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WINNIPEG AFFAIRS
ARE *YOUR* AFFAIR

YOUR TAX PROBLEM

?

BULLETIN No. 11 *of*
CITIZENS RESEARCH LEAGUE
OF WINNIPEG

FROM THE

Citizens Research League of Winnipeg

TO THE CITIZENS OF WINNIPEG, THE CITY GOVERNMENT AND THE HEADS OF CIVIC DEPARTMENTS:

Some months ago the Winnipeg City Council passed the following resolution:

"RESOLVED—That the Council affirm that the taxation of the City should be raised in the following manner:

"First:—For specific City purposes, including all direct and public service, by the present method of taxation of real estate, business tax, licenses, special franchises, etc.; the basis of the Business Tax as a tax to be subject to further consideration and revision.

"Second:—That the method of raising the taxes for essentially Provincial or General purposes should be on the basis of ability to pay, which, in the Province of Manitoba, is the principle of the Income Tax."

The attention of the Manitoba Government was drawn to the foregoing by a civic delegation which urged the appointment of a recess committee (representing the city and provincial governments and the public generally) to make careful study of the whole matter with a view to possible action at the next session of the Legislature.

The accompanying address on "Local Taxation" was delivered by Professor Arch. B. Clark, M.A., of the University of Manitoba, at the largely attended annual meeting of the Citizens Research League, February 28th, 1918. **The views expressed are those of Professor Clark personally, and in printing them the League does not go on record as necessarily adopting them.** It was felt, however, that their publication would form a valuable contribution to intelligent consideration of the problem.

April, 1918.

S. R. TARR, President.
R. P. FARLEY, Secretary.

Preceding Bulletins of League may be obtained from Secretary:

No. 1, Keeping Track of Citizens' Business; No. 2, Bird's Eye View of City's Budget; No. 3, Civic Assessment and Property Values; No. 4, That $2,000,000 Fire Tax; No. 5, Problem of Street Transportation; No. 6, Your forgotten $700,000 Pension Liability; No. 7, Jitney or Street Car?; No. 8, Has the Jitney a Place?; No. 9, A Year's Efforts (Annual Report of League); No. 10, Plan for Reorganized Board of Trade and Civics.

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NAME ....

ADDRESS ....

Local Taxation—The Problem in Winnipeg

The Argument for a Provincial Income Tax

BY

Professor ARCH. B. CLARK, M.A., F.S.S.,
University of Manitoba
Fellow of the Royal Economic Society

(An Address delivered at the Annual Meeting and Dinner of the Winnipeg Citizens Research League at the Royal Alexandra Hotel, 28th February, 1918)

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THE system of taxation in operation in Winnipeg has now for many months b n the subject of discussion, with a view to its revision. Indeed, it was as long ago as October, 1916, that the City Council, responsive to public opinion, requested .rd of Valuation and Revision to consider the whole tax system of the City, an d, to hold a public inquest, and collect information on methods of taxation wh be de ned suitable for adoption in the City of Winnipeg.

The Report of the Board of Valuation and Revision

Of that inquest the outcome, so far, has been the "Report" of the Board published early last July (1917). It is undoubtedly an able document and one deserving of careful study, and it has in fact already been, by most of us, read with interest and with profit, by reason of its clear and accurate diagnosis of the disease at present unhappily afflicting our civic revenue system, even though the prescription it recommends has not met with general approval. The prescription in question, as probably everybody here knows, is the substitution for the existing Business Tax, on a "rental value" basis, of an "Income Tax" on all incomes originating within the City.

Is a City Income Tax Feasible?

Now, many of us, while looking to the institution of some form of income tax as affording the most likely solution of the present problem, have from the first been frankly more than doubtful of the success of any such scheme as that outlined in the "Report." We have never believed that a purely City Income Tax of any kind, standing alone, could possibly succeed. And in a memorandum submitted at a public session of the Board of Valuation and Revision in November, 1916, I stated what appeared to me strong objections to such a tax—objections resulting from the fact that the basis of income, under modern conditions, is not local, not even provincial, but national, or, it may be, international. From this it follows that an income tax is, other things equal, more likely to prove successful in proportion as its basis is widened.

Professor Seligman's Scheme

But in the memorandum already mentioned I pointed out that the objections to a local income tax could be to a great extent overcome if, as Professor Seligman has suggested,*

* "National Tax Association: Proceedings of 1915 Conference," 135-45.

it were made a supplement to a Provincial or Dominion income tax, neither of which, by the way, at that time existed. The returns made for the purpose of the Dominion income tax assessment would simply be duplicated for the purpose of the City income tax. The City could then levy its own tax, its officials having access to the Dominion returns. Moreover, there would be this resulting advantage, that the co-operation of the City and Dominion officials in securing the accuracy of the returns would materially tend to lessen evasion, and so increase the productiveness of the tax. There would naturally be some variations from the Dominion tax. There would, for example, be no reason for allowing exemption, in the case of the City tax, to quite the same extent as in the Dominion tax, where a rather high exemption limit is required in order to balance the Customs and Excise duties, which fall heavily on consumers with small incomes.

Under a system such as this, the tax could be levied not only on the recipient but on the source of income, not only on the income of residents but on all income which originates within the City and is received by non-residents. This is naturally an important consideration in the case of a City like Winnipeg, where a considerable proportion of the income originating in the City is paid over to non-residents. It may be objected that this would lead to double taxation, since a man having his business in one city, and his residence in another, might be taxed in both on the same income. But this double taxation could be avoided by a decision of the Dominion Courts as to the proportion of income which should be assigned for taxation purposes to place of residence and place of source respectively. Further, both the place of legal residence and that of the origin of the income would have to be shown in the Dominion returns.

This then is the essence of Seligman's scheme for a local income tax, formulated with special reference to New York City; and it seemed for us in Winnipeg to represent one possible line of development.

Scheme of the Board of Valuation and Revision

But the Board of Valuation and Revision, in their "Report," took, as we have seen, quite another line. They proposed to broaden the basis of taxation by introducing what they styled an "Income Tax," but what was in reality a tax upon a part of income a tax on rent, interest, and earnings arising within the City known to students of public finance as a partial produce tax.* An income tax is generally understood to mean a tax which bears some relation to the whole net income of the taxpayer, from whatever source arising a tax proportional to ability to pay. It may not, it is true, be levied on the whole net income; parts of that income being reached by other taxes, levied perhaps on a capital basis, as in Massachusetts; or reached, as in the case of wage earners' incomes, by means of taxes on commodities. But if employed, as it invariably is, in supplement of other taxes, which inevitably in the long run come out of somebody's income, the object of a direct income tax should surely be, having due regard to productiveness, to make the whole burden of taxation as nearly as possible proportional to the ability or faculty of the taxpayer. A tax confined to the part of income arising within the City, would clearly, however, have no ne ary relation to ability to pay; and, while "a rose by any other name would smell as sweet," it is only natural that a partial produce tax, masquerading in the guise of an income tax, should have failed to commend itself to either the Council or the citizens.

* See Bastable, Public Finance, 395; Seligman, Income Tax, 13-15, 384-7

11-5-40

Recent Proposals of the Assessment Commissioner

A keener appreciation of what is at once practicable and equitable is, I think, shown in a proposal recently submitted to the City Council by the Assessment Commissioner, Mr. Donley, to substitute for the present Business Tax, on the basis of rental value, a business tax upon the net profits of businesses controlled, conducted and carried on within the City. Net profits is certainly a much more reliable index of the taxpayer's liability—whether determined on the basis of "ability to pay" or of "benefits received"—than is the annual rental of the premises occupied.

Mr. Donley's further proposal of a personal income tax on all the income received by residents, also represents an advance on the earlier scheme by which only income originating within the City was to be taxed. But this revised scheme is still open to several serious objections. A city tax standing alone can provide no effective means of checking the returns made by the taxpayers. Thus, even if we admit that not all men are liars, it is clear that the system would put such a strain on the honesty of many that the tax would quickly become inequitable; for through evasion much of the income would escape tax-free, and the burden on the conscientious would be unduly increased. Again, a tax confined to residents would allow much income which originates in the City and is received by non-residents, to escape altogether. And, finally, it would give a strong inducement to many people to take up their residence in neighbouring municipalities outside the City limits.

Action by the City Council

But the whole outlook has been altered, and the issue at last clearly defined, by the resolution recently adopted by the City Council and submitted by them to the Provincial Government. The resolution is as follows: "That the Council affirm that the taxation of the City should be raised in the following manner:

"First: For specific City purposes, including all direct and public service, by the present method of taxation of real estate, business tax, licenses, special franchises, etc.; the basis of the business tax as a tax to be subject to further consideration and revision.

"Second: That the method of raising the taxes for essentially provincial or general purposes should be on the basis of ability to pay, which, in the Province of Manitoba, is the principle of Income Tax."

The Council in this resolution has put itself, broadly speaking, in line with the general movement of tax reform on this continent at the present day; for the tendency in the States to the south unmistakably is towards a system which combines taxation of income with taxation of real estate, or even tangible property both real and personal, on its capital value.

General and Specific Services—Ability and Benefit as Bases of Taxation

There is an obvious and admitted distinction between public services of a **general** or national character and those which exclusively or mainly concern the inhabitants of the locality.

The benefit of the **first** class to individuals cannot be measured in money, and should therefore be provided for by the imposition of taxes in their nature onerous to the local taxpayer. Such services are education, poor-relief, police, and the administration of justice. These duties are assigned to the local government, not to secure a just distribution of the burden, but for the sake of more effective and economical management and supervision, or to obtain the variety and flexibility required to meet differing local conditions. For such burdens, too, taxation in proportion to faculty or ability to pay is the recognized ideal.

This, in Manitoba, will, I am convinced, be found to mean a Provincial Income Tax· possibly though not necessarily of the same type as the Wisconsin Income Tax, which, while assessed and collected by the State Tax Commission, is not a State income tax in the sense that it is applied to State purposes. On the contrary, of the money raised by it, 70 per cent. goes to the local taxing unit city, town, or village where it was collected, 20 per cent. to the county, and the remaining 10 per cent to the State. This 10 per cent. was meant to cover the cost of administration but it very much more than does so. On the basis of actual cash collections, .. cost of administration is less than 3 per cent., and the State has thus a net balance of between 7 and 8 per cent. It is one of the least expensive direct taxes. This, however, is a digression.

To return to the second group of services already mentioned· It includes services preponderantly local in character, or, as they may be called, **specific** services, which confer upon the local taxpayers a direct and peculiar benefit, more or less commensurate with the burden they involve. These services are properly provided for by what are technically known as **beneficial** taxes, as contrasted with the **onerous** or burdensome taxes already described. In the case of a beneficial tax, the tax is payment for benefit received, such as water supply, fire protection, public lighting, cleaning, drainage, provision of streets and sidewalks, or public parks. For these and similar services, the benefit basis, or **quid pro quo** basis, of taxation, is the sound one; and, as such, it is applied in our present taxes on real estate, business, special franchises, and in licenses.

There is, it is true, no hard and fast line of division between the two classes of services. But this is a common difficulty of classification in dealing with economic problems. We are always meeting with perplexing marginal cases. That, however, does not invalidate the distinction. We define, as distinct conceptions, l· ' . r, capital, and land; wages, interest, and rent. But where exactly are the dividing lines to be drawn? What, for example, are we to say of the skilled workman? Can we classify him as exclusively a labourer earning wages, and shut our eyes to the fact that he is also a capitalist receiving interest on his personal capital in the shape of acquired skill, and perhaps also, if he is a man of genius, receiving rent of his rare natural ability? So again, we distinguish between income and capital. But there is no sharp dividing line, for the one is continually being converted into the other. These, however, are but illustratioos of what Marshall has called the principle of continuity in economic conceptions. They shade into one another by insensible gradations. A distinction may be real and quite useful, though it is impossible to draw rigid lines of division where nature has made none.

There is then, to resume, a valid and useful distinction between general and specific services, onerous and beneficial taxes.

So far as local expenditure is directed to purposes resulting in definite specific benefit, the tax on land and houses is a good rough approximation to taxation in proportion to benefit received· though, incidentally, I may confess to a personal preference for the British system of taxation on annual value or rent, as against the system which prevails on this continent of taxation on capital value. But, so f··, as the benefit test is inapplicable, and it is necessary to have recourse to the ultimate . of ability to pay, it seems desirable to supplement taxes on real estate by taxation raised from some different source or sources.

The Movement Towards the State Income Tax

Now, the direct taxation of intangible personalty for local purposes by local authorities, is, as experience shows, both uncertain and difficult. This indeed has been the cause of the general breakdown of personal property taxes, and, incidentally, one of the leading causes of the movement towards the State income tax.

The sentiment in favour of the State income tax has grown rapidly in the United States within recent years; and the adoption of the income tax by the different States has been recommended by the leading American authorities on public finance, including Professor Seligman, of Columbia University, till recently its foremost and most weighty opponent; Professor Bullock of Harvard; and Professor Plehn of California, also a former opponent. The State income tax has been adopted by Wisconsin, Massachusetts, Connecticut, West Virginia, Oklahoma, Mississippi, Nebraska, North Carolina, and South Carolina; and it has been recommended by the Committee on Taxation for New York, and by the State Tax Commission for California.

Central Control Essential to Success

It is true that in many of these States experience of the income tax has not been encouraging. In Virginia, for example, where it has been in operation for a very long period, it can only be described as a very limited success. The reason, however, for this partial failure is found in the absence of centralized administrative control. [illegible] as in England the arbitrary and lax methods of the local officials led to gross abuse in the administration of the old poor law, before centralized supervision was introduced by the Act of 1834, so, in the United States, wherever the administration of the State income tax law has been left in the hands of local officials it has been foredoomed to failure, through arbitrariness and want of uniformity of administration, laxity in enforcement, and consequent unproductiveness.

On the other hand, in Wisconsin, where central control is secured by placing the administration of the law entirely in the hands of the permanent State Tax Commission, the income tax has been a conspicuous success. A recognition of the vital importance of central control is also a striking feature of the more recently enacted income tax law of Massachusetts. In the words of Professor Bullock:

"This is one of the wisest provisions of the law because it is vitally important that the act shall be uniformally administered without fear or favor by intelligent administrators in every part of the commonwealth."

It would be extravagant to maintain that an income tax is necessarily everywhere and at all times the most equitable of all taxes, even assuming that it could be assessed with perfect fairness which is by no means the case. But, accepting the principle that general burdens should be met by taxation in proportion to faculty or ability to pay, there is a **prima facie** case for making the income tax an integral part of the tax system. Administrative difficulties, however, may in certain cases render a tax law which is equitable in the abstract, most unfair in its practical application. It is, for example, admittedly more difficult to secure either equity or productiveness in the practical operation of an income tax in an agricultural community than in one predominantly industrial and commercial. In any case, it may be necessary to supplement income by other criteria of faculty; taxing, for instance, property held for enjoyment; or expenditure where income cannot be ascertained, or where the individual is only temporarily within the jurisdiction of the taxing body. Not by any single tax, but by various routes, can we hope to reach the ideal of taxation in proportion to ability, which, as we have seen, gives the fairest distribution of general burdens or what are known as onerous taxes.*

* See Seligman, Income Tax, pp. 15-18

Certain Objections to a Provincial Income Tax Considered

The objection sometimes taken to the adoption of a provincial income tax in Manitoba: that it would compete with the Dominion income tax, which is levied for war purposes, and so lessen its productiveness, will not, in my opinion, bear examination. All taxes are in the long run paid out of income; and, indeed, most of them take more out of income than if they were levied directly on it. In respect of exhausting the source of revenue, an income tax is quite different from a tax on a commodity, say tobacco. If the Province were to supplement the Dominion tax on tobacco by another tax on the same article, it might hurt the Dominion revenue by checking consumption. In the taxation of commodities, it is well known that a continual increase in the tax may lessen and ultimately kill the revenue. Adam Smith * aptly quotes in this connection the saying of Dean Swift, that "in the arithmetic of the customs, two and two, instead of making four, make sometimes only one." But a tax on income will not check income earning, any more than taxes otherwise levied; for all such taxes are, as we have seen, ultimately and in the long run but disguised income taxes.

Nor is a Provincial income tax open to the objection that it would mean double taxation; for the Provincial and Dominion taxes are not levied for the same purpose but for the maintenance of different branches of Government, both of which are entitled to levy and do levy direct taxes.

The Revenue Problem in Winnipeg

In Winnipeg, today, we are face to face with the same difficulty as is being experienced in other cities on this continent, such as New York and Pittsburg—a steady increase in the number and expensiveness of the duties that the municipal government is called on to perform, while the municipal revenue system shows no corresponding elasticity. It is an awkward fact that men's demands on government, whether central or local, are more elastic than is their will to bear the cost. Most of this civic expenditure, too—in Winnipeg more than half—is beyond the direct control of the City Council. The Board of Valuation and Revision in their Report rightly state that the alarming demand for increased revenue has made assessment and taxation practically the chief civic problem. But to understand clearly the revenue system of the City, we must consider it in its relation to that of the Province.

The Provincial Revenue System

In Canada the general tax situation is this: the Dominion Government, under the British North America Act of 1867, has the exclusive right to levy and collect customs and excise duties, and the Provincial Governments are limited to licenses, and direct taxation within the province for provincial, local, and municipal purposes. As direct taxation, however, was at that time (1867) wholly in the hands of the Municipalities, it was necessary to provide a supplement to the provincial revenues in order to compensate for the loss of the right, which the pre-confederation colonies had held, of levying customs and excise duties. This was done by means of the Dominion Subsidy. Into the details of this I may not enter here, though I may observe that, in the case of the Prairie Provinces, the Subsidy forms much too large a percentage of the total provincial revenue. Hence the revenue systems of these provinces are lacking in elasticity.

Owing, it is said, to the unpopularity associated in Canada with direct taxation, the provincial governments have only slowly and reluctantly entered that field. They do, however, levy corporation and succession duties, railway and similar taxes, and in some cases land taxes and income taxes. Manitoba has as yet no provincial income tax, but that I believe is not far distant.

* Wealth of Nations, Vol. II., p. 362 (Everyman's Edition)

Municipal Taxation—The Increasing Burden on Real Estate Owners

The sources of revenue placed, under this system, at the disposal of the municipalities are: the Personal Property Tax, or its modern substitute the Business Tax, the Real Estate Tax, the Income Tax, the Special Franchise Tax, and Licenses. In effect, however, the municipal authorities have had to rely for by far the greater part of their revenue on the taxation of property, real and personal. But personal property is elusive. It readily escapes taxation, with the result that the tax system becomes grossly inequitable; and for this reason the personal property tax—a failure in Canada as in the United States and elsewhere—has in Winnipeg long been superseded by the business tax. Real estate, however, is the one form of property which, being immovable, can be most easily got at by direct taxation; and thus, for administrative reasons, it has become more and more the chief subject, and frequently almost the sole subject of local taxation. Thus in Winnipeg in 1917 the estimate for the yield of the real estate taxes is 80 per cent. of the total civic revenue.

Here it is fruitful to remember the principle that all taxes are in the long run open or disguised income taxes—that real estate taxes, though nominally imposed on land and buildings, are really paid out of the net income, from whatever source arising, of the real estate owner. The value of the real estate he owns is merely taken as the index or measure of his liability to contribute towards the maintenance of the public services, whether that liability is determined on the basis of "ability to pay" or on that of "benefits received."

But it will, I think, be admitted that value of real estate owned has become a very faulty measure of such liability, whether based on benefit or ability, in a large industrial commercial city such as Winnipeg. A system in which 80 per cent. of the whole expenses of government of a modern city is deducted from the incomes arising from the ownership of real estate—only one of the many varied forms of property—is clearly a system that calls for justification on the part of its supporters.

Incidence of the Real Estate Tax

It is of course argued that the burden of taxation, though imposed in the first place on the real estate owners, is not ultimately borne by them, but is shifted in the guise of increased rent to the tenants, and through them, in the case of business premises, to the consumers of the commodity supplied. In a time of active demand for house accommodation the tax on buildings may be, and doubtless is, so shifted; but the tax on the value of land is a tax on a differential advantage, and rests, as such, on the owner. Even the tax on buildings cannot always be shifted. There is a certain amount of economic friction to be overcome, and the shifting depends on the state of the demand for, compared with the supply of buildings. It is only in the long run, by affecting the supply of buildings, that a tax on the building value tends to be shifted to the tenants.

Recent conditions in Winnipeg, it may be said, are abnormal. But equally it may be replied that a period of real estate activity, of the nature of a boom, is abnormal. The tax system should clearly have some relation to the value of real estate on the average of a sufficiently long period, or to the actual income annually derived therefrom. But, even if the assessments were made to correspond more accurately than they have been with the actual value, it would still remain true that the City of Winnipeg relies for too large a proportion of its revenue on taxation of the incomes of real estate owners, while other species of income entirely escape.

The equity of any tax can, it need hardly be said, be decided only when that tax is taken not by itself, but in relation to the whole tax system of the community. It might be equitable, for example, that the City should tax more heavily classes that could be shown to be only lightly touched by Dominion or Provincial taxation. But there is no evidence that the owners of real estate are singularly favoured in this respect.

Property v. Income as the Basis of Taxation

The overtaxation of real estate is not, I believe, entirely unconnected with the system which prevails on this side of the Atlantic, under which the basis of taxation is the assessed capital value. The existing method, I admit, has the support of the leading American economists.* They hold that for local purposes capital value is a more satisfactory basis of taxation than is the annual yield or rent, which is the basis adopted in Great Britain for local rates, and for the taxation of real estate under the income tax.

It has been argued that in a modern society where land is continually being bought and sold, the capital value will be approximately the capitalized value of the rent—that they are, in short, related to one another as capital to interest. But to this general proposition there are, as a matter of fact important exceptions. Where, for example, urban or suburban land is not yet ripe for building, but has a speculative building-site value, a system of taxation on capital value may impose an immensely heavier burden than would result from taxation on the annual value or rent. It is, however, just this characteristic of the system of taxing real estate on its capital value—that it appears to reach the land speculator—that constitutes one of its chief merits in the eyes of many of its supporters. And it was for this reason, too, that it was adopted as the basis of the new national land taxes introduced by the British Finance Act of 1909-10.

Time will not allow of a discussion of the question whether speculation in land is the unmixed evil it is popularly supposed to be. It cannot, in any case, be prevented by any annual tax on land value that falls short of confiscation. For the purchaser, once the tax is imposed, will secure the land for a price lessened by the capitalized value of the tax, and has thus a good speculative investment.

It would appear, therefore, that the soundness of the policy of taxing real estate on its capital value is at least open to question. It is no doubt true that, in general, taxation of property is merely a form of assessment, the payment being actually met out of income. But the tax is not, as we have seen, always proportional to income. Income, however, is a fairer measure than property of the ability or faculty of the tax payer. There is, as already noted, no rigid line of division between capital and income; and no system of fiscal arrangements can provide, as Mill says, "that taxation shall fall entirely on income and not at all on capital." That depends, **inter alia**, on the amount as well as on the form of taxation. Nevertheless, our system of taxing real estate on its capital value certainly appears more liable to the risk of trenching on capital, and thus in the long run lessening the production of wealth, than is the system of taxing he annual yield or rent.

But, while holding as an ideal the taxation of real estate on its annual value, I recognize that on this continent the method of taxation on capital value is firmly rooted. Looking therefore to the facts as they are, I believe that the principle embodied in the resolution adopted by the City Council and submitted to the Provincial Government, provides the basis for a real and substantial reform. It now rests with the Government and the Council to work out such a scheme as will put that principle into practice.

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* See Seligman, **Essays in Taxation**, p.p.60, 488-95; Taussig, **Principles of Economics**, Vol. II., p.p. 523-5; Bullock, **National Tax Association Report** (1916), p.p. 381-2

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THE BETTERMENT OF MUNICIPAL AFFAIRS

(1) by systematic study of civic problems, by disseminating accurate information concerning them, and generally by promoting in a practical way, better civic, economic and social conditions;

(2) by co-operating with city officials in securing efficient administration of civic interests and with other organizations which represent movements concerned with citizen welfare.

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BULLETIN No. 11 *of*
CITIZENS RESEARCH LEAGUE
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