to organized labor. Thus by means of this \$1040 "exclusion" from taxable income, the City of Springfield was the first income tax levying municipality in Ohio to forego, at least in part, the taxation of low income recipients. The equity of this provision

⁴ Springfield Ord. 4741, Sec. 8.

⁵ Columbus Ord. No. 592-48, supra. p. 162.

⁶ Springfield Ord. 4741, Sec. 15 reads in part as follows: "The provisions of this ordinance shall not be construed as levying a tax upon the following: (g) Salaries, wages, commissions or other compensation or net profits, whether earned by an individual, association, corporation or business, when the same in the aggregate, for each of the six (6) months periods constituting the last half of the calendar year of 1948 and the first half of the calendar year 1953 are not in excess of \$520.00, or when the same, in the aggregate, for each of the calendar years from 1949 to 1952, inclusive, are not in excess of \$1040; provided, however, (a) that when the aggregate of all salaries, wages, commissions or other compensation or net profits exceed the foregoing amounts for the aforesaid respective periods, the tax imposed by this ordinance shall apply to the full and actual aggregate amount of all such salaries, wages, commissions or other compensation or net profits earned during said periods."

It is interesting to observe that the Springfield "exclusion" is similar to the rate "kick-back" under the former British income tax rate structure, where, for example, an income of £ 130 was exempt but an income of £ 131 received an "abatement" of only £ 120, leaving £ 11 taxable. To mitigate the harshness of this "kick-back," the taxpayer was permitted to make a gift to the government of the margin by which his income exceeded the limit and, thus, minimize the tax.

Cf. Plehn, Carl C., "Introduction to Public Finance," New York: Macmillan Co., Fourth Edition, 1920, p. 259.

may at least be questioned for while the person with an earned income of \$1040 pays no tax, the individual with an earned income of \$1041 pays a tax of \$10.41. This **differential** treatment indicates the result of this rather arbitrary classification.

This provision has been the subject of some litigation in Springfield courts. The case of Owen Miller vs. The City of Springfield, Ohio⁷ is and has been for some time pending in the Common Pleas Court of Clark County, Ohio; the case stands on the second amended petition of the plaintiff, an answer for the city and a reply filed by the plaintiff. According to Mr. Robert C. Acton, former City Solicitor,⁸ the sole question at issue is the constitutionality of the "exclusion,"--all other questions having been disposed of by the holding of the Ohio Supreme Court in the Angell case.⁹ Had the exclusion been held unconstitutional, the saving clause of the Ordinance, Section 16, would have operated to preserve the balance of the tax ordinance.

While decision in the Miller case was held in abeyance by the Common Pleas Court, the same question was raised in the Springfield Municipal Court. On May 26, 1951, the Municipal Court of Springfield, Ohio upheld the constitutionality of the \$1040 exclusion clause contained in the Springfield Income Tax Ordinance.¹⁰ This

⁷ Owen Miller vs. City of Springfield, Ohio, N. 42130, Common Pleas Court of Clark County, Ohio.

⁸ Letter to the writer from Mr. Robert C. Acton, then Springfield City Solicitor, dated February 14, 1951.

⁹ Angell v. City of Toledo, 153 Ohio St. 179. (1950).

¹⁰ City of Springfield, Ohio vs. Vernon E. Kenney, (continued p. 181.)

decision was appealed to the Clark County Court of Appeals,-- by-passing the Common Pleas. On November 5, 1951, the Clark County Court of Appeals upheld the validity of the Springfield "exclusion as a proper act of classification."¹¹ It must be noted that in 1895, the Supreme Court of Ohio held that an exemption, similar in form to the Springfield exclusion, was unconstitutional as a violation of Section 2 of the Bill of Rights of the State Constitution.¹² This holding has not been reversed, or modified. It may well be that when, as and if the Springfield question gets to the Supreme Court, the Ferris case will be overruled or distinguished; until then the two decisions appear to conflict. From an equitable standpoint, the exclusion is obviously an extremely blunt fiscal device.¹²

The allocation of funds section of the ordinance is similar to that of Columbus rather than that of Toledo in that no rigid expenditure program for the utilization of income tax revenue is

¹⁰ (continued from p. 180.) No. 62707, Municipal Court of City of Springfield, Ohio. (1951)

¹¹ City of Springfield v. Kenney, No. 487, Clark Cty. (Ohio) Court of Appeals (1951). See Appendix IV for opinion.

¹² State ex rel Schwartz v. Ferris, 53 Ohio St. 314 (1895), further discussed in Chapter IX, infra.;

Personal tax exemptions, generally, take three forms: (1) Lump-sum, (2) continuing, and (3) vanishing. Under a "lump-sum" exemption, where the tax base exceeds the exempted amount, the entire amount is taxable. Thus, the Springfield "exclusion" is, in effect, an example of the "lump-sum" exemption. "Continuing" exemptions allow the full amount of the exemption regardless of the size of the tax base. This is the familiar exemption found in the Federal Personal Income Tax. In this instance, the value of the exemption increases as the tax base increases. The third type, the so-called "vanishing" exemption, diminishes as (continued on p. 182.)

established; rather a flexible expression of objectives is made with emphasis placed upon cleaning up unpaid bills, operating over-drafts and using the balance for general operating expenditures.¹³

¹² (continued from p. 181.) the tax base increases over the exemption figure until it finally fades away. Cf. Schultz, William J., and Harriss, C. Lowell, "American Public Finance," New York: Prentice Hall, Fifth Edition, 1949, p. 261 ff, where the "lump-sum" exemption is characterized as inequitable and rarely used.

¹³ Ord. 4741, Sec. 18, reads as follows: "The funds collected under the provisions of this ordinance shall be applied for the following purposes and in the following order, to wit:

(a) Such part thereof as shall be necessary to defray all costs of collecting the taxes levied by this ordinance and the cost of administering and enforcing the provisions hereof.

(b) Such part thereof as is necessary and appropriated for the payment of lawfully incurred unpaid bills and accounts owing by the City which accrued prior to January 1, 1948; provided that the amount required for such purpose shall be appropriated therefor from funds collected for the periods from July 1, 1948, through December 31, 1948, and for the year 1949.

(c) Such part thereof as is required and appropriated from time to time for the purpose of accomplishing, during the life of this ordinance, full restoration to the various funds of the City the amounts overdrafted from each thereof prior to January 1, 1948.

(d) Such part thereof as is appropriated from time to time for general operating expenses of the City, which amounts so appropriated shall be paid into the General Fund.

(e) Such part thereof as is appropriated from time to time for the purposes of repair, deferred maintenance, improvement and replacement of equipment other than street and sewer equipment; repair, maintenance and improvements of streets, sewers and bridges; and repair, deferred maintenance and essential improvement of buildings, including the City Hospital.

(f) Such part thereof as is appropriated from time to time for the purpose of repair, deferred maintenance, improvement, replacement and acquisition of street improvement, street cleaning, snow removal and sewer maintenance and cleaning equipment.

(g) The balance of any such funds collected under the provisions of this ordinance shall be placed in the Permanent Improvement Fund of the City and, as appropriated from time to time shall be used for essential capital improvement purposes, (continued on p. 183.)

Thus, while Section 18 of the Ordinance leaves actual expenditure allocation up to subsequent appropriation action, it sets out a system of expenditure priorities designed to improve the city financial situation during the five year period of the tax. In this connection, Section 19 of the Springfield tax ordinance is unusual in that it declares that it is the policy of the City Commission not to increase the rate of the tax and, moreover, to reduce the rate of the tax or repeal the ordinance at the earliest possible moment consistent with financial solvency.¹⁴ While this provision can hardly bind the City Commission, it is significant as an indication of tax salesmanship.

13 (continued from p. 182.)

including, without limitation, the establishment of a fund for the improvement and relocation of fire stations.

The term "appropriated" as used in this section (18) shall mean appropriations made by the City Commission in the manner required by law and the provisions of the City Charter, after public notice and hearing."

14 Ord. 4741, Sec. 19 reads as follows:

"The City Commission reserves the right to amend, supplement or repeal this ordinance at any time. Provided, however, that the City Commission in enacting this ordinance, notwithstanding any legal right vested in it to amend or supplement the provisions hereof, hereby declares certain policies which shall prevail throughout the effective period of this ordinance, namely: (a) that in no event will the rate of the tax herein imposed be increased; (b) that the Citizens Committee heretofore provided by the City Commission and which participated in the planning of this ordinance shall continue as an active body for the purpose of advising or making recommendations to the Commission with respect to any subject matter of this ordinance, including, but not limited to, the appropriation and use of funds collected under the provisions, the repeal of this ordinance or a downward revision of the rate of tax herein imposed; and (c) that in the event that taxes collected under this ordinance during the prescribed five (5) year period of imposition thereof exceed the reasonable needs and requirements of the City for the objects and (continued on p. 184.)

At the end of 1950, some reports from Springfield suggested that a reduction in the city income tax rate from 1% to $\frac{1}{2}$ of 1% might be made.¹⁵ No such rate reduction has been made and there appears a little immediate likelihood that downward rate revision will materialize.

Supplementing the ordinance, regulations were issued, similar to those issued by other Ohio levying municipalities, and published December 14, 1948.¹⁶ Springfield had its income tax, which was in the main similar to other Ohio municipal income taxes with the exception of the \$1040 "exclusion" from taxable income which is peculiar to the Springfield levy.

IMPROVED CITY FINANCIAL CONDITION

By June 21, 1950, the City Auditor could more cheerfully state the changed financial situation of the city as follows: "Since the inception of our income tax, we have been able to accomplish the following:

- (1) All overdrafts and unpaid bills have been cleared with the result that the City is now on a "pay-as-you-go" basis.
- (2) Trash collections have been fully restored.
- (3) In 1949, a street improvement program, costing approximately \$260,000.00 was accomplished at the sole cost of the city. A similar program is on the calendar for 1950 as well as a sewer extension program.

¹⁴ (continued from p. 183.) and purposes set forth in Section 18 hereof, the City Commission will, concurrently with the establishment of such excess, either upon the recommendation of said Citizens Committee or its own initiative, repeal this ordinance or provide for a downward revision of said tax rate as the case may require."

¹⁵ "Springfield Considering 'Modest Cut' in Income Tax," The Columbus Dispatch, December 7, 1950, page 12-A, c 1.

¹⁶ The Springfield (Ohio) Daily News, December 14, 1948.

- (4) Nine (9) members have been added to the Police Department and nineteen (19) to the Fire Department.
- (5) Recreation activities have been restored to normal and those of the Health Department have been materially augmented.
- (6) Fifteen (15) vehicles have been added or replaced in the Police Department and two (2) in the Fire Department at a cost of approximately \$34,000.00.
- (7) ^perating, maintenance and other costs of the City Hospital have been augmented by approximately \$590,000.00.
- (8) Street, sewer and other equipment have been added or replaced, costing about \$60,00.00.
- (9) Salaries and wages of all employees have been adjusted, so that they are nearly commensurate with those paid in private enterprise."¹⁷

This improved financial condition of the city is attributable chiefly to the revenue yield of the city income tax, which is indicated along with cost of collection in Table XV.

TABLE XV

CITY INCOME TAX REVENUE, COST OF COLLECTION AND COST OF COLLECTION AS A PERCENTAGE OF INCOME TAX REVENUE, CITY OF SPRINGFIELD, OHIO, ANNUALLY, 1948-1951

<u>Year</u>	<u>Income Tax Revenue</u>	<u>Cost of Collection</u>	<u>Cost of Collection As a Percentage of Income Tax Revenue</u>
1948 (a)	\$ 357,488	\$32,914	9.21
1949	1,280,499	57,679	4.50
1950	1,319,007	53,768	4.08
1951 (b)	11,260,000		

(a) period 7-1-48 to 12-31-48 only.

(b) City Auditor's Estimate.

Note: Revenue and cost of collection figures to nearest dollar.

SOURCE: Reports of City Auditor to Board of Review, City of Springfield, Ohio, unpublished.

Presumably the low yield of the initial tax period from July 1

¹⁷ Statement of Mr. Mark O. Armstrong, op. cit.

to December 31, 1948 was the result not only of its short duration but also of initial problems in obtaining compliance by those taxpayers not subject to withholding. Moreover, the date in Table XV is based on calendar years rather than the years during which the tax liability accrued so that where taxpayers not subject to withholding made their main tax payments with a final 1948 return on or prior to March 15, 1949 but after December 31, 1948, such payments would be shown in 1949 rather than in 1948 in the revenue figures in Table XV. In this connection, the high percentage of collection costs as compared with tax revenue is distorted not only by the costs of establishing a tax collection system and purchasing necessary equipment but also by the fact that obtainable revenue data are based on a calendar year rather than a tax year basis. The percentage figures for 1949 and 1950 probably indicate a more realistic base for evaluation of the cost of collection. In this connection, while it may be assumed that in general the cost-revenue percentage will be higher in smaller levying cities, even so, a cost of collection of 4 to 4.5% of collections does not appear to be unreasonable. A more detailed break-down of administrative costs is given in Table XVI. It will be noted that, as might be expected, personal service and supplies are the largest cost components.

ORGANIZATION AND ADMINISTRATION

As presently constituted, the Springfield Department of Income Taxation, established by Section 13 of the ordinance, includes the City Manager, who is designated administrative head

of the Department, the City Treasurer and three representative citizens; a Commissioner of Taxation and other employees unspecified in the ordinance. At present, the Department includes the Commissioner, a part time Tax Consultant (who was the original Commissioner), an office manager (position presently held by the Commissioner), a Chief Auditor, 3 Office Auditors, 3 Field Auditors and clerical personnel. The present salary schedule for Department employees is as follows:

<u>Position</u>	<u>Monthly Compensation</u>
Tax Commissioner & Office Manager	\$420
Tax Consultant (part time)	250
Chief Auditor	325
Office Auditor	290
Field Auditor	275
Clerical	180-210

In addition to the personnel indicated above, the City Solicitor serves as Deputy Commissioner of Taxation without additional compensation and is charged with the duty of providing legal advice to the Department. In the opinion of city officials questioned, the present salary schedule is adequate to hold essential personnel with a minimum of turnover.¹⁸

Turning to the problem of enforcement and auditing, to date, the Department of Income Taxation has adopted a procedure of giving returns a preliminary audit and has begun a small program of enforcement audits. It is to be expected that this program will be expanded as time goes on and as the Department has a greater number of returns to evaluate for particular taxpayers. In this
¹⁸ Interview with Mr. Mark O. Armstrong, City Auditor and Mr. Robert C. Acton, Esq., City Solicitor.

connection, as far as individual taxpayers are concerned, the principal focal point of non-compliance has been with respect to employees of Wright Field, who are residents of Springfield but work outside the city at the federal installation which, of course, does not withhold the city tax.

The City Solicitor has adopted a policy of bringing civil actions for the tax due rather than bringing criminal actions as has been the enforcement procedure in both Toledo and Columbus. This civil procedure is more lengthy and of course brings up the troublesome problem of enforcing civil judgments once they have been obtained. To date, some 75 civil cases have been instituted, in the main against Wright Field employees. In this connection, it will be noted that while it is impossible to enforce third party claims (garnishee process) against Federal agencies, it is frequently the policy of such agencies to terminate employment of individuals when either one or two notices of such claims are presented. It is assumed that this fact will be a powerful collection lever and that after the present city collection policy is sufficiently publicized, improved compliance will be forthcoming. In addition to the seventy-five civil cases brought for failure to comply with the ordinance provision that a return be filed,¹⁹ the City Solicitor has brought three criminal actions, which are more expeditious than civil enforcement, and has obtained convictions in all three cases. It will be noted that this enforcement activity contrasts most favorably with what has been done in Columbus, a larger city, to date.²⁰

19 Springfield Ord. 4741, Sec. 12. 20 supra. p. 172.

TABLE XVI

**ADMINISTRATIVE COSTS BY TYPE OF COST, INCOME TAX DEPARTMENT, CITY
OF SPRINGFIELD, OHIO, ANNUALLY, 1948-1950**

<u>Type of Cost</u>	<u>1948</u>	<u>1949</u>	<u>1950</u>
Personal Service	\$18,324.09	\$38,455.43	\$39,546.12
Office Supplies	6,622.46	4,251.68	4,871.28
Rent	1,950.00	3,900.00	3,900.00
Insurance-Bonds	1,056.44	204.21	4.00
Telephone & Telegraph	139.15	320.49	487.46
Furniture, Fixtures	- - - -	1,013.16	902.71
Equipment	3,507.36	4,520.80	1,069.21
Other Expenses	1,314.40	5,012.83	2,986.72
Total	\$32,913.90	\$57,678.60	\$53,767.50

SOURCE: Reports of City Auditor to Board of Review, City of Springfield, Ohio.

In connection with procedural technique and enforcement, it may be noted in passing that to date no appeals based upon the incidence of the income allocation formula have been taken from decisions of the Commissioner of Taxation to the Board of Review.²¹ This parallels the experience in Columbus, which suggests that the Board of Review as an appellate authority is, in fact, less significant than would be considered to be the case from a comparative reading of city income tax ordinance provisions.

Turning to the expenditure of revenue derived from the city income tax, Schedule 5 indicates the original tentative city expenditure plan for the period 1948 through 1953. This Schedule is presented in exactly the same form as formulated by city officials. It will be noted that, except for the fractional part of 1948 during which the tax was levied, administrative costs have exceeded **estimated** expenditures for that purpose.

The original recommended allocation of funds set forth in Schedule 5 was predicated upon an estimated annual income tax collection of one million dollars. Income tax collections, as indicated in Table XV, have materially exceeded expectations and bid fair to further increase in dollar amounts, if not in purchasing power, under currently anticipated levels of economic activity. In this connection, it may be observed that the City Auditor's estimate of 1951 collections as \$1,260,000.00 is presumably conservative.

While not entirely comparable in form to Schedule 5, Table XVII

21 Interview with City Auditor and City Solicitor.

SCHEDULE 5
RECOMMENDED ALLOCATION OF INCOME TAX, SPRINGFIELD, OHIO

May 14, 1948

Exhibit (1)

	Adm. Costs	Unpaid Current Bills (1-1-48)	Restoration of over-drafted funds	Service	Deferred Maintenance	Repair, Re- placement and new Equip.	Essential Improvements
1948 Service Functions	50,000	150,000	35,000	150,000	50,000		
6 No. Streets & Bridges							
Sewers							
Hospital				32,500	32,500		
1949 Service Functions	50,000	179,000	70,000	349,986	76,246		35,000
Streets & Bridges					74,168	30,600	
Sewers					20,000		
Hospital				50,000	65,000		
1950 Service Functions	50,000		110,000	384,986	76,246		35,000
Streets & Bridges					173,168	30,600	
Sewers					15,000		
Hospital				50,000	75,000		
1951 Service Functions	50,000		110,000	384,986	76,246		35,000
Streets & Bridges					173,168	30,600	
Sewers					15,000		
Hospital				50,000	75,000		
1952 Service Functions	50,000		110,000	384,986	76,246	30,600	35,000
Streets & Bridges					173,168	30,600	
Sewers					15,000		
Hospital				50,000	75,000		
1953							
6 No. Service Functions	50,000		43,000	192,492	35,000		25,000
Streets & Bridges					84,208	15,300	
Sewers					5,000		
Hospital				25,000	25,000		

TABLE XVII

DISBURSEMENTS, REFUNDS AND ALLOCATIONS, INCOME TAX FUND, CITY OF
SPRINGFIELD, OHIO, ANNUALLY, 1948-1950

	1948*	1949	1950
Total Administrative Cost	\$ 32,913.90	\$ 57,678.30	\$ 53,767.50
<u>Refunds</u>			
Exemptions, Exclusions, Overpayments	120.91	6,380.23	22,207.77
<u>Fund Allocations</u>			
General	259,721.04	720,000.00	496,232.00
Hospital Operating	21,934.35	278,056.00	383,509.73
Hospital Deferred			
Maintenance	21,934.36	65,000.00	27,790.19
Gasoline Tax		104,768.00	74,000.00
Snyder Park		20,379.00	
Cliff Park		1,797.00	
Construction			15,204.89
Permanent Improvement			236,768.00
Emergency Poor Relief			23,995.00
Total Disbursements	\$336,624.56	\$1,254,058.83	\$1,333,475.08

* Period July 1, 1948 to December 31, 1948 only.

SOURCE: City Auditor's "Detailed Statement of Funds," City of Springfield, Ohio, Annually, 1948-1950. Unpublished Statements from the files of the Springfield City Auditor.

indicates the actual allocation of Springfield income tax revenue from the enactment of the tax until the end of calendar 1950. According to the City Auditor, all overdrafts and unpaid bills, including those of both the City and the Municipal Hospital, were liquidated from revenues received during the first eighteen months of income tax collection. This expenditure is included in the General Fund and Hospital Operating Fund allocations shown in Table XVII for 1948 and 1949. It will be observed that in the 1949 allocations material amounts are disbursed for deferred maintenance, streets (note the allocation to gasoline tax fund) and city parks. As to 1950, while the General Fund and Hospital Operating Fund allocations of \$496,232.00 and \$383,509.73, respectively, are the largest allocations for the year, it was possible for the city fathers to turn over the sum of \$236,768.08 for permanent improvements. While mounting operating costs may curtail capital improvements expenditures, it is presumed that, in the absence of excessive increases in the price level, additional amounts will be available for this type of expenditure during the remaining life of the ordinance. Certainly it is not too soon to say that the city income tax has materially improved the financial status of the City of Springfield, Ohio. Detailed treatment of the ordinance will be omitted except insofar as germane to comparative consideration of income tax ordinance provisions later herein.²²

²² Cf. Chapter IX, *infra*.

RESIDENT CREDIT PROVISION ADOPTED

Shifting attention to another aspect of local income taxation, it has already been noted with respect to the experience of Pennsylvania local governments and with respect to the latest ordinance provision of the City of Toledo, Ohio, that in the absence of or because of state rules, cities levying such taxes must face up to the problem of what policy to adopt with respect to the problems and inequities of territorial multiple taxation by two or more municipalities. If a particular taxpayer lives and works in two different municipalities, both of which levy a local income tax, he will be subject to double taxation, which while not illegal, at least raises questions of equity and adjustment by means of exemptions or reciprocal credits. In this connection, approximately two hundred residents of the City of Springfield are subject to municipal income taxes of other cities, principally the tax of the adjacent city of Dayton, Ohio. On January 2, 1951, effective January 1, 1951, the Springfield City Commission passed Ordinance No. 5106 amending Ordinance 4741 so as to permit residents of Springfield, Ohio to deduct from the income tax payable to that city taxes paid to other levying cities,--limited however to the total of Springfield tax attributable to the income or profits earned in the other city.²³

²³ Springfield Ordinance, No. 5106 reads in part as follows:

"Section 1. That Ordinance No. 4741, passed the 24th day of May, 1948, and commonly known as the Income Tax Ordinance, shall be and the hereby is amended and supplemented by the enactment of Supplemental Section 2-A thereto to read as follows: (continued on p. 195.)

Thus, in the absence of any state regulation of local income taxation in Ohio, Springfield has joined Dayton and Toledo in providing some relief for the individual who resides in one city and works in another when both levy a city income tax. It will be noted that this provision is much simpler than the reciprocal credit

23 (continued from p. 194.)

Section 2-A Income Tax Paid in Another City

Anything contained in Section 2 hereof to the contrary notwithstanding, every individual taxpayer who resides in The City of Springfield, Ohio and receives net profits, salary, wages, commissions or other compensation for work done or services performed or rendered in another City or Cities shall be allowed a credit against the tax levied by this ordinance, if it is established that an income tax has been paid to such other city or cities upon such net profits, salary, wages, commissions or other compensation by or on behalf of said taxpayer, which said credit shall be in the amount of the tax so paid to such other City or Cities; and every association and unincorporated (as such terms are defined and referred to in Section 1 and 2 hereof) conducted by residents of the City of Springfield, Ohio, and which earns net profit for work done or services performed or rendered in another City or Cities shall be allowed a credit against the tax levied by this ordinance, if it is established that an income tax has been paid to such other City or Cities upon such net profit by or on behalf of such association or unincorporated business, which said credit shall be in the amount of the tax so paid to such other City or Cities; provided, however, that the afore-said credits shall in no event exceed the amount of the tax assessed by this ordinance upon such net profits, salary, wages, commissions or other compensation earned in such other City or Cities where an income tax is paid: PROVIDED further, however, that said credits shall be effective only insofar as net profits, salary, wages, commissions or other compensation earned on and after January 1, 1951 are concerned." (Emphasis added)

It will be noted that corporations are not covered by this credit provision in view of the fact that corporate profits are taxable under the Springfield Ordinance, regardless of the domicile of the corporation, only to the extent that they arise from business in Springfield. Cf. Springfield Income Tax Regs. Sec. 5.

provision in the new Toledo ordinance.²⁴ It is similar to the resident credit provision of the Dayton Income Tax Ordinance.²⁵ The subject of credit provisions and reciprocity will be considered in some detail in Chapter IX.

As might be expected the Springfield tax has given rise to a certain amount of litigation; the validity of the "exclusion" has already been considered.²⁶ The question of the right of the city to tax ^{the} income of a resident earned outside the city was raised in Springfield v. Krichbaum in the Court of Appeals of Clark County.²⁷ The fact that the place of earnings was not properly before the Court and hence was not considered. The Krichbaum case stands for three propositions. First, that a city income tax is not discriminatory for failing to levy a tax on types of income whose property source is taxed by the State. Second, that such a tax is not discriminatory as a result of exempting corporate income earned outside the taxing city while all income of residents is taxable. Third, that taxing net profits of associations, corporations, and business concerns and taxing wage earners' gross income is a reasonable classification and is not discriminatory. The authority of the city in taxing the income of a resident earned entirely outside

²⁴ Toledo Ord. 689-50, Sec. 15; cf. Chapter V, supra.

²⁵ Dayton Ord. 16922, Sec. 17; cf. Chapter VIII, infra.

²⁶ Supra. p. 180.

²⁷ City of Springfield, Ohio vs. Joseph H. Scheetz and City of Springfield v. Oscar Krichbaum (Nos. 477 and 478, Court of Appeals of Clark County, Ohio), 88 Ohio App. 329 (1950), 24 Ohio Bar (No. 29), 329.

the city was later approved by the Court of Appeals in the Kurtz
²⁸
 case.

In addition to these appellate decisions, a case affecting the Springfield city income tax has **recently** been decided by the Ohio Supreme Court.²⁹ Petitions for the initiation of an ordinance amending Ordinance 4741 by reducing the rate from one (1) per cent to $\frac{1}{2}$ of 1% and by establishing exemptions similar to those existing under the federal personal income tax were circulated in Springfield between May 4, 1950 and August 21, 1950. The proposed exemption would not have been applicable to corporate taxpayers.³⁰ A citizen's committee circulated these petitions and filed them with the Clerk of the City Commission as required by the City Charter. The Clerk determined that the petitions submitted did not bear signatures aggregating 5% of the registered voters of Springfield as of the day they were filed. Accordingly, the proposed initiated ordinance was not submitted to the Springfield electorate on November 7, 1950.

The Kurtz case resulted as a means of testing the validity of this "ministerial" act of the Clerk. It was an action in mandamus originating in the Ohio Supreme Court to compel the

²⁸ City of Springfield v. Kurtz, No. 480, Clark City, (Ohio) Court of Appeals, April 2, 1951.

²⁹ State, ex rel, Kurtz v. Shaffer, Clerk, et al. 155 Ohio St 491, 24 Ohio Bar No. 23, issue of June 4, 1951 (May 31, 1951).

³⁰ Proposed amendatory ordinance, cf. Appendix III.

Clerk of the City Commission and the Clark County Board of Elections to submit the proposed ordinance to the electors. The Ohio Supreme Court denied the petition for a writ of mandamus on May 31, 1951.³¹ Since the precise legal questions revolve about the non-applicability of general law³² to the initiative process of an Ohio charter city and the interpretation of the charter provisions of the Springfield City Charter,³³ they need not be elaborated upon here. The city income tax as established in Ordinance 4741 at a one percent rate with the exclusion but without exemptions similar to those in the federal income tax continued to be levied in Springfield. The fact pattern in the Kurtz case indicates the tenacity with which city officials cling to a fruitful source of local revenue. It also suggests the dissatisfaction of a presently indeterminate percentage of Springfield citizens with this form of taxation which seems to create more consciousness than usual on the part of the low income receiver that he is, as in fact he almost always is, directly or indirectly, contributing to the cost of city government. Consideration of the appropriateness and administrative feasibility of personal exemptions as a component of local income taxes will be deferred to Chapter X. The experience of Springfield, Ohio would seem to indicate that a local income tax, while not necessarily popular

³¹ 155 Ohio St. 491, 498 (1951).

³² Ibid. 496, G.C. 4227-12

³³ Springfield City Charter, adopted August 26, 1913, Sec. 53, 54.

with all segments of the municipal population, can raise enough revenue, if judiciously expended, to assist materially in solving the financial problem of the middle sized urban center.

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CHAPTER VIII

OTHER EXAMPLES OF CITY INCOME TAXATION IN OHIO

Thus far this study has considered local income taxation in Pennsylvania, the occupational excise taxes levied by the Kentucky municipalities of Louisville and Paducah; and the city income taxes of Toledo, Columbus, and Springfield in Ohio. Three additional municipalities in Ohio, Dayton, Youngstown, and Warren, have adopted such taxes. Two additional Ohio cities, Portsmouth and Grandview Heights, enacted income tax ordinances but repealed them prior to collecting any tax. The experience of these other Ohio levying municipalities will be considered briefly in this chapter. It is considered unnecessary to go into any great detail in view of the marked similarity of the taxes of these cities to those municipal income taxes previously discussed.

THE YOUNGSTOWN CITY INCOME TAX

The City of Youngstown, Ohio, with a population of approximately 178,000, adopted a 3/10ths of 1 percent income tax on June 7, 1948 applicable to income earned after July 1, 1948 and for the calendar year of 1949.¹ Youngstown re-enacted this tax on November 29, 1949 to cover the calendar years 1950 and 1951, at the same tax rate.² The revenue derived from the city income tax is as follows:

<u>Year</u>	<u>Income Tax Revenue</u> ³
1948 (six months, 7/1 thru 12/31)	\$393,487.06
1949	913,000.00
1950	989,000.00

1. Youngstown (Ohio) Ordinance No. 49349.

2. Youngstown (Ohio) Ordinance No. 51251.

3. Data included in letters to the writer from Mr. J. Emerson Davis, Director of Finance, City of Youngstown, Ohio, dated July 19, 1950 and January 19, 1951.

The cost of collection for the income tax was approximately \$66,000.00 in 1949 and \$67,000.00 in 1950, according to Mr. Davis,- these cost totals cover the salaries of nineteen persons employed in the collection of the tax plus all other administrative expenses. In general, the Youngstown tax ordinance is similar to other city income tax ordinances and no special treatment will be given it. However, Youngstown has differed from other income tax levying cities in one significant regard, in its treatment of corporations.

It is particularly noteworthy that on December 18, 1950, the Youngstown City Council passed an amending ordinance raising the income tax rate on the net profits earned on and after January 23, 1951 by corporations having a place of business in that city as a result of work done or services performed or business done in the city from 3 mills to one (1) percent.⁴ This new ordinance was vetoed by the Mayor on December 28, 1950. However, the Youngstown City Council, by a two-thirds vote, passed the ordinance over the Mayor's veto on January 10, 1951. Thus, Youngstown became the first Ohio city to attempt the taxation of corporate net profits at a higher rate than individual earned income under its city income tax.

This enactment of a corporate rate differential was promptly attacked in the courts,- and on July 9, 1951 was held invalid by the Common Pleas Court of Mahoning County, Ohio which court granted a permanent injunction against putting the new tax into effect.⁵

4. Youngstown Ordinance No. 52037 amending Ordinance No. 51251.

5. Letter to the writer from Mr. H. Herschel Hunt, Director of Law of the City of Youngstown, Ohio, dated July 20, 1951 and opinion of Judge Harold B. Doyle in The Youngstown Sheet and Tube Co., The General Fireproofing Co., Republic Steel Corp. and United States Steel Corp. et al v. City of Youngstown et al, No. 134499 in the Court of Common Pleas, Mahoning County, Ohio.

Cf. also, "Corporation Tax Ruled Invalid at Youngstown", The Columbus Dispatch, July 10, 1951, p. 4-A, c 1.

The Common Pleas opinion,⁶ appears to be grounded on the rule that equal protection permits reasonable classification but requires that all persons and properties similarly situated be treated substantially alike. The differential treatment of the profits of corporate business as compared with unincorporated business was held a violation of the equal protection clause of the Fourteenth Amendment of the U. S. Constitution. In this opinion the Court would seem to be on sound ground in view of the holding of the United States Supreme Court in Quaker City Cab Co. v. Pennsylvania,⁶ in which a gross receipts tax on corporations operating taxicabs with no corresponding tax on privately operated cabs was held bad under the same provision.

On appeal, the Sixth District Court of Appeals affirmed the Mahoning County Common Pleas decree permanently enjoining the collection of the corporate tax.⁷ This decision also invalidated a similar .7 percent corporate tax levied by the nearby city of Campbell, Ohio. The affirmance of the Common Pleas holding was based on the opinion that both the Youngstown and Campbell taxes violated the equal protection of the laws provisions of the Ohio and Federal Constitutions.⁸ Thus, unless this decision is reversed by the Ohio Supreme Court, it would appear that personal and corporate income must be taxed at the same rate by Ohio municipalities and that an Ohio municipality may not successfully levy only a corporate income tax as was attempted by the City of Campbell.⁹

⁶ 277 U.S. 389 (1928).

⁷ "Corporation Tax Levies Are Ruled Unconstitutional", The Columbus Dispatch, November 19, 1951, p. 1.

⁸ Ohio Const., Art. 1, Sec. 2; U.S. Const., 14th Amendment. See Appendix IV for Courts opinion.

⁹ Campbell, Ohio, Ordinance No. 51-1562; Campbell levied a .7% tax on corporate income arising in the city with no tax on personal income. Letter to the writer from Mr. Paul R. Van Such, Campbell City Solicitor, dated March 13, 1951; Youngstown Sheet and Tube Co. et al. v. City of Campbell, Mahoning County Common Pleas No. 134332 was the companion case to the Youngstown case noted supra n5, this chapter.

In connection with the Youngstown tax, it may be observed that State Senator Carney of Youngstown introduced Senate Bill No. 17, 99th General Assembly, which would have vested exclusive authority to levy and collect an income tax in the State of Ohio.¹⁰ This negative approach to city income taxation would, had it been enacted, have deprived the City of Youngstown of an estimated one million dollars of needed revenue in 1951. The Youngstown Finance Director, Mr. Davis, has stated: "If this city tax is eventually eliminated, it does not necessarily follow that the rate of the property tax will be increased proportionately to provide additional income. The property tax is more or less a constant figure based upon the valuation of the property. If it would have been possible to adjust the property tax rate to over come any deficit that a city operation might have, I can assure you, that would have been accomplished prior to July 1, 1948, the date of the installation of the Youngstown City Income Tax."¹¹ This statement speaks for itself. Elimination of the tax, should that materialize, would leave two alternative revenue possibilities, either other non-property taxes, particularly those, if any, permitted by state legislative enactment, or increased dependence upon state aid.

THE WARREN CITY INCOME TAX

Warren, Ohio adopted an income tax ordinance on June 6, 1949, effective July 1, 1949 at a rate of 7/10ths of 1 percent for the remainder of 1949 and at a rate of 1/2 of 1 percent for the year 1950.¹²

10. S.B. No. 17, 99th General Assembly died in committee.

11. Letter to the writer from Mr. J. Emerson Davis, dated January 19, 1951.

12. Warren (Ohio) Ordinance No. 3839/49.

The Warren ordinance was ^{204.}unique in that it levied its tax "upon the earnings in excess of \$1200.00 per annum".¹³ This is the sole exemption of this type that the writer has noted in the field of city income taxation; the provision of the Springfield, Ohio ordinance being significantly different in that if the Springfield taxpayer receives taxable income in excess of \$1040.00 all of his income is taxable.

Section 16 of the Warren ordinance reads significantly as follows:

"In the event the financial condition of the City of Warren is not solvent by August 1, 1940, then it is recommended that the question of the continuance of this ordinance after December 31, 1950, shall be submitted to the voters for their approval at the general election to be held in November, 1950."

With the exception of this provision and the exemption, the Warren ordinance was generally similar to other such ordinances. The writer has been unable to obtain any significant data on the operation of the Warren tax. At all events, the injunction of the City Council voiced in Section 16 was heeded and the question of continuing the tax was submitted to the Warren electorate at the November, 1950 election. The tax was voted down. Accordingly, the Warren tax expired under the provisions of Ordinance 3839/49 on December 31, 1950. It may be suggested that, in all probability, with a \$1200 exemption and a .5 percent rate, the cost of administration of the Warren tax was high in comparison with its revenue yield.

THE PORTSMOUTH TAX: ADOPTION AND REPEAL

Another more marginal experience is that of Portsmouth, Ohio, which adopted an income tax ordinance in September, 1949.¹⁴ However, the tax was repealed prior to any collections as a result, in part, of the passage of an additional 2 mill tax levy.¹⁵

13. Ibid. Sec. 2

14. Portsmouth (Ohio) Ordinance No. 81-48.

15. Interview with Mr. Lowell C. Thompson, City Solicitor.

205.
THE DAYTON, OHIO CITY INCOME TAX

The experience of the City of Dayton, Ohio illustrates another type of difficulty which may beset the income tax city. On February 2, 1949, the Dayton City Commission adopted Ordinance No. 16614 providing for the levy of an income tax at the rate of 1/2 of 1 percent on the earned income of individuals and on the net profits of businesses, professions and other activities received after April 1, 1949. This ordinance was not submitted to any referendum. Section 171 of the Dayton City Charter, approved by vote of the people November 6, 1945, establishes what ostensibly appears to be a tax limitation applicable solely to ad valorem taxation.¹⁶ The fact that the income tax ordinance was not submitted to a referendum vote

16. Section 171 reads as follows:

"The City Commission is hereby granted the authority, without a vote of the people, to levy taxes upon the tax lists or duplicates of property assessed and listed for taxation according to value for all the purposes the City of Dayton, its boards, departments and institutions, in amounts not in excess of the following total maximum levies for the years specified to wit:

Eight and one-half (8 1/2) mills on each dollar of assessed valuation in the tax list or duplicate for the years 1945 to 1950 (for the purposes of the fiscal years 1946 to 1951, both inclusive) both inclusive;

Nine (9) mills on each dollar of assessed valuation on the tax list or duplicate for the years 1951 and 1952 (for the purposes of the fiscal years 1952 and 1953).

Ten (10) mills on each dollar of assessed valuation on the tax list or duplicate for the year 1953 and all years thereafter (for the purposes of the fiscal year 1954 and all years thereafter).

Out of said total maximum levy for each of said years, an amount shall annually be levied sufficient to pay the interest, sinking fund and retirement charges on all bonds and notes of the City of Dayton heretofore or hereafter authorized to be issued without authority of the electors, which levy shall be placed before and in preference to all other levies and for the full amount thereof. Of the remaining portion of said total maximum levy, commencing with the levy against the tax list or duplicate for the year 1945 and continuing thereafter, an amount not exceeding five (5) mills may be levied annually for the general fund of said city.

The City Commission, without a vote of the people, may not authorize any tax levy or levies for permanent improvements other than those which may be made within the five (5) mill levy for the general fund, as set forth in the fifth paragraph of this section, if such levy or levies will increase the total levies for all city purposes, (continued on page 206.)

was utilized as a basis for successfully challenging the validity of the ordinance in the much publicized Hagerman case.¹⁷ In that case, a demurre to the petition was sustained by the Court of Common Pleas of Montgomery County, Ohio and plaintiff electing not to plead over, judgment was entered for defendant, Hagerman. On appeal, the Court of Appeals for Montgomery County affirmed. The Supreme Court of Ohio allowed a motion to certify the record. In a per curiam opinion, the court overruled the Court of Appeals and held Ordinance No. 16614 invalid. The following extract from the opinion is significant:

"On behalf of the city it is argued that this amendment (Charter Section 171) pertains solely and is applicable only to ad valorem taxes. It is true that most of the amendment does apply to ad valorem taxes, but the language," unless authorized and approved by a vote of the electors conformably with the general laws of this state, the City Commission shall levy no tax outside of the limitation set forth in this section," is broad and we are of the opinion that courts should construe strictly the charter power conferred upon a municipality to levy taxes. In other words, where the authority of the municipality is ambiguous, it is our duty to construe it strictly against the taxing authorities and in favor of the taxpayer."¹⁸

16. (continued from page 205) "inclusive of all levies to pay for the interest, sinking fund and retirement charges on all unvoted bonds and notes of the city of Dayton and those voted bonds heretofore or hereafter issued pursuant to vote of the electors at any election held prior to November 15, 1945, beyond eight and one-half (8 1/2) mills for the years 1945 to 1950, nine (9) mills for the tax years 1951 and 1952, and ten (10) mills for the tax years 1953 and all years thereafter.

Unless authorized and approved by a vote of the electors conformably with the general laws of this State, the City Commission shall levy no tax outside the limitations set forth in this section." (Provision is made for annual debt levies permitted by the charter or the general law of the State.)

17. Zimmer et al v. Hagerman, Director of Finance, 153 Ohio St. 187 (1950).

18. Ibid., 153 Ohio St. 187, 190, 191.

207.

This decision of the Ohio Supreme Court was announced the same day as that of the Court in Angell v. Toledo.¹⁹ The first Dayton city income tax was out.

Undeterred by this judicial invalidation of its first attempt at the levy of a city income tax, the City of Dayton enacted a second city income tax, Initiated Ordinance No. 16922 by popular vote, May 23, 1950 thus complying with the rule of the Hagerman case. This new tax ordinance was approved by the City Commission July 19, 1950 and became effective July 1, 1950. This new ordinance is generally similar to others previously discussed with the notable exception that it included a provision permitting residents subject to another city income tax on income earned outside the City of Dayton to deduct such taxes from their Dayton tax to the extent of the Dayton tax attributable to such income.²⁰ While Toledo and Springfield have recently given attention to the problem of multiple territorial city income taxation, Dayton was the first Ohio municipality to adopt a provision at least partially correcting the burden of overlapping city income taxes. This problem will be considered with a view to the formulation of appropriate policy in Chapters IX and X.

19. 153 Ohio St. 179.

20. Dayton Ord. No. 16922, Sec. 17 reads as follows: "Every individual taxpayer who resides in the City of Dayton but who receives net profits, salary, wages, commissions or other personal service compensation for work done or services performed or rendered outside of said City, if it be made to appear that he has paid a City income tax on such net profits, salary, wages, commissions or compensation in another City, shall be allowed a credit of the amount so paid by him or in his behalf in such other City, this credit to be applied only to the extent of the tax assessed by this ordinance by reason of such net profits, salary, wages, commission or compensation earned in such other City or Cities where such tax is paid."

Collections under the first ²⁰⁸Dayton tax, which was invalidated by the Ohio Supreme Court, amounted to \$2,255,700.²¹ A portion of this collection must be refunded under the decision of the Montgomery County Common Pleas Court in Chapman v. Dayton.²²

Collections under the present Dayton income tax, from when it became effective July 1, 1950 to December 31, 1950, amounted to the sum of \$1,029,300.00. Total collections under both ordinances through December 31, 1950 amounted to \$3,265,000.00. Mr. Gross estimates that the cost of collection for the year 1951 will amount to approximately 5.5% of revenue collected.²³ While Dayton encountered material difficulty in getting its city income tax under way, it appears committed to that method of taxation at present. In the opinion of Mr. E. E. Hagerman, the Dayton Finance Director, this type of local taxation is the solution to the municipal "financial plight".²⁴

21. Letter to writer from Mr. Charles Gross, Supt. of Dept. of Taxation, City of Dayton, Ohio, dated January 25, 1951.

22. Ohio Tax Reporter, Vol. 2, Chicago: Commerce Clearing House, Para. 72-020.50, p. 7202. Chapman v. Dayton (No. 101962, Montgomery Cty. C.P.) is summarized as follows: "Since it is possible to ascertain what portion of the general fund on March 8, 1950, represented money collected under the Dayton income tax ordinance, declared invalid on that date, the persons who paid into this fund under the invalid ordinance are entitled to a refund on a pro rata basis from such part of this fund as represents unexpended income tax money. Money collected under the income tax which has already been expended was lawfully expended, even though the ordinance under which it was collected was later declared invalid, and no refund may be claimed." (decided June 14, 1951.)

23. Letter from Mr. Gross, op. cit.

24. Letter to the writer from Mr. E. E. Hagerman, dated July 19, 1950.

REJECTION OF INCOME TAX ^{209.} IN GRANDVIEW HEIGHTS, OHIO

Lastly in a consideration of local income taxation in Ohio, several peripheral cases must be considered. The City of Grandview Heights adopted a one percent (1%) income tax similar to those already discussed on November 6, 1950.²⁵ This ordinance occasioned a good deal of adverse reaction among residents of that city and was repealed on March 5, 1951.²⁶ This repeal resulted in part from the fact that the ordinance, passed as an emergency measure, was not subject to referendum.²⁷

The original ordinance was noteworthy as it included a provision for the deduction of city income taxes paid elsewhere.²⁸ Thus with the coterminous City of Columbus, Ohio levying a 1/2 of 1% city income tax, a resident of Grandview Heights, working in Columbus and earning all of his taxable income in Columbus, would have paid a .5% tax to each of the two cities under the ordinance credit provision. It was estimated by city officials that the tax would have brought in about \$50,000 to \$80,000 revenue.

On June 4, 1951, the City Council of Grandview Heights adopted a second city income tax ordinance to be effective on January 1, 1952.²⁹ This second ordinance was submitted to a referendum vote in the November, 1951 election and was beaten almost five to one.³⁰ The financial problems of Grandview Heights remain largely unsolved.^{31.}

25. Grandview Heights (Ohio) Ordinance No. 49-50.

26. Grandview Heights (Ohio) Ordinance No. 7-51; CF. also "Grandview Income Tax Law Repealed", The Columbus Dispatch, March 6, 1951, p. B-7, c 4; State and Local Tax News, 2, No. 26 (March 28, 1951) p. 4 (New York: Prentice Hall).

27. The Columbus Dispatch, December 30, 1950, p. 1; Id. March 2, 1951, p. 1.

28. Ordinance 49-50, Sec. 3-A.

29. The Columbus Dispatch, June 5, 1951, p. 16-A, c 3.

30. The Columbus Dispatch, November 7, 1951, p. 1.

31. Interview with Mr. Fred Dunn, Auditor of Franklin County, Ohio, November 15, 1951.

Lastly, the City of Campbell, Ohio, which is coterminous with Youngstown, adopted a .7% levy on the income of corporations doing business in the City.³² This tax has been invalidated in the courts as already discussed.³³ The City of Struthers, also coterminous with Youngstown, adopted a city income tax ordinance, which was on the ballot for referendum at the November, 1951 election.³⁴

Recently the Ohio cities of Marietta, Canton and Delaware have had local income taxes under consideration. These straws in the wind indicate that local income taxation may become a spreading phenomenon in Ohio local government finance. Consideration of appropriate state policy will be made in Chapter X.

32. Campbell (Ohio) Ordinance No. 51-1562, adopted January 18, 1951.

33. Cf. discussion of the Youngstown tax supra. this chapter, particularly note 9.

34. Letter to the writer from Mr. Paul R. Van Such, City Solicitor of Campbell, Ohio, dated March 13, 1951.

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CHAPTER IX

LEGAL PROBLEMS OF LOCAL INCOME TAXES AND
COMPARATIVE ORDINANCE PROVISIONS

City income taxation refers in reality to two separate and distinct taxes; one levied on the taxable earned income of individuals including salaries, wages, commissions and the like,- the so-called "payroll tax"; the other levied on the net profits of business activity. This second component tax is generally applicable to all forms of business enterprise regardless of the form of business organization. Individual proprietorships, partnerships, quasi-corporate forms and corporations are taxed except insofar as a particular city is precluded from taxing particular types of business organization or particular forms of income as a result of the operation of the general law of the state from which its taxing power is derived. This distinction should be born in mind throughout the subsequent discussion in this chapter for it must be constantly recalled that city governments in drafting revenue measures are not free agents with the ability to give free rein to the idealism of the critic but, on the contrary, must operate within the relatively narrow confines of what is permitted by state authority and that which is sufficiently politically palatable to be accepted as a workable compromise by the diverse bargaining groups which call the tune of municipal action.

RATE LIMITATIONS

City income tax rates have varied from 3 mills in the City of Youngstown, Ohio for the 1949 tax year to 1 1/4% in the City of Philadelphia. Most cities discussed in this study have levied rates of either 1% or 1/2 of 1%. Taxes of this type have been levied by local

governments in Pennsylvania, Ohio,^{212.} Missouri, Kentucky and the District of Columbia.* Of these states, Pennsylvania and Kentucky have set a rate ceiling.¹ However, should cities where no legal limit is presently operative, as in Ohio, increase rates to the 5% upper limit of the District of Columbia tax, it seems quite likely that legislative limitations on rates would result rather quickly. This probability, along with the obviously continuing necessity for popular acceptance, place limitations on the level of tax rates. This suggests that more than mild rate graduation is not feasible. However, from a legal standpoint, progression would be possible in jurisdictions where statute, or the uniformity provision of the State Constitution is not applicable to the taxation of income. Progression would not presently be permitted at the city level in the state of Pennsylvania.²

In Ohio, income taxation is covered by constitutional provision.*³ In addition, the constitutional uniformity provision is not applicable

* Cf. Appendix V for a brief discussion of the District of Columbia graduated income tax which is usually considered as more similar to state income taxes than to the city income taxes here under consideration.

1. Supra. p. 63 . and p. 100 .

2. *Supra. p. 54 .

3. *Art. XII, Sec. 8, Ohio Const. reads as follows: "Laws may be passed providing for the taxation of incomes, and such taxation may be either uniform or graduated, and may be applied to such incomes as may be designated by law; but a part of each annual income not exceeding three thousand dollars may be exempt from such taxation." (Adopted Sept. 3, 1912.)

Art. XII, Sec. 9, Ohio Const. reads as follows: "Not less than fifty per centum of the income and inheritance taxes that may be collected by the state shall be returned to the county, school district, city, village, or township in which said income or inheritance tax originates, or to any of the same as may be provided by law." (Adopted November 4, 1950.)

to income per se.⁴ Article XII, Sec. 8 does not apply specifically to municipal corporations. Accordingly, while there is clear authority for the progression of income tax rates and for the exemption from tax of amounts not exceeding three thousand dollars should the State of Ohio levy such a tax, there is no such clear authority for progressive rates or exemptions under an Ohio city income tax. The possibility exists that the old case of State ex rel. Schwartz v. Ferris,⁵ which invalidated a graduated inheritance tax prior to the adoption of Art. XII, Sec. 7, Ohio Const., as being in conflict with Section 2 of Art. I of the Ohio Constitution may yet stand in the way of progressive city income taxation and even in the way of exemptions. Syllabus 3, which is the law of the case in Ohio, reads as follows:

"The Act of April 20, 1894, entitled: 'An act to impose a direct inheritance tax,' 91 O.L.166, by its exemption from taxation of the right to receive or succeed to estates not exceeding twenty thousand dollars in value, and the taxing of the whole right of receiving or succeeding to estates which exceed that sum in value, and in taxing at a higher rate per centum the right to receive or succeed to estates of a larger value than to estates of smaller value, is in conflict with Section 2 of the Bill of Rights of the constitution of this state, which declares that: 'All political power is inherent in the people. Government is instituted for their equal protection and benefit;' and the whole act is therefore unconstitutional and void."

4. Article XII, Sec. 2, Ohio Const. reads in part as follows: "No property, taxed according to value, shall be so taxed in excess of one per cent of its true value in money for all state and local purposes, but laws may be passed authorizing additional taxes to be levied outside of such limitation, either when approved by at least a majority of the electors of the taxing district voting on such proposition or when provided for by the charter of a municipal corporation. Land and the improvements thereon shall be taxed by uniform rule according to value."

5. 53 O.S. 314 (1895)

6. Art. I, Sec. 2, Ohio Const. reads as follows: "All political power is inherent in the people. Government is instituted for their equal protection and benefit, and they have the right to alter, reform, or abolish the same, whenever they may deem it necessary; and no special privileges or immunities shall ever be granted, that may not be altered, revoked, or repealed by the General Assembly."

The following extract from the opinion of Burket, J. in the Ferris case,⁷ gives further indication of the attitude of the Court at that time:

"The right or privilege of receiving or succeeding to property is valuable in proportion to the value of the property received. It cannot be consistently said that the right to receive twenty thousand dollars is of no value, and that the right to receive twenty thousand and one dollars is of the value of two hundred dollars and one cent.

Again he who uses the right or privilege of receiving property of the value of twenty thousand and one dollars and pay therefor a tax of two hundred dollars and one cent, is not equally benefited for the tax paid, as he who uses the same right or privilege of receiving property to the value of twenty thousand dollars without paying any tax whatever for the use of such right. The exemption of twenty thousand dollars and the increase of the percent as the value of the estate increases, renders this statute unconstitutional."

On the basis of this holding both exemption and progression were invalid at the state level until the adoption of the 1912 Amendments to Art. XII, - Sec. 7 removing the bar as to inheritance taxation and Sec. 8 removing it with respect to state income taxation. Had these amendments not been adopted, the Court might have distinguished, modified or reversed the rule of the Ferris case; the following extract from the opinion of Nichols, C. J. in State ex rel Zielonka v. Carrel,⁸ the case which established the Ohio preemption doctrine, indicate a changed attitude on the part of the court which, however, does not go to the point of materially impairing the rule of the Ferris case:

"Section 7 of this article (Art. XII, Ohio Const.) is a new product, and is in no sense a limitation of power being rather a special grant, and has to do with taxation on inheritances.

Its incorporation in the constitution may be said to have been introduced by the decision of this court in the case of State ex rel v. Ferris

7. 53 O.S. 314 at 337 (1895).

8. 99 O. S. 221, 222 (1919).

Judge, 53 O.S. 314, and to make perfectly clear not so much that the General Assembly might provide for the levy of taxes on the right to receive inheritances, but that such tax might be a graduated or progressive type, and, furthermore, that an exemption of the smaller inheritances might be utilized.

Section 8 of the same article, providing for the taxation of income, for the same reason cannot be said to be a limitation of power, nor can it be said to be equivalent to a conclusion that without such express grant incomes might not be the subject of taxation. It is much more likely that the incorporation of this new section by the constitutional convention of 1912 was occasioned by a desire on the part of its members that the method of levying taxes on incomes should be precisely similar to taxation of inheritances, in so far as it might relate to graduation of rates and exemptions.

At this point it is proper to say that taxation of incomes or inheritances is not the imposition of direct taxes on property per se, but is rather in the nature of an excise tax."

The Court goes further in indicating the wide powers of the General Assembly as follows:

"A majority of this court are of the opinion that there is no constitutional limitation resting upon the authority of the general assembly to levy on property of every kind and character, except that it must be uniform and according to its true value in money. Nor is there even this limitation on its power to provide for the levy of taxation of incomes, inheritances, and franchises, including the imposition of excise taxes."⁹

Carrel.

The final word on the subject in the Carrel case is this statement:

"We are likewise of the opinion that the power to levy taxes on these several subjects comes from the grant in Section 1, Article II, and that there was no necessity for the inclusion in the Constitution of new sections 7, 8, and 10, Article XII, except for the purpose of providing for the graduated method of levying such taxes and for the permissive feature of exemption of the lesser inheritances and incomes."¹⁰

Thus, the Carrel dicta indicate the acceptance by the Court of the proposition that the General Assembly has the inherent power to levy income and inheritance taxes without specific grants of power which were adopted in the 1912 Amendments to Article XII of the Ohio Constitution.

9. Ibid at 225.

10. Ibid at 255.

However, it should be carefully ^{216.}noted that the Ferris case was not over-ruled or distinguished; presumably then the reason that the state of Ohio can use progressive rates and provide for exemptions lies in the grant of power to do so provided by the 1912 addition of Section 7 and 8 to Article XII. Since, these two sections do not specifically apply to local taxation, there is a legal question as to the use of progressive rates and exemptions under local income tax ordinances in Ohio.¹¹ While it is quite likely that the Supreme Court of Ohio would not adopt the restrictive interpretation of the equal protection clause of the state Constitution today that it did in 1895, the cloud will remain until such time as the issue is raised, presented to the Court as a justiciable question and a ruling obtained. Competent authorities have suggested that in that event the court should distinguish the Ferris case so as to permit the use of progressive rates at the local level.¹² The question remains moot. Evaluation of progressive rates from an economic and administrative standpoint will be deferred to Chapter X.¹³

With regard to another aspect of tax rate variation, differential rate treatment of various types of income is possible. This distinction obviously can be made between earned income and profits from business activity and was attempted by the City of Youngstown, Ohio which established a 1% rate applicable to corporate income taxable by the City while levying the rate applicable to personal earned income and personal taxable net profits at 3/10%.¹⁴ This differentiation proved invalid in

11. But see City of Springfield v. Kenney, Chapter VII supra. and Appendix IV.

12. Fordham, Jefferson B. and Mallison, W. Thomas, Jr., "Local Income Taxation", 11 Ohio St. L. J. 240 (1950).

13. In fra., p. 240.

14. Youngstown, Ohio Ordinance No. 52037; supra. p201.

PERSONS SUBJECT TO TAX

Turning to consideration of the persons and entities subject to the city income taxes, individuals are subject to variable treatment depending on whether they are residents or non-residents of the taxing jurisdiction. Most levying municipalities tax their residents on all earned income regardless of its place of origin or earnings; non-residents are usually taxed only on that portion of their earned income which is a result of work done or services performed within the taxing city. In fact, one of the most frequent arguments in favor of the city income tax is that it requires commuters, the so-called "daylight citizens", to contribute to the support of the governmental unit in which they earn their livelihood. Parenthetically, it may be observed that while the "benefit theory" as a rationalization of taxation has gone into an eclipse, it affords perhaps a partial rationale for the city income tax. Some will raise the point that this state of affairs amounts to "taxation without representation" for the suburbanite. To this the reply is two fold; first, the nonresident accepts the benefits conferred by the central city in terms of employment opportunity and subordinate services and must accept the resultant tax burden along with the benefit. Second, a more fruitful reaction would be cooperative effort to modernize the

15. Cf. discussion of the Youngstown tax Chapt. VIII, supra., Cf. Appendix IV for opinion of Mahoning County Court of Appeals in Youngstown Sheet and Tube Co. v. Youngstown et al. (1951).

structure of local government by both residents and non-residents who derive income from employment in the central city.

Deviating from the general case are the two Kentucky municipalities of Louisville and Paducah, whose "occupation taxes" apply only to earnings within the city regardless of the residence of the taxpayer.¹⁶ Also, it will be recalled that Pennsylvania school districts are limited by state statute to the taxation of the income of residents.¹⁷

As pointed out previously,¹⁸ employed individuals are taxed on gross earnings while self-employed individuals are taxed on net profits after deduction of ordinary business expenses. This, in a very rough sense,

16. Supra, p. 90 .

17. Supra, p. 74 .

18. Supra, p. 211.

affords approximately equal treatment of individuals in the two categories, since each is taxed on what amounts to his "take-home pay". It should be noted that the self-employed, as well as trustees and like categories of taxpayers, are taxed only on income arising from "business" which raises the troublesome question of differentiating between business activity and the mere conservation and management of property. This difficulty will be considered shortly as a part of the what is taxable income.

TAXATION OF PARTNERSHIPS

City income taxes apply to the net profits of partnerships and other unincorporated forms of business organization as well as those of self-employed individuals. In the majority of cities noted, partnerships have been taxed as an entity.¹⁹ However, under this majority approach, where the taxable entity is itself non-resident and cannot be reached directly by the city, then in that event partnership is taxable on the basis of the distributive shares of such income payable to resident partners only.²⁰ Dayton, Ohio and Warren, Ohio, during the brief period that it levied a tax, have rejected the entity approach and tax partnership income individually to partners on the basis of the distributive shares received. Accordingly, only information returns are required from partnerships in a fashion similar to existing federal income tax practice. Thus, under this minority approach, resident partners of partnerships having a place of

19. Philadelphia (Pa.) Regs. Art. II-3(a), Art. II-4; Erie (Pa.) Regs., Art. II-3 (a); Toledo (Ohio) Regs. (under Ord. 18-46) Art. II-3 (3); Columbus (Ohio) Regs. Art II-3 (4), Art. II-4 (3); Springfield (Ohio) Regs. Art II-3, Art. II-4; Youngstown (Ohio) Regs. Art II-4 (3), II-3(3); Louisville (Ky.) Regs., Art. II-2, Sec. 1, 2 (c).

20. Ibid.

business in Dayton, Ohio are taxable individually on their distributive share of all partnership income from whatever location derived.²¹ On the other hand, a non-resident partner is taxable on his distributive share of net profits originating in or attributable to partnership activity in Dayton.²² This same dichotomy is applicable to other unincorporated businesses. One point in favor of taxing partnerships on the distributive share basis is that city income tax practice thus conforms with federal practice. It would seem that where possible the two systems should be similar. However, the majority of levying cities have followed the original Philadelphia plan and have evidently had no particular difficulty with this technique.

TAXATION OF CORPORATIONS

Taxation of corporate net profits is usual under all the city income taxes considered except those levied in the State of Pennsylvania where the pre-emption doctrine of that jurisdiction bars cities from tilling this fertile revenue field. The failure of Philadelphia to gain entry to the field has already been discussed.²³ Where corporate net profits are taxable, as in Ohio, no attempt has been made to tax all corporate net profits even of corporations having their sole place of business within a levying city, - rather cities have taxed that portion of corporate net profits attributable to activity within the city. The necessary allocation is made either on the basis of separate accounting where the activities of the corporate taxpayer as sufficiently departmentalized or

21. Dayton Regs., Art. IV-1,3; Warren Regs. Art. II-3 (3).

22. Dayton Regs. Art. II-1-3.

23. Supra., p. 57.

separable as to make this procedure^{221.} feasible. When this is not the case, the income allocation formula previously discussed is utilized.²⁴ The same formula is also used where allocation of individual income is required.

Fiduciaries, trustees and the like are also covered where their activities can be construed as resulting in the realization of earned income or net profits resultant from business activity. Mere passive holding of a trust res and the receipt and distribution of what is essentially investment or unearned income therefrom does not ordinarily constitute business activity and hence is not taxable. Between the limit of what is business on the one hand and what is mere passive receipt of investment income or conservation of a particular res, many "hard cases" must perforce fall.²⁵

A closely related problem is the taxability of executors and administrators. Dayton, Ohio has specifically exempted them during the process of administration of decedent's estates.²⁶ Toledo, Columbus, Springfield, Warren and Louisville (Ky.) have differentiated between income resultant from business activity and mere passive receipt; without such activity income is non-taxable.²⁷ Certainly from the standpoint of logic, where "business activity" is carried on as an incident of estate administration,

24. Supra., Chapter III, p.53; Ch. IV. p. 90; Ch. V. p.126; Ch. VI.p.156; Ch. VII, p.178; Ch. VIII, p.200.

25. Reference is made to the several Pennsylvania cases on this point discussed in Chapter IV.

26. Dayton Regs. Art. XVI-1-7.

27. Toledo Regs. Art. I-1 (b); Columbus Regs. Art I-1 (b); Springfield Regs. Sec. 1-2; Warren Regs. Art. I-1 (b); Louisville Regs. Art II-2, Sec. 2 (b).

resultant income should be taxable in the same fashion as income resultant from trust administration, which does not, however, lessen the difficult administrative problem of delimiting the area of what is "business".

TAXATION OF COOPERATIVES

In Ohio, cooperatives have been subject to local income taxation on the basis of the residue left from gross receipts after the deduction of costs and patronage refunds paid in cash within 90 days after the close of the appropriate accounting period of the "non-profit" corporation.²⁸ Such treatment appears clearly logical. The cities of Toledo, Warren and Youngstown have not yet taxed this type of income.

Turning from the subject of persons and entities subject to the tax to the equally important problem of taxable income, it may be initially observed that the determinations of economists have been something less than perfectly helpful to the legal draftsman, the legislator and the tax administrator on this question. It is the height of understatement to say that there has been lack of agreement on any theory of taxable income.²⁹ Whatever miscegenations of theory are involved, the definition of taxable income under existing local income taxes appears to have been determined pretty largely by two factors, - prior federal income tax experience and, secondly, legal limitations hedging the area within which local tax initiative can operate. In general, the earnings component of

28. Cf. eg. Columbus Regs. Art. II-6-1; Springfield Regs. Art. II-6, Dayton Regs. Art. II-6.

29. Cf. Paul H. Wueller, "Concepts of Taxable Income", The German Contribution, Political Science Quarterly; id., "Concepts of Taxable Income II, The American Contribution" Political Science Quarterly, 53 (1938) p. 557; "Concepts of Taxable Income III, The Italian Contribution", Political Science Quarterly, 54 (1939) p. 555.

the tax covers virtually all forms²²³ of realized personal service compensation including salaries, wages, commissions, bonus payments, other incentive payments and other personal service compensation and, frequently, tips.³⁰ Certain cities have provided specific exclusions from taxable income. Those included in the Columbus ordinance indicate the typical exclusions, as follows: (1) earnings of persons under 18 years,³¹ (2) military pay, allowances, and bonus payments paid as a result of the rendering of military service,³² (3) poor relief, old age pensions, disability payments, annuities and gratuities,³³ With respect to this third category of exclusions, it is difficult to see their being construed as taxable earned income in any event; however, the exclusion makes for additional certainty. There are, of course, minor variations in what constitutes taxable income. For example, Philadelphia does not now include payments to clerics for performance of religious functions as a result of an adverse court decision.³⁴ Louisville, Kentucky also excludes such payments from taxable income.³⁵

Usually tips are included as taxable under city income taxes.³⁶

Investment income unrelated to business activity is non-taxable in Pennsylvania.³⁷ (Supra. p. ____). In Ohio, state taxation of intangible personal property is measured by income yield.³⁸ The tax however is a property tax. The question as to whether or not the application of the pre-emption doctrine bars local taxation of investment income in Ohio

30. Cf. eg. Columbus Regs. Art. II-1, A (e).

31. Columbus Regs. Art. II-1, B (d).

32. Columbus Regs. Art. II-1, B (a).

33. Columbus Regs. Art. II-1, B (b) & (c).

34. Ross v. Philadelphia, 149 Pa. Super. 33, 25 A2d 834 (1942).

35. Louisville Regs. Art. II-1, Sec. 2, 1.

36. Philadelphia Regs. Art. II-1(e); Columbus Regs. Art. II-1A(e); Dayton Regs. Art. II-4-2(e); Louisville Regs. Art. II-1, Sec. 1, e; 1(a); Springfield Reg. Sec. II-1 F(1); Toledo Regs. Art. II-1(e); Warren Regs. Art. II-1(e); Youngstown Regs. Art. II-1(e).

37. Supra. p. 57.

38. Ohio General Code Sections 5323, 5388, 5389.

has not been judicially resolved. However, the separate concurring opinion of Taft, J., in the Angell case strongly suggests the application of the pre-emption doctrine to local taxation of income should that be attempted.³⁹ To date, no Ohio municipalities have made any such attempt. Other than the bar of the pre-emption doctrine, there appears to be nothing else standing in the way of local income taxation of investment income.⁴⁰

CAPITAL GAINS

Cities levying income taxes have split in their treatment of capital gains. Columbus, Youngstown and formerly Warren exclude capital gains from the determination of net profits earned.⁴¹ Other cities, including Dayton, Springfield and Toledo in Ohio, include capital gains when realized in the determination of taxable net profits.⁴² The following extract from the Dayton, Ohio Income Tax Regulations is representative of the treatment accorded capital gains by this second group of cities:

"Capital gains and losses, and the gains and losses from the disposition of depreciable property, including only gains and losses realized or incurred during the taxable year, shall be used in determining net profits subject to the taxes imposed by the ordinance. No adjustment shall be made to reduce such net profit (permissible under Section 117 of the Internal Revenue Code) regardless of the length of time the capital assets are held. Capital Gains and Losses shall not be affected by transactions consummated prior to July 1, 1950, excepting to establish a basis for the computation of gain or loss."⁴³

Thus, capital gains and losses are included in income from business

39. 153 Ohio State 179, 186-187, 91 N.E. 2d 250, 253-254 (1950).

40. Fordham and Mallison, op. cit. p. 249.

41. Dayton Regs. Art. II-10(j); Youngstown Regs. Art. II-9(j); Warren Regs. Art. II-9(j).

42. Dayton Regs. Art. II-9(e); Springfield Regs. Sec. II-8C; Toledo Regs. Art. II-9(j); Philadelphia Regs. Art. II-7(j); Louisville Regs. Art. II-5(j).

43. Dayton Regs. Art. II-9(e); Cf. similar provision in Toledo Regs. Art. II-9(j).

without benefit of any special treatment of capital assets based on the length of time held as is the case under the federal tax. Dayton goes one step further, as follows:

"Net profits as used in Section 2, subparagraphs (1) and (2) of the Ordinance and in Articles II-1 and II-2 of these regulations applies to the net profits derived by individual Residents and Non-Residents from activities or undertakings by such individuals whether or not such individuals are conducting, engaging in or carrying on an unincorporated business, profession or other activity."⁴⁴

Reading these two provisions together, it appears that Dayton is not simply including capital gains as a component of income from business activity by including them in the definition of "net profits" but rather, in effect, is taxing capital gains as such without regard to any "business" derivation of this type of "taxable income".

Before comment on this local tax innovation, a digression on tax treatment of capital gains in general is necessary in order to provide a basis for evaluation. Analytically, a capital gain or loss results from a change in the value of a source of investment income. Opinion as to the proper tax treatment of such gains or losses and their actual treatment have varied considerably,⁴⁵ from non-recognition on the one hand to complete recognition as ordinary income on the other.⁴⁶ Extensive treatment of this ever-open subject in the field of public finance is beyond the scope of this study. Fundamentally, the degree of recogni-

⁴⁴ Dayton Regs. Art. 11-9 (a).

⁴⁵ Cf. Magill, Roswell, Taxable Income, New York, Ronald Press: rev.ed. 1945, Ch.3, pp 81-142; cf. also for a general discussion of the Problem, Kendrick, M. Slade, Public Finance, Principles and Problems, New York: Houghton-Mifflin Co., 1951, p.527-545.

⁴⁶ Cf. Simons, Henry C., Personal Income Taxation, Chicago: University of Chicago Press, 1938, p. 148 et seq.; Groves, Harold M., Postwar Taxation and Economic Progress, New York: McGraw-Hill Co., 1946, p. 223 et seq.; Shoup, Carl, et al, Facing the Tax Problem, Twentieth Century Fund New York, 1937, p. 476-491.

tion of gain or loss for tax purposes^{226.} depends upon the prevalent concept of what constitutes "taxable income" in a particular jurisdiction. For example, British income tax practice, based upon a concept of income as recurrent receipts does not recognize a gain as giving rise to taxable income except where it arises and is realized in the course of "trade".⁴⁷ American treatment of capital gains in federal taxation has varied. At present, the federal income tax accords different treatment of gain or loss depending on the time a capital asset is held prior to actual realization of gain or loss. If a capital asset is held not more than six months prior to realization, the resulting sum is treated as ordinary income. Only 50% of long term gains realized on assets held longer than six months are counted with an effective ceiling tax rate of 25%.⁴⁸

It is interesting to note, parenthetically, that capital gains were held not taxable under the 1867 income tax; the Supreme Court regarded such gains "merely an increase of capital".⁴⁹ After the passage of the Sixteenth Amendment, when the question of the propriety of taxing capital gains was submitted to the court, it held them taxable.⁵⁰ The court followed the well-known definition of income; previously approved in Eisner v. Macomber,⁵¹ "Income may be defined as a gain derived from capital, from labor or from both combined, provided it be understood to include profit gained through sale or conversion of capital assets." The Court

47. Cf. Magill, Roswell, op. cit., p. 82 et seq.

48. Cf. I.R.C., Sec. 117; increased to 26% by Revenue Act of 1951.

49. Gray v. Darlington, 15 Wall 63 (1872); cited and discussed, Magill, op. cit., p. 103. The Gray case achieved transitory significance after the passage of the Sixteenth Amendment in Lynch v. Turrish, 247 U.S. 221, 38, S. Ct. 537 (1918) where the Court narrowly missed acceptance of the British philosophy on the tax treatment of capital gains.

50. Merchants Loan and Trust Co. v. Smietanka, 255 U.S. 509, 41 S. Ct. 38 (1921).

51. 252 U. S. 189, 40 S. Ct. 189 (1920).

also stated:⁵²

"In determining the definition of the word 'income' thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists and has approved, in the definition noted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution.

The British income tax decisions are interpretations of statutes so wholly different in their wording from the acts of Congress which we are considering that they are quite without value in arriving at the construction of the laws here involved."

With respect to argument that gain from an isolated sale should not be taxable and that only profits from sales made by persons engaged in the business of buying and selling for profit should be taxed, the Court stated:

"It is sufficient to say of this contention, that no such distinction was recognized in the Civil War Income Tax Act of 1867, c. 169, 14 Stat. 471, 478, or in the Act of 1894, c. 349, 28 Stat. 509, 553, declared unconstitutional on an unrelated ground; that it was not recognized in determining income under the Excise Tax Act of 1909, as the cases cited supra, show; that it is not to be found, in terms, in any of the income tax provisions of the Internal Revenue Acts of 1913, 1916, 1917, or 1919; that the definition of the word "income" as used in the Sixteenth Amendment, which has been developed by this Court, does not recognize any such distinction; that in departmental practice, for now seven years, such a rule has not been applied; and that there is no essential difference in the nature of the transaction or in the relation of the profit to the capital involved, whether the sale or conversion be a single isolated transaction or one of many. The interesting and ingenious argument, which is earnestly pressed upon us, that this distinction is so fundamental and obvious that it must be assumed to be a part of the 'general understanding' of the word 'income' fails to convince us that a construction should be adopted which would, in a large measure, defeat the purpose of the Amendment."⁵³

Accordingly, capital gains are and have been properly taxable at the federal level from a legal standpoint. Competent opinion has been expressed that the home rule taxing powers of Ohio municipalities extend to the

52. 255 U.S. at 519.

53. 255 U. S. at 520.

taxation of capital gains and that no state levy preempts the field.⁵⁴

While there appear to be no legal bars to capital gains taxation at the local level, the economic and administrative propriety of this policy is questionable. Certainly, taxing a gain which has accrued over a long period in the year of realization has elements of inequity under a system of progressive rates. Mitigation of this type of inequity at the federal level by means of averaging devices has not gone far. Similarly, in an economy characterized by a variable price level, many realized money gains are at least partially illusory as a result of variations in purchasing power. Conceptually, correction might be made with a "capital index"; actually, no such index is available and little has been done to mitigate the inequity of taxing illusory gains.⁵⁵

As long as the economic concept of income as a net addition to economic power and the legal requirement of realization as a basis for taxability are jointly applied, gains, in all probability, will be taxed. This conclusion is supported by the general feeling that non-taxation of gains would open a significant loop-hole for tax avoidance through coordination of corporate and personal tax minimization devices.⁵⁶

Accordingly, as a practical matter, at the federal level, reform and more equitable treatment of the taxation of capital gains will likely consist of averaging devices and attempts to compensate for the illusory character of much of what is presently taxed as gain. While the problem

54. Fordham and Mallison, *op. cit.* p. 249.

55. The Revenue Act of 1951 provides for nonrecognition of gain where the sale of a taxpayer's principal residence is followed within a period of one year by the purchase of a new residence. In this case, gain will be recognized only to the extent that the selling price of the old residence exceeds the cost of the new one. Cf. Act. Sec. 318.

56. Cf. eg. Groves, *op. cit.*, & Simons, *op. cit.*

is less acute at the local level due to the fact that rates are presently proportional rather than progressive, the general problem has significant relevance to local income taxation; obviously, city income taxes should be kept as simple as possible consistent with an adequate revenue yield. It is likely that the yield from including gains in the definition of taxable net profits will not be significant. Local income taxes with narrow tax bases are hardly the place for the type of complexities above described and city governments are ill equipped to administer this type of taxation. It is recommended that cities eliminate this inclusion from definitions of net profits earned. On balance, the Conclusions of Columbus and Youngstown seem on better ground than the practice of Dayton, Springfield and Toledo as to the treatment of capital gains. Alternatively, if gains are to be taxed at the local level, a city doing so would be well advised to follow as closely as possible the existing federal practice. If taxed, the distinction between long and short term gains should be applied at the local level so that uniform treatment of gains would be made at all levels of government which tax them. It may be observed that low proportional rates blur tax inequities at the local level, yet even so valid improvements should be carefully considered by city tax authorities.

In prior discussion of persons and entities subject to city income taxation, it was pointed out that net profits earned resulting from business activity within the taxing city by self-employed individuals, unincorporated businesses and corporations (with the exception of Pennsylvania) are taxable. Allocation of income where necessary is by formula as above discussed.⁵⁷

⁵⁷. Supra. p. 220.

230.
EXEMPTIONS AND DEDUCTIONS

With two exceptions, city income tax ordinances allow no personal exemptions or deductions. Springfield, Ohio, allows a lump-sum exemption from the tax of \$1040.00 per annum. However, if income exceeds \$1040, the entire amount is taxable.⁵⁸ Thus, an individual with an earned income of \$1040 would pay no tax while another individual with an earned income of \$1041. would incur a tax liability of \$10.41. This situation appears clearly inequitable. As noted in Chapter VII, this provision has been approved by a decision of the Clark County Court of Appeals.

The now defunct Warren, Ohio tax granted an exemption of \$1200 per annum.⁵⁹ An exemption of this type reduces the city income tax base materially. When coupled with a low proportional tax rate, it may make the revenue yield so low as to make use of the tax unsatisfactory. While fiscal adequacy is not the sole criterion of a sound tax, it is a most significant one. Appropriateness of exemptions will be discussed in Chapter X.

MULTIPLE TAXATION

One major problem arising from local taxation of income in an inter-dependent, mobile economy is that of double taxation,- subjecting a given amount of income to taxes levied concurrently by a number of different jurisdictions. This problem is accentuated by (1) the present tendency for metropolitan labor forces to be drawn from adjacent local jurisdictions, and (2) the exodus of city populations to suburbs and nearby rural areas. This particular problem of local income taxation arose

⁵⁸. Springfield Ord. Sec. 15 g.

⁵⁹. Warren Ord. Sec. 2.

earlier with respect to state income taxes. Some years ago, Professor E.R.A. Seligman considered this problem of multiple taxation with respect to the question of how to tax non-residents under the New York state income tax.⁶⁰ Seligman suggested three possible alternative patterns of income taxation as follows: (1) tax residents and non-residents alike on income received from sources within the taxing jurisdiction; (2) tax residents on their entire income and exclude income of non-residents; (3) tax residents on their entire income from whatever source derived and tax non-residents only on that part of their income arising from or attributable to sources within the taxing jurisdiction. Seligman rejected the first and second of the above alternatives and considered the third most appropriate on the grounds that it would not allow non-residents to go scot-free from tax on income arising within the taxing jurisdiction and also that it would not serve to encourage change of residence in order to avoid the tax.⁶¹

It should be noted that this proposal in and of itself offers no solution to the problem of double or multiple taxation in the case where income is subject to the concurrent levies of several different jurisdictions. Seligman's solution was "a provision whereby the state where the income is earned permits the non-resident to make a proportionate deduction of such tax on the income earned within the state from the tax, if any, which may be levied by the state of residence. This was the solution suggested by the present writer and adopted in the present New York law."⁶² The result, Seligman felt, was "equality all around".

60. Seligman, E.R.A., "The Taxation of Non-Residents in the New York State Income Tax", Chapter 9, Studies in Public Finance, New York: MacMillan, 1925, p. 180 at 191 et seq.

61. Ibid. p. 195.

62. Ibid. p. 195, 196.

Turning from this analysis, which^{232.} was presumably influential in shaping the form of the New York provision, to what has actually happened in American state income taxation, four general approaches have been made, as follows:

- (1) The Wisconsin Plan, - the tax base includes all income arising in the state regardless of the residence or non-residence of the taxpayer. (It will be recalled that this is, in effect, the plan used by the City of Louisville, Kentucky.)
- (2) The Delaware Plan, - the tax base includes all income realized by residents only from whatever source derived.
- (3) The New York Plan, - the tax base includes all income of residents and the income of non-residents originating in the state.
- (4) The Massachusetts Plan, - the tax base includes only the income of residents; tax rates differentiate between different categories of income. This plan, for purposes of territorial multiple taxation may be categorized with the Delaware plan above.⁶³

While a uniform rule may be considered desirable, it has not materialized. Such being the case, it would appear that the New York Plan coupled with the credit provision suggested by Professor Seligman is, if not an ideal solution, the least-worst one consistent with what is possible. It reconciles equity with fiscal adequacy. It is relatively obvious that a uniform treatment of income under state income taxation cannot be achieved without more state cooperation and federal state coordination that has yet been achieved. It is hardly to be expected that states will gracefully adopt the Delaware Plan and restrict taxation to the income of residents only or that they will adopt the

⁶³. Cf. Smart, L. Edwin, "A Study of Personal Income Taxes of Various States and Probable Yields of Such Taxes If Applied in Ohio" (Columbus, Ohio, Ph. D. Dissertation, Ohio State University, 1930), p. 23.

Wisconsin Plan basing taxation ^{233.} on the location of earnings only. In the absence of cooperatively achieved uniformity on either of these two bases, the New York Plan with appropriate credit provisions is the proper solution. With this evidence on development at the state level, the reactions of local governments to the problems of multiple territorial taxation created by adoption of local income taxes will be considered on a comparative basis.

It will be recalled that this problem gave rise to state control legislation in Pennsylvania. Philadelphia was given priority under Act 481 so that taxes due that city are deductible from all other city income taxes. As a result, there are no taxes levied adjacent to Philadelphia by neighboring communities. All other levying Pennsylvania cities operate within a state created pattern which gives priority to the city where the taxpayer lives as against the city of the situs of earnings. Under this rule, small fringe communities have been encouraged to levy income taxes, thereby reducing the revenue of larger centers.⁶⁴ The Pennsylvania pattern seems to be formalized with tax priority accorded the place of residence.

In Ohio, currently all cities have the right to levy such taxes. It is questionable if the legislature has power to bar small cities from using the tax and permit its levy by larger cities. Municipal classification is covered by constitutional provision in Ohio.⁶⁵

Certainly currently there is no bar to local initiative in this field except that contained in the incidence of the pre-emption doctrine. At

⁶⁴. Supra Chapter III, p. 18 et seq.

⁶⁵. Ohio Const. Art. XVIII, Sec. 1; Art. XIII, Sec. 6; and cf. State v. Bish, 104 Ohio St. 206, 135 N.E. 816.

present, five of the larger Ohio cities, Toledo, Columbus, Dayton, Youngstown and Springfield, are levying a city income tax. Warren has abandoned the tax. Taxes are or recently have been under consideration in Struthers, Campbell, and Marietta. Portsmouth and Grandview Heights have enacted income tax ordinances and repealed them prior to any collection. It is to be expected that other Ohio municipalities will adopt such taxes to the extent that property tax revenue and state aid are less than financial requirements.

TAX CREDITS

The majority of Ohio income tax ordinances initially ignored problems of and remedies for multiple taxation. Subsequent development without state control has shown material progress in the granting of tax credits which can largely solve the problem. Dayton, in its second income tax ordinance included a provision directed at the problem of double territorial taxation. Dayton gives its resident taxpayers a credit for the amount of tax paid on income earned outside the city to the extent of the Dayton tax levied on such income.⁶⁶ This provision is applicable solely to residents. Non-residents subject to the Dayton tax are allowed no credit if subject to a second income tax at their place of residence.

Springfield, Ohio has recently adopted a similar provision.⁶⁷ This provision permits Springfield residents only to deduct from their Springfield tax liability taxes paid to another city on income earned in

⁶⁶. Dayton Ord. Sec. 17; Dayton Regs. Art. XVII-1.

⁶⁷. Springfield Ord. No. 5106 amending Ord. 4741, passed January 2, 1951; cf. supra. Chapter VII.

such other city. Like the Dayton^{235.} credit provision, the credit is limited to the amount of the Springfield tax attributable to the income earned and taxed in the other city. There is no provision for non-residents.

Toledo, Ohio has gone one step further by providing a credit for both residents and non-residents.⁶⁸ With respect to non-residents, subject to a city income tax levied by their residence city, Toledo permits deduction from the Toledo tax of the amount of tax due the city of residence on Toledo earnings. The deduction is limited to 50 per cent of the Toledo tax on such earnings. Also this credit is further limited by a provision requiring that the other city have a reciprocal provision benefitting Toledo residents in its income tax ordinance.

The new Toledo ordinance also covers residents. It creates a credit for Toledo residents subject to another city income tax equal to the tax paid elsewhere. This is limited to the Toledo tax levied on outside earnings. Thus, the resident credit is similar to like provisions in the Dayton and Springfield ordinances. Section 15 also provides that any claim for a refund or credit thereunder must be made within one year following the year for which the refund or credit is claimed. These three provisions appear to be the sum of local development in Ohio thus far. Toledo has set the pace again by being first in the adoption of a credit provision covering both residents and non-residents.

Several hypothetical cases will illustrate the Toledo resident credit provision.

I. Assume X lives in Toledo and earns \$3000.00 there, his tax will be \$30.00.

⁶⁸. Toledo Ord. 689-50, Sec. 15.

- II. Assume X lives in Toledo and earns \$3000.00 outside the city but where no other city income tax applies, his tax is \$30.00.
- III. Assume X lives in Toledo and earns \$3000.00 outside that city but in a city which also levies a 1 per cent tax, his tax bill will include a liability of \$30.00 due the other city but nothing will be due Toledo.
- IV. Further assume that, in addition to the \$3000.00 earned outside Toledo, X also earns \$2000.00 in Toledo. Then he will owe a total tax bill of \$50.00 of which \$20.00 will be payable to Toledo and \$30.00 will be due the other city. Again his tax liability is the same as if all the income were solely subject to the Toledo tax.
- V. If the city of earnings has a 1/2 percent tax rate; other assumptions the same, X will owe the other city \$15.00 on the \$3000.00 earned there and will have a Toledo tax of \$35.00, a total tax of \$50.00.
- VI. If the city of earnings levies a 1 1/2 percent tax; other assumptions the same, X will owe the outside city \$45.00 on the \$3000.00 earned there and will have a Toledo tax of \$20.00. Accordingly, X's total tax will be \$65.00 as compared with a tax of \$50.00 if the entire \$5,000.00 of earned income were taxable solely under the Toledo impost. When the outside city has a tax rate higher than that imposed by Toledo, the city of residence, the Toledo residence credit provision is limited to the amount of tax at Toledo rates (1 percent) that would be levied on the outside earnings by Toledo. In this case, X is paying what amounts to a premium or penalty of 1/2 per cent (\$15.00) for having an inter-jurisdictional pattern. Complete uniformity would require a uniform rule and cannot be entirely accomplished by credit provisions.

As the examples indicate, the Toledo resident will have the same total tax, regardless of whether he works within or without Toledo and whether or not he is subject to one or two city income taxes except where the outside city levies at a rate higher than the existent Toledo rate. No city has as yet levied a city income tax in excess of 1 per cent except Philadelphia which has a 1 1/4 percent rate.

If a Toledo suburb levied a 1 1/4 percent income tax, in example VI, the Toledo resident would have an additional \$7.50 tax burden as a result of having an income arising in two jurisdictions. Parenthetically, he would be deriving benefits from the two jurisdictions as

well. While this aspect of the resident credit provision may be construed as encouraging fringe cities to increase rates should they levy such a tax; it should be noted that normally the income arises in the central city rather than in the pattern indicated in the examples discussed above. Also, the Toledo credit device applicable to non-residents employed in Toledo has an opposite effect as indicated in the following set of examples. On balance, at the sacrifice of some revenue, Toledo has given her residents a considerable degree of equitable treatment in the event that city income taxes spring up in adjacent incorporated areas.

Illustrations of the credit device applicable to non-residents of Toledo employed in Toledo are as follows:

- I. Assume that X, a non-resident of Toledo, earns \$3000 in Toledo and that there is no tax in the city where he resides, his total tax of \$30.00 is payable to Toledo.
- II. Assume that the residential suburb in which X lives levies a 1/2 percent income tax, then X owes Toledo \$30.00 and his city of residence \$15.00 additional.
- III. However, if the residential suburb includes a reciprocity provision in its tax ordinance, X will owe \$15.00 to Toledo and ~~\$15.00~~ \$15.00 to his city of residence.
- IV. Assuming that the suburb city hikes its rate to a full one percent, X will still owe Toledo \$15.00, since the credit is limited to fifty percent of the Toledo tax due. X will also owe \$30.00 to the city of his residence. Thus, his total tax bill will be \$45.

Thus under the credit provision applicable to non-residents, an incorporated suburb or adjacent city can levy a 1/2 percent city income tax and place no additional burden on those of its residents who work in Toledo. If, on the other hand, it increases its rate to one percent, it adds 1/2 percent to the effective tax rate applicable to its residents. It remains to be seen whether or not this iron fist in the

velvet glove approach will hold any fringe city income taxes that may be adopted in the Toledo area in the future to a 1/2 percent rate.

If one favors the central city as compared with adjacent residential suburbs, the problems of multiple local income taxation would seem to be pretty largely solved by this type of tax credit device. If, on the other hand, fringe cities are favored, state action could limit municipalities to taxation of the income of residents only. Also, if the problem of over-lapping taxation caused by rate differentials should grow acute and could not be solved by municipal cooperation, the General Assembly could adopt the Pennsylvania policy of placing a rate ceiling on the local power to tax income. The question of appropriate state policy will be reserved until Chapter X.

EVALUATION OF CITY INCOME TAXATION AND RECOMMENDATIONS

SUMMARY

Income taxation is a recent development in financing American local government and is being utilized currently chiefly by cities in three states, Pennsylvania,¹ Kentucky,² and Ohio.³ This development has occurred as a part of local government experimentation with non-property taxation as source of additional revenue. The introduction of this study indicated the financial problems facing municipal governments and possible alternative solutions including the use of non-property taxation at the local level.⁴ Chapter II sketched the legal limitations, - constitutional, statutory and judicial, - which seriously restrict the operation of local initiative in the revenue field. Legal limitations affecting Ohio municipalities were given particular attention. The spread of local income taxation in Pennsylvania was surveyed in Chapter III. Primary attention was given to the City of Philadelphia in view of the fact that it was the innovator in using an income tax at the municipal level and is the prototype for most of the similar taxes levied elsewhere. The use of this impost by the Kentucky municipalities of Louisville and Paducah was considered in Chapter IV. The adoption and levy of city income taxes by the Ohio cities of Toledo,⁵ Columbus,⁶

1. Cf. Chapter III, supra.

2. Cf. Chapter IV, supra.

3. Cf. Chapters V - VIII; The brief experience of St. Louis, Mo. was discussed in Chapter II.

4. Cf. Chapter I, p. lff.

5. Cf. Chapter V.

6. Cf. Chapter VI.

Springfield,⁷ Dayton,⁸ Youngstown,⁸ and formerly Warren⁸ have been presented in some detail.

Comparative analysis of the tax treatment of both persons and entities and of different types of income was made in Chapter IX. Also, the spontaneous development of credit devices designed to mitigate the impact of overlapping local income taxation in Ohio was considered. In this final chapter, an attempt is made to evaluate this tax development and to determine the desirability and propriety of the inclusion of income taxes in city revenue systems. Finally, tentative recommendations for local and state policy with respect to this tax area are submitted.

EVALUATION

Initially, it may be stated that any tax should measure up, insofar as possible, consistent with an adequate yield, to the canons of ability, certainty, convenience and economy originally postulated by Adam Smith.⁹ Assuming that Smith meant literally what he said concerning taxation in proportion to ability in the first canon, these taxes measure up because without exception city income taxes are proportional in form. The question of the extent to which these taxes do violence to presently prevalent concepts of ability to pay and the further question of whether any violation of these concepts makes proportional city income taxation an inappropriate method of raising needed revenue will be considered later in this chapter.¹⁰

7. Cf. Chapter VII.

8. Cf. Chapter VIII.

9. Smith, Adam, An Inquiry Into The Nature and Causes of The Wealth of Nations, Book V, Ch.2, (Cannan Edition) New York: Modern Library, 1937, p. 777ff. Smith's first canon is as follows: "The subjects of every state ought to contribute towards the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State."

10. Infra. p. 250.

Turning to the other Smithian canons, city income taxes are "certain", there are few ambiguities in the taxing ordinances and while certain inclusions to and exclusions from taxable income are questionable policywise,¹¹ the tax base is certain and definite. Since these taxes follow the withholding system developed under the federal income tax, they are relatively convenient for the great mass of taxpayers. For those taxpayers not subject to collection at source, the preparation of a city income tax return, while perhaps irritating, can hardly be unduly burdensome in view of the fact that such persons or entities must already comply with the return and reporting requirements of the federal income tax. In this connection, it cannot be urged too strongly that in a double or triple decker tax system, the canon of convenience suggests that insofar as possible the tax base be defined similarly by each levying governmental unit so as to simplify the reporting duties of both taxpayers and withholding employers.

COST OF COLLECTION AND COMPLIANCE

As to the canon of economy, costs of collection ranging from 2% to 5% of revenue income are not unreasonable. However, where audit and enforcement programs lag,¹² low cost of collection figures must be viewed with some suspicion since it is possible that they indicate not economical administration but rather mere skimming of the cream from the top of the bottle by the levying city. Cost of collection and compliance is likely to be excessive when small cities or other local governments of

11. Cf. Chapter IX, *supra*. p. 224, 228.

12. Cf. Chapter IV re Louisville, Ky.; Cf. Chapter VI re Columbus, Ohio.

less than approximately 50,000 population levy income taxes. This possibility suggests the non-levy of such taxes by small units.¹³

It is unfortunate that there is a virtual dearth of material on the compliance costs of both individual taxpayers and of employers subject to the standard withholding requirements of city income tax ordinances. For example, the P. Lorillard Company withheld from employees remunerations earned in the City of Louisville, Kentucky in 1950 the sum of approximately \$30,000.00; yet the company is presently unable to make what in its opinion would be an accurate estimate of the cost it absorbed in so doing.¹⁴ In fact, if the policy of the General Electric Company is representative, employers do not attempt to segregate compliance costs by individual taxes or compile statistics showing the total cost of compliance with particular tax statutes. It has been estimated that the annual cost to the General Electric Company of complying with the withholding provisions of local income tax ordinances amounts to approximately \$3.00 per employee.¹⁵ As of December 31, 1950, General Electric had 2300 employees subject to Ohio city income taxes and 21,600 employees subject to the income taxes of Erie and Philadelphia in Pennsylvania.¹⁶ Accordingly, if Mr. Kitendaugh's estimate is accurate, General Electric's cost of compliance with city income tax withholding requirements was \$6,900 in Ohio and \$64,800 in Pennsylvania. In addition, General Electric spent from \$200 to \$300 in determining its own tax liability under each applicable city income tax. Since corporate

13. Cf. Chapter III, p. 82 .

14. Letter to the writer from Mr. J.J.Darby, Comptroller, The P.Lorillard Co., dated March 14, 1951.

15. Letter to the writer from Mr. G.H.Kitendaugh, Tax Accountant, The General Electric Co., dated April 10, 1951.

16. Ibid.

income is not taxable locally in Pennsylvania,^{243.}¹⁷ the company would have been subject to five city income taxes in Ohio in 1950,- those of Columbus, Dayton, Toledo, Warren and Youngstown,- making a total compliance cost of about \$1500 in addition to the sum of \$6,900 expended to comply with Ohio local withholding requirements. While undue significance should not be attached to a single case, these estimates illustrate the burden laid on employers by collection at source provisions. In the absence of general data, judgment on compliance costs must be inconclusive; nevertheless, the probability of heavy compliance costs,- accentuated, as it necessarily would be, by the overlapping incident to any widespread utilization of local income taxation, is a valid criticism of these taxes.

