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AN IMMEDIATE TAX PROGRAM FOR THE STATE OF KENTUCKY ¹

BY JAMES W. MARTIN*

I. PRESENT STATE AND LOCAL TAX SYSTEM

Preliminary to suggestions for distributing more fairly the cost of government in Kentucky must come an analysis of the present state and local tax system. It is not feasible to develop a constructive tax program without first ascertaining how it will fit into the background of the present scheme, which itself is the product of a long course of evolution. The first step in proposing immediate constructive changes, therefore, is to outline the tax situation now existing in the state.

A. *Taxes Now Levied In Kentucky*

The present state and local tax system of the commonwealth of Kentucky is characterized by two outstanding features: (a) the great emphasis on property taxation and (b) the failure to utilize many of the most important revenue sources. Accurate statistics respecting local tax collections are lacking but some

¹This paper is the substance of an address before the University of Kentucky College of Law on March 9, 1933. Certain pages are practically identical with similar pages in a report submitted in May (1933) to the Kentucky Educational Commission. They are used with the approval of the Commission. Miss Margaret Bargar of Columbus, Ohio, has been good enough to read the manuscript and offer valuable suggestions.

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effort will be made below to indicate the statistical results of the present tax system. Here, the purpose is briefly to describe the existing situation and thereby lay the foundation for development of a constructive program for tax reform.

*The Real Estate Tax.*² In Kentucky there is no difference in the tax rates applied to different types of real property. The state rate in all cases is thirty cents on the \$100 valuation³ and the local rates vary to meet budgetary requirements. That the real estate rate in the state is lower than the personal property tax rate seems to be an almost unique characteristic of the Kentucky system. Indeed, instead of levying a higher rate on certain types of personal property as is done in Kentucky, many states completely exempt some or all personal property.

The generally accepted notion that the real estate tax is paid primarily by farmers is shown by examination of the facts to be an error. The 1931 *Report* of the State Tax Commission indicates⁴ that the different classes of real estate constitute the following proportions of the total:

Class of Realty	Proportion of Total Realty
Rural lands	42.0%
City lots and improvements	45.3
Franchise corporation realty	11.2
Minerals and mineral rights	1.5
Total	100.0

It is obvious from these figures that about 58 per cent of the total real property in the state is situated in municipalities or owned by franchise or mining corporations. As a matter of fact, the rural land item, in addition to farm, grazing and forest lands, includes mineral tracts.

*Classification in Kentucky.*⁵ The anomalous classification of real estate under the tax laws of Kentucky has already been indicated. In the general classification system there are many other interesting features, some of them usual, some unique.⁶ The class generally known as intangibles, but including only certain types of intangibles, such as stocks, bonds, mortgages,

² Cf. especially Carroll's *Kentucky Statutes*, secs. 4019 to 4280 (cited *infra*. K. S. 4019 to 4280).

³ K. S. 4019a-10.

⁴ P. 123.

⁵ K. S. 4019a-1 to 4020.

⁶ *4 Federal and State Tax Systems* 123-133.

and certain other evidences of debt, is separately classified for taxation at a flat rate of fifty cents on the \$100 valuation and is completely exempt from local taxation.⁷ Farm and manufacturing machinery actually used in farming or in manufacturing as the case may be, are likewise subject only to the state rate of fifty cents. Live stock, domestic fowls, and manufacturing inventory, whether in the form of raw material or goods in process, are also taxable exclusively for state purposes at this same rate.⁸ Agricultural products held in storage are subject to the fifty-cent state rate plus a local general rate of not more than thirty cents.⁹ In addition to the special treatment of manufacturing enterprise, municipalities (but not city school districts) are authorized at their discretion, to grant temporary exemption (not exceeding five years) to new manufacturing establishments as to all other types of property as an inducement to secure location of the plant in the city.¹⁰ Bank deposits¹¹ and shares of stock in building and loan associations¹² are classified for taxation at the rate of ten cents on the \$100 valuation. Franchises,¹³ defined practically in terms of the earning capacity of certain types of corporations, especially public utilities, are taxable at the maximum state and local rates. The shares of stock of banks, trust companies and domestic insurance companies are taxable for state purposes at fifty cents on the \$100 and are subject to maximum rates for local purposes as follows: Municipal, twenty cents; county, twenty cents; and school, forty cents.¹⁴

⁷ K. S. 4019-a-10. See also S. E. Leland, *Taxation of Intangibles in Kentucky*, Bureau of Business Research, University of Kentucky.

⁸ K. S. 4019a-5, 4019a-10.

⁹ K. S. 4019a-16.

¹⁰ *Constitution of Kentucky*, sec. 170; *Louisville v. Board of Education*, 154 Ky. 316, 157 S. W. 379.

¹¹ K. S. 4019a-3.

¹² K. S. 4019a-6 to 8.

¹³ K. S. 4077 to 4091 and decisions cited.

¹⁴ K. S. 4019a-10 and 4092. There is little doubt, as suggested by Myers (Blakey and others, *Taxation in Minnesota* 294) and by Whitaker (Brookings Institution, *Report on a Survey of the Organization and Administration of the State, County, and Town Governments of New Hampshire* 549) that Kentucky's bank tax is invalid under sec. 5219 U. S. R. S. *Merchants' National Bank of Richmond v. Richmond*, 256 U. S. 635; *Minnesota v. First National Bank of St. Paul*, 273 U. S. 561; *First National Bank v. Hartford*, 273 U. S. 548; *First National Bank of Guthrie Center v. Anderson*, 269 U. S. 341; *Des Moines National Bank v. Bennett*, 284 U. S. 239; *Keating v. Public National Bank*, 284 U. S. 587; affirming *Public National Bank v. Keating*, 47 F. (2d)

The Highway Taxes on Motor Users. Two lucrative revenue measures in the Kentucky tax system are the motor registration and gasoline taxes. Motor registration taxes are collected from those who operate motor vehicles on the public roads in conjunction with the issuance of the license plates required by law.¹⁵ The average registration tax rates in Kentucky are slightly above the average rates imposed by other states.¹⁶ The revenue derived from the imposition of these taxes, amounting on the average to more than \$4,000,000,¹⁷ is used mainly for the purpose of financing the activities of the State Highway Department.¹⁸

In addition to the state registration tax, several municipalities impose local registration taxes ranging from a minimum of about \$2.50 a vehicle to a maximum of about \$60 a vehicle. The average rate seems to be slightly under \$12.¹⁹ These municipal rates are lowest on private automobiles, intermediate on trucks and contract buses and highest of all on common-carrier buses.²⁰

The commonwealth also imposes a tax of five cents a gallon on the sale of motor fuels of various sorts.²¹ A similar tax is imposed by each of the forty-eight states and the District of Columbia.²² A few states impose rates as low as two cents a gallon, while Florida and Tennessee impose a rate of seven cents a gallon for state purposes. The gasoline tax rate in Kentucky is higher than the average rate in the several other states but slightly lower than the average rate for the various states south of the Mason-Dixon Line and the Ohio River.²³

Because of the fact that certain of the commonwealths

561. See also Buschmann, *Taxation of National Bank Shares*, 6 Ind. L. J. 316; *State Taxes and the National Banks*, 41 Yale L. J. 609.

