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Edmund H. Bodden

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LEGISLATIVE SUGGESTIONS.

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TAXATION OF MERCHANTS' AND MANUFACTURERS' STOCK

BY EDMUND H. BODDEN,

TAX COMMISSIONER OF THE CITY OF MILWAUKEE, WIS.

SUBMITTED AT THE ELEVENTH ANNUAL CONFERENCE OF THE
NATIONAL TAX ASSOCIATION, HELD AT ATLANTA,
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Tax investigating bodies, students of taxation, and experienced tax administrators have always been confronted with the practical difficulties of assessing this class of property. Compared with the assessment of other classes or species of property, both real and personal, this class of property has never been uniformly and equitably assessed. However earnest and efficient the administration of a general property tax may be, it is practically impossible in a large city to assess accurately the value of merchants' and manufacturers' stock. The assessment of such property is not satisfactory and by the very nature of things can never be so. Some of our ablest writers and advocates of tax reform have frequently alluded to these objectionable features.

This form of taxation has always appeared to me to be one of the weaknesses, if not the greatest one, of the present tax laws of our country. Many and various substitutes for this form of taxation have been advanced. For instance, a classified property tax has been proposed. Again it has been suggested that ice dealers be taxed on their average yearly stock, the same is true of coal dealers, grain dealers, lumber and logging companies. Furthermore, it has been proposed to substitute a pure income tax in lieu of a property tax and thus we may cite many other substitutes suggested by acknowledged authorities for this form of taxation.

Last year difficulties were had with the grain dealers in the city of Milwaukee. They succeeded in having passed a law taxing them a certain percentage per bushel upon all grain that passed through their elevators during the year in lieu of a tax upon their stock on hand. This greatly reduced their tax and

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we fought out the proposition in the Supreme Court of Wisconsin. The court held this to be a valid occupational tax. The bankers of our state, whose bank stock under the present law is assessed at its market value endeavored to have the legislature pass an income tax law on the basis of ten per cent. of their net earnings in lieu of the property tax. The main reason advanced by the bankers who favored this change was the injustice and inadequacy of the assessment of merchants' and manufacturers' stock as compared with bank stock. The legislature, however, did not pass the law. Our state tax commission has favored the abolition of the personal property tax altogether and have instead, a pure income tax. Our governor, in his message to the legislature of our state strongly advocated that merchants and manufacturers be compelled to pay both the property and income tax.

Because of this local agitation, we have tried to evolve some method which would prove more just and equitable to both our merchants and manufacturers and to the state than either of the methods suggested, and our object in advocating the proposed change of method is to obtain a more just and uniform assessment of this class of property and a more just and equitable adjustment between it and all other property. The thought of deriving more revenue from it did not enter into the proposition only in so far as might be found, that the same had not heretofore borne its proportion of taxes based upon a fair and reasonable basis. After rejecting the assessment of this class of property on the average and the other suggested substitutes, the thought occurred: If the bankers' money is willing to pay ten per cent. of its net earnings for taxes, why should not our merchants and manufacturers be willing to pay a relative amount based upon their gross sales? Why not tax merchants and manufacturers for the privilege of doing business, measuring such tax upon their gross sales? How then can we determine what rate to apply to gross sales so as to obtain a relative and equitable rate?

From this thought as a basis, we endeavored to find the relationship between the normal net earning power of money and gross sales of a manufacturer or merchant. The earning power of money in our state is five per cent. While it may earn more, the consequent risk is greater. Averaging the greater risk with the rate, however, no more than five per cent. will be realized.

What relationship then does this bear to gross sales? By taking \$1,000.00 of money at five per cent. (the rate of return in our state) we have a \$50.00 net income with a tax of ten per cent. thereon, (the rate the bankers were willing to pay) a \$5.00 tax is obtained. Taking gross sales at \$1,000.00 and taxing it at one-half of one per cent. will produce the same amount of tax (\$5.00). To determine the rate of one-half of one per cent. as above applied to gross sales on the basis of ten per cent. to net income, multiply the net income (\$50.00) by twenty and consequently divide the ten per cent. by twenty. In this way the same results are obtained and the relative basis between net income of money and gross sales is established for our purpose.

At once the question will present itself: "Is not the income on gross sales in one line of business larger than in another?" This question, however, does not meet this situation, for we are here determining the relative basis between normal income of money so as to ascertain a rate to be applied for the privilege of doing business based on gross sales.

You must disabuse your mind that this is a property tax, but rather it is a privilege or license tax to do business. As will be explained later in this paper, the difference in profit realized on gross sales will be taken care of by our income tax.

The question as thus presented does not, however, raise all of the objections. Besides the objection to the tax that profits may vary, due to the fact that some stock is turned at a greater profit while other stocks are turned over many times during the year, thus producing a greater profit, there is the objection that the rate is a fixed rate and therefore does not vary with the increase or decrease of public expenditures. With these objections in mind and taking one-half of one per cent. as a basis, we endeavored to meet the objections heretofore stated.

In our calculation of one-half of one per cent. we did not take into consideration the fact that if money paid a tax of ten per cent. upon its net income, it would pay no personal property tax. In order therefore to arrive at a proper and reasonable adjustment of this rate and to take into account an income tax which would act as a leveling tax as between concerns which made little or no profits, and concerns which made large profits, we found it necessary to reduce this rate. After careful consideration and research work based upon data in our office showing the assessment on present stocks and the income tax paid by merchants

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and manufacturers, and by preparing a table of figures, we came to the conclusion that the occupational tax should be one-quarter of one per cent. rather than one-half of one per cent., so as to take into account the additional income tax, or the leveling tax.

This, however, did not take care of the fact and still left the objectionable feature that the rate was a fixed one. The great majority of tax experts are opposed to fixed rates for the reason that property enjoying a fixed rate does not participate or contribute its share to special or extraordinary improvements or expenses incurred by municipalities. It does not give the merchant and manufacturer an interest in expenditures and in the economical administration of the city government. With the basis then of one-quarter of one per cent. on the gross sales plus the income tax, we sought a form of taxation which would be flexible, depending upon the ordinary rate of taxation applicable to all taxable property in the city.

The average rate of taxation applicable to real estate and other taxable property in Milwaukee is two per cent. Take gross sales at \$1,000.00 and apply the rate of one-quarter of one per cent., a tax of \$2.50 is obtained. By taking \$1,000.00 gross sales and dividing the same by eight and applying to the quotient so secured the going rate (which as stated above in our city averages two per cent.) we find the result to be the same, \$2.50. The figure eight is used as the divisor because by using this figure we come to the same results, for you divide the amount of your gross sales by the same figure by which you multiply the rate (eight) and therefore the result must be the same.

We have used the divisor eight to gross sales as gathered by the assessors and have tested it out on various forms of industry, and have found in practice, that it lends itself best to existing conditions in the city of Milwaukee. From the steps in our calculations by which we have arrived at this figure eight you will note, that it is not an arbitrary basis but that it is based first upon the relation between the net income of money and the gross sales of merchants' and manufacturers' stock. We have also ascertained, and are at the present engaged in trying to determine the various net profits on gross sales, and find from those industries where we have obtained reliable figures thus far, that the factor eight is practicable when used together with the income tax. In other words, it checks up. We find also by using the factor eight that where merchants' and manufacturers' stocks have heretofore been properly assessed under the property tax

they will on the average be taxed thirty-seven and one-half per cent. less than under the property tax, and we further find that the per cent. of tax used as an offset to the income tax by our merchants and manufacturers in the city of Milwaukee averages about the same per cent., thus equalizing one with the other.

In a few words, the scheme of handling the taxation of merchants' and manufacturers' stock is to divide the total sales for the year by eight and multiply the fraction so secured by the property tax rate and adding thereto the present income tax of Wisconsin.

We have therefore overcome the two objections, for we have a tax which with the income tax will take care of the varying profits on gross sales and when applied by the method proposed, will be a flexible tax depending upon the ordinary rate of taxation applicable to real estate and other taxable property. In other words, we have a tax which ties up the tax rate on gross sales with the general rate applicable to real estate and other taxable property. As the needs or requirements, therefore, of the municipality increase, so will the taxes increase or decrease on this class of property in the same manner as it does on all property which is assessed under the property tax law. It will give to the merchant and manufacturer an interest in the expenditures and in the economical administration of government. It will insure absolute uniformity so far as the occupation tax is concerned and as our income tax is a graduated tax, it will act both as a leveling tax and a tax based upon ability to pay. It will have a tendency to encourage new enterprise, to foster struggling concerns which may have made no profits, by lightening their burdens and yet require them to contribute a substantial amount towards the maintenance of the government from which they derive protection and many other valuable and expensive services, in years when they have no income.

Then, too, this form of taxation will eliminate guess work on the part of the assessors in valuing the numerous and varied kinds of merchants' and manufacturers' stock. The only thing that will be required of the merchant and manufacturer will be a statement under oath, of his gross sales for the previous year. This is the least inquisitorial and the easiest to answer of any of the statements required to be answered for the purpose of taxation, indeed, the merchant and manufacturer must make answer to the very same question to both the Federal government and the State in the determination of the income tax.