Randolph Paul

# FEDERAL MANUFACTURERS', WHOLESALE AND RETAIL SALES TAXES

A memorandum prepared by the Treasury at the request of the Committee on Ways and Means, House of Representatives

This memorandum describes the principal features of three types of general sales taxes: (1) a manufacturers' tax, (2) a wholesale sales tax, and (3) a retail sales tax. Numerous proposals have been made for a Federal sales tax. None of these has been enacted. A legislative history of the proposals for a Federal sales tax is given in Exhibit 1. Sales taxes are now being levied by 22 States (see Exhibit 2) and by several foreign countries (see Exhibit 3).

A. Tax base

1. Manufacturers' sales tax: A manufacturers' sales tax is one which applies to sales of tangible personal property by manufacturers and producers. The tax ordinarily applies to finished articles when in a form packaged and labeled ready for shipment or delivery to final users and consumers. The tax ordinarily does not apply to services, although sales of gas and of electrical energy are sometimes included.

2. Wholesale sales tax: A wholesale sales tax is one which applies to sales at wholesale of tangible personal property when in a form packaged and labeled ready for shipment or delivery to final users and consumers. Like the manufacturers' sales tax, the wholesale sales tax ordinarily excludes services, although sales of gas and electrical energy are sometimes included.

3. Retail sales tax: A retail sales tax is one which applies to sales at retail of tangible personal property to final consumers and industrial users. It ordinarily applies not only to retail sales of consumers' goods but also to final sales of finished articles, such as machinery, equipment and supplies to industrial and commercial users. In addition, a retail sales tax may apply to various types of services, such as public utilities, communication, transportation, the operation of places of amusement and services such as those rendered by hotels, rooming houses, office buildings and parking lots. Some State retail sales taxes include none of these services; others include some of them, while a few include all of them. Generally, personal, professional or repair services are not subject to the retail sales tax.

Since services are frequently rendered along with the sale of a commodity at retail, they are more commonly included in the retail sales tax than in the manufacturers' or wholesale sales tax.

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In this memorandum it is assumed that the retail sales tax applies to only tangible personal property.

4. Sale price: Under any one of the three types of taxes, the tax ordinarily applies to the sales price of the article in a finished form ready for shipment or delivery to the final user or consumer. The sales price for tax base purposes usually includes charges for coverings and containers of whatever nature, and charges incident to placing the article in condition packed and ready for shipment to the final user or final consumer.

B. Persons subject to tax

1. Manufacturers' sales tax: A manufacturers' sales tax would be paid by manufacturers, producers, and importers, unless the manufactured articles are specifically exempt. In addition to manufacturers, taxpayers would also include those wholesalers and retailers who do some manufacturing.

2. Wholesale sales tax: A wholesale sales tax would be paid by persons making sales at wholesale. Since persons other than wholesalers sell at wholesale, taxpayers might also include manufacturers, importers, and retailers.

3. Retail sales tax: The retail sales tax would be paid by persons making sales at retail. Taxpayers under a retail sales tax would include many manufacturers and wholesalers as well as retailers since under our integrated economic business structure some businesses of all these types make final sales to users and consumers.

C. Exemptions

1. Prevention of multiple taxation: In order to avoid multiple taxation, provision must be made for the exemption of sales at stages other than that at which the tax is imposed. Under a manufacturers' sales tax, this requires provision for tax-free sales of articles for further manufacture. The wholesale sales tax requires, in addition, the exemption of sales of finished articles intended for resale to persons other than retailers and final users or consumers. The retail sales tax also would require the exemption of articles for further manufacture and articles for resale to persons other than final users or consumers.

2. Exemption of particular items: As under existing manufacturers' excises, exemption might also be accorded sales to Federal and State governments and their agencies, sales for export, sales for shipment to United States' Possessions, sales of certain supplies for use on certain vessels and foreign aircraft, and sales of articles produced by Indians. In the aggregate, these exemptions would reduce the size of the tax bases appreciably. Especially important during the war period are sales to the Federal Government.

Articles already subject to excise taxes might or might not be exempted from a general sales tax, irrespective of the form of the tax. In addition, other general classes of items (such as foods, clothing, and medicines) might be exempted. Each exemption, of course, reduces still further the base of the tax.

The exemption or other favored treatment of specific articles raises administrative problems of drawing a precise line between exempted and taxable items. For example, in the administration of the exemption of foods under some State retail sales taxes, it has been found necessary to list in detail items of food and the brand names of many items that are and are not to be regarded as foods. The administrative experience under the Australian wholesale sales tax has been similar to that under the State retail sales taxes.

3. Exemption of particular taxpayers

a. Manufacturers' and wholesale sales taxes: Under the manufacturers' and wholesale taxes, it might be found desirable, from the administrative point of view, to exempt those with annual gross sales below a specified amount. The 1937 Census of Manufactures data indicate that under the manufacturers' tax an exemption of $20,000 probably would reduce the number of taxpayers by 30 percent and the tax base by not much more than 1 percent. The 1935 Census of Business data indicate that under a wholesale sales tax, such an exemption probably would reduce the number of taxpayers by about 35 percent and the tax base by less than 5 percent.

Exempting the small taxpayer, however, makes it difficult to detect evasion by sellers whose sales are only slightly above the amount exempt. Furthermore, a substantial part of the cost of administering the tax would not be saved by making exemptions, since it would be necessary in any event to license or register all sellers, including those exempt.

b. Retail sales tax: The exemption of small taxpayers might be found more pressing under the retail form of tax than under the manufacturers' or wholesale taxes because of the larger number of retailers. However, such exemption would afford greater opportunities for tax evasion and greater likelihood of competitive inequalities than would be true under the manufacturers' or wholesale taxes where there would be fewer very small business units.

The 1935 census data indicate that the exemption of retailers with annual sales of less than $1,000 would reduce the number of taxpayers under a Federal retail sales tax by about 30 percent and the tax base by less than 2 percent. A $5,000 exemption would reduce the number of taxpayers by 50 percent and the tax base not much more than 3 percent.

However, a $5,000 exemption would introduce inequalities among competitors in certain retail lines. For example, in the candy and confectionery trade, 65 percent of the independent retail stores accounting for 24 percent of the sales reported sales of less than $5,000 in 1935. A $20,000 retail sales exemption would reduce the number of taxpayers about 80 percent and the tax base about 17 percent.

D. Estimates of revenue

Since sales to governments would likely be exempted the vast increase in purchases by the Federal Government during war time would reduce the volume of taxable goods, thereby reducing the volume of goods subject to the sales tax. This might be offset in part by price rises. At the same time, in wartime a larger part of consumer expenditures are likely to be directed towards services instead of commodities, since the demand for war purposes affects the available supply of commodities more than it affects the supply of services.

Estimates of the yields of sales taxes at the manufacturers', wholesale, and retail levels and at rates of 1, 5, and 10 percent are given in Table 1. These estimates assume a volume of sales at the expected level of the fiscal year 1943 and are for a full year of tax collections after the tax had been in effect long enough to absorb the initial anticipatory buying as a result of its imposition.

Major interest attaches to items 4 to 9 of Table 1, since the first three items include taxes on goods sold to governments and to contractors for use in war production. At the manufacturers' level, a 10 percent tax yields $2,382 million on the broadest base that excludes sales to governments and war contractors; and $305 million on the narrowest base for which an estimate is given. At the wholesale level, a 10 percent tax yields from $3,059 to $446; and at the retail level, from $4,632 to $780.

The estimates are made on the basis of sales taxes which would be limited to sales of tangible personal property when in a form, packaged and labeled ready for shipment or delivery to final users or consumers.

Personal, professional, or repair services have not been included in the sales tax base. Sales of the following major industries have been exempted from the tax base except for such sales of tangible personal property as they make: The various types of service establishments (including finance, amusement, hotels, etc.), the communication industry, the transportation, trucking, and warehousing industries, utilities and extractive industries. Water, electricity, and gas are not treated as tangible personal property. Sales of finished products (i. e., not for resale to the same industry) by the extractive industries -- agriculture, forestry, fishing, and mining -- are exempt except as they are made directly to the ultimate consumer.

In the base of manufacturers' sales tax is included the value of the final sale at the manufacturers' plant of tangible personal property as a finished product. In general, any sale by a manufacturer of tangible personal property which is not for resale to other manufacturers is considered the sale of a finished product; e. g., sales to wholesalers, retailers, and ultimate consumers or users. Also, if the sale is to another manufacturer or processor who is the ultimate consumer or user, it is taxable. The exemption of manufactured products sold to other processors has been interpreted as applying only to goods that are further processed or are incorporated in other manufactures, and not as applying to goods like industrial machinery, fabricated construction materials, certain containers and wrappings, or office supplies, sold to other industrial users but not made an integral part of a factory product.

The contents of the base of the tax on sales at wholesale include the final sale of tangible personal property at wholesale as a finished product. In general, the base includes all sales by either wholesalers or manufacturers to ultimate consumers or retailers.

The tax on sales at retail is on the final sale of tangible personal property to the ultimate consumer or user and is distinguished from the sale of (a) realty or of (b) intangibles, such as the sales of service establishments. The ultimate consumer is deemed to be the purchaser who actually consumes the tangible personal property. "Sales at retail" is not synonymous with "sales by retailers"; it includes sales by manufacturers or wholesalers to the ultimate consumer or user. Whereas sales of tangible personal property by manufacturers to wholesalers or retailers for resale are included in the tax on manufacturers, such sales are excluded from the tax on sales at retail. Thus, the sale at retail would include the value added by distributors or the spread between the values of finished commodities at producers' prices and their cost to the ultimate consumer.

E. Tax rates

1. Rates needed to raise the same amount of revenue from the three types of sales tax: As the revenue estimates given above indicate, a lower tax rate would be needed to raise a given amount of revenue from a retail sales tax than from a wholesale or a manufacturers' sales tax because of the differences in sales prices at the different stages of production and distribution. Table 2 presents rates of tax on sales of tangible personal property at the manufacturers', wholesale, and retail levels necessary to yield $1 billion.

The rate needed under a manufacturers' sales tax is from 1.3 to 2.5 times the rate needed under a retail sales tax, the exact difference depending on the exemptions granted. The rate needed under a wholesale sales tax is from 1.2 to 1.8 times the rate needed under a retail sales tax.

Table 1.

Estimated yields of sales taxes on tangible personal property at the manufacturers', wholesale, and retail levels, with rates of 1, 5, and 10 percent

(In millions of dollars)

| | Manufacturers' sales | | | Sales at wholesale | | | Sales at retail | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1% | 5% | 10% | 1% | 5% | 10% | 1% | 5% | 10% |
| 1. All sales of finished articles (including industrial and commercial machinery, equipment and supplies not resold as part of tangible personal property) . . . . . . . . . . | 759 | 3,780 | 7,471 | 833 | 4,143 | 8,142 | 1,014 | 5,018 | 9,702 |
| 2. Same as (1), but exempting sales to Federal Government and its agencies. | 378 | 1,875 | 3,661 | 452 | 2,238 | 4,332 | 633 | 3,113 | 5,892 |
| 3. Same as (2), but exempting sales to State and local Governments . . . . | 368 | 1,825 | 3,561 | 442 | 2,188 | 4,232 | 623 | 3,063 | 5,792 |
| 4. Same as (3), but exempting final sales to contractors for use in war production . . . . . . . . . . . | 248 | 1,228 | 2,382 | 322 | 1,592 | 3,059 | 503 | 2,469 | 4,632 |
| 5. Same as (4), but exempting tangible personal property subject to Federal excise taxes . . . . . . . . . | 155 | 771 | 1,513 | 216 | 1,069 | 2,083 | 349 | 1,721 | 3,296 |
| 6. Same as (5), but exempting sales of foods, (excepting restaurant meals, etc.). . . . . . . . . . . . . . . . . | 77 | 384 | 760 | 100 | 496 | 980 | 174 | 864 | 1,691 |
| 7. Same as (6), but exempting sales of medicines and drugs . . . . . . . . . | 72 | 359 | 712 | 94 | 466 | 922 | 166 | 824 | 1,616 |
| 8. Same as (7), but exempting sales of clothing (i.e. all wearing apparel). | 32 | 159 | 317 | 46 | 232 | 461 | 81 | 404 | 799 |
| 9. Same as (8), but exempting sales of fuels 1/ . . . . . . . . . . . . . . . | 31 | 153 | 305 | 45 | 224 | 446 | 79 | 394 | 780 |

Treasury Department, Division of Research and Statistics March 14, 1942

1/ Fuels exempted in item 9 exclude bituminous coal, exempted under item 5, and gas and electricity which are not considered to be tangible personal property.

Table 2.

Rates of tax on sales of tangible personal property at the manufacturers', wholesale and retail levels necessary to yield $1 billion 1/

| | Rates needed to raise $1 billion | | |
|---|---|---|---|
| | Manufacturers' tax | Wholesale tax | Retail tax |
| 1. All sales of finished articles (including industrial and commercial machinery, equipment and supplies not resold as part of tangible personal property) . . . . . . . . . | 1.3% | 1.2% | 1.0% |
| 2. Same as (1), but exempting sales to Federal Government and its agencies | 2.6 | 2.2 | 1.6 |
| 3. Same as (2), but exempting sales to State and local Governments . . . . | 2.7 | 2.3 | 1.6 |
| 4. Same as (3), but exempting final sales to contractors for use in war production . . . . . . . . . . . | 4.0 | 3.1 | 2.0 |
| 5. Same as (4), but exempting tangible personal property subject to Federal excise taxes . . . . . . . . . | 6.5 | 4.6 | 2.9 |
| 6. Same as (5), but exempting sales of foods (excepting restaurant meals, etc.). . . . . . . . . . . . . . . . . | 13.0 | 10.0 | 5.7 |
| 7. Same as (6), but exempting sales of medicines . . . . . . . . . . . . . . . | 13.9 | 10.6 | 6.0 |
| 8. Same as (7), but exempting sales of clothing . . . . . . . . . . . . . . . | 31.3 | 21.7 | 12.3 |
| 9. Same as (8), but exempting sales of fuels . . . . . . . . . . . . . . . | 32.3 | 22.2 | 12.7 |

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Source: Based on Table 1.

1/ The tax rates are based on fiscal 1943 sales estimates and assuming a full year's collections after the sales tax has been in effect long enough to absorb the initial anticipatory buying as a result of its imposition.

2. Effect of the rate on the administration of the tax: In general, greater administrative problems will be encountered under high than under low tax rates. High tax rates aggravate inequalities and give taxpayers a greater incentive to evade the tax. In the initial stages of the tax, when a new staff must be trained and a body of experience built up, such administrative problems are especially difficult.

3. Differential tax rates: The items subject to tax might be classified according to type of article or price of article and different rates imposed on different groups. For example, the British purchase tax levies a 33-1/3 percent tax on the wholesale value of luxuries and articles not normally requiring immediate replacement, and a 16-2/3 percent tax on the wholesale value of non-luxuries which are not subsistence goods.

Any such differential tax rates would contribute to administrative problems. The setting up of a class of articles subject to a low rate is an invitation to producers and sellers of closely related articles to get their articles under the low rate either by law or administrative regulation. The setting of a higher rate on articles selling above some specified price is an invitation to producers and sellers of such articles to make their articles subject to the lower rate by cutting price, by cutting quality, by selling the article in separate pieces, or by selling the article in combination with other lower priced articles.

F. Estimates of number of taxpayers

Estimates of the number of taxpayers under manufacturers', wholesale, and retail sales taxes which are comparable to the revenue estimates given above are not available. However, estimates for 1935, the latest year for which the necessary data were available, are presented in Table 3 to indicate the relative number of taxpayers under the three types of sales taxes. These estimates must be viewed as rough approximations, even for 1935. For example, the number of taxpayers under a manufacturers' sales tax is unknown since manufacturers with annual sales of less than $5,000 are not reported by the Census of Manufactures. The number of small, unreported manufacturers is probably large. Furthermore, the Census reports manufacturing "establishments" rather than "manufacturers." Manufacturing establishments are more numerous than taxpayers because an unknown number of manufacturing plants were counted as two or more "manufacturing establishments."

Table 3.

Estimated number of taxpayers under a manufacturers', wholesale, and retail sales tax, 1935

| | Estimated number of taxpayers |
|---|---|
| **Manufacturers' sales tax** | |
| Assuming exemption of articles for further manufacture and of establishments with annual sales of less than $5,000 | 139,000 |
| **Wholesale sales tax** | |
| Assuming exemption of articles for further manufacture and articles for resale at wholesale, and of establishments with annual sales of less than $5,000 | 258,000 |
| **Retail sales tax** | |
| 1. Assuming exemption of articles for further manufacture | 2,386,000 |
| 2. Same as 1 but also exempting those with annual sales of less than $5,000 | 1,191,000 |

Treasury Department, Division of Tax Research March 14, 1942

G. Lack of uniformity in sales tax bases

For a variety of reasons, any type of general sales tax would not affect all taxpayers uniformly. The circumstances resulting in unequal taxation are explained below.

1. Under a manufacturers' sales tax: Under a manufacturers' sales tax uniform treatment would be reached most practicably by adjusting all prices, irrespective of type of business organization, to the sales price at which manufacturers sell to wholesalers and to industrial users. Less than 50 percent of manufacturers' sales in 1935 were made to industrial users and wholesalers. The remainder of the sales by manufacturers were made to their own wholesale branches, to their own retail stores, to retailers, and to household consumers, all of which represent substantially different prices from the prices to wholesalers. Such prices would need to be adjusted to a uniform price basis, which would be administratively very difficult.

Unless the manufacturers' sales tax were levied on a uniform price basis, such as the f.o.b. price to wholesalers of finished articles finally packaged and labeled ready for shipment and delivery, serious changes would undoubtedly occur in the forms of business organization and business transactions as a result of the attempt to minimize taxation. Business organizations would be encouraged to reorganize their production and distribution functions under separate legal entities. Where one company existed before the tax was levied several might arise. It might become advantageous for taxpayers to get under the control of the same business organization a manufacturing company, a packaging and labeling company, and a selling company, if the taxpayer could successfully maintain that the transaction prices between subsidiary units constitute the proper bases of tax. Since such transactions would not be arm's-length sales, the administrative problems might be very difficult. Other manufacturers might attempt to reduce the tax base by having the manufacturing done by contractors.

Small taxpayers might not be able (and others might not be willing) to undertake the apparent legalistic outlets to tax inequality and would suffer competitive disadvantages.

2. Under a wholesale sales tax: The problems under a wholesale sales tax are similar to those outlined above for a manufacturers' tax. However, sales appear to be more homogeneous at the wholesale level of sales than at the manufacturers' level of sales f.o.b. plant.

In 1935, about 75 percent of the sales of wholesale establishments that reported the distribution of sales by classes of customers were made either to retailers or to industrial users. These sales represent the base to which it would be necessary to adjust all other types of sales under a wholesale sales tax.

3. Under the retail sales tax: The retail sales tax likewise involves the problem of tax base uniformity encountered under the manufacturers' and wholesale form of sales taxes, since, for example, sales of finished articles to industrial users would be taxed as sales at retail.

In 1935, about 43,000 manufacturers made about $11 billion of sales (valued at f.o.b. prices for census purposes) to industrial users. These sales probably were made at prices ranging from f.o.b. plant to door-delivery and some price quotations no doubt would include installation charges. In the same year, wholesalers reported about $10 billion of sales to industrial users. For administrative reasons, finished articles purchased by building contractors, tailors, barber and beauty shops, repair shops, and other service establishments such as laundries may be taxed when sold to them, although in many cases such establishments also sell articles at retail. Thus the retail tax would not attach uniformly at the point of sale of articles at retail to final consumers but would include sales at different levels of production and distribution to industrial users and persons selling taxable finished articles in combination with services. The variations in sales prices of such articles would reflect the embodiment of different amounts of the production and distribution functions, and changes in the forms of business organization and methods of sale might consequently result in the attempt to avoid unequal taxation.

Retail prices to final consumers vary as regards the elements of cost included. Unless adjusted, these prices would not constitute a uniform base for tax purposes. Transportation and delivery, and other charges for credit, installation, insurance, guarantees and repairs, enter directly or indirectly into every sales transaction. However, great variations exist among competitors (whether they be manufacturers, wholesalers or retailers) in the manner in which these cost elements are included in or excluded from their sales prices. Unless provision is made for adjustment of these types of differences from a uniform price basis, certain taxpayers may have to change their mode of business or suffer competitive disadvantages.

H. Effect on consumer prices

Even though levied on all items at a uniform rate, a sales tax of whatever form is unlikely to affect all prices equally. The possibilities of multiple taxation and pyramiding are two of the most important factors leading to an unequal effect of the sales tax on prices.

1. Multiple taxation: The possibility of multiple taxation arises because it is difficult to define comprehensively "articles for further manufacture." If the definition exempted only articles that entered as "physical parts" of finished articles, then all other articles like, for example, machinery, equipment and office supplies, contributing to the

cost of producing and distributing finished articles would be taxed once as finished articles and again as component costs entering into the sales price of finished articles. Consequently, the accumulated sales tax on any one finished article and the sales price to the consumer would be greater than is indicated by the rate of tax.

2. Pyramiding: The increase in price as a result of a sales tax may be larger than the sales tax itself if the seller's margin is a relatively fixed percentage of the price at which he purchases goods for resale. In such a case, if the tax has been paid on the items purchased for resale, the application of the customary percentage margin will raise the final price by more than the amount of the tax. The final users or consumers of taxable articles may, therefore, pay more in increased prices as a consequence of the tax than the Government receives in revenue. Pyramiding differs from multiple taxation in that the latter is an accumulation of tax that the Government receives while the former is a tax-induced addition to a seller's spread or margin that is not received by the Government.

The available data indicate that distributors' margins are relatively rigid and that, consequently, pyramiding is likely to occur. The nearer to the final consumer a sales tax is imposed the less is the opportunity for pyramiding to occur. Accordingly, pyramiding is less under a retail sales tax than under a wholesale sales tax and less under a wholesale sales tax than under a manufacturers' sales tax.

## I. Distribution of sales tax burden

The burden of general sales taxes is distributed regressively; that is, the tax borne by final consumers constitutes a larger percent of a small income than of a larger income. Persons with small incomes spend a larger proportion of their incomes than do persons with large incomes. Furthermore, a larger fraction of their expenditures are in general for tangible goods as contrasted to services.

Table 4 presents rough estimates for 1942 of the distribution of a retail sales tax expressed as a percentage of consumer income. This table does not show the actual percentage of consumer income taken by a retail sales tax. It only shows the relative distribution of tax burden among the several consumer income groups. The table also shows the greater importance of food in the budgets of the lower income groups by estimating the difference in the relative distribution of sales tax burden when foods are exempted.

Table 4.

Rough estimates of the relative distribution of retail sales tax burden for 1942, expressed as a percentage of consumer incomes by income classes, with food taxed and with food exempt from tax

| Consumer income class | Relative percentages of incomes taken by tax: If tax base included food | Relative percentages of incomes taken by tax: If tax base excluded food |
|---|---|---|
| Under $500 | 1.00% 1/ | 1.00% 1/ |
| 500 - 750 | .80 | .90 |
| 750 - 1,000 | .75 | .90 |
| 1,000 - 1,250 | .71 | .87 |
| 1,250 - 1,500 | .67 | .85 |
| 1,500 - 1,750 | .65 | .85 |
| 1,750 - 2,000 | .62 | .85 |
| 2,000 - 2,500 | .59 | .82 |
| 2,500 - 3,000 | .56 | .82 |
| 3,000 - 4,000 | .53 | .79 |
| 4,000 - 5,000 | .49 | .77 |
| 5,000 - 10,000 | .42 | .69 |
| 10,000 and over | .27 | .49 |

Treasury Department, Division of Tax Research — March 14, 1942

Source: Based on information obtained from the Office of Price Administration, Research Division.

1/ At a sales tax rate which imposes a burden of 1% of consumer income on those with incomes of less than $500.

J. Administrative problems

The administrative problems under a general sales tax fall into two general categories: The rapid development of additional administrative personnel and the determination of regulations designed to tax all articles uniformly.

1. Problems of administrative personnel: A Federal sales tax, regardless of type, will require the development of a large administrative staff to handle the large number of monthly returns and to audit the books and records of registrants and taxpayers. These expenses will tend to be largest in the initial stages of the tax when the staff is being built up and experience accumulated.

The administrative problems associated with the number of taxpayers are greatest under a retail sales tax. The tax must be collected in smaller amounts and from a larger number of taxpayers than the other two forms of sales tax. On the other hand, the manufacturers' and wholesale sales taxes involve serious problems of determining uniform prices for tax base purposes.

2. Definitions and uniformity of tax base: Under the manufacturers' sales tax, many borderline cases would arise over the question of what constitutes a manufacturers' sales price. In industries that produced similar articles in varying stages of completion, equal treatment of different firms would require that such items as the value of packages and containers and selling and advertising expenses be uniformly excluded so as to approximate an f.o.b. price. However, the uniform exclusion of such charges and expenses from the tax base also introduces difficult administrative problems. That is, the tax base frequently might have to be determined by deducting a taxpayer's allocated costs and expenses of packaging and selling the finished articles, or by determining the cost of producing the unfinished articles and adding thereto an estimated fair mark-up for profits. Such determinations could be expected to raise many points of dispute between taxpayers and the Treasury over such matters as the proper allocation of costs and expenses between "production" and "distribution" functions. If, in addition, the costs and expenses of distribution varied greatly among taxpayers producing the same articles, it might be exceedingly difficult to establish general regulations.

Under the wholesale sales tax, the same types of problems would also be encountered. Here equal treatment of different taxpayers would require that such items as the value of packages and containers and selling and advertising expenses be uniformly included in the tax base. However, administrative problems resulting from attempts to achieve a uniform tax base might be expected to arise less frequently than under a manufacturers' sales tax.

The experience of the States reveals some of the problems involved in the determination of a uniform tax base under the retail sales tax. Generally, State retail sales taxes apply to tangible personal property. Sales that involve both the rendering of services and the transfer of property present difficulties. Repairing by a garage or shoe repairman, department store sales of articles that it installs, services rendered by building contractors, shampoos by barbers, and tailor-made clothing are examples of cases involving difficult problems of the proper tax base.

Retail prices often include installation and transportation charges. Most States specifically allow the deduction of installation charges from gross sales if records are so kept as to identify such charges. Approximately half of the States allow a deduction for transportation charges "if such charges are rendered to the purchaser and not to the seller." Other States permit the exemption of transportation charges when separately billed to the purchaser.

The treatment of trade-ins presents administrative problems under retail sales taxes. Several of the State sales taxes permit a deduction of the allowance for trade-ins from the price of the new article and tax the trade-in when it is sold. Other States tax the full sales price of original stock and exempt the trade-in when it is sold, regardless of whether it is sold for cash or whether another item is traded in as part-payment. In order to make sure that deductions allowed for sales of trade-ins are not in excess of the original valuation of the trade-ins, special records must be kept of individual transactions.

Installment sales present additional administrative problems. In order to arrive at uniform bases of taxation, finance and interest charges should be excluded. Some of the State sales taxes provide specifically for the exemption of such charges if they are separately billed and proper records are kept. Questions also arise whether the tax should be collected on the full selling price at the time the sale is made or upon the payments as they are received. Open credit accounts present somewhat similar problems as to the time of payment of tax and the treatment of worthless accounts.

3. Definition of "articles for further manufacture": The exemption of "articles for further manufacture" is necessary to avoid multiple taxation, but it raises difficult problems of definition and interpretation. Limiting tax-free articles to those (1) for use as materials in the manufacture of or as component parts of a taxable article, (2) for resale by the vendee for such use by his vendee, and (3) even broadening the concept to include those articles representing "direct expense," does not avoid multiple taxation but merely limits it.

Whatever the line of demarcation between tax-free "articles for further manufacture" and taxable articles, difficult problems of administrative interpretation will arise. To mitigate this general problem it may be necessary to define articles for further manufacture specifically and, perhaps, also to provide a higher degree of finality with respect to administrative findings of fact than has heretofore been permitted the Commissioner of Internal Revenue. Under the Canadian sales tax, the Minister is "the sole judge as to whether or not goods are 'partly manufactured goods' within the meaning" of the Act.

The problem of administering exemption of "articles for further manufacture" probably would be as great under a retail sales tax as under the other two forms of sales tax.

4. Problems of tax amounting to a fraction of a cent: It is difficult to devise a retail sales tax schedule which will permit all kinds of retail businesses to shift the exact amount of tax. This difficulty arises from the limited divisibility in the medium of exchange (one cent) and the small size of many retail sales.

The States have attempted to frame methods of collection whereby retailers will recover on an average the amount they must pay the State. State administrators generally have prescribed a schedule for uniformly adding the tax to prices. Under this schedule or bracket system the amount to be collected on sales of various sizes is specified. While it is simple enough in its operation, it does not provide precision. There necessarily must be discrimination or penny-splitting.

Many of the States minimize effective tax rate variations by providing a taxpaying medium in fractional-cent denominations. Tokens eliminate most of the inequity in applying the sales tax to small purchases but they are a source of annoyance and inconvenience to the taxpayer and create some danger of counterfeiting. Because of the nuisance aspects, some States have abandoned their use.

5. Registration and licensing: In administering tax-free sales under any one of the three forms of sales tax, a system of licenses or registration probably would be required. The license or registration methods has the administrative advantage of tending to shift the policing of exempt articles for further manufacture to the licensees or registrants.

Under a licensing system, manufacturers, wholesalers, and retailers would be required to take out licenses at a nominal fee and post bonds in varying amounts, depending on the size of the licensee's probable tax liability. This method is now used in Canada and Australia.

The voluntary registration system now existing under the manufacturers' excise taxes with respect to certain sales could be expanded for general sales tax use. The license system appears to have no advantage over a registration system for purposes of controlling tax-exempt sales under a manufacturers' or wholesale sales tax. If the self-interest of manufacturers and wholesalers will induce them to apply for certificates of registration, the requirements and penalties under registration could be identical with those under licenses.

Licenses or compulsory registration probably would be a necessary feature of a retail sales tax. For enforcement purposes, it would be necessary to have a census of retailers. The mortality rate of retail business is high and the administrator must have some method of discovering new businesses and getting returns from discontinuing or bankrupt businesses. Most of the States having general sales taxes require taxpayers either to register once or to obtain an annual license.

Exhibit 1.

## History of Federal general sales tax proposals

The Federal Government has never imposed a general sales tax but at various periods in our history Congress has given consideration to such a tax.

Civil War. The first movement for a general sales tax in the United States occurred during the Civil War. While the proposal of a general sales tax was rejected by Congress, a comprehensive system of production and consumption taxes was established.

1918-1921. After the World War a demand arose for the repeal of the excess profits tax, reduction of the surtax rates on individual incomes, and elimination of the special war excises. The sales tax was brought forth as a possible alternative source of revenue.

Senator Borah introduced a bill in September, 1918, providing for a transactions tax. This proposal was presented at the hearings before the ~~Ways and Means~~ Senate Finance Committee on the Revenue Act of 1918, but no action was taken.

During the first session of the 67th Congress, Senator Smoot introduced a series of sales tax amendments (five in number) to the Revenue Act of 1921. The first proposal was a 1% turnover tax which applied to all sales (or leases) of goods in excess of an annual turnover of $6,000. When strong opposition was expressed to the proposal on the floor of the Senate, Senator Smoot presented a revised bill providing for a 3% manufacturers' and producers' tax. Later in the session the second Smoot amendment was reintroduced in a modified form providing for a 1% manufacturers' and producers' tax. This proposal was voted on and defeated November 3, 1921. The following day Senator Smoot proposed a 0.5% turnover tax which also was defeated. A third and final proposal for a 3% production tax was defeated three days later. 1/

After the failure of the Smoot amendments, the sales tax issue remained closed for about ten years.

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1/ During the second session of the 67th Congress, several proposals for financing veterans' compensation by a sales tax were introduced, but none received serious consideration.

Exhibit 1.

(continued-2)

1932. In 1932 the sales tax issue was revived. The Treasury Department's tax recommendations submitted to the House Ways and Means Committee in January, 1932, expressed opposition to a general sales tax and favored excise taxes on selected commodities. 1/ A bill providing for a 2.25% sales tax introduced by Representative Crisp, Acting Chairman of the Committee on Ways and Means, was considered in connection with hearings on the Revenue Bill of 1932 and was reported as part of the Revenue Bill. The Treasury Department withdrew its objection to the sales tax and supported the Committee's bill. When the Revenue Bill was considered in the House on March 24, 1932, an amendment offered by Representative Doughton to strike the sales tax was adopted. Efforts to restore the tax to the Revenue Bill on April 1, 1932 were defeated.

1933-1941. A 1.75% manufacturers' sales tax was offered by Senators Reed, Walsh and Byrd as an amendment to the N.I.R.A. Act, but was defeated on June 9, 1933.

Beginning with the McGroarty bill (the first so-called "Townsend pension bill") introduced in January, 1935, a series of bills (more than a score in number) providing for sales taxes of broad application, transactions taxes or gross income taxes, have been proposed as means of financing old age pensions. Congressional committees have given careful consideration to certain of these bills in connection with House and Senate hearings on the Economic Security Bill in 1935 and hearings of the House Select Committee Investigating Old Age Pension Organization in 1936. One of the bills (H.R. 6466) introduced by ~~Senator~~ Representative Hendricks in May, 1939, was reported by the Ways and Means Committee without recommendation and was defeated when it came to vote on June 1, 1939.

1/ Secretary of the Treasury Mellon appeared before the House Ways and Means Committee on January 13, 1932, and stated his reasons for opposing a general sales tax and favoring taxes on selected commodities: "We laid aside all thought of a general sales or turnover tax, not only because generally speaking it bears no relation to ability to pay and is regressive in character, but because of the great administrative difficulties involved and the almost inevitable pyramiding of the tax in the course of successive sales. The objections to a general sales tax are not in this respect applicable to a tax on selective articles of the character heretofore employed in this country and now recommended. * ** We concluded that our immediate needs could best be met by utilizing a known general plan with such changes as might be appropriate in the light of altered conditions rather than embarking on new and untried ventures in taxation."

Exhibit 2

State Sales Taxes: Types and Rates – January 1, 1942

| State | Type of tax 1/ | Use tax | Rates on retail sales: Tangible personal property | Automobiles | Amusement places | Restaurants | Public utilities | Rates on receipts from other specific sources |
|---|---|---|---|---|---|---|---|---|
| Ala. | Retail sales | x | 2 | 1/2 2/ | 2 | | | |
| Ariz. | General sales | | 2 | | 2 | 1 | | Manufacturing, preparation for sale of agricultural and horticultural products, slaughtering animals for food, sales of poultry products and stock feed, 1/4%; extracting, processing, printing and publishing, contractors, advertising, transportation, 1%; hotels and garages, credit and collection agencies, 2%. |
| Ark. 3/ | Retail sales | | 2 | 2 2/ | 2 | 2 | 2 4/ | Printing, 2%. |
| Calif. | Retail sales | x | 3 | 3 | | | | |
| Colo. | Retail sales | x | 2 | 2 | | 2 | 2 5/ | |
| Ill. | Retail sales | | 2 6/ | 2 6/ | | | 3 5/ | |
| Ind. | Gross income | | 1/2 | | 1 | 1 | 1 | All income, 1%, except that received from wholesales, and from display advertising which is taxable at 1/4 of 1%. |
| Ia. | Retail sales | x | 2 | 2 | 2 | | 2 | |
| Kans. | Retail sales | x | 2 | 2 | 2 | 2 | 2 | |
| Mich. | Retail sales | x | 3 | 3 | | 3 | 3 7/ | |
| Miss. | Gross receipts | x | 2 8/ | 1 9/ | | 2 | 2 10/ | Wholesaling, 1/8%; manufacturing, 1/8-1%; contractors, 1%; extracting, 2-2½%; all other businesses and professions not specifically exempted, 2%. |
| Mo. | Retail sales | | 2 | 2 | 2 | 2 | 2 | |
| New Mex. | Gross receipts | x | 2 12/ | 1 11/ | 2 | 2 | 2 | Wholesaling, 1/8%; extracting, 1/2 or 2%; processing and manufacturing, 1/4 or 1/2%; contractors, 2%; transportation, real estate commissions, factors, agents, brokers, advertising, personal and professional services, 2%. |
| N.C. 13/ | General sales | x | 3 | 3 | 3 | | | Wholesaling, 1/20%. |
| N. Dak. | Retail sales | x | 2 | 2 | 2 | | 2 | |
| Ohio | Retail sales | x | 3 | 3 | | | | |
| Okla. | Retail sales | x | 2 | 14/ | 2 | 2 | 2 | Printing and publishing, transportation (of passengers only), advertising, 2%. |
| S. Dak. | Retail sales | x | 2 | 2 | 2 | 2 | 2 | |
| Utah | Retail sales | x | 2 | 2 | 2 | 2 | 2 | Transportation (except intrastate movements of freight and express or street railway fares), 2%. |

Exhibit 2

State Sales Taxes: Types and Rates - January 1, 1942

(Continued - 2)

| State | Type of tax 1/ | Use tax | Tangible personal property | Automobiles | Amusement places | Restaurants | Public utilities | Rates on receipts from other specific sources |
|---|---|---|---|---|---|---|---|---|
| Wash. | Retail sales | x | 3 12/ | 3 | | | | |
| | Gross receipts | | 1/4 | | | | | Wholesalers (except wholesalers of wheat, oats and barley, which are 1/100%), extractors, manufacturers, printers and publishers, 1/4%; all other businesses and professions not specifically exempted, 1/2%. |
| W. Va. | Retail sales 15/ | | 2 | | 2 | | | |
| | Gross income | | 1/2 | | 65/100 | 65/100 | 1.3-5.2 | Wholesaler, 195/1000%; extracting, 1.3-7.8%; manufacturing, 39/100%; contractors, 2%; industrial loan companies 1%; all other businesses not specifically exempted, 1%. |
| Wyo. | Retail sales | x | 2 | 2 | 2 | 2 | 2 | |

1/ Type of tax; (1) Retail sales - imposed upon sales of tangible personal property at retail or for consumption. In most States applies also to admissions and restaurant and public utility sales.
(2) General sales - applies to wholesaling, extractive industries and manufacturing in addition to sales at retail.
(3) Gross receipts - includes sales of public services and personal and professional services in addition to transactions and receipts under (1) and (2).
(4) Gross income - applies, in addition to all transactions and receipts under (1), (2), and (3), to receipts from non-business activities such as wages and salaries of employees, interest, rents and dividends.

2/ New automobiles.
3/ Rates in cities or incorporated towns bordering other States same as that in adjoining State.
4/ Rate applies to allpublic utilities except transportation.
5/ Telephone and telegraph services, gas and electricity sales. In Illinois the rates on utilities are imposed under a separate Act.
6/ The 2% rate is applied to 98% of gross receipts.
7/ On gas and electricity only.
8/ Retail sales of pasteurized milk, 1%.
9/ Automobiles and trucks.
10/ Industrial sales receive a preferential rate of 1%.
11/ Automobiles, trucks or tractors.
12/ Tax applies to rentals as well as sales.
13/ Maximum tax of $15 on a single article.
14/ A special excise tax of 2% is applied to an automobile at the time it is transferred, used or first registered in the State.
15/ Applies not only to sales of tangible property but also to all services except professional and personal services, services rendered by an employee to his employer, and services furnished by corporations subject to the control of the Public Service Commission and State Road Commission.

State Sales Taxes: Types and Rates
January 1, 1942

Sales taxes are now imposed in 22 States. 1/ The most restricted type but the one most frequently used by the States is the retail sales tax. It is imposed upon sales of tangible personal property at retail or for consumption. In most States, however, the retail sales tax also applies to admissions and restaurant and public utility sales. Retail sales taxes are now imposed by 17 States:

| | | | |
|---|---|---|---|
| *Alabama | Illinois | Missouri | *South Dakota |
| Arkansas | *Iowa | *North Dakota | *Utah |
| *California | *Kansas | *Ohio | *Washington |
| *Colorado | *Michigan | *Oklahoma | West Virginia |
| | | | *Wyoming |

A broader form of the tax is that which affects sales of tangible personal property both at retail and for resale and in one instance reaches the acts of extracting natural resources and of manufacturing. Such a tax is termed a "general sales" tax and is imposed in two States:

Arizona *North Carolina

In the latter only retail and wholesale sales are taxed; the former has the broader application.

A still broader type of tax has the essential elements of the general sales tax but is extended to include sales of public services and personal and professional services. These so-called "gross receipts" taxes are imposed in three States:

*Mississippi *New Mexico Washington

The broadest type of sales tax is the "gross income" tax which applies, in addition to all transactions and receipts in the previously mentioned taxes, to receipts from non-business activities such as wages and salaries of employees, interest, rents and dividends. This type of levy is found in two States:

Indiana West Virginia

In both Washington and West Virginia retail sales are taxed twice - in Washington under the gross receipts tax as well as the retail sales tax, and in West Virginia under the gross income tax and the retail sales tax.

The rates which apply to retail sales are distributed as follows: 1/2% in one State, 2% in 16 States, and 3% in five States. The rates on receipts from sources other than retail sales range from 1/100% to 2-1/2% under general sales and gross receipts taxes and from 195/1000% to 7.8% under gross income taxes.

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1/ Not included in this number are the States with so-called "selective" sales taxes limited in application to certain commodities specifically named, e.g., tobacco products, beer and malt. Neither does it include several States which impose low rate taxes on a sales or purchases basis upon merchants, manufacturers and other occupational groups.

* The use tax, a supplementary device to prevent sales tax evasion by out-of-State purchases, applies to the use, storage or consumption of tangible personal property brought into the State. Such taxes are now in effect in the 16 States marked with an asterisk (*). The use tax rate in every State is the same as the rate on retail sales.

Treasury Department, Division of Tax Research March 14, 1942

Exhibit 3.

Type and rate of sales tax at present in effect in Australia, Canada, and Great Britain

| Country | Type | Rate |
|---|---|---|
| Australia | Wholesale | Goods classified according to the degree of necessity at rates of 20%, 10%, and 5% |
| Canada | Manufacturers' | 8% (12% on furs) |
| Great Britain | Wholesale | 33-1/3% on wholesale value of certain luxuries and articles not normally requiring immediate replacement.<br>16-2/3% on wholesale value of non-luxuries which are not subsistence goods. 1/ |

Treasury Department, Division of Tax Research March 14, 1942

1/ Items exempt include: food, water, gas, electricity, coal, petrol, tobacco and drink; children's clothing and boots and shoes; farm machinery, and certain medicines. The British sales tax is imposed in the form of a "purchase tax" on certain goods purchased from registered dealers (generally wholesalers) by unregistered dealers (generally retailers).