¹⁵ K. S. 2739g-1 to 69.

¹⁶ James W. Martin (Chairman), *Report of the Committee of the National Tax Association on Taxation of Motor Vehicle Transportation* (1930). Bureau of Business Research, University of Kentucky, 20.

¹⁷ Cf. recent annual reports of the State Tax Commission.

¹⁸ K. S. 2739g-63, par. i.

¹⁹ James W. Martin and C. M. Stephenson, *Taxation of Private and Common-Carrier Motor Vehicles*, Bureau of Business Research, University of Kentucky, 6-12.

²⁰ *Loc. cit.* See also Martin, *Neglected Aspects of the Taxation of Commercial Motor Transportation*, 22 Proceedings, National Tax Association, 517 (1929).

²¹ K. S. 4224b-1 to 12.

²² Martin (Chairman), *Report of the Committee of the National Tax Association on Taxation of Motor Vehicle Transportation* 10-11.

²³ *Loc. cit.*

authorize counties or municipalities or both to impose gasoline taxes and that Kentucky does not authorize such local levies, some of the states which appear to impose lower rates than does Kentucky may actually have higher rates. In Alabama, for example, it is possible that the aggregate state plus county plus municipal rate may exceed ten cents a gallon.²⁴

The Business Taxes. The business tax structure in Kentucky is, in comparison with that of other states, a highly complex and relatively indefinite thing. The first tax to which all domestic corporations are subjected is the so-called organization tax paid to the Secretary of State on the basis of capitalization at the time the corporation is organized in Kentucky.²⁵

The state imposes on concerns *not subject to the franchise* tax a corporation license tax at the rate of seventy cents on the \$100 Kentucky asset value of the corporate stock.²⁶ This is the nearest thing to a general business tax that the state levies. It yields less than \$400,000 of revenue annually.²⁷

Retail merchants in the commonwealth are subject to a tax measured by gross sales at rates ranging from .05 per cent if the aggregate sales of the merchant are \$400,000 or less to 1 per cent of that part of the sales in excess of \$1,000,000.²⁸ This tax, however, is offset by the amount of corporate or other license taxes which the merchant may have paid.²⁹ At the present time collection of this tax from about forty of the larger taxpayers, who would pay most of it were its provisions enforced, is enjoined by a federal court order pending determination of the constitutionality of the act.³⁰ The yield of this measure thus far has been less than \$100,000 a year.³¹

In addition to heavier registration taxes required of each motor vehicle for hire,³² motor transportation companies must pay a business excise tax ranging in the case of passenger vehicles from one-fourth of a cent a mile for vehicles having a

²⁴ American Petroleum Institute, "Alabama City and County Gasoline Taxes."

²⁵ K. S. 4225.

²⁶ K. S. 4189-1 to 10.

²⁷ State Tax Commission, *loc. cit.*

²⁸ K. S. 4202a-1 to 12; *Moore v. State Board of Charities and Corrections*, 239 Ky. 629.

²⁹ K. S. 4202a-4.

³⁰ *Kroger et al. v. Lewis et al.*

³¹ State Tax Commission, *loc. cit.*

³² K. S. 2739j-27-1 to 27-3.

seating capacity of seven passengers or less to three cents a mile for those having a seating capacity of thirty passengers or more. In the case of property carriers the rate ranges from one-half a cent a mile upward.³³ In the case of both property and passenger carriers, there is a 50 per cent higher rate for vehicles equipped with solid tires. There is also a permit fee which is collected in connection with the issuance of a permit or a certificate of necessity and convenience.³⁴

Any concern engaged in the operation of a race track is required to pay a tax of \$2,500 a day if the track is located within twenty miles of a city of 200,000 population or greater. In all other cases the tax is \$500 a day of actual operation.³⁵ In both cases municipalities are prohibited from imposing an additional business tax.³⁶

In addition to the special property tax on liquors,³⁷ there is a license tax on the privilege of manufacturing or warehousing distilled spirits at the rate of ten cents a proof gallon on liquor manufactured and placed in a warehouse prior to 1926 and two cents a gallon on that manufactured after that date.³⁸ Drug stores and others selling liquor also pay a license tax of fifty cents on each pint.³⁹

In general the insurance business is taxed in Kentucky, as in most other states, on the basis of premiums.⁴⁰ The rates are generally 2 per cent of the premiums as defined by law. There are additional requirements which make the aggregate rate in the case of certain types of companies 2.5 per cent. In addition, there are municipal taxes or licenses on the insurance business, agencies, and agents in most of the cities of the commonwealth. They appear in various forms and at various rates.⁴¹

There are many state miscellaneous license taxes on certain specified businesses.⁴² They are imposed in several forms and at various rates. In addition to the state licenses, municipali-

³³ K. S. 2739j-78 to 97.

³⁴ K. S. 2739j-69.

³⁵ K. S. 4223b-1a.

³⁶ K. S. 4223b-3.

³⁷ K. S. 4105 to 4114.

³⁸ K. S. 4214a-1 *et seq.*

³⁹ K. S. 4214b-1 *et seq.*

⁴⁰ K. S. 4226 to 4237; cf. 4 *Federal and State Tax Systems* 147-148.

⁴¹ L. B. Averett, *Local Taxation of the Insurance Business in the United States*. Bureau of Business Research, University of Kentucky.

⁴² K. S. 4224.

ties may impose privilege taxes on practically any type of business.⁴³ In some of the cities almost every imaginable sort of business is thus taxed.⁴⁴

Oil Production Tax. While the oil production tax might be regarded as a business tax, it may be treated separately as a severance tax, and regarded as being shifted to consumers. In Kentucky the rate for state purposes is .5 per cent, and counties or school districts may impose not to exceed 1 per cent, of the market value of all petroleum produced.⁴⁵

Inheritance Tax. Kentucky imposes a graduated inheritance tax on the legacies left to different classes of heirs.⁴⁶ There is an initial exemption ranging from \$500 in the case of distant relatives and strangers to \$20,000 in the case of widows. The first \$25,000 in excess of the exemption is taxable at the rate of 1 per cent in the case of direct heirs, 2 per cent in the case of collateral heirs and religious or charitable organizations, and 6 per cent in all other cases. The maximum rate of 16 per cent is applicable to direct and collateral heirs so far as legacies in excess of \$10,000,000 are concerned and to strangers on legacies in excess of \$500,000. Kentucky educational, religious, charitable or public institutions receiving legacies are exempt.⁴⁷

Poll Tax. The statutes^{47A} authorize counties and school districts to impose poll taxes. From no point of view, however, are such levies of any great importance.

B. General Results

Fiscal Results. As indicated above statistics of tax yields are inadequate to render possible an analysis of the exact results in financial terms of the tax system which is described above. An estimate of the total tax revenues of the state and its local subdivisions, however, for the calendar year 1931 has recently

⁴³ E. g. K. S. 2980, 3174.

⁴⁴ "Privilege License for City of Middlesboro, 1932-3" and "License Tax Ordinance of City of Paducah, 1933" provide illustrations.

⁴⁵ K. S. 4223c-1. Before 1932 the rates were twice as high.

⁴⁶ K. S. 4281a-1 to 4281a-11.

⁴⁷ Cf. Rodman Sullivan, *The Inheritance Tax in Kentucky*, Bureau of Business Research, University of Kentucky.

^{47A} K. S. 1882, 4239i-1, 4239i-2, 4281u-1, 4440 (and cases cited), and 4464.

been published.⁴⁸ The figures are quoted in Table I and indicate that nearly three-fourths of the revenues in that year were derived from the taxation of property. The only other taxes

TABLE I
TAX COLLECTIONS IN KENTUCKY

State and Local	Calendar Year 1931
General property†	\$52,168,731
Intangibles	2,787,862
Franchise‡	2,162,087
Property tax on distilled spirits	40,452
Bank deposits	302,716
Bank and trust companies and domestic life companies† ...	968,000
Building and loan association stock	91,941
Poll‡	500,000
Inheritance	1,055,373
Corporation license	390,418
Foreign insurance companies‡	1,170,099
Foreign building and loan	
Miscellaneous insurance companies‡	748,006
Other insurance taxes and fees‡	203,135
Gross sales	88,656
Motor transportation companies‡	112,818
Intoxicating liquors	169,712
Gasoline	8,798,584
Corporation organization‡	25,536
Oil production	48,542
Race tracks	262,500
General licenses‡	3,415,000
Registration of motor vehicles	4,501,597
Special assessments‡	1,200,000
Total	\$81,211,765

†Estimated. "General property" in common Kentucky parlance and here means those property taxes not shown separately.

‡Fiscal year, July 1, 1931 to June 30, 1932.

yielding substantial revenues were general licenses, motor registrations and taxes on motor fuels and the insurance business. The maximum yielded by any other tax did not greatly exceed \$1,000,000.

While this tabulation includes the proceeds of special assessments it does not include revenues from fees, local utility, and other charges. In other words, the tax revenues included

⁴⁸ 4 *Federal and State Tax Systems* 198.

in this tabulation are those derived from the exercise of the taxing power by the state and its local subdivisions and municipalities.⁴⁰

Conclusion. Examination of the Kentucky tax system, as compared with the systems employed in other states, indicates that this commonwealth depends very heavily on property taxation; though the diversity in the property tax itself as shown in Table I, is substantial. Moreover, it must be said that numerous other states depend as heavily as does Kentucky on property taxation. (See Table II.) Some progressive commonwealths, however, have reduced the relative importance of the property tax until at the present time less than half of their

TABLE II

PLACE OF PROPERTY TAXES IN THE STATE AND LOCAL TAX SYSTEMS OF ALL SOUTHERN STATES FOR WHICH DATA ARE AVAILABLE, 1931.¹

(Amounts in Thousands of Dollars)

	Total State Tax Revenue	Revenue from Property Tax		Revenue from Other Taxes	
		Amount	Percentage of Total	Amount	Percentage of Total
Kentucky	81,212	58,522	72.06	22,690	27.94
Alabama ²	48,425	30,563	63.11	17,862	36.89
Arkansas	50,153	33,071	65.94	17,083	34.06
Florida	84,282	61,601	73.09	22,680	26.91
Louisiana ²	67,771	48,063	70.92	19,709	29.08
Mississippi ²	38,116	26,032	68.30	12,084	31.70
Missouri ²	128,554	84,516	65.74	44,038	34.26
North Carolina ²	94,709	59,911	63.26	34,798	36.74
South Carolina ²	37,367	20,629	55.21	16,738	44.79
Tennessee ²	45,914	22,392	48.77	23,519	51.23
Virginia	80,347	38,829	48.33	41,518	51.67
West Virginia	72,046	52,900	73.43	19,146	26.57

¹ *Federal and State Tax Systems* 197 et seq.

² Incomplete or partly estimated.

³ The proportion of revenue from property taxation was reduced by 1932-33 to about 49 per cent. In 1933-34 it will be still lower.

* There is, of course, an element of the police power in the imposition of some of the license and privilege taxes; but for present purposes this consideration may be ignored.

revenue, rather than about three-fourths as in Kentucky, is derived from this source.

In the second place, the Kentucky situation is particularly characterized by the fact that there is no general business tax, such as may be found in most other states, yielding large revenues.

Thirdly, the commonwealth of Kentucky has not developed any really important revenue measures in the nature of sales taxes. In many of the states, there are tobacco excises, beverage taxes, taxes on admissions to places of amusement, in addition to the so-called general sales taxes. In a number of states, too, the exploitation of natural resources is subject to a privilege tax. In this state, the only tax of this type is that on oil production, which yields annual revenue of less than \$50,000 in comparison with several millions yielded in states no richer in natural resources than Kentucky.⁵⁰

Finally, the Kentucky state and local tax system contains no effective personal tax requiring a contribution from each citizen approximately in proportion to his ability to pay taxes. It is true that a local poll tax is imposed in many parts of the state. This is a personal tax, but it bears no relation to the capacity of the individuals to contribute to the support of government.⁵¹ About two-thirds of the states have met this shortcoming, as shown below, by the imposition of state income taxes on individuals.

These characterizations of the Kentucky tax system pointedly suggest the wisdom of enlarging the tax base in the commonwealth to require contributions from numerous individuals who own little or no property but who are recipients of substantial incomes, and so have considerable ability to pay taxes. The remainder of this discussion will be devoted to an attempt to point out ways and means of providing further corrections suggested by the existing facts summarized here.

II. IMPROVING THE KENTUCKY STATE AND LOCAL TAX SYSTEM

The most essential steps in reforming the tax system in Kentucky are (a) improvement in the classification of property

⁵⁰ 4 *Federal and State Tax Systems* 197-201.

⁵¹ 12 *Proceedings*, National Tax Association, 426 *et seq.*

for taxation, (b) improvement in the administrative structure for tax law enforcement, and (c) shifting from extremely heavy dependence on the property tax to a broader basis for taxation which will secure revenue from those not now making substantial contributions. Immediate attention must be centered on the last of these developments, since the first and second are essentially long-run problems.

The classification system in Kentucky lacks conformity with any plan whatever and reflects simply the play of economic forces represented directly or indirectly in the legislature. It is so complex as to render administration unnecessarily difficult and to result in confusion among taxpayers. The effects of the present system of classification require (and are receiving) careful study, so that the economic interests involved may know the consequences of the present classified property tax and of alternative possibilities. Revision of this scheme can not and perhaps ought not be effected over night. Discriminating investigation of the whole situation in the light of present administrative practices will be necessary.

In part, improvement of the administrative structure for enforcement of tax laws depends on constitutional changes; but it depends much more on the development of civil service reform for state and local personnel recruiting and promotion; on the integration of local administration; and on the development of closer relationships between state and local officials involved in tax administration. There must come a rearrangement, based on functional considerations, which ought to accompany a comprehensive program of state and local reorganization, rather than be an isolated effort to improve tax administration.⁵² By way of illustrating this point, attention may be directed to the multiplicity of county officers now involved in property tax procedure. The number includes not only the tax commissioner (assessor) and sheriff (collector) but also the county clerk, the county attorney, and, under certain circumstances, other local officials. (If the multiplicity of municipal and school tax authorities were introduced, the picture would be more realistic.) Each of these officers is independently chosen; and the plan of

⁵² See Brookings Institution, *op. cit.* 617 and National Institute of Public Administration, *Findings and Recommendations on a Survey of the Administrative Structure of the State Government of Arkansas* 9, 22-23.

administration, therefore, not integrated in any substantial way. Indeed one official may work consciously at cross purposes with others.⁵³

But there is no logical or constitutional reason why the distribution of the tax burden can not be greatly simplified without delay. Those not now making contributions to the support of the state and its localities can be required by appropriate legislation to do so, and those now paying an undue proportion be correspondingly relieved. The method by which such a redistribution of tax liability may be effected is *through enactment of revenue measures designed to reach primarily those who are not now paying substantial taxes and the substitution of such state income for revenue now derived from the operation of the property taxes*—especially the real estate tax.

This suggestion involves two distinct problems: (a) how the substitution of additional revenues for property tax revenues shall be made, and (b) how the additional tax revenues shall be raised. Suggestions on both these points are presented.

A. *Reduction of Property Taxes by Eliminating State Real Estate Levy*

How shall new revenues be substituted for present property taxes? As viewed by many people, the obvious answer is that the state real estate tax should be repealed and the revenue replaced by other levies. This suggestion has been so vigorously argued and so frequently reiterated that many have come to regard it as the only possibility, the obvious path to tax reform. In spite of this chorus of approval, however, there are dissenting voices so clamorously and so logically effective that a comprehensive study of the experience of states which have and those which have not repealed state real property taxes throughout the United States has been made to check the results of each policy in terms of the arguments which have been submitted for and against such a program.⁵⁴

The results revealed by this study are so significant for present purposes that several of them are summarized.

⁵³ Concrete instances have been observed in several counties.

⁵⁴ Martin and Stephenson, *Aspects of the Movement Toward Separation of Sources of State and Local Revenue*, Bureau of Business Research, University of Kentucky (1933).

1. The tangible property tax is one of the few comparatively stable sources of state revenue which yield considerable income for non-highway purposes. Its repeal means even less stability of income in times of prosperity and depression than now characterizes the state revenue systems of most states.

2. Experience demonstrates that repeal of the state property tax has not ordinarily resulted in a long-run reduction in the proportion of state and local revenues derived from taxes on property. It has meant a reduction in state property taxes but an increase in local property taxes. The immediate effect of the repeal of state taxes is a net decline in the proportion of revenue derived from property taxation. In the long run increases, which neutralize this effect, occur in local revenue systems, so that the net effect, after the expiration of a few years, is practically no change in the relation of property taxes to total taxes.

3. Proponents and opponents of the state property tax have argued according to their respective views that such a measure would result in substantial economies or would encourage unduly lavish expenditures. The statistics of those states which have tried the plan, as compared with figures for others, indicate that neither result has followed the repeal of the state property tax. There is no perceptible difference in the extent to which governments in one class are wasteful as compared with those in the other.

4. While quantitative measurement has proved impractical, the evidence seems clear that the program of abandoning the state property tax and relegating this source of revenue to the localities has resulted in lessening the consciousness on the part of the state government of the existence of local fiscal problems. If state taxes are derived solely from sources other than those utilized by the localities the feeling of local autonomy is generally sufficient to deter the state government from giving any considerable attention to problems of local administration. This results in bringing about an unfortunate failure on the part of the state to cooperate with local officials and agencies and on the part of the local officers to cooperate with state officials. It seems clear, therefore, that local autonomy has resulted unfortunately for any effort to develop joint action for the improvement of tax administration, since such improvement should be based on local knowledge of political and economic conditions

and on technical skill which can normally be provided only by centralized action.⁵⁵

5. But the difference in assessment efficiency is more significant than any other differences found in states which have, as compared with those which do not have a state tax on tangible property. It has proved possible to measure the effectiveness of assessments by two methods.⁵⁶ In the first place, the relationship between the assessed value of property and the legal full value has been measured statistically. Data for some twenty-five or thirty states, including all of those which have repealed the state property tax as a definite state policy, indicate clearly that the average assessment ratios⁵⁷ are lower in states that have repealed the state property tax than in others.⁵⁸

The second measure of assessment efficiency is even more significant. It is a mathematical measure of the extent to which assessment ratios of the individual parcels of property are scattered. The technical name for the measure is "coefficient of dispersion."⁵⁹ Examination of the coefficients of dispersion for the twenty-five or thirty states indicates that the states which have abandoned the state property tax have substantially higher coefficients (that is, that assessments are worse scattered or more unequal) than those still imposing the tax.⁶⁰

To these findings, based on technical administrative and economic considerations, perhaps one thought based on expedience should be introduced. For some years, 88.5 per cent of the proceeds of the thirty-cent Kentucky state tax on real estate has been dedicated to public education. In the light of circum-

⁵⁵ *Ibid.*, p. 3.

⁵⁶ *Ibid.*, pp. 12 to 14.

⁵⁷ "Assessment ratio" means the assessed valuation of property divided by the market value of the same property.

⁵⁸ The assessment ratios for rural realty average 41.53 per cent in states which have repealed their property taxes as compared with 61.00 per cent in other states. The corresponding figures for urban assessments are 41.53 per cent and 54.49 per cent respectively.

⁵⁹ The "coefficient of dispersion" used in the study is derived from the statistical measure known as mean deviation from the mean (except in one or two cases in which median deviation from the median had to be utilized) and represents simply the average extent to which the individual assessments deviated from the average assessment. The coefficient is stated in terms of a percentage of the average.

⁶⁰ "The median (middle case) of the coefficients of dispersion for the samples of rural assessment is 35.52 per cent for the states without a state real estate tax and 32.60 per cent for the others. For urban properties the medians are 35.95 and 32.39 per cent respectively." *Ibid.*, p. 13.

stances in the state, it is doubtful whether, if the state real estate tax were repealed, there would be a chance to assure the replacement of the four million dollars now raised for education by this levy. Consequently, the friends of public education have special reason to look askance at the suggestion that the property tax now used for state purposes be abolished. This is particularly true now that the revenues from intangibles have declined so much as seriously to cripple the program of public education.

The conclusion from this showing seems to be obvious. The state property tax should not be repealed, unless either (a) there is a possibility of overcoming the unfortunate results of such a program or (b) the alternative to such repeal which is available is even less fortunate. The chance of avoiding the unfortunate results of such a program in the state of Kentucky, with political conditions as they are, is extremely remote; and the possibilities of a better method of dealing with the situation seem to be inviting.

B. *Retention of State Tangible Property Tax With Reduction in Local Property Taxes*

The most important argument for the retention of the state property tax on tangible personalty and real estate, aside from the purely negative one that repeal leads to the unfortunate results outlined in the preceding section, is that the state governments must take increasing account of the fiscal problems and needs of municipalities and other local subdivisions. One of the most effective means of developing and maintaining relationships conducive to the feeling of inter-dependence is the definite state assumption of financial responsibility in collaboration with local subdivisions of the state.

Adoption of such a plan of state-local financial cooperation must contemplate two definite issues, and a satisfactory solution to each of them must be reached as a precedent condition to initiating the improvement. The first problem is to develop a concrete plan of financial inter-dependence and cooperation, and the second is to find tax revenues which will render possible the reduction in property taxes and the assumption by the state of some financial responsibility hitherto borne by a local agency.

A Plan of Integration. One plank in the program of integrating state and local affairs is assumption by the state of

definite responsibility for the collection and publication, through the cooperation of local officials, of the financial statistics of city and county government. A recent study⁶¹ embracing all of the states demonstrates that about a dozen of the commonwealths have attempted comprehensive plans of centralizing statistics of local government and that something like an equal additional number have centralized statistics of several types of financial activities. Thus, as Professor Haygood finds, about half of the states have made a fairly satisfactory beginning on this problem.

After the survey referred to above, the author has turned his attention to a plan for Kentucky. He believes there is little doubt that the possibility of making direct comparisons between different units of local government would result in Kentucky in very marked improvement in the present situation. He suggests, however, that, before any substantial program can be formulated, (a) there is need of uniformity of fiscal periods in counties and cities,⁶² (b) the bases for financial reports in the various jurisdictions must be unified, and (c) all localities must provide financial reports to a central office maintained by the state government. Mr. Haygood's general conclusions respecting the Kentucky situation are as follows:

"There is genuine need in Kentucky for a uniform method of collecting financial data from county and city governments. Some state agency now in existence should gather information, assimilate and digest it, and publish it at regular intervals. Statement of income, expenditures, property values, bonded and other indebtedness, as well as data on other financial matters should be secured through the use of forms made up and sent out by this central office. This material should be presented to the taxing offices in the state and to all interested parties in such form as will be understood by them. That will involve much discretion and judgment on the part of the state agency.

"In no state does the law requiring financial reports by local governments provide the exact information to be included in the published reports. It would be unfortunate if this were not true. Some of the states having the best plans have the simplest legal provisions.

"The beneficial results of comprehensive plans for centralizing local financial statistics may be both direct and indirect. The actual monetary savings are, of course, difficult of determination, but estimates in the states having such plans range in amounts from a few thousand to five million dollars. These have come about primarily from the uniform accounting feature of the centralization practices.

"The indirect benefits of centralization are far-reaching. A large part of the work of the central office is the education of the public in

⁶¹T. F. Haygood, *State Control of Local Expenditures through Centralization of Financial Statistics*, Tax Magazine.

⁶²*Ibid.*, p.

matters of governmental finance. The reports are the bases for intelligent study of governmental functions in relation to their costs. In other words, the central agency is a sort of clearing house for information and ideas; and upon that office rests the responsibility of developing a spirit of cooperation among all those individuals who are interested in the subject of governmental economy. There appears to be no reason why these benefits, direct and indirect, may not be had in the State of Kentucky through the centralization of local financial statistics."⁶³

The second plank in the program of integration undoubtedly involves state assumption of increased responsibility for educational support. It has recently been shown⁶⁴ that there are glaring inequalities between the different school districts of the state in the support of education and also in the ability of the various districts to provide this support. To give only one example, the fifty-cent local tax rate in one county yields approximately four dollars a school child (as enumerated in the official census), while in another county exactly the same rate yields approximately forty-three dollars a census child. Moreover, for topographical and population reasons, the cost of providing a given educational standard would be higher in the first than in the second county.

It has also been proved⁶⁵ that, while the present legal situation in the state⁶⁶ renders it impractical to develop a thoroughly modernized program of educational support in the commonwealth, definite and marked improvement can be effected by the simple process of increasing the state school fund and thereby making possible a reduction in local property tax rates for school purposes. The measure of equalization which can be brought about by only a moderate increase in the state school fund, provided in the year 1931-32, is substantial.⁶⁷

A similar program has been suggested for the reorganization of the highway plan of Kentucky. The commonwealth has increasingly assumed responsibility for highway construction and maintenance but the plan of requiring contributions from the several counties for the construction of roads in that particular county has led to a large highway debt borne by local

⁶³ *Ibid.*, p.

⁶⁴ Martin and others, *Report of the Subcommittee on Financial Support to the Kentucky Educational Commission*, May, 1933, pp. 35-43.

⁶⁵ *Ibid.*, pp. 40 *et seq.*

⁶⁶ Especially that developed by *Talbott, Auditor v. State Board of Education*, 244 Ky. 826.

⁶⁷ *Ibid.*, Charts 3, 5-8. The amount of the fund has declined greatly since 1931-32.

property taxpayers. The plan contemplated would have the state assume increased financial responsibility for local highways, thereby relieving the local property taxpayers and incidentally reducing or eliminating the county highway levies. The state of North Carolina has provided a definite precedent for assumption by the state of entire responsibility for its rural highway program. The present suggestion may involve complete assumption by the commonwealth of such financial responsibility or it may result in only partial assumption of the tax burden for highway purposes.

There are thus three distinct steps in a program of integrating state and local finances in the interest of a better tax system and in the interest of more economical expenditures of tax revenues. (1) The state must collect and publish financial statistics of local government. (2) The state must assume larger responsibility for the essentially state function, education. (3) The state, which has developed machinery for collecting specific highway taxes, must increasingly provide for local highways.

Acceptance of this constructive plan for integrating state and local government more effectively will involve, in the case of the last two items, a method of substituting added state revenue for local property taxes. It is necessary to point out some of the possible sources of such additional revenue as will be essential to the development of the plan.

C. *Available Sources of Additional Revenue*

There is no one method by means of which the revenues suggested above should be raised. Certain specific planks which appear to be needed in any satisfactory program of tax reform in the state, may, however, be mentioned.

Inheritance tax. Probably the most available means of securing additional revenue in Kentucky without the imposition of a new tax is through revision of the present inheritance tax. Such revision may well lie along two distinct lines. The most obvious of these involves utilizing completely the offset equal to a maximum of 80 per cent of the tax due the federal government under the old estate tax law, which is offered on account of state death taxes, whether levied on legacies or on estates. The

simplest method of making provision for utilizing all of the offset, of which in recent years a maximum of nearly \$50,000 annually has been lost to the federal government, is the insertion of a provision that in no case should the amount payable by any estate be less than a schedule equal to 80 per cent of the old federal estate tax rates.

But as the Kentucky inheritance tax law is drawn, there is reason to believe that the amount paid by small and moderate-sized estates is much less than might be collected without unfortunate results. The possibilities of increased revenue lie along two lines. The first is the reduction of exemptions to secure some small contribution from each legacy of any substantial size. The rate need not be materially advanced; but, if the exemption be cut from the present maximum to, say, \$5,000 on direct heirs and \$500 on collateral heirs and strangers, the revenue would be much greater. In this connection, it may be observed that the exemption for widows in Kentucky is twice the model exemption provided in other states.

A second means by which an increase in revenue can be secured without unfortunate results is through reduction in the sizes of brackets to which the initial rates are applicable. At the present time, the 1 per cent rate on a legacy to a widow is applicable to the first \$25,000 in excess of the \$20,000 exemption. In Arkansas, the widows' exemption is only \$6,000 and the 1 per cent rate applicable to the next \$5,000, 2 per cent to the next \$10,000 and so on.⁶⁸ Initial brackets in Kentucky might be at most \$10,000.

Modernizing the business tax structure. There is no complete accord among tax students respecting the best methods of business taxation, but it seems fairly simple to criticise constructively the set-up in Kentucky. If the sole corporate tax must be an excise measured by capital stock, the rate may well be substantially increased over that provided at the present time (seventy cents on the \$1,000 of asset value). Many of the states already have higher rates than the Kentucky capital-stock tax rate and, at the same time, impose other forms of taxation on the privilege of doing business in the state or on the corporate income as such. Experience demonstrates that more aggregate

⁶⁸ 4 *Federal and State Tax Systems* 154.

corporation tax revenue can be collected without any undue legal, administrative, or economic difficulties.⁶⁹

But approximately two-thirds of the states have corporate tax plans superior to any that could be developed by means of capital stock taxes alone. Some thirty states levy, either in addition to capital stock taxes or in lieu of such imposts, corporation income taxes; and several impose either gross sales taxes as in Connecticut⁷⁰ and Delaware⁷¹ or gross income taxes which include those varieties of business income a corporation tax can not reach.⁷²

By way of simplifying the problem and of avoiding some of the difficulties inherent in the taxation of non-corporate business, it is suggested that the business tax structure in Kentucky, so far as it has to do with corporations, might be modernized by the introduction of a corporate income tax. This might be superimposed on the present corporate license tax if the rates were low (say not in excess of 3 or 3.5 per cent), or such a measure might provide for a credit equal to the amount paid under the present corporate license tax against the tax due under the corporation income tax if it were deemed wise to levy a higher rate income tax. Experience in other states demonstrates that such a levy can be satisfactorily enforced at 5 or 5.5 per cent.⁷³ A careful estimate indicates that in the year 1932, on the basis of corporate incomes of 1931, such a tax if imposed at the rate of 5 per cent would have yielded nearly \$2,000,000 less any offset allowed. The offset would not involve a reduction in this revenue equal to the total amount of tax now paid under the corporate license tax, since some enterprises now pay the latter which do not at present earn a net income.

While many students believe that there should be a business tax on non-corporate enterprise, as well as corporate, it would

⁶⁹ 4 *Federal and State Tax Systems* 180; cf. also 25 *Proceedings*, National Tax Association 242 (1932).

⁷⁰ Revised Code 1930 secs. 1340 to 1351.

⁷¹ *Code*, 1915, T. 3, chap. 6, art. 12, secs. 159-161; *Laws*, 1917, chap. 11 and *Laws*, 1919, chap. 23.

⁷² Oregon Laws 1933, chap. 400; South Dakota Senate Bill No. 101, 1933 (not yet codified); Arizona H. B. 146, 1933 (not yet codified and not operative owing to a temporary injunction); Indiana H. B. 513, 1933 (not yet codified); and North Dakota Senate Bill No. 315, 1933 (not yet codified).

⁷³ 4 *Federal and State Tax Systems*, 172, et seq.; Blakey, *op. cit.*, chap. xv.

probably be generally accepted by tax experts that a state like Kentucky would find it well to develop its administrative machinery for dealing with corporate taxes before concerning itself with the taxation of unincorporated business.⁷⁴ At any rate, this suggested plan contemplates immediate improvement of the corporate tax structure along the lines indicated without attempting at the present any provision for the taxation of non-corporate business enterprises as such.

A Personal Tax in Proportion to Ability to Pay. As already indicated, Kentucky imposes no personal tax in proportion to the ability of members of the community to contribute to the support of government. Undoubtedly the most urgent measure of reform in Kentucky is the provision of a personal income tax with low personal exemptions, moderate but steeply graduated rates, and central administration. The feasibility, indeed the wisdom, of such a measure has been verified by the experience of about two-thirds of the states and by the experience of practically all foreign states.⁷⁵

Aside from the desirability of the revenue which might be expected from such a tax (see Table III), the most important reason for a personal income tax is improvement in the distribution of the tax burden. At the present time, the effect of the tax system in Kentucky is to impose higher aggregate tax rates on the poor than on the well-to-do. The utilization of an income tax of the type suggested above would correct this inequity and perhaps develop some slight element of progression. This is to be desired. Moreover, there are numerous individuals in the state at the present time who have taxable capacity and who, not owning property, pay nothing directly toward the support of the general government of the commonwealth and its subdivisions. A personal income tax would require some contribution from such persons. Numerous other arguments have been

⁷⁴ It is desirable to direct attention to the impossibility of administering an income tax without technically proficient personnel, as shown by James W. Martin and A. J. Lawrence, *Personnel for the Administration of State Income Tax Laws*, Bureau of Business Research, University of Kentucky. As shown in Martin, *Possibilities of Income Taxes as Sources of State and Local Revenue*, *ibid.*, the expense of administering a corporation income tax is low (about 0.5 per cent of the revenue).

⁷⁵ *4 Federal and State Tax Systems* 120, 170-179; Blakey, *loc. cit.*

advanced on this score,⁷⁶ but these are sufficient to give a general indication of the desirability of this form of tax.

TABLE III
ESTIMATES OF INCOME TAX REVENUE POSSIBILITIES
IN KENTUCKY

Rates	Estimated Kentucky Revenues		
	1920 ¹	1930 ²	1931 ³
<i>Personal Income Tax</i>			
Rates of North Carolina ⁴	\$3,558,000	\$3,020,000	\$2,313,000
Rates of North Dakota ⁵	2,920,000	2,478,000	1,898,000
Rates of Virginia ⁶	2,219,000	1,883,000	1,442,000
<i>Corporate Income Tax</i>		1930 ⁷	1931 ⁸
3%		1,465,800	1,177,000
4%		1,954,400	1,569,000
5%		2,443,000	1,962,000
6%		2,931,600	2,354,000

¹ Estimates are of revenue which would have been raised in Kentucky by a state personal income tax at the various rates and are calculated from *Statistics of Income* for 1920 upon incomes less Federal personal exemptions. Income statistics for 1920 have been used as in that year only are incomes of those in the lower brackets reported fully.

² Estimates are those of 1920 reduced by the percentage of reductions in 1930 incomes in Kentucky over those of 1920 for incomes over \$4,000 as reported in *Statistics of Income*.

³ Adjusted to 1931 on basis of Brookmire estimates of income.

⁴ 2% first \$2,000, 3% second \$2,000, 4% third \$2,000, 5% fourth \$2,000, 5½% fifth \$2,000, 6% excess of \$10,000.

⁵ 1% first \$2,000, 2% second \$2,000, 3% third \$2,000, 4% fourth \$2,000, 5% fifth \$2,000, 6% excess of \$10,000 of income.

⁶ 1½% first \$3,000, 2½% next \$2,000, and 3% excess of \$5,000 income.

⁷ Estimate is the mean of estimates arrived at by reducing the 1929, 1930, and 1931 average corporation income tax revenues of thirteen states which tax corporate income at a flat rate to a 1 per cent base, calculating the revenue per dollar of income [using an average (mean) of income estimates of *Sales Management*, N. E. A. projection of the National Industrial Conference Board and Brookmire and applying each of these revenue ratios to Kentucky, 1930, income (derived as above)].

⁸ Adjusted to 1931 on basis of Brookmire estimates of income.

Selective Excise Taxes. In the event additional revenue should be needed from sources other than the property tax after reforming the inheritance and business taxes and supplying a personal income tax, selective excises offer a reasonably

⁷⁶ Martin and others, *Report of the Subcommittee on Financial Support of Education* 63-65.

available source of considerable income. Table IV shows the prospective annual productivity of several possible measures of this sort. The rates suggested in each instance are moderate and in many cases could be increased without considerably curtailing the transactions taxed.

TABLE IV
ESTIMATES OF REVENUE FROM SELECTIVE EXCISES
IN KENTUCKY¹

	Rates	Revenue Estimated
<i>Gross Pari-Mutuel Bettings</i>	5% { 6 yr. av.	\$1,425,000
	{ 1932	640,000
<i>Tax on Soft Drinks</i>	1c each 5c retail value bot- tled drinks } 76c per gallon, fountain } syruups } 2c per pound, malt extracts }	1,500,000
<i>Tax on Manufactured To- bacco Products</i>	1c each 10 cigarettes	1,100,000
	10% of retail price other manufactured tobacco prod.	200,000
<i>Tax on Admissions to Places of Amusement</i>	1c on each 10c of price of ticket	700,000
<i>Severance Tax on Coal</i>	1c per ton	375,000
<i>Tax on Electricity</i>	2% of gross receipts	400,000
	½ mill per kwh.	375,000
<i>Tax on Sale of Candy</i>	10%	500,000
<i>Tax on Sale of Chewing Gum</i>	1c per package	300,000
<i>Tax on Sale of Jewelry</i>	5% on jewelry	200,000
	5% on clocks and watches	50,000
	5% on silverware	35,000
<i>Tax on Sale of Cosmetics, Toilet Preparations and Compounds</i>	<i>Type:</i> Proprietary and patent medicines 10%	400,000
	Proprietary and patent com- pounds (antiseptics and de- odorants only) 10%	75,000
	Perfumes, cosmetics and other toilet preparations 10%	400,000
<i>Tax on Coffee and Tea</i>	1c each 10c of retail price of coffee	500,000
	4c per pound of tea	50,000

¹ Martin and others *Report of the Subcommittee on Financial Support to the Kentucky Educational Commission* 54.

In general the taxes which offer the most attractive possibilities are listed first in the table. For example, the first six items shown represent types of imposts used in the various states at the present time; whereas, the items toward the bottom of the table, though possible and though used in other countries, have not been frequently employed in the commonwealths of the United States. Experience has demonstrated that tobacco taxes can be imposed at higher rates than those suggested in the table. For instance, Tennessee imposes rates approximately twice as high; and, with a population approximately equal to that of Kentucky, raises about twice as much revenue as the figures shown in the table. On the other hand, it is probable that anything much higher than one cent a ton on coal would result in impairing the activity of the coal industry and would not raise much greater revenue. The same objection, in general, applies to a higher tax on pari-mutuel betting. Indeed it is doubtful whether the 5 per cent rate suggested would be feasible unless the "take-out" provided for the pari-mutuel operators were somewhat reduced. (The "take-out" is now much higher in Kentucky than in most other places which authorize race track gambling.)

The tax possibilities suggested toward the bottom of the table are perhaps not to be recommended. A tax on candy, chewing gum, or coffee and tea would not be seriously objectionable on economic grounds, and such taxes are frequently imposed in other countries. However, there would be considerable political difficulty in levying this type of impost, and it is probably not essential from a budgetary point of view in Kentucky at the present time. The possibilities of taxing jewelry and toilet preparations are not inviting. Such taxes would be comparatively difficult to administer and would undoubtedly have considerable influence in shifting some local trade to mail-order business. The revenue possibilities, however, at approximately maximum rates are indicated on the assumption that no considerable shift in the present business situation would result from the tax. The assumption is of doubtful validity.

That this general outline of a tax program does not ignore revenue considerations is demonstrated by Table V, which shows for certain southern states the average annual income and selective excise tax revenue for the last three years for

TABLE V

COMPARISON OF TAX REVENUES FROM INCOME AND SELECTIVE EXCISE TAXES (OTHER THAN GASOLINE) IN KENTUCKY AND NEIGHBORING SOUTHERN STATES FOR WHICH DATA ARE AVAILABLE

(Figures in thousands of dollars are three-year averages)

	Personal Income Tax		Corporation Income Tax		Selective Excises	
	Amount (-000 Omitted)	Amount per Capita	Amount (-000 Omitted)	Amount per Capita	Amount (-000 Omitted)	Amount per Capita
Kentucky	000	\$0.00	000	\$0.00	14 ¹	\$0.01
Georgia	258	0.09	631	0.22	1285	0.44
Mississippi	639	0.32	999	0.50	883 ²	0.44
North Carolina	1469	0.46	5573	1.76	000	0.00
South Carolina	409	0.24	1510	0.87	3529	2.03
Tennessee	667 ³	0.25	650	0.25	2203	0.84
Virginia	1669	0.69	1842	0.78	325 ⁴	0.14

¹ Margarine tax; not collected at all prior to 1932. This figure is for first twelve months the impost was effective.

² 1932 data only.

³ Tax on income from stocks and bonds only.

⁴ Two-year average.

which reports are available. In each instance, at least two years of the current depression are included, partly to avoid giving an exaggerated idea of the amount each of the several classes of taxes may be expected to yield. It will be observed that the states which have done most toward shifting from property to income and selective excises are North Carolina, Virginia, and South Carolina. The first two named have utilized primarily the individual and corporation income taxes; while South Carolina, although imposing both kinds of income taxes, has made the shift primarily by means of selective excises. The revenues are derived largely from taxes on tobacco, those on admissions to places of amusement, and those on soft drinks. This tabulation, of course, ignores the new taxes imposed during the current year.

A comparison of the revenues derived by North Carolina and Virginia with the rate structures shown in footnotes to Table III will indicate that the revenues shown are secured without extraordinary rates and so without undue hardship on taxpayers.

Examination of the table discloses that Kentucky is the only one of these southern states which makes no use of income taxes as a source of revenue. Moreover, it is one of two or three which makes practically no use of selective excises other than those on gasoline and on the severance of natural resources. Both these classes are excluded completely from the table. Alabama and Florida are omitted because data available are inadequate. Both of these states, however, impose selective excises; and there is a strong movement, especially in Alabama, to levy income taxes. Indeed the legislature has passed a bill effective when and if the people approve the constitutional amendment which has been submitted.

Conclusions. The general notion which has been advanced in the course of this discussion contemplates raising considerable additional revenue by means of state taxes other than those on property and substituting the proceeds for local property taxes. Experience in the United States indicates clearly that an attempt to make the substitution by replacing the state property tax revenues with the proceeds of other taxes would not be a constructive step. Moreover, circumstances in Kentucky are definitely favorable to a replacement of local levies by means of state tax income. In the course of such a substitution, the state government will be more definitely linked with county and municipal activities; this coordination is very much to be desired.

In the order of preference, the state taxes which should be employed to raise the needed revenue are (a) a personal income tax, (b) a corporation income tax, (c) a revised inheritance tax, and (d) various selective excise taxes on specified commodities or services. The reasons for this ranking have become largely apparent in the discussion above, and no further argument on the point need be incorporated here. It may be well to add, however, that more than twenty years ago Professor Seligman, the dean of American public finance experts, urged the enactment of a personal income tax even though the revenue were not needed and the levy should simply replace revenue from other sources.⁷⁷ This view probably expresses the attitude of the majority of students of taxation.

⁷⁷ Seligman, *The Income Tax*, Macmillan Company, 1911, p. 642.