As long as city income taxes are levied mainly by large urban centers with relatively little overlapping by different city income taxes, this criticism need not be given much weight by either local tax authorities or state policy makers in view of the multiple reporting duties imposed on business units by all levels of government and the absence of adequate comparative data. On the other hand, when a large percentage of all potential taxpayers are covered by one or more local income taxes, this problem of compliance cost may become critical. Such a development, seemingly the current case in Pennsylvania, suggests the adoption of a state income tax in lieu of multiple local income taxation. In summary, reserving judgment on rate structure and regarding evaluation of compliance costs as largely an inconclusive matter for lack of adequate data, the city income tax, when levied by a large urban center, measures up to the criteria established by the Smithian canons.

¹⁷. Ch. Chapter III supra., p. 51..

This conclusion can hardly be extended to the levy of the tax by multiplicity of small governmental units as is presently the case in Pennsylvania.

Eight years ago, the Groves-Gulick-Newcomer Committee suggested that the solution of the local government fiscal problem is to be found in the adoption and utilization of a new local revenue source.¹⁸ Is the local income tax an answer? This question requires consideration of the tax in some detail. As pointed out in the introductory chapter of this study,¹⁹ the Committee set up four criteria for evaluating the needed revenue source; in substance as follows, it should: (1) not overlap existing Federal and State taxes; (2) enable localities to tap their own resources without running hat in hand to central governments; (3) cover all or a vast majority of interested citizenry; and (4) not be regressive.²⁰ Finding a local revenue source that would satisfy these four requirements perfectly is "no easy assignment" and, in fact, such a tax probably exists only in the realm of ideals rather than within the scope of possible local action. These proposed criteria do, however, provide a basis for evaluating city income taxes in relation to the expressed need for an additional source of municipal revenue. In the interest of accuracy, each proposed criterion will be considered critically as well as used as a yardstick for determining the appropriateness of the local income tax.

First, city income taxes obviously overlap other existing taxes;

18. "Federal, State and Local Government Fiscal Relations", Senate Doc. 69, 78th Congress, 1st Session, 1943, p. 413.

19. *Supra.* p. 3.

20. "Federal, State and Local Government Fiscal Relations," *op. cit.*, p. 409.

in all cases they overlap the federal income tax.^{245.} No state personal income tax is levied in Ohio and Pennsylvania.²¹ Pennsylvania levies a corporate tax. There is overlapping with a state income tax in the case of the Kentucky municipalities of Louisville and Paducah.²² Also this was formerly the case under the St. Louis, Missouri, city income tax.²³ Accordingly, city income taxes do not meet the requirements of the first proposed criterion. The question then arises, what significance, if any, does this fact have?

Separation of the revenue sources of the three layers of American government was, to a large extent, a realized fact in nineteenth century America. As the expenditure requirements of government increased, this pre-existing separation was progressively abrogated as both federal and state governments expanded into revenue fields which had previously been largely the preserve of the other. For example, in the income tax field, in addition to the federal levy, at present, 29 states and the District of Columbia impose individual net income taxes; corporate income taxes are levied by 32 states and the District

21. A proportional .5% state income tax was proposed by the Pennsylvania Governor at this session of the Pennsylvania General Assembly. On August 8, 1951, the Senate Finance Committee killed H.B. 840, which as passed by the House would have levied a .5% personal income tax. In September, the Committee reconsidered the bill and reported it out with an amendment changing the effective date to January 1, 1952. Cf. State Tax Review, Commerce Clearing House, Vol. 12, No. 39 (September 27, 1951) p.3. At the date of this writing, the Pennsylvania legislature has recessed, but not adjourned, without further action on the tax proposal. It is anticipated that any such tax, if adopted, will not immediately disturb the existing use of income taxes by Pennsylvania local governments.

22. Cf. Chapter IV, supra. p. 87.

23. Cf. Chapter II, supra. p. 28.

of Columbia.²⁴ ^{246.} While separation of sources may be regarded with understandable nostalgia for the structural simplicities of the past, it appears doubtful that American state governments will forego state taxation of income and leave the area the exclusive domain of the Federal government. In 1948, personal and corporate income taxes accounted for 15.9% of total state tax revenues, excluding unemployment compensation taxes.²⁵ Despite possibilities of administrative simplification and uniform treatment of income inherent in the idea of income taxation solely by the federal government, it is highly probable that the present double-decker system of income taxation will continue, - it is unlikely that state and their local governments will voluntarily vacate the field.²⁶ Assuming the continuance of two layers of income taxation in the United States, the question then arises as to the propriety of adding another layer to the tax structure by permitting local taxation of income.

The argument that a triple level system of taxation increases administrative and compliance costs is obvious. The problem would not arise in the same form in a unitary state. In a federal system, the

24. "Federal-State Tax Coordination, A Treasury Tax Study", Division of Tax Research, U.S. Treasury Department, Washington, D.C., 1949, p.1.

25. *Ibid.*, p. 2.

26. For a recommendation that states withdraw from taxing income cf. eg. Maxwell, James A., *The Fiscal Impact of Federalism in the United States*, Cambridge: Harvard University Press, 1946, p. 269ff. In this connection, the Canadian Dominion-Provincial wartime tax agreements, which provided temporarily for Dominion pre-emption of income taxation during World War II have frequently been mentioned as an example of federal-state tax cooperation. As a matter of fact, these agreements expired in 1947 and the two important provinces of Quebec and Ontario have elected not to participate further in the accord. Perhaps this indicates that lesser governments in a federal system will not lightly sacrifice tax rights in the interest of coordination movements.

validity of the argument depends^{247.} upon the alternatives open to local governments. It is difficult to envisage any practical solution to local government financial problems by means of taxation that would not result in tax overlapping. If the expansion of grants is rejected as a complete solution on the non-economic ground that it entails an excessive sacrifice of home rule powers.²⁷ added revenue must of necessity come from either an increased yield from an existing source or from a new revenue source. Presumably if revitalized property taxation were a complete solution, supplementary non-property taxation would not have come into being.²⁸ Accordingly, cities must turn for additional tax revenue to high yield taxes of which income, excise or business taxes are most significant. Any one of these will, if utilized at the local level, overlap some similar tax levied by either or both state and federal governments. Thus, unless the states or the federal government are willing to vacate significant tax sources to localities, some overlapping will result from local non-property taxation. Since no significant vacation appears likely, separation of sources is quite simply neither practical nor possible at present. Any new tax will in all probability overlap taxes of one other if not two other layers of government.²⁹ This situation may be accepted as a fiscal fact of life in mid-twentieth century America. Accordingly, it is submitted that the

27. Cf. Chapter I, supra., p. 4.

28. Cf. eg. remarks of Youngstown, Ohio, Director of Finance, Chapter VIII, supra. p. 203.

29. It will be recalled that the Ohio "preemption doctrine" prevents concurrent levy of the same or a similar tax by the State of Ohio and its local governments. Similarly, local taxation of corporate income is not permissible in Pennsylvania due to state preemption. Cf. Chap. II, III, supra. Thus, as the Ohio and Pennsylvania situations stand at present only a double layer of income taxation is possible. It is quite conceivable that judicially approved permissive legislation might permit concurrent levy in either state at some future time. This time may be not so far off in Pennsylvania. Cf. Note 21, supra.

fact that city income taxes violate the first criterion propounded by the Groves-Gulick-Newcomer Committee is not of controlling significance.

Even if separation of sources were probable, which in fact it is not, it would be rather delusive conceptualism to regard any superficial separation of revenue sources as affording a functional separation of economic burden. Tax payments must come from either the income or the capital of the taxpayer unless the tax be shifted. Given current expenditure levels, if governmental outlays are to be met by taxation, taxes must of necessity tap income where it is. This means that the main burden of taxation must fall on those income receivers in the less than \$5000 per annum bracket.³⁰ The form of the imposts utilized will necessarily vary; the fact remains that, analytically, the tax burden must fall on taxable capacity where it exists in the prevailing distribution of income, - namely in the lower than \$5000 bracket. City income taxes meet this requirement.

If separation of sources is rejected as unrealistic and if recognition is given to the fact that effective local taxation must necessarily be adjusted to taxable capacity, it would appear that overlapping taxation is largely unavoidable. If so, criticism of overlapping, mitigated by reciprocal credits, is not effective as to present local income taxation in Ohio. However, where such taxation proliferates to the point of covering all or a significant portion of the population of larger jurisdiction, the question arises of balancing administrative simplicity and economy with the non-economic values of self-

30. Report of the Committee on Finance on the Revenue Act of 1948, 80th Congress, 2d Session, Senate Report 1013, pp. 30-31; also Kendrick, M Slade, "Public Finance, Principles and Problems", Boston: Houghton-Mifflin, 1951, p. 496.

supporting local government.^{249.} At such a point, the question of the appropriateness of a state income tax as an alternative to local income taxes becomes important. Until such time, the existence of overlapping, provided that the resultant inequities are mitigated by appropriate credit devices,³¹ need not be given undue weight as a criticism of the local income tax.

As to the second criterion suggested, the city income tax certainly permits a municipality to tap the resources of its own population and in addition allows it to tax effectively beyond its legal boundaries so as to require the residents of adjacent suburban areas, from which the city labor force is frequently drawn, to support the cost of operating the central city. City income taxation is particularly appropriate as an effective means of taxing an economic area which benefits from the existence of a central city. This conclusion does not deny the acute need for modernization of local government or the fact that in the long run obsolete city boundaries should be extended to cover functional urban areas. In view of the fact that such modernization is an extremely slow process, it may be observed that city income taxes not limited to residents provide an effective means of financing city government during what will be an extremely long structural and boundary adjustment process. Parenthetically, it may also be noted that the future of self-supporting local self-government appears bleak if it fails to adjust governmental units or ad hoc districts to appropriate economic service areas. One by-product of failure in this regard would probably be further centralization of the taxing function. There is no question as

31. Cf. Recommendation, *infra*. p. 265.

to the fiscal adequacy of such taxes given a reasonable standard of administrative competence when they are levied by a metropolitan center.³²

As to the third criterion,- that a city tax should cover all or virtually all persons,- city income taxes cover all employed persons within a given levying city and, in addition, cover self-employed persons and those in business. Where taxation of corporations is not barred by state action, corporate income is taxable. In conjunction with existing property taxation, all taxable individuals and entities would seem to be covered under the Ohio taxes.

It will be recalled that the fourth and final criterion suggested by the Groves-Gulick-Newcomer Committee was that a "city tax should not be regressive".³³ Comparison of existing city income taxes with this criterion requires extended discussion. If one is to avoid mere symbolic persuasion, certain definitional distinctions must be made and followed. A tax is "proportional" if as the tax base (income) increases, the tax rate remains constant; it is "progressive" if, as the tax base increases, the tax rate also increases.³⁴ Similarly, a tax is "regressive" when as the tax base decreases, the tax rate increases. On the basis of these definitions, city income taxes are proportional by definition. In this sense they meet the requirement of Smith's first canon of taxation and are in a basic legal sense equitable in that all persons similarly circumstanced are treated alike.³⁵

32. Cf. Chapter V supra. re Toledo.

33. "Federal, State and Local Government Fiscal Relations", op.cit.p.409.

34. The fact that many taxes usually termed "progressive" are sometimes more strictly characterized as "degressive" will be ignored here.

35. Cf. supra. (p. 240. *to be*).

The term "regressive" is ^{251.}often used with a different implicit definition from that used above. In this second sense, "regressive" refers to a tax which takes a larger percentage of the income of a low income recipient than a larger income receiver, - and any relationship between rate and base is no longer essential to the meaning of the definition. Using this second meaning of the word, one may find any tax which is not progressive as to its rate structure condemned as "regressive". On the other hand, a tax cast in proportional form when coupled with a continuing exemption will be progressive in fact. As the tax base, income, increases above the exemption, the amount exempted is a decreasing fraction of the whole and the tax as a percentage of income increases.³⁶ This fact is sometimes not made explicit in consideration of the actual results of taxes with proportional rates.

Also in considering the general propriety of alternative tax rate structures, it must be noted that money income is an imperfect measure of real income and "ability to pay" due to the presence of significant amounts of income in kind; various benefits accruing to some individuals as a result of governmental expenditure programs; and changes in the price level. In this connection the incidence of benefits is fully as important as the incidence of taxation. Income is redistributed just as much by government expenditure as by taxation. It is theoretically conceivable that significant real income redistribution could be accomplished by expenditures while simultaneously leaving the relative distribution of money income unchanged.

36. Schultz, William J. and Harriss, C. Lowell, American Public Finance, Op. cit., p. 267.

In general fiscal theory, the distribution of the burden of taxation is significant in terms of systems of taxes rather than in terms of any particular tax. In an even broader sense, the combined effect of expenditures, which offset much of the lower-income bracket tax burden by making offsetting non-taxable additions to real income in the form of welfare and other payments, and taxation in general must be considered. In this broad area, agreement is difficult, hinging as it does on questions of psychology, ethics, mathematics and political philosophy as well as economics.

However, this study is not directed to such broad questions but rather, at this point, to the much narrower question of the appropriateness of alternative rate structures in local income taxation. Should such taxes have proportional or progressive rate structures from a practical policy standpoint? There are a number of valid reasons for maintaining proportional rates at the local level.

First, one characteristic of local government finance is the existence of marked variations in both wealth and income between different local jurisdictions. For example, a particular suburb of a large urban center may have a much higher per capita income and much greater wealth than a similar city of comparable population in another section. Probably, a progressive rate structure would have a greater effect than a proportional one in stimulating migration, which to the extent that it materialized, would further increase inter-jurisdictional differentials in taxable capacity.

Second, local governments operate on a narrowly circumscribed tax base within a framework largely established and controlled by higher

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levels of government. The limitation of the local tax base suggests that if federal, state and local governments (desiring a given revenue) simultaneously levied progressive net income taxes the resultant combined tax rate might become confiscatory or almost so for upper bracket income. It should be observed, however, that the deductibility of one income tax from taxable income under another income tax reduces the progression of the first tax. Under the federal income tax, state income taxes are an allowable deduction in the computation of net income. Also, two-thirds of the states which levy a state income tax permit the deduction of federal income taxes in the determination of state income tax net income. This feature of reciprocal deductibility means in effect that no combination of rates can be confiscatory if no single rate is confiscatory.³⁷ To what extent income tax levying states desiring to increase the yield of state income taxes will continue permitting the deduction of federal income taxes in computing state net income is uncertain.

In this connection, it should be noted that city income tax payments are an allowable deduction from adjusted gross income under the federal personal income tax. This fact is of little practical significance for the many taxpayers who use the "optional standard deduction", \$1000 or ten percent of adjusted gross income whichever is less, in lieu of itemizing deductions. In such cases, the specific deduction of city income tax payments is absorbed by the optional standard

37. "Federal-State Tax Coordination", op.cit. p. 6. "Thus, the maximum effective rate of 77% under the (1948) Federal tax plus a maximum rate of 15% under the State tax would produce a combined effective rate of only 77.9% if reciprocal deductibility is in effect and of 80.45% if the Federal government permitted but the state denied the deduction."

deduction and the taxpayer gains nothing that he did not already have. Where specific itemization of deductions is appropriate for a particular taxpayer, city income taxes are deductible. However, federal income tax payments are not generally deductible from taxable income in the determination of local income taxes.³⁸

Thirdly, a flat rate facilitates collection and tends to minimize fluctuations in revenue yield as compared with a progressive rate structure. "Built in flexibility", the tendency of a progressive tax to produce more revenue in prosperous periods than in cyclical downswings of the economy, may be a desirable characteristic of the federal income tax. However, revenue stability is quite important to local governments which can hardly program their activities with the flexibility possible for higher governmental levels. While income yields will vary under either a proportional or a progressive rate structure they will probably vary less with a proportional rate.

On the basis of the points discussed above, the taxation of income at the local level should remain proportional. This conclusion should not prove unacceptable even to those desirous of utilizing a progressive rate structure to redistribute national income in some more generally, if rather imprecisely defined, "equitable" fashion as long as the city levy on earned income is not unduly heavy. Current levies up to 1% appear reasonable. Professor Harold M. Groves has defended the proportional city income tax as follows: "It facilitates collection at the sources and avoids reliance upon an unstable element in income

³⁸. Stockwell v. Columbus, (C.P.Ct., Franklin Cty., Ohio, \$175387) 39 O.O. 499; 55 O.L.A. 168; 86 N.E. 2d 822 (1949).

tax revenues. A proportional tax, of course does not perform the function of equalizing income, but perhaps the equalizing role should be left mainly to the federal government."³⁹

Assuming that Professor Groves meant equalization by means of taxation, the comment is appropriate; the redistributational aspect of tax policy can best be left solely to the federal government on the ground that it is the level of government best equipped in a federal system to perform broad overall functions which affect the economy as a whole. It must also be noted that expenditure programs of state and local governments do perform a significant role in terms of equalizing real income.

Another aspect of the propriety of local tax progression arises as a part of the problem of the proper division of powers in the federal system. If, as appears likely in the absence of any really effective federal-state-local fiscal coordination, fiscal policy in its anti-cyclical sense is to be almost entirely a federal government function, it is important that state and local government tax policies do not work at cross purposes with federal fiscal programs designed to provide economic stability and full employment levels of national income without inflation. In the past, the "perverse" policies of state and local governments have run counter to what would have been

39. Groves, Harold M., "Income Versus Property Taxes for State and Local Governments" in Trouble Spots in Taxation, Essays in the Philosophy of and Other Public Finance Problems. Princeton: Princeton University Press for the University of Cincinnati, 1948, p. 83.

an adequate anti-cyclical policy.⁴⁰ As local government financial structures evolve, attention needs to be given to implementation which will minimize future conflicts of this type.

Anti-cyclical fiscal policy relies upon the conscious, planned utilization of governmental taxing and spending powers to achieve particular goals. Modification of the progression of the tax system as a whole is one possible fiscal policy technique. For example, it is obvious that one possible component of anti-inflationary fiscal policy would be to reduce the progression of the tax system with a view to reducing the rate and volume of personal consumption expenditures. Any such modification would in all probability be achieved, if at all, through modification of the federal personal income tax. It may be observed, parenthetically, that much of the effect of this type of program may be cancelled out by a simultaneous increase in governmental expenditures. Exactly the opposite type of program might be utilized to free income from the impact of taxation with the expectation that by increasing the progression by either reducing rates in the lower tax brackets or by changing the level of personal exemptions, consumption expenditures would be increased. In either event, it is conceivable that utilization of progressive rates at the local level, characterized by inter-district rate variation and little real concern for the niceties and timing requirements of federal planning, would impede national fiscal policy. This possibility suggests that potential conflict would be avoided by maintaining the

40. Hansen, Alvin H., and Perloff, Harvey S., "State and Local Finance in the National Economy", New York: W. W. Norton & Co., 1944, p. 48 ff.

neutrality of city income taxes by the use of flat proportional rates.

It will be recalled that current judicial interpretation of constitutional requirements in Pennsylvania requires that such taxes be proportional; that ruling would bar progressive city income taxes in that state even if state legislation setting a one percent ceiling on city income tax rates were repealed.⁴¹ In Ohio, Article XII, Section 8 of the Ohio Constitution, adopted in 1912, authorizes the levy of an income tax by the state at progressive rates. This section is not specifically applicable to municipalities. As previously discussed,⁴² the rule of *State ex rel Schwartz v. Ferris*⁴³ casts a cloud on the legality of progressive local income taxation in Ohio. The rejection of progressive rates in this study is not predicated upon legal bars in the way of their utilization, - such bars could be removed, - but rather on the basis that such rates are not appropriate from an economic and administrative standpoint. This conclusion has been arrived at by others not all of whom are noted for their fiscal conservatism.⁴⁴

Turning to another ground for criticism of city income taxes as now constituted, there are no general exemptions from taxable income. All earned income is taxable at the flat rate regardless of the number of dependents and the total income of the taxpayer. This state of affairs invites criticism.⁴⁵ It has frequently been stated that when

41. Cf. Chapter III, *supra*. p. 54.

42. Cf. Chapter IX, *supra*. p. 213.

43. 53 Ohio St. 314, 41 N.E. 579 (1895).

44. Hicks, Ursula K., Public Finance, Cambridge: Cambridge University Press, 1947, p. 271; Groves, Harold M., *op. cit.*, p. 83; Hansen, Alvin H. and Perloff, Harvey S., State and Local Finance in the National Economy, *op. cit.*, p. 249; Vickrey, William, Agenda for Progressive Taxation, New York: Ronald Press, 1947, p. 321.

45. Cf. eg. "Federal, State and Local Governmental Fiscal Relations", *op. cit.*, p. 407.

a particular taxpayer has such a low income that the application of a tax would tend to constitute the person a public charge as a result of the burden of the tax, than the levying authority is justified in exempting the property or income of the person from taxation.⁴⁶ On the other hand, for many years, authorities have held that all those who vote should be subject to at least a minimal tax.⁴⁷ Variations in the level of personal exemptions under the federal personal income tax, ranging from \$3000.00 for a single person and \$4000.00 for a married person in 1913 to a low of \$500.00 per person during World War II, suggest that the actual level of personal exemptions has varied with revenue needs and administrative feasibility rather than concepts of tax consciousness and ability to pay.

With the development of efficient collection at source techniques, administrative desiderata may no longer be particularly compelling at the federal level. Present city income tax practice presents a significant difference in that those receiving all of their taxable income from sources subject to withholding do not file a final individual tax return. Adoption of exemptions would require filing a final annual return by all taxpayers. This would increase administrative costs due to the necessity of processing additional small returns. Refunds that would need to be made in many cases would increase costs of administration still further. Coupled with this administrative reality is the additional fact, which has been pointed out by others,⁴⁸ that the

⁴⁶. Martin, James W., "General Theory of Tax Exemption", in Tax Exemptions Symposium Conducted by the Tax Policy League, New York: The League, 1939, p. 6.

⁴⁷. Cf. eg. Marshal, Alfred, "Appendix G, The Incidence of Local Rates With Some Suggestions As To Policy", Principles of Economics, 8th Edition, Macmillan Co., 1920, p. 804.

⁴⁸. Newcomer, Mabel, "The Level of Personal Income Tax Exemptions" in Tax Exemptions, op. cit., p. 100.

importance of the tax consciousness argument increases as the vested interest of small income receivers in governmental spending and welfare programs grows.

Consideration of exemptions at the city level is not only a matter of appropriate degrees of tax equity. If the revenue yield of a city income tax is materially reduced by exemptions coupled with low proportional rates, it may not only become a feeble aid to financing government but also may fail to demonstrate sufficient results to obtain continued electoral approval.

Clearly a strong case can be made for minimal exemptions in theory. Policywise, this point is not particularly significant as long as (but no longer) rates are at a low proportional level. Under the present federal income tax, a single individual with an annual income of \$700 would pay a federal tax of \$8.00; the same individual if subject to a 1% city income tax would pay a city tax of \$7.00. The comparison indicates the relative burden. Of course any significant increase in local rates would magnify the inherent inequity of the present no-exemptions policy. It is not likely that such rate increases will materialize; legislative limitation would probably prevent such a development. On balance, particularly from an administrative and yield standpoint, it would appear that the present system of no exemptions should continue. Certainly from a policy standpoint it can be left to the discretion of the respective city administrations subject as they are to the close control of their respective electorates. There is no present necessity for state intervention in this regard.

Stating the problem differently, would urban populations be better

served by city income taxes cast in their present form or by similar taxes modified to include exemptions at the existing federal level with the tax rate increased so as to raise approximately the same revenue yield? This would seem to be the nub of the problem from a practical standpoint if levying cities are to continue to obtain adequate supplementary revenue from this new non-property source. Posed this way, the answer would seem to be for the affected electorate. Under the second solution, it is likely that administrative costs would be increased due to increased bookkeeping and the expense of refunds. For all but the most marginal income receiver the practical result would be substantially the same.

In considering the problem of exemptions, it will be recalled that welfare payments and other types of unearned income, which increase ability to pay in terms of real income, are excluded from the tax base since city income taxes are levied on earned income only.⁴⁹ Accordingly, retired persons and many in the lower income brackets would not be subject to the tax. On balance, as long as rates are low, the existing system appears adequate and reasonable. Lack of adequate exemptions for dependents cannot be defended at any but the lowest rates. In this connection, the modification in the proposed Springfield (Ohio) ordinance are indicative of possible change.⁵⁰ It must be remembered that if the need which calls a particular income tax into being is real, acute and continuing, then adding even moderate exemptions requires either an appropriate off-

49. Cf. Chapter IX, p. 222.

50. Cf. Chapter VII, p. 197.

setting increase in the tax rate or a new search for additional revenue from another source which is no easy matter at the local level.⁵¹

Another problem arises with respect to who bears the burden of the city income taxes. The extent to which a particular tax is shifted from the base upon which it is legally imposed is, to say the least, a "nice question". The present state of economic analysis does not afford answers notable either for clarity or precision except within the framework of extremely limiting assumptions which materially reduce the validity of resultant determinations when applied to actual situations.⁵² It has been stated: "The extent to which a given tax remains where imposed or is shifted forward to purchasers or backward to producers is impossible to determine with any degree of accuracy".⁵³

With respect to city income taxes, this question of shifting is even further obscured by the complex nature of present industrial compensation. The payroll deduction resulting from the levy of a city income tax is merely one of many deductions from the pay envelope or check of many individuals. To what extent, if at all, this single item is shifted is blurred by the complexity of the entire payroll situation. Certainly with the marked increase in the effective bargaining power of modern labor organizations, it is reasonable to assume that in some cases the payroll tax is shifted to the employer. This cannot be assumed to be a uniform result in view of the large numbers of unorganized workers and of the varying degree of tightness

51. Cf. Chapter I, p. 16.

52. Cf. e.g. Groves, Harold M., "Financing Government", Third Edition, New York: Henry Holt, 1950, p. 132 et seq.

53. "A Study of the Tax and Revenue System of the State of Ohio and Its Political Subdivisions", Ohio Department of Taxation, 1947, p. 12.

in the labor market through time. When shifting to the employer does take place, the further question of whether the employer absorbs the tax or shifts the burden further by means of a price increase on the good or service produced for sale depends upon the interaction of numerous factors. These include: (1) the cost situation of the firm; (2) the structure of the market within which the firm is operating; (3) the relative position of the firm in the market; and (4) the general economic situation. Unfortunately this means that as a practical matter the answer to the question of shifting is indeterminate in the absence of specific empirical investigations of conditions applicable to a given employer at a given time. No such information is currently available.

It may be suggested that in all probability all of the tax burden is not borne exclusively by the taxpayer. In addition, it seems likely that such taxes are not shifted to the same extent as many consumption taxes. As long as individuals think in terms of net take home pay and strive either to increase that amount or at least to maintain it at a given purchasing power par, there will be a continuing attempt to shift payroll deductions.

Conclusion that a proportional rate structure and continuance of a policy^{of} no exemptions are appropriate; and that the results of shifting are largely indeterminate may have little popular appeal. Should political considerations become paramount, it would be better policy to modify the status quo by granting exemptions and retaining proportional rates (increasing them if necessary) than to attempt the difficult feat of administering a progressive income tax with exemptions

with all its attendant complications at the local level.⁵⁴

Problems of multiple territorial taxation, as previously discussed,⁵⁵ can be largely solved either by state control as has been the case in Pennsylvania or by the more or less cooperative development of reciprocal credit provisions as has been the case in Ohio. The development of credit devices which amount to a procedure for inter-municipal tax sharing reduce the validity of criticism of multiple territorial taxation to rather insignificant proportions. If local government cooperation is inadequate, state limitations can achieve the same result with celerity, as will be indicated shortly.

On the basis of the above evaluation of city income taxes, it would appear that the city income tax in its present form, while a rather blunt fiscal tool, is essentially sound. Much more significantly it makes feasible supplemental self-financing by city governments and affords an important base for the retention of vital non-economic values implicit in the concept of local self-government.

No tax system is static and while city income taxation in its present form appears appropriate, subsequent change either in local government structure or in the form of federal-state revenue systems

54. Even authorities convinced of the desirability of progression for virtually all taxes have concluded that the case for progression at the local level is rather weak. Cf. Vickrey, William, *op. cit.*, p. 321-322. Professor Vickrey suggests for local income taxes that only mild graduation be imposed by the city of situs of earnings and that a bolder progression be established by the city of taxpayer residence, - this is designed to take care of the problem of inter-jurisdictional incomes. To the writer, this proposal would create unnecessary and inappropriate complications for local tax administration. Tax credits would seem a better solution within the framework of a local proportional rate structure, leaving the control of progression at the federal level.

55. Cf. Chapter IX, *supra.* p. 230.

may change its future value. When this eventuality materializes, if at all, and if the technique of tax supplementation becomes more than a theoretical possibility, local income taxation could be fairly easily adapted to such a modified system.

To this qualified acceptance of city income taxes, a caveat must be appended. These or any other taxes are and will be only as effective and just as the quality of those who administer them. Ultimate control of this problem, particularly at the local level, is a matter squarely in the hands of the electorate, without whose effective participation in the democratic process no satisfactory solution to financing government can be achieved or long maintained.

RECOMMENDATIONS

With respect to specific recommendations, these can be epitomised in two categories, one dealing with levying cities, the other dealing with problems of state policy. Turning to the first category:

1. Local income taxation is appropriate as an important supplementary source of revenue for large and middle-sized urban centers only. Municipalities with less than 25,000 to 50,000 population should consider alternative sources of revenue carefully before adopting an income tax, based as it would be, on a very narrow income base.
2. Tax rates should be set on a low proportional basis, despite the natural tendency to consider progressive rates desirable. This recommendation is made in view of the narrowness of the city income tax base, the high quality personnel requirements and the high cost

of administration of a progressive income tax at the local level. Legal limitations may make this recommendation a work of supererogation by making proportionality mandatory.

3. Exemptions should be held to a minimum in order to cut administrative and compliance costs and to reduce unnecessary complexity as long as the rate is relatively low.

4. As far as possible consistent with legal limitations on local action, city income tax ordinances should conform with definitions, collection and reporting techniques prevailing under the federal income tax.

5. In the absence of a state mandate to the contrary, the difficulties inherent in multiple territorial local taxation of income should be mitigated by the adoption of local credit provisions. The second Toledo (Ohio) Income Tax Ordinance provides an excellent model of such a credit provision.⁵⁶

6. A city income tax, if adopted, should be considered as a permanent addition to a given city revenue system rather than as a temporary emergency expedient. Accordingly, properly trained, adequately compensated administrative personnel should be promptly engaged and an adequate and continuing audit-enforcement program should be instituted.

The second category of recommendations, those applicable to state policy, are submitted as follows:

1. Assuming the legality, in whole or in part, of local taxation of income, the State must decide whether coordination of the patchwork

⁵⁶. Cf. Appendix I.

quit system of local income taxation is to be left to the variable cooperative impulses of local governments or whether state control is required in the interest of uniformity.

2. Assuming that the latter decision is made, several subsidiary questions must then be resolved:

- A. Is a ceiling on the tax rate appropriate?
- B. Is ordinance uniformity to be required?
- C. Is mandatory reciprocal deductibility on a uniform basis to be the rule and, if so, which is to be given priority the city where income is earned or the city of the taxpayer's residence to the extent that they differ?

These questions are considered in the order stated, as follows:

A. It is suggested that a rate ceiling is not appropriate in the initial stages of local income tax development within a particular state since the adoption of a ceiling operates to create a natural tendency to push rates up to the legal limit regardless of local revenue need. This power can well be held in reserve until such time as over-eager localities push rates to a critical level.

B. With respect to the question of ordinance uniformity, there is a marked similarity in most city income tax ordinances, which follow the Philadelphia-Toledo pattern with minor deviations (except with respect to the problem of tax credits). The difficult formulation of a standard ordinance can well be deferred until experience indicates more clearly the inadequacies, of the present system. No model ordinance has been drafted as yet.⁵⁷ In this connection, the new Toledo (Ohio) ordinance reflecting five years of income tax experience is well worth the careful consideration of any City Solicitor faced with the problem of drafting a city income tax ordinance.

⁵⁷. Letter to the writer from Mr. Charles S. Rhyne, General Counsel, National Institute of Municipal Law Officers, dated October 9, 1950.

C. Problems created by over-lapping city income taxation may require state coordination. The experience of Pennsylvania has been discussed.⁵⁸ As already mentioned, Ohio levying municipalities appear to be gradually working out provisional solutions on their own initiative.⁵⁹ To the extent that the State adopts uniform rules, it would seem most appropriate for such rules to grant priority to the city of the situs of earnings rather than the municipality of residence. This conclusion is predicated upon the assumption that the need of large urban centers is more acute than that of smaller fringe units. Giving the city of residence priority merely stimulates the adoption of taxes by the circle of fringe suburbs around each central city.

In conclusion, city income taxes provide one means by which cities may obtain significant supplemental revenue without dependence upon other governmental units. Provided that adequate personnel are obtained and efficient administration is established, most defects of this revenue source can be corrected. The city income tax as it has developed in Pennsylvania, Ohio and Kentucky in the last decade provides a useful addition to the rather restricted number of fiscally significant local taxes; its use provides an effective means for the fiscal implementation of municipal home rule.

58. Cf. Chapter III, *supra*.

59. Cf. Chapter IX, *supra*.

APPENDIX I

THE SECOND TOLEDO, OHIO CITY INCOME TAX ORDINANCE: NO. 689-50

Ord. 689-50 Levying a tax to provide funds for the purposes of general Municipal operations, maintenance and New Equipment and Capital Improvements, on all salaries, wages commissions and other compensation earned by residents of the City of Toledo; on all salaries, wages, commissions and other compensation earned by non-residents of the City of Toledo for work done or services performed or rendered in the City of Toledo; on the net profits earned on all businesses, professions or other activities conducted by residents of the City of Toledo; on the net profits earned on all businesses, professions or other activities conducted in the City of Toledo by non-residents, and on the net profits earned by all corporations doing business in the City of Toledo as the result of work done or services performed or rendered in the City of Toledo; requiring the filing of returns and furnishing of information by employers and all those subject to said tax; imposing on employers the duty of collecting the tax at the source and paying the same to the City of Toledo; providing for the administration, collection and enforcement of said tax; declaring violation thereof to be a misdemeanor and imposing penalties therefor.

Be it ordained by the Council of the City of Toledo:

SECTION 1. To provide funds for the purposes of general municipal operations, maintenance, new equipment and capital improvements of the City of Toledo there shall be and hereby is levied a tax on salaries, wages, commissions, and other compensation, and on net profits as hereinafter provided.

SECTION 2. As used in this ordinance, the following words shall have the meaning ascribed to them in this section, except as and if the context clearly indicates or requires a different meaning.

DEFINITIONS

ASSOCIATION- A partnership, limited partnership, or any other form of unincorporated enterprise, owned by two or more persons.

BUSINESS- An enterprise, activity, profession, or undertaking of any nature conducted for profit or ordinarily conducted for profit, whether by an individual, co-partnership, association, corporation or any other entity.

CORPORATION- A corporation or joint stock ~~company~~ association organized under the laws of the United States, the State of Ohio, or any other state, territory, or foreign country or dependency.

EMPLOYER- An individual, co-partnership, association, corporation, governmental body or unit or agency or any other entity, whether or not organized for profit, who or that employs one or more persons on a salary, wage, commission, or other compensation basis.

NET PROFITS- The net gain from the operation of a business, profession, or enterprise after provision for all costs and expenses incurred in the conduct thereof, either paid or accrued in accordance with the accounting system used, and without deduction of taxes imposed by this ordinance or federal taxes based on income.

NON-RESIDENT INDIVIDUAL - An individual domiciled outside the City of Toledo.

NON-RESIDENT UNINCORPORATED BUSINESS ENTITY- An unincorporated business entity not having an office or place of business within the City of Toledo.

PERSON- Every natural person, co-partnership, fiduciary, association or corporation. Whenever used in any clause prescribing and imposing a penalty, the term "person" as applied to association shall mean the partners or members thereof, and as applied to corporations, the officers thereof.

RESIDENT INDIVIDUAL - An individual domiciled in the City of Toledo.

RESIDENT UNINCORPORATED BUSINESS ENTITY- An unincorporated business entity having an office or place of business within the City of Toledo.

TAXPAYER - A person, whether an individual, co-partnership, association, or any corporation or other entity, required hereunder to file a return or pay a tax.

COMMISSIONER OF TAXATION- The Commissioner of the Division of Taxation in the Department of Finance of the City of Toledo, or the person executing the duties of the aforesaid commissioner.

The singular shall include the plural, and the masculine shall include the feminine and the neuter.

SECTION 3. IMPOSITION OF TAX.

An annual tax for the purposes specified in Section 1 hereof shall be imposed at the rate of one per cent (1%) per annum on the following:

1. On all salaries, wages, commissions and other compensation earned on and after January 1, 1951 by resident individuals of the City of Toledo.

2. On all salaries, wages, commissions and other compensations earned on and after January 1, 1951 by non-resident individuals of the City of Toledo for work done or services performed or rendered in the City of Toledo.

3. (a) On the net profits attributable to Toledo under the formula or separate accounting method provided for herein, earned on and after January 1, 1951, of all resident unincorporated businesses, professions or other activities, derived from work done or services performed or rendered and business or other activities conducted in the City of Toledo, whether or not such unincorporated business entity has an office or place of business in the City of Toledo.

(b) On that portion of the distributive share of the net profits, earned on and after January 1, 1951, of a resident individual partner or owner of a resident unincorporated business entity not attributable to Toledo under the formula or separate accounting method provided for herein and not levied against such unincorporated business entity.

4. (a) On the net profits attributable to Toledo under the formula or separate accounting method provided for herein, earned on and after January 1, 1951, of all non-resident unincorporated businesses, professions or other activities, derived from work done or services performed or rendered and business or other activities conducted in the City of Toledo, whether or not such unincorporated business entity has an office or place of business in the City of Toledo.

(b) On that portion of the distributive share of the net profits earned on and after January 1, 1951, of a resident individual partner or owner of a non-resident unincorporated business entity not attributable to Toledo under the formula or separate accounting method provided for herein and not levied against such unincorporated business entity.

5. On the net profits attributable to Toledo under the formula or separate accounting method provided for herein, earned on and after January 1, 1951, of all corporations derived from work done or services performed or rendered and business or other activities conducted in the City of Toledo, whether or not such corporations have an office or place of business in the City of Toledo.

6. The portion of the entire net profits of a taxpayer to be allocated as having been made within the City of Toledo shall be determined:

(a) Except in the case of net income from finance, investment, or construction activities, net profit shall be allocated to the City of Toledo by multiplying the entire net profit by a business allocation percentage to be determined by a three-factor formula of payroll, property and sales, each of which shall be given equal weight, as follows:

1. **PROPERTY-** Ascertaining the percentage which the average value of the taxpayer's real and tangible personal property within the city during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period. Property shall be valued at the basis used for federal income tax purposes.

2. **PAYROLL-** Ascertaining the percentage which the total wages, salaries and other personal service compensation during such period of employees within the city, except general executive officers, bears to the total wages, salaries, and other personal service compensation, similarly computed, during such period for all the taxpayer's employees within and without the city, except general executive officers.

3. **SALES-** Ascertaining the percentage which the gross receipts of the taxpayer from sales within the City of Toledo, plus the gross credits or charges for work done and performed or services rendered in the City of Toledo bears to the total gross receipts from sales wherever made plus the total gross credits or charges for work done and performed or services rendered. "Within the City" sales shall be deemed to include:

(1) All sales of tangible personal property delivered to purchasers within the city of shipped or delivered from an office, store, warehouse, factory, or place of ~~business~~ storage located within the city;

(2) All sales of tangible personal property delivered to purchasers within the city even though transported from a point outside the city if both of the following conditions are present:

(i) If the taxpayer is regularly engaged through its own employees in the solicitation or promotion of sales within the city, and

(ii) The sale is directly or indirectly the result of the taxpayer's activities within the city in soliciting or promoting sales;

(3) All sales of tangible personal property shipped from an office, store, warehouse, factory or place of storage within the city to purchasers in other cities if

(i) The taxpayer is not, through its own employees, regularly engaged in the solicitation or promotion of sales in such other cities or

(ii) Even if it is so engaged if the sales are not directly or indirectly attributable to such activities.

In the application of the foregoing provisions, a carrier shall be considered the agent of the seller, regardless of the f.o.b. point or other conditions of the sale; and

4. Adding together the percentages determined in accordance with sub-paragraphs 1, 2 and 3 above, or such of the aforesaid percentages as shall be applicable to the particular taxpayer's business and dividing the total so obtained by the number of percentages used in deriving said total

(b) Income from finance, investment, or construction activities shall be allocated to the City of Toledo by means of separate accounting; provided, however, that there shall be an adjustment for the contribution made to the production of such net income by headquarters activities of the taxpayer. Such adjustment shall be made by deducting from such net income allocated to the City of Toledo that portion represented by the ratio of headquarters payroll to total payroll, and by adding to such net income allocated to the City of Toledo that portion of the entire net profit of the taxpayer represented by the ratio of headquarters payroll within the City of Toledo to total payroll.

(c) Provided, however, that in the event a just and equitable result cannot be obtained under the formula and separate accounting method provided for herein, the Board of Review, upon application by the taxpayer or the Commissioner of Taxation, shall have the authority to substitute other factors or methods calculated to effect a fair and proper allocation.

SECTION 4. Said tax shall be levied, collected and paid with respect to the salaries, wages, commissions and other compensations earned on and after January 1, 1951, and with respect to the net profits of businesses, professions or other activities earned on and after January 1, 1951.

SECTION 5. RETURN - PAYMENT OF TAX.

Each taxpayer who engaged in business, or whose salaries, wages, commissions and other compensation are subject to the tax imposed by this ordinance shall, whether or not a tax be due thereon, make and file a return on or before March 15 31st of each year with the Commissioner of Taxation or such other official as may be designated by the Council of the City of Toledo, on a form furnished or obtainable from the Commissioner of Taxation setting forth the aggregate amount of salaries, wages, commissions and other compensation earned by him, and/or gross income from such business less allowable expenses incurred in the acquisition of such gross income, earned during the preceding year and subject to the said tax, together with such other pertinent information as the Commissioner of Taxation may require. Provided, however, that when the return is made for a fiscal year or other period different from the calendar year, the return shall be filed within ninety days from the end of such fiscal year or other period. Upon written request of the taxpayer the Commissioner of Taxation may extend the time for the filing of the annual return for a period of not to exceed thirty days, or to thirty days beyond any extension requested of or granted by the Bureau of Internal Revenue for the filing of the federal income tax return, provided a tentative return, accompanied by payment of the amount of tax shown to be due thereon, shall be filed by the date the return is normally due. No penalty or interest shall be assessed in those cases in which the return is filed and the final tax paid within the period as extended.

The return shall also show the amount of the tax imposed by the ordinance on such earnings and profits. The taxpayer making the said return shall at the time of the filing thereof, pay to the Commissioner of Taxation the amount of taxes shown as due thereon. Provided further, however, that where any portion of the tax so due shall have been deducted at the source and shall have been paid to the Commissioner of Taxation by the person making such deduction pursuant to the provisions of Section 6 of this ordinance or where such taxpayer pursuant to the provisions of Section 7 of this ordinance, credit for the amount so paid shall be deducted from the amount shown to be due and only the balance, if any, shall be due and payable at the time of filing said return. Should it then appear that the taxpayer has overpaid the amount of tax to which the City of Toledo is entitled under the provisions of this ordinance, such overpayment shall be applied against any subsequent liability hereunder, or, at the election of the taxpayer and so indicated on the return such overpayment (or part thereof) shall be refunded. Provided, however, that no additional taxes or refunds of less than one dollar shall be collected or refunded.

Within ninety (90) days from the final determination of any Federal tax liability affecting taxpayer's Toledo tax liability, such taxpayer shall make and file an amended Toledo return showing income subject to Toledo tax based upon such final determination of Federal tax liability, and pay any additional tax shown due thereon or make claim for refund of any overpayment.

The Commissioner of Taxation is hereby authorized to provide by regulation, subject to the approval of the City Manager, that the return of an employer or employers, showing the amount of tax deducted by said employer or employers from the salaries, wages, commissions or other compensation of an employee and paid by him or them to the Commissioner of Taxation, shall be accepted as the return required of any employee whose sole income, subject to the tax or taxes under this ordinance, is salary, wages, commissions or other compensation .

SECTION 6. COLLECTION AT SOURCE.

Each employer within the City of Toledo who employs one or more persons on a salary, wage, commission or other compensation basis shall deduct at the time of the payment of such salary, wage, commission or other compensation, the tax of one per cent of the gross salaries, wages, commissions or other compensation due by the said employer to the said employee and shall, on or before the last day of the month following the close of each calendar quarter make a return and pay to the Commissioner of Taxation the amount of taxes so deducted. Said return shall be on a form or forms prescribed by and obtainable from the Commissioner of Taxation and shall be subject to the rules and regulations prescribed therefor by the Commissioner of Taxation. Such

employer in collecting said tax shall be deemed to hold same until payment is made by such employer to the City of Toledo as Trustee for the benefit of the City of Toledo and any tax collected by such employer from his employees shall, until the same is paid to the City of Toledo, be deemed a trust fund in the hands of such employer.

SECTION 7. DECLARATIONS.

Every taxpayer who anticipates any income which is not subject to the provisions of Section 6 hereof, or who engages in any business activity shall file a declaration of estimated ~~income~~ setting forth such estimated income or the estimated profit or loss from such business activity together with the estimated tax due thereon, if any. Such declaration shall be filed on or before March 31, 1951, and a similar declaration shall be filed on or before March 31st of each year during the life of this ordinance by all such taxpayers. Such declaration shall be filed upon a form furnished by, or obtainable from, the Commissioner of Taxation, which form may simply state that the figures used in making such declaration are the same figures used in making the declaration of the estimate for the federal income tax, provided that it is understood that such figures maybe adjusted according to the provisions of this ordinance so that the declaration required by this section shall set forth only such income as is taxable under the provisions of this ordinance.

Such declaration of estimated tax to be paid to the City of Toledo shall be accompanied by a payment of at least one-fourth ($\frac{1}{4}$) of the estimated annual tax and at least a similar amount for such year shall be paid on or before the June 30, September 30 and December 31 of such year. Provided, however, that such estimate may be amended at the time of making ~~the quarterly return~~ any quarterly ~~estimate~~ payment, and further provided that on or before March 31st of the year following that for which such declaration was filed, an annual return shall be filed and any balance which may be due the City of Toledo shall be paid therewith. Should it then appear that such taxpayer has paid more than the amount of tax to which the City of Toledo would be entitled under the provisions of this ordinance, such overpayment shall be applied against any subsequent liability hereunder or, at the election of the taxpayer, and so indicated on the return, such overpayment (or part thereof) shall be refunded, but in no event shall overpayment of less than one dollar be refunded.

Those taxpayers having a fiscal year or period differing from the calendar year shall file a declaration on or before ninety days after the start of each fiscal year or period, accompanied by a payment of at least one-fourth ($\frac{1}{4}$) of the estimated annual tax shown due thereon, and shall make at least quarterly payments each ninety days thereafter.

SECTION 8. DUTIES OF THE COMMISSIONER OF TAXATION.

It shall be the duty of the Commissioner of Taxation to collect and receive the tax imposed by this ordinance in the manner prescribed by this ordinance. It shall also be his duty to keep an accurate record showing the amount received by him from each taxpayer required to file a declaration and/or make a return and the date of said receipt.

Said commissioner is hereby charged with the enforcement of the provisions of this ordinance, and is hereby empowered, subject to the approval of the City Manager, to adopt and promulgate and to enforce rules and regulations relating to any matter or thing pertaining to the administration and enforcement of the provisions of this ordinance, including provisions for the re-examination and correction of returns and payments.

SECTION 9. The Commissioner of Taxation, or any authorized employee, is hereby authorized to examine the books, papers and records of any employer or of any taxpayer or person subject to the tax for the purpose of verifying the accuracy of any return made, or, if no return was made, to ascertain the tax due under this ordinance. Every such employer, supposed employer, taxpayer or supposed taxpayer is hereby directed and required to furnish the Commissioner of Taxation, or his duly authorized agent or employee, the means, facilities, and opportunity for making such examinations and investigations as are hereby authorized. The Commissioner of Taxation is hereby authorized to examine any person under oath, concerning any income which was or should have been returned for taxation, and for this purpose may compel the production of books, papers and records and the attendance of all persons before him, whether as parties or witnesses, whenever he believes such persons have knowledge of such income.

The refusal of such examination by any employer or person subject or presumed to be subject to the tax shall be deemed a violation of this ordinance.

Any information gained as the result of any returns, investigations, hearings or verifications required or authorized by this ordinance shall be confidential, except for official purposes, and except in accordance with proper judicial order. Any person divulging such information shall, upon conviction therefor, be deemed guilty of misdemeanor and shall be subject to a fine or penalty of not more than Five Hundred Dollars (\$500) or imprisoned for not more than six (6) months or both said fine and imprisonment for each such offense.

SECTION 10. INTEREST AND PENALTIES.

All taxes imposed and moneys withheld by employers under the provisions of this ordinance and remaining unpaid after they have become due shall bear interest, in addition to the amount of the unpaid tax or withholdings, at the rate of six per cent (6%) per annum.

In addition thereto, the taxpayers upon whom such taxes are imposed shall be liable to a penalty of one per cent (1%) of the amount of the unpaid tax for each month or fraction of thereof if paid during the first three months after said taxes became due, five per cent (5%) of the amount of the unpaid tax if paid during the next three months, and ten per cent (10%) of the amount of the unpaid tax if paid later than six months after they have become due. Excepting that, employers required to withhold taxes from employees under the provisions of this ordinance, shall be subject to a penalty of five per cent (5%) of the unpaid tax if paid during the first month after such taxes became due, ten per cent (10%) of the unpaid tax if paid during the second or third months after such taxes became due, and fifteen (15%) per cent of the unpaid tax if paid later than three months after they have become due.

Provided, however, that penalty shall not be assessed on an additional tax assessment made by the Commissioner when a return has been filed in good faith and the tax paid thereon within the time prescribed herein; and provided further ~~that~~ neither penalty nor interest shall be assessed on any additional tax assessment resulting from a federal audit, providing an amended return is filed and the additional tax is paid within ninety (90) days after final determination of the federal tax liability.

SECTION 11. COLLECTION OF UNPAID TAXES.

All taxes imposed by this ordinance shall be collectible, together with any interest and penalties thereon, by suit, as other debts of like amount are recoverable. Except in the case of fraud, or omission of a substantial portion of income subject to this tax, an additional assessment shall not be made after three (3) years from the time of payment of any tax due hereunder, provided, however, in those cases in which the Commissioner of Internal Revenue and the taxpayer have executed a waiver of the Federal statute of limitation, the period within which an additional assessment may be made by the Commissioner of Taxation shall be three years from the time of the final determination of federal tax liability. And except further that taxes erroneously paid shall not be refunded unless a claim for refund is made within three (3) years from the time of payment thereof, or within three (3) years after final determination of the federal tax liability.

SECTION 12. VIOLATIONS; PENALTIES.

Any person, firm or corporation who shall fail, neglect or refuse to make any return or declaration required by this ordinance, or any taxpayer who shall fail, neglect or refuse to pay the tax, penalties and interest imposed by this ordinance or any person who shall refuse to permit the Commissioner of Taxation, or any duly authorized agent or employee, to examine his books, records, and papers, or who shall knowingly make any incomplete, false or fraudulent return, or who shall attempt to do anything whatever to avoid the payment of the whole or any part of the tax shall be guilty of misdemeanor and shall be fined not more than One Hundred Dollars (\$100.00) or imprisoned for not more than sixty (60) days or both. The failure of an employer or taxpayer to receive or procure a return or declaration form shall not excuse him from making a return or declaration or from paying the tax.

SECTION 13. BOARD OF REVIEW.

A Board of Review, consisting of the Director of Law, the Director of Finance and the City Auditor is hereby created. All rules and regulations and amendments or changes thereto, which are adopted by the Commissioner of Taxation under the authority conferred by this ordinance, must be approved by the Board of Review before the same become effective. After such approval such rules, regulations and changes shall be filed with the Clerk of Council and shall be open to public inspection.

Any person dissatisfied with any ruling or decision of the Commissioner of Taxation, which is made under the authority conferred by this ordinance may appeal therefrom within ninety (90) days from the announcement of such ruling or decision by the Commissioner of Taxation, and the Board of Review shall on hearing, have jurisdiction to affirm, reverse or modify any such ruling or decision or any part thereof. Any person dissatisfied with any ruling of the Board of Review may appeal therefrom to a Court of competent jurisdiction within ninety(90) days from the announcement of such ruling or decision.

The Director of Law shall be chairman of the Board of Review, and the Director of Finance shall serve as secretary thereof. A majority of the members of the Board of Review shall constitute a quorum. The Board of Review shall adopt its own procedural rules and shall keep a record of its transactions. All hearings by the Board may be conducted privately and the provisions of Section 9 hereof with reference to the confidential character of information required to be disclosed by the ordinance shall apply to such matters as may be heard before the Board of Review on appeal..

SECTION 14. ALLOCATION OF FUNDS.

The funds collected under the provisions of this ordinance shall be applied for the following purposes and in the following order to wit:

1. Such part thereof as shall be necessary to defray all costs of collecting the taxes levied by this ordinance and the cost of administering and enforcing the provisions hereof.

2. The sum of \$3,100,000 per year, or such part thereof as may be appropriated by Council to the General Fund for general operating expenses.

3. The sum of \$250,000 per year, or such part thereof as may be appropriated by Council to the Maintenance and New Equipment Fund for the purpose of paying the cost of maintenance and the purchase of new equipment.

4. Each year there shall be paid into the Stabilization Reserve Fund a sum equal to that produced by a one mill levy in the City of Toledo.

The City each year shall release to the Lucas County Budget Commission one mill in order that the Budget Commission may make such mill available to the County of Lucas and the Board of Education of the City of Toledo.

The sum set aside in the Stabilization Reserve Fund shall be placed in the General Fund to replace the mill levy that has been released.

5. Each year there shall be paid to the Board of Trustees of the University the sum of \$350,000 to be used for the purpose of building needed capital improvements.

6. The balance of the funds collected under the provisions of this ordinance shall be paid into the Capital Improvement Fund of the City of Toledo to be used for the construction of and costs incidental to the construction of needed improvements. Provided, however, that nothing in this ordinance shall be interpreted or construed to waive any of the provisions of law or of the Charter of the City of Toledo now in effect.

7. Recognizing the instability of conditions, and in order to provide for the possibility of increased costs of governmental operation, there shall be added to the general government fund in the year 1952 and thereafter during the life of this ordinance, a sum equal to provide an increased allowance, if needed, as follows:

(a) The increased cost of General Government allowance will be determined in accordance with changes in the "Consumers' Price Index for Moderate Income Families in Large Cities" "All Items" published by the Bureau of Labor Statistics, U.S. Department of Labor (1935-1939 equals 100) and hereafter referred to as the BLS Consumers Price Index.

(b) The BLS Consumers' Price Index as of January 1, 1951 shall be considered as the basis for the operation of the provisions of this ordinance.

(c) If during the life of this ordinance the BLS Consumers' Price Index shall show an increase during the basic periods hereinafter outlined, the Council of the City of Toledo may appropriate from funds ordinarily paid into the Capital Improvement Fund to the General Fund a sum equivalent to \$100,000 for each one point rise in the BLS Consumers' Price Index. Appropriations so made for the purpose of keeping in balance the General Fund requirements of the City of Toledo for the succeeding year and for no other purpose.

(d) The basic period for the determination of whether or not a rise has taken place and the foregoing provisions of the ordinance invoked shall be as follows:

For the year 1952- the period from January 1, 1951 to Sept. 30, 1951.

For the year 1953- the period from Oct. 1, 1951 to Sept. 30, 1952.

For the year 1954- the period from October 1, 1952 to September 30, 1953.

For the year 1955- the period from Oct. 1, 1953 to Sept. 30, 1954.

8. In the event that the funds ordinarily provided for poor relief shall be insufficient to meet the necessary requirements, the Council of the City of Toledo may appropriate in any year moneys from the Capital Improvement Fund to the Poor Relief Account. Provided, however, that in no event shall such appropriation exceed the actual need of such Poor Relief Account and provided further than unexpended balances from such fund so appropriated shall be returned to the Capital Improvement Account.

SECTION 15. RECIPROCITY PROVISIONS.

1. Payment of any tax on salaries, wages, commissions, other compensation or on net profits of businesses, professions, or other activities to a municipality, other than Toledo, by residents thereof, pursuant to an ordinance or resolution passed or adopted by such other municipality, shall be credited to and allowed as a deduction from the liability of such person for any like tax under this ordinance, provided, however, that such credit to or deduction from the liability under this ordinance shall not exceed fifty percentum of the total tax due hereunder, and provided further that such credit to or deduction from the liability under this ordinance shall not be allowed unless a reciprocal provision under which a similar credit is allowed non-residents of such other municipality is contained in the ordinance or resolution imposing such tax in such other municipality, and

2. Provided further that every individual taxpayer, who resides in the City of Toledo, but who receives net profits, salary, wages, commission or other personal service compensation for work done or services performed or rendered outside of said city, if it be made to appear that he has paid a city income tax on such net

profits, salary, wages, commission or other personal service compensation for work done or service performed or rendered outside of said city, if it be made to appear that he has paid a city income tax on such net profits, salary, wages, commission, or compensation in another city, shall be allowed a credit in the amount so paid by him or in his behalf in such other city, this credit to be applied to the extent of the tax assessed by this ordinance by reason of such net profits, salary, wages, commission or compensation earned in such other city or cities where such tax is paid.

3. Notwithstanding the provisions contained in Section 11 hereof, or any other provisions inconsistent herewith, a claim for refund or credit under this section shall be made in such manner as the Commissioner of Taxation may by regulation provide. No such refund or credit shall be allowed unless made on or before December 31st of the year following that for which such refund or credit is claimed.

SECTION 16. This ordinance shall not apply to any person, firm, corporation or to any property as to whom or which it is beyond the power of the Council to impose the tax herein provided for. If any sentence, clause, section or part of this ordinance or any tax against any individual or any of the several groups specified herein is found to be unconstitutional, illegal or invalid, such unconstitutionality, illegality or invalidity shall affect only such clause, sentence, section or part of this ordinance and shall not affect or impair any of the remaining provisions, sentences, clauses, sections or other parts of this ordinance. It is hereby declared to be the intention of the Council of the City of Toledo that this ordinance would have been adopted had such unconstitutional, illegal or invalid sentence, clause, section or part thereof not been included herein.

SECTION 17. This ordinance shall continue effective insofar as the levy of taxes is concerned through December 31, 1955, and insofar as the collection of taxes levied in the aforesaid period and actions or proceedings for the collecting any tax so levied or enforcing any provisions of this ordinance are concerned it shall continue effective until all of said taxes levied in the aforesaid period are fully paid and any and all suits and prosecutions for the collection of said taxes or for the punishment of violations of this ordinance shall have been fully terminated, subject, however, to the provision of Section 11 hereof with respect to the limitation of time within which an additional assessment shall be made. Provided, however, that annual returns for the year ending December 31, 1955, shall be filed on or before March 31st, 1956, and any tax shown due thereon for the year ending December

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31, 1955, which is not paid and collected under the provisions of Sections 6 and/or 7 hereof shall be paid on said date, except in those cases in which the time for filing returns and/or payment of the tax due has been extended in accordance with Section 5 hereof.

SECTION 18. This ordinance shall take effect and be in force from and after the earliest period allowed by law.

Passed Nov. 29, 1950, recess session.

MICHAEL V. DISALLE
Mayor

Attest: C.F. DIEFENBACH
Clerk of Council

It is the opinion of this Board that the tax, imposed by Toledo Ordinance 18-46, is a tax directly on two categories of earned income, as contrasted with the Federal Income Tax which taxes income generally; that the net profits of a dealer derived from business activities carried on in Toledo is earned income within the meaning of the Toledo Income Tax Ordinance and is therefore subject to tax under such ordinance. It is well established that the Toledo tax is a tax directly upon income, and that it is not a property tax. Angell v. City of Toledo et al., 153 O.S.179.

It is further the opinion of this Board that the Ohio Personal Property Tax is a property tax on the shareholders of a dealer at the source, irrespective of domicile, and is not a tax upon the dealer. Senior v. Braden 30 N.P.N.S., affirmed 295 U.S. 422, 70 L.Ed.1520, 55 S.Ct.800, 2 O.O.460. We therefore see no merit in the contention that the field of income taxation has been occupied by the State of Ohio, in the case of a dealer in intangibles, to the exclusion of a municipal tax on income.

With respect to the contention that the General Assembly of the State of Ohio has limited or restricted municipalities in the imposition of an income tax by the wording of Section 5414-3, G.C., it is our opinion that said Section together with Section 5414-2, G.C. and other sections pertaining specially to dealers in intangibles, merely provide a substitute basis for taxation of the property of the dealer and its shareholders at the source, and cannot be construed as an expression of the General Assembly prohibiting the imposition of a tax by the municipality directly upon the net profits of the dealer itself.

Furthermore, we are unable to find any provision in the Statutes of Ohio restricting or limiting a municipality in the imposition of an income tax in the case of a dealer, and we find no basis for application of the judicially developed doctrine of preemption for the reason that the State of Ohio's tax and the Toledo tax are different taxes upon two different taxpayers, the former a property tax upon the shareholders, the latter a tax directly upon the net profits of the dealer itself.

We are unable to agree with the contention that the income of a dealer, represented by interest, is taxed under the Personal Property Tax of the State of Ohio, or that the phrase "undivided profits" is synonymous with net earnings or income, it being our opinion that, in the case of a dealer, the note from which interest is received is part of the property upon which the net worth of the shares of stock of the shareholders is based, which shares are the thing taxed, and that undivided profits of a dealer, to the extent retained in business, is also property of the dealer, the value of which is taken into consideration in determining net worth of such shares. We are in accord with the position of the Commissioner that undivided profits elected to be retained in the business have lost their identity as net profits in the same manner as reserves and other items which determine net worth of the shares

of stock in a dealer. As stated in the brief of the Commissioner:

" It should be noted that the state tax, being a property tax, is due, in the case of an ordinary business corporation, from the shareholders and the business entity whether or not a profit is earned to the extent that there is value to the property (accumulated wealth) itself, and, in the case of a dealer, whether or not a profit is earned, on the shares to the extent the shares in a dealer show value based on net worth of the dealer, while the Toledo tax is levied to the extent an annual net profit is earned."

Other contentions merely confuse the fundamental issue in this case, and although considered by this Board will not be commented upon. The simple fact is that the Toledo tax does not reach, in the case of a dealer, either the same taxpayer or the same thing as the State Property Tax.

It is therefore concluded that the Commissioner of Taxation was correct in ruling that the _____ Co., the _____ Co., and the _____ Co., are subject to the one percent Toledo tax on net profits attributable to Toledo operations since the inception of ~~the tax~~ Toledo Ordinance 18-46 on March 1, 1946.

It is therefore, the judgment and decision of this Board that the ruling of the Commissioner of Taxation in the within case be and the same is hereby affirmed.

John J. McCarthy
R.T. Anderson
Rudy Klein
Board of Review

Note: Names of appellants are not included in view of the confidential provisions of Toledo Ord. 18-46 and at the request of the Toledo Department of Taxation.

APPENDIX III

PROPOSED INITIATED ORDINANCE AMENDATORY TO ORDINANCE NO. 4741
OF THE CITY OF SPRINGFIELD, OHIO.

" An ordinance amending Section 1 of and enacting, new supplemental Section No. 15-A to Ordinance No. 4741, entitled ' An ordinance levying a tax to provide funds for the purposes of general municipal operations, retirement of certain debts and over-drafts, deferred maintenance, repairs, and essential capital equipment and improvements, on all salaries, wages, commissions and other compensation earned by residents of the City of Springfield, Ohio; on all salaries, wages, commissions and other compensation earned by non-residents of the City of Springfield, Ohio for work done or services performed or rendered in the City of Springfield, Ohio; on the net profits earned on all businesses, professions or other activities conducted by residents of the City of Springfield, Ohio; on the net profits earned on all businesses, professions or other activities conducted in the City of Springfield, Ohio by non-residents and on the net profits earned by all corporations having an office or place of business in the City of Springfield, Ohio, as the result of work done or services performed or rendered in the City of Springfield, Ohio; requiring the filing of returns and furnishing of information by employers and all those subject to said tax; imposing on employers the duty of collecting the tax at the source and paying the same to the City of Springfield, Ohio; providing for the administration, collection and enforcement of said tax; and declaring the violation thereof to be a misdemeanor and imposing penalties therefor.' As passed by the City Commission of the City of Springfield, Ohio, on May 24, 1948, said new supplemental section providing a credit against the tax imposed by said ordinance."

BE IT ORDAINED BY the people of the City of Springfield, Ohio:-

Section 1. That Section No. 2 of Ordinance No. 4741, entitled as aforesaid and passed by the City Commission on the City of Springfield, Ohio, on May 24th, 1948, be and the same is hereby amended so as to read as follows:

SECTION 2., IMPOSITION OF TAX.

To provide funds for the purpose of general municipal operations, retirement of certain debts and over-drafts, deferred maintenance, repairs, and essential capital improvements equipment and improvements of and for the City of Springfield, Ohio, there be and is hereby

levied a tax at a rate of one-half of one percent per annum upon the following:

- (1) On all salaries, wages, commissions and other compensation earned after this ordinance becomes effective as provided by charter, by residents of the City.
- (2) On all salaries, wages, commissions and other compensation earned after this ordinance becomes effective as provided by charter by non-residents of the City for work done or services performed or rendered in the City.
- (3) On the net profits earned after this ordinance becomes effective as provided by charter, of all associations and businesses conducted by residents of the City.
- (4) On the net profits earned after this ordinance becomes effective as provided by charter, of all associations and businesses conducted in the City by non-residents.
- (5) On the net profits earned after this ordinance becomes effective as provided by ~~charter~~ charter, by all corporations having their principal office and place of business in the City, or an office or place of business in the City, said tax being levied on such part of the net profits as is earned by such corporations as a result of work done or services performed or rendered and business or other activities conducted in the City.
- (6) On that portion of the gross receipts of non-profit organizations engaged in business activities similar to those in which profit corporations and other taxpayers under this ordinance are engaged, remaining after the deduction of (a) all costs and expenses of doing business, including reserves for depreciation and bad debts and (b) patronage refunds paid in cash within ninety days after the close of the taxpayers calendar or fiscal year with respect to which such refunds are made. For the purpose of this sub-paragraph (6) the term "non-profit" organization means corporations, associations and other similar organizations including but not by way of limitation, corporations organized under authority of Section 10186-1 to 10186-30, both inclusive of the General Code of Ohio.

The portion of the entire net profits of a taxpayer to be allocated as having been made within the City may, in the absence of actual and bona fide records thereof, be determined as follows:

(a) Multiply the entire net profit by a business allocation percentage to be determined by :-

(1) Ascertaining the percentage which the average value of the taxpayer's real and tangible personal property within the City bears during the period covered by its report bears to the average value of all taxpayer's real and tangible personal property wherever situated during such period.

(2) Ascertaining the percentage which the gross receipts of the taxpayer derived from the business within the City during the period covered by the report bear to the total gross receipts wherever derived.

(3) Ascertaining the percentage which the total wages, salaries, commissions and other compensation, during the period covered by the report, of employees within the City, except general executive officers, bears to the total wages, salaries, commissions and other compensation during such period of all the taxpayer's employees within and without the City, except general executive officers, and

(4) Adding together the percentages determined in accordance with sub-paragraphs (1), (2), and (3) above, or such of the afore-said percentages as shall be applicable to the particular taxpayer, and dividing the total so obtained by the number of percentages used in deriving said total.

(b) Provided, however, that in the event a just and equitable result cannot be obtained by the use of the factors contained herein, the Board of Review shall have the authority to substitute factors calculated to effect a fair and proper allocation.

Section 2. The new supplemental Section No. 15-A be and the same is hereby enacted as a part of Ordinance No. 4411 entitled as aforesaid, so as to read as follows:

" Section 15-A. There shall be allowed for the purpose of the tax imposed by this ordinance the following credits against the net income, viz:

(1) Personal Exemption. In case of a single person or a married person not living with husband or wife a personal exemption of six hundred dollars; In the case of a married person living with husband or wife a joint personal exemption of \$1200.00. If such husband or wife makes separate returns the personal exemption may be taken by either or divided between them.

(2) Credits for Dependents. \$600.00 for each person other than husband and wife dependent upon and receiving his or her chief support from the taxpayer if such dependent person is under eight years of age or is incapable of self-support because mentally or physically defective."

Section 3. That original section 2 of said Ordinance No. 4741 as originally passed May 24th, 1948, and all ordinances and parts of ordinances of the City Commission in conflict with the provisions of this ordinance be and the same are hereby, to the extent of such conflict, repealed.

Section 4. That this ordinance shall take effect upon its approval by a majority vote of the electors of the City of Springfield, Ohio voting thereon as provided by Section 57 of the Charter of said City and thereupon continue in full force and effect until June 30, 1953, unless earlier repealed or amended as provided by Section 59 of said Charter."

Note: This proposed Ordinance is on file in the above form in the Office of the City Auditor of the City of Springfield, Ohio, in the form of an affidavit executed by John Krieg, one of the committee proposing the amendatory ordinance, on May 4, 1950; same being marked " Filed" May 5, 1950.

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APPENDIX IV

TWO RECENT OHIO CITY INCOME TAX DECISIONS

I. The City of Springfield, Ohio, Plaintiff-Appellee,

v.

Vernon E. Kenney, Defendant, Appellant.

No. 487 in the Court of Appeals of Clark County, Ohio; opinion rendered November 5, 1951, by Miller, J.

" This is a law appeal from a judgment of the Municipal Court of Springfield, Ohio, wherein the defendant-appellant was found to be indebted to the plaintiff-appellee in the sum of \$69.00 and interest under the provisions of Ordinance No. 4741, which is better known as the City Income Tax Ordinance. The case was submitted upon an agreed statement of facts which are a part of the record and will not be fully restated.

The first question presented is whether the defendant is a resident of the City of Springfield (this portion of the opinion will be omitted since it is not germane to the main problems of interest herein; defendant resided in a Federal Housing project and the court held that this fact did not operate to bar his liability under the city income tax). *****

It is next urged that since Defendant's income was earned entirely outside the corporate limits of the City of Springfield, that he is not subject to the provisions of the ordinance. We held otherwise in the case of The City of Springfield v. Kurtz, No. 480, Clark County, decided by this Court on April 2, 1951. We adhere to our former ruling on this question.

It is next urged that the ordinance is unconstitutional for the reason that it excludes from taxation all persons having an income of \$1040.00 or less for a year and does not grant this exemption to those whose income is more than the minimum. In other words, those having an income of more than \$ 1040.00 per year pay the tax based upon the total income and not only on the excess over and above the \$1040.00. This, appellant claims, constitutes a classification which is " artificial, arbitrary, unreasonable, and discriminates between those similarly situated." If the appellant were correct in his factual conclusions we would agree with him that the section of the ordinance under consideration is in violation of the Constitution.

However, we differ upon the finding of fact. We are of the opinion, that it operates equally upon each member of the class since it provides that all persons making less than \$1040.00 per year are in one class and pay no tax, while all persons making more than \$1040.00 per year pay a tax upon their total income. In considering whether or not the tax is arbitrary or unreasonable the burden of proof is upon the appellant and upon the record submitted we cannot come to such a conclusion. The presumption is that the City of Springfield in enacting the ordinance acted upon sound consideration of policy and until this presumption is overcome by the evidence it must prevail. It is well settled that hardship and administrative complexity may be considered by the court in its consideration of the constitutionality of the provision in question. 51 Amer. Jur. 242, Section 182. A leading case on this question is Carmichael v. Southern Coal and Coke Co., 301 U.S. 495, which involved an Alabama Unemployment Compensation Act, which provided a payroll levy upon the payroll of certain employers while exempting others. It was contended on behalf of the petitioner that the Act was violative of the equal protection clause of the Constitution of the United States because it excluded certain classes of employers. The contention was rejected by the Court, Justice Stone saying at page 510:

" It is argued here, and it was ruled by the court below, that there can be no reason for a distinction, for purposes of taxation, between those who have eight. Yet, this is the type of distinction which the law is often called upon to make. It is only a difference of in numbers which marks the ~~moment~~ moment when day ends and night begins, when the disabilities of infancy terminate and the status of legal competency is assumed. It separates large incomes which are taxed from the small ones which are exempt, as it marks here the difference between the proprietors of smaller businesses who are not. Administrative convenience and expense in the collection or measurement of the tax are alone a sufficient justification for the difference between the treatment of small incomes or small taxpayers and that meted out to others."

The record in the case at bar discloses that the additional administrative work required to service the returns of this excluded group would be increased approximately 30 percent and the additional amount collected would in all probability produce little or no additional revenue, or may even cause a loss. The maximum amount that could be collected from this excluded class would be only \$10.40 per

year and in many instances it would no doubt be necessary to use pressure to enforce the collection of even to resort to suits at law. We are therefore of the opinion that the classification is reasonable and operates equally upon each member of the classes created. Even though the exclusion clause were unconstitutional it is severable from the other parts and would not invalidate the whole ordinance. The basic rule for determining this question is set forth in 28 O. Jur. page 496. Section 301, as follows:

" It is a general rule that where a bylaw or ordinance consists of several and independant parts, having no general influence over each other, and a part is valid and a part is void, the part which is valid is operative and will be carried into effect."

(The balance of the opinion considers the question of severability and is not included here as it is not related to the constitutionality of the "exclusion".)

" Finding no error in the record, the judgment will be affirmed."

HORNBECK, P.J. and Wiseman, J., concur.

II. Opinion of the Seventh District Court of Appeals (Ohio) in
The Youngstown Sheet and Tube Co. et al v. The City of
Youngstown et al, Case No. 3491 and
The Youngstown Sheet and Tube Co. et al v. The City of
Campbell et al, Case No. 3498. (November 19, 1951.)

FESS, J.

Appeals on law and fact from judgments in separate cases permanently enjoining the defendants from levying and collecting income taxes under the provisions of certain ordinances of the municipalities on the ground that such ordinances are repugnant to Article I, Section 2 and Article XIII, Section 4 of the Constitution of Ohio, and to the Fourteenth Amendment of the Constitution of the United States.

I. The Youngstown Income Tax Ordinance.

As amended on January 10, 1951 (effective January 23, 1951) the Youngstown Income Tax Ordinance levys a tax of .3% per annum on compensation and net profits of residents and a like tax upon compensation received and net profits earned by non-residents, other than corporations, for services performed or business conducted within the City of Youngstown. A tax of 1% per annum is levied upon the net profits of corporations having an office or place of business in Youngstown. The tax is limited to such part of the net profits as is earned by such corporations as a result of business conducted in the city, determined according to a certain formula set forth in the ordinance.

The power of cities to levy an income tax has been definitely established. *Angell v. Toledo*, 153 Ohio St., 179. At the outset, appellees attempt to divide taxes into three classes, - (1) Poll, (2) Property, and (3) Excise. Appellees contend that the income tax is a property tax within the purport of the term as employed in the Constitution of Ohio. The city contends that it is in the nature of an excise tax and is to be distinguished from other forms of taxation. Whether an income tax is a property or an excise tax has not been definitely determined in Ohio. In the opinion in *Angell v. Toledo*, supra, it is said:-

" While an income tax may be regarded as in the nature of an .excise tax, the Constitution of Ohio differentiates an excise tax from an income tax/ ***** In the interpretation of the Ohio Constitution an income tax is not to be treated as an excise tax."

Analogically, the Ohio Constitution differentiates an income tax from a property tax as well as from an excise tax and in interpreting the Constitution, an income tax should not be treated as a property tax.

Income taxes are not of recent origin. *Shaffer v. Carter*, 252 U.S. 37, 51; argument of George F. Edmunds in *Pollock v. Farmers Loan and Trust Co.*, 157 U.S., 429, 488-489. Prior to the adoption of the Federal Constitution, nearly all the States imposed a poll tax, taxes on land, livestock, and various kinds of personal property, and seven of the thirteen states assessed their citizens upon their profits from professions, trades and employments. *Pollock v. Farmers, etc. Co.*, 157 U.S., 429, 559. Prior to the *Pollock* case, federal taxes on successions, business transactions and upon income were sustained as excise taxes and as such, indirect taxes not subject to apportionment but subject to the principal of uniformity. *Pacific Ins. Co. v. Soule*, 7 Wall., 433; *Veasie Bank v. Fenno*, 8 Wall., 533, 544-546; *National Bank v. United States*, 161 U.S., 1; *Scheley v. Row*, 23 Wall., 331; *Railroad Co. v. Collector*, 100 U.S. 595; *Springer v. United States*, 102 U.S. 586. The *Pollock* case did not overrule the prior decisions but distinguished them in holding that the tax on rents was a tax upon the real estate itself and therefore a direct tax.

But the mere question of definitions has no legitimate bearing upon a question of constitutionality. The decision whether a municipal tax contravenes rights secured by the Constitution must depend not upon any mere question of form, construction or definition, but upon the practical effect of the tax imposed. A state may tax the incomes of its own citizens and residents because of the privileges they enjoy under its constitution and laws and the protection they receive from the State. A State, from whose laws property, business and industry derive the protection without which production and gainful occupation would be impossible, may also exact a share of those gains in the form of income taxes for the support of the government from non-residents. Just as a state may impose income taxes upon its own citizens whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and not more onerous in its effect, upon incomes accruing to non-residents from their property and business within the State. *Shaffer v. Carter*, 252 U.S., 37. It is therefore concluded that under the Ohio Constitution the income tax in question is neither a property tax nor an excise tax but is a special tax, - an income tax, and that the tax in question does not violate Section 4 of Article XIII of the Constitution.

However, the requirement of equal protection prescribed by Article I, Section 2 of the Ohio Constitution and the Fourteenth Amendment of the United States Constitution prevents discrimination as between persons subject to taxation. All tax payers similarly situated are entitled to equality of treatment under any Ohio tax law. To be valid,

taxation and other statutes must operate equally upon all persons in the same class; no discrimination or favoritism among them is permitted. *Winslow, Inc. v. Evatt*, 144 Ohio St. 471, 476.

Private corporations are regarded as persons within the meaning of the constitutional provisions relating to persons. *Wheeling Bridge, etc. Co. v. Gilmore*, 8 O.C.C., 658; *State v. Gardner*, 58 Ohio St. 599, 609; *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, 574.

Section 2 of Article I does not declare that every person shall receive the same amount of protection and benefit but does declare that "Government is instituted for their (the people's) equal protection and benefit. Equal protection means the protection of equal laws." *State v. Felton*, 77 Ohio St. 554, 571. It is, however, manifestly impossible to obtain an absolute universality of operation, and due regard must be had as to different capabilities, conditions and relations between men and physical forces. There is a wide latitude of selection of classification, and it is only when the power of selection has been abused that the courts may interfere. Legislation involving classification will not be held invalid unless the classification attempted is obviously unreasonable to the point of discriminating against members of the same class, so as to deny the equal protection of the laws. *City of Xenia v. Schmidt*, 101 Ohio St., 437. A classification must rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and may not be made arbitrary and without any such reasonable and just basis. Class legislation is prohibited; but legislation which is limited in its application and within the sphere of its operation affects all persons similarly situated, is not invalid. *State v. Felton*, supra, p. 574. One of the most sensible tests is whether any substantial favor is gained by one class, or any greater burden is fastened on the other by reason of the classification. *State ex rel v. United States Fidelity, etc. Co.*, 96 Ohio St., 250, 255. A classification which undertakes to arbitrarily separate some persons from others upon whom the act would operate and thus form a class, not upon any reasonable basis of different characteristics, capriciously, but as a matter of will and not of reason, is invalid. *Williams v. Donough*, 65 Ohio St., 499, 504. Cf. *Chambers v. Owens A.K.Co.*, 146 Ohio St. 599. Specifically, a classification for taxation to be valid, must be a classification of the subject of taxation, - property and not a classification of taxpayers. *State ex rel Davis*, 132 Ohio St., 555, 564; *State ex rel Hunt*, 132 Ohio St., 568, 577; *Winslow-Spacarb, Inc. v. Evatt*, 144 Ohio St., 471, 476.

The classification in the instant case is between individuals and corporations. Individuals are to pay one rate and corporations a higher rate. There is apparent no reasonable basis for distinguishing the different rate as between natural persons and corporations. It follows that the ordinance violates Section 2 of Article I of the Ohio Constitution.

The tax is also repugnant to the equal protection clause of the Fourteenth Amendment. No doubt there are subjects as to which corporations admissably may be accorded different treatment, but there are other subjects as to which such a course is not admissable, the distinguishing principle being that classification must rest on differences pertinent to the subject in respect to which classification is made. *Power Co. v. Saunders*, 274 U.S., 490, 494. The equal protection clause does not forbid classification. The power of the State to classify for purposes of taxation of wide range and flexibility, provided always, that the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. *F.S. Royster Guano Co. v. Virginia*, 253 U.S., 412, 415, 64 L. Ed. 989, 990, 40 Sup. Ct. Rep. 560; *Air-way Electric Appliance Corp. v. Day*, 266 U.S., 71, 85, 68 L. Ed., 169, 177, 45 Sup. Ct. Rep. 12; *Schlesinger v. Wisconsin*, 270 U.S., 230, 240, 70 L. Ed. 577, 564, 43 A. L. R., 1224, 46 Sup. Ct. Rep. 260. That is to say, mere differences is not enough; the attempted classification must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis. *Gulf, C & S. F. R. Co. v. Ellis*, 165 U.S. 150, 41 L. Ed. 666, 668, 17 Sup. Ct. Rep. 255; *Louisville Gas and Electric Co., v. Coleman*, 277 U.S. 32, 37.

In 1920 Pennsylvania enacted a law providing a tax on gross receipts derived by corporations from their operation of taxicabs in interstate transportation of passengers, but did not tax the like receipts of individuals engaged in the same kind of business. In *Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, the Supreme Court held that the act violated the equal protection clause of the Fourteenth Amendment. The court says :

" Here the tax is one that can be laid upon receipts belonging to a natural person quite as conveniently as upon those of a corporation. It is not peculiarly applicable to corporations as are taxes on their capital stock or franchises. It is not taken in lieu of any other tax or used as a measure of one intended to fall elsewhere. It is laid upon and is to be considered and tested as a tax on gross receipts; it is specifically that and nothing else.

" In effect #23 divided those operating taxicabs into two classes. The gross receipts of incorporated operators are taxed while those of natural persons and partnerships carrying on the same business are not. The character of the owner is the sole fact on which the distinction and discrimination are made to depend. The tax is imposed merely because the owner is a corporation. The discrimination is not justified by any difference in the course of the receipts or in the situation or character of the property employed. It follows that the section fails to meet the requirement that a classification to be consistent with the equal protection clause must be based on a real and substantial difference

having reasonable relation to the subject of the legislation. *Power Co. v. Saunders*, supra. (274 U.S., 490). No decision of this court gives support to such a classification. In no view can it be held to have more than an arbitrary basis. As construed and applied by the state court in this case, the section violates the equal protection clause of the Fourteenth Amendment. See the *Railroad Tax Cases*, 13 Fed. 722. *County of Santa Clara v. Southern Pacific R. Co.*, 18 Fed. 385. *Northern Pacific R. Co. v. Walker*, 47 Fed. 681. The tax cannot be sustained."

It should be pointed out however, that Justices Holmes, Brandeis, and Stone dissented, principally on the ground that the discrimination between corporations and individuals with regard to a gross receipts tax can not be pronounced arbitrary. The dissenting opinions refer to the decision in *Flint v. Stone-Tracy Co.*, 220 U.S., 107, which sustained the Corporation Tax Act of 1909 imposing a tax of one percent on the net income of corporations, with no corresponding tax on the income of individuals. The Corporation Tax was attacked under the Fifth Amendment, but Justice Stone could see no reason for not applying ~~it~~ it to the Fourteenth Amendment as well. However, during the intervening twenty-four years the Supreme Court has not seen fit to overrule the *Quaker City Cab* case.

It is therefore concluded that as to appellees, the Youngstown Income Tax Ordinance violates Section 2 of Article I of the Constitution of Ohio and that appellees are denied the equal protection of the laws of Ohio under the Fourteenth Amendment of the Constitution of the United States.

Finding and judgment as in the common pleas court and cause remanded for execution for costs and further proceedings if any are necessary.

II . The Campbell Income Tax Ordinance.

The Campbell ordinance levies an income tax of .7% per annum upon net profits of corporations earned as a result of business activities conducted in the City of Campbell. On its face, the discrimination is not as apparent as in the Youngstown ordinance levying the tax on individuals at one rate and upon corporations at a higher rate. It is stipulated, however, that no other ordinance of the city taxes individuals or partnerships and exempts corporations, and no other ordinance taxes individuals or partnerships or their property at a rate different from that at which corporations or their property are taxed.

In *Flint v. Stone-Tracy Co.*, 220 U.S. 108, the constitutionality of the Corporation Income Tax arose under the Fifth Amendment, and the Court said, as obiter, that even if the Fourteenth Amendment applied, there was a sufficiently substantial difference between businesses as carried on in the manner specified in the act and as carried on by partnerships and individuals to justify the classification. The Court held that the tax ~~therein~~ imposed was not a franchise tax but a tax on the doing of business with the advantages which inhere in the peculiarities of corporate or joint stock organizations of the character described in the act; that the requirement to pay such excise taxes involved the exercise of privilege, and if business is not done in the manner described no tax is payable.

But as indicated above, the validity of the classification as between corporations and individuals under the Fourteenth Amendment was definitely decided by the Supreme Court in 1927 in *Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, and although rendered by a divided court, the decision has not been overruled. As recent as 1948, the Supreme Court in *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, held that the Ohio tax levying an ad valorem tax on accounts receivable of foreign corporations derived from sales of goods manufactured in Ohio but not used in the conduct of their business in Ohio but in their general business, denied such corporations the equal protection of the laws. Accounts receivable of identical nature owned by residents and domestic corporations were exempt from the tax. The inequality to which the foreign corporations were subjected was not based on Ohio's relation to the decisive transaction but solely on the difference in residence of the owner of the accounts receivable. It is of interest to note that in this case the decision of the Ohio Supreme Court sustaining the tax in question (*Corp. v. Glander*, 150 Ohio St., 229) was reversed.

It is therefore concluded that the appellees herein have been denied the equal protection of the laws of Ohio guaranteed by the Fourteenth Amendment,

Finding and judgment as in the common pleas court and cause remanded thereto for execution for costs and further proceedings, if any are necessary."

CONN and SAVORD, JJ., concur.

APPENDIX V

THE WASHINGTON, D.C. INCOME TAX

The three income taxes levied by the District of Columbia since 1939,¹ individual, unincorporated business and corporation,-- are generally considered as state income taxes rather than in the city income tax category.² Nevertheless, utilization of the tax suggests that this revenue source is one effective means of financing the government of a metropolitan area. The present District income taxes are levied under the " District of Columbia Income and Franchise Tax Act of 1947" which is the basis for this summary of the present status of this summary of the present status of this metropolitan income tax.³

The personal income tax is a graduated net income tax. Present exemptions are \$4000 for the taxpayer and \$500 for each dependent.⁴ The tax applies to individuals domiciled in the District of Columbia on the last day of the tax year, individuals who are residents of the District for seven months or more of the taxable year, estates and trusts.

¹ Cf. District of Columbia Income Tax Act, Title II of the District of Columbia Revenue Act of 1939- Public Law 225, 76th Congress, approved July 26, 1939.

² Blakey, Roy G. and Johnson, Violet, State Income Taxes, Chicago: Commerce Clearing House, 1942, p.4.

³ Article I of the " District of Columbia Revenue Act of 1947", P.L. 45, 80th Cong. 1st Sess., approved July 16, 1947 (H.R. 3737) as amended by P.L. 509, 1948 and P.L. 76, 1949.

⁴ P.L. 76(1949); cf. CCH State Tax Guide Service, Para. 280904.

The basis of the tax is taxable income, net income after personal exemptions and credits have been deducted from gross income. In general, deductions are similar to those existing under the Federal Income Tax. However, income from an unincorporated business which is subject to the District income tax on unincorporated businesses is not also subject to the personal net income tax. Also in the case of a resident of the District who is an elective or appointive officer or employee of the U.S. Government and is domiciled outside the District during the whole tax year, income received from the federal government and income received from sources within the state of domicile of such person are excluded from the tax base. Present individual tax rates are as follows:

<u>Taxable Income</u>	<u>Tax Rate</u>
First \$5000	1½%
Second 5000	2 %
Third 5000	2½%
Over 15000	3 %

The District also levies an income tax on taxable income of foreign and domestic corporations engaged in business or trade in the District of Columbia. The tax is levied at a rate of 5% of net income of subject corporations derived from sources within the District. In addition, annual flat rate license fees of \$10.00 are required.

An unincorporated business tax is levied on the business income of both resident and non-resident individuals engaging in non-corporate business activity in the District. The tax is limited to income arising within the District. The basic unincorporated business net income exemption is \$5000 and the rate is 5%. One significant feature is

noteworthy, personal service unincorporated business net income is largely excluded from the tax so that it is taxable under the personal income tax. The following statement summarizes the exclusion: " Any trade or business which by law, custom or ethics cannot be incorporated or, any trade or business in which more than 80 percent of the gross income is derived from personal services actually rendered by an individual or members of a partnership or legal entity in conducting said business and in which capital is not an income producing factor, is not subject to the tax.⁶"

Table I indicates the annual revenue derived from income taxes by the District of Columbia for the period 1940-1950. As previously noted with respect to city income taxes, these taxes are fiscally adequate. About 10% of total District income was derived from this source in 1950; total D.C. revenue was \$120,900,000 of which \$12,195,062 was received from income taxes.⁷ Unfortunately, as is so frequently the case, no adequate data on cost of collection are available. In 1942, Blakey estimated that the cost of collecting the D.C. income tax was 1.68% of revenue yield.⁸ District officials do not break down cost of collection figures by type of tax, all that can be given is total cost of collection for all taxes for a given year.⁹ Thus,

6 CCH State Tax Guide Service, op. cit., Para. 28-931.

7 Letter to the writer from Mr. E.A. Dent, Assessor, District of Columbia, dated February 16, 1951.

8 Blakey and Johnson, op. cit. p. 107.

9 Letter to writer from Mr. Ernest S. Griffith, Director, Legislative Reference Service, Library of Congress, dated Nov. 21, 1950; Dent letter, op. cit.

TABLE ***XVIII*****REVENUE FROM INDIVIDUAL, CORPORATE AND UNINCORPORATED BUSINESS
INCOME TAXES, DISTRICT OF COLUMBIA, ANNUALLY, 1940-1950**

(Yield in thousands of dollars)

<u>Year</u>	<u>Individual</u>	<u>Corporation</u>	<u>Unincorporated Business</u>
1940	\$1,319	\$ 956	\$
1941 1941	1,790	2,082	
1942	2,375	3,209	
1943	2,741	4,470	
1944	3,469	5,207	
1945	3,489	5,421	
1946	3,947	5,275	
1947	4,319	5,634	
1948	4,260	6,004	477 (a)
1949	4,643	6,205	663
1950	5,044	5,945	1,206

(a) First Year for Unincorporated Business Tax.

SOURCE: Data furnished by Assessor, District of Columbia,
Letter to writer, dated Feb. 16, 1951.

the fact that the 1950 appropriation for the Office of the Collector of Taxes for the District of Columbia was \$262,000 is not particularly revealing or informative.

This appendix to a study of city income taxes gives only a summary of the Washington D.C. income tax picture. It would appear that the Washington experience indicates that a mildly graduated tax can be a significant fiscal tool in financing a large urban area. The policy question of whether or not progression is desirable at the local level has been considered elsewhere.¹⁰ It should be recalled that the tax situation of the District is unique in that there can be only two layers of taxation in that particular jurisdiction which materially simplifies the total tax structure as compared with the normal American three layer governmental structure.

10 Cf. Chapter X, *supra*.

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AUTOBIOGRAPHY

I, Arthur Dellert Lynn, Jr., was born in Portsmouth, Ohio, November 12, 1921. I received my secondary school education in the public schools of the cities of Deland, Daytona Beach, Flagler Beach and Bunnell, in Florida, Chicago, Illinois and Portsmouth, Ohio. My undergraduate training was obtained at the Virginia Military Institute, The United States Naval Academy and The Ohio State University, from which I received the degree Bachelor of Arts in 1941. From The Ohio State University, I received the degrees of Master of Arts in 1943 and Bachelor of Laws in 1948. I was a Graduate Assistant in the Department of Economics of The Ohio State University in 1942; an Assistant in 1942; in 1943 an Assistant Instructor. I was on active duty in the Army of the United States as a Lieutenant, Field Artillery, from 1943 until separated from the service in 1946, serving on the Faculty of the Field Artillery School, Fort Sill, Oklahoma, with the 27th Division Artillery on Okinawa and in Japan, and as Aide to the Provost Marshal General of Tokyo. Upon discharge, I received an appointment as Instructor in the Department of Economics of The Ohio State University. I held this position while completing the requirements for the degree Doctor of Philosophy with the exception of the year 1949-1950 during which time I engaged in the general practice of law as a member of the firm of Lynn and Lynn, Portsmouth, Ohio.

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APPENDIX II

AN OPINION OF THE BOARD OF REVIEW FOR THE DIVISION OF TAXATION
OF THE CITY OF TOLEDO, OHIO, RENDERED JULY 13, 1950.

In Re : Appeal of _____ from a ruling of the Commissioner of Taxation, dated January 19, 1950, as to their taxability under Toledo Ordinance 18-46, for the period from March 1, 1946 through December 31, 1948 and the calendar year 1947 et seq.

Although the above cases were not heard together, the question to be determined being the same in each case, we will render one opinion for both cases.

The briefs indicate that it is agreed that such companies are dealers in intangibles within the meaning of the Ohio Personal Property Tax Law; that each of said companies has appealed from a ruling of the Commissioner of Taxation to the effect that they are subject to the one percent Toledo tax, imposed under Toledo Ordinance 18-46, on the net profits attributable to Toledo activities, earned after March 1, 1946.

The same question was presented to this Board in the matter of the _____ Finance Company, which was decided on December 15, 1948. Certain of the contentions made by one or both of the above-mentioned taxpayers were considered in that case.

Among such contentions, was the contention that Article II-9 (m) of the Toledo Income Tax Regulations precludes the Commissioner of Taxation from imposing the Toledo income tax on the net profits of a dealer in intangibles. It was stated by this Board with respect to this contention that :

" the particular Regulation referred to is directed to and applies only to taxpayers receiving dividends and interest from intangibles personal property who are required to pay a tax to the State of Ohio measured by such income, and does not apply to a dealer who is required to return and pay a property tax to the state based upon net worth."

While it is true that Article II - 9 (m) of the Toledo Income Tax Regulations was amended on July 17, 1947, we see no reason to modify our previous decision and are of the opinion that such Regulation, as amended, is directed to ordinary taxpayers receiving dividends and interest upon which they are required to pay the Ohio Personal Property Tax, and does not apply to a dealer having net profits derived from a business carried on in Toledo.