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TAX LIMITATION : REFORM FOR THE FUTURE ?

BACKGROUND

A recent innovation aimed at limiting the growth of government has been attracting increased attention across the nation. This innovation is a constitutional amendment for state constitutions which would place a ceiling on the amount of taxes the state could collect. The limitation would be based on a percentage of the total personal income of the state's residents. This concept is unique in that it addresses the collection of taxes rather than the appropriation of monies.

The drive to get as many states as possible to adopt the tax limitation amendment has been spearheaded by the National Tax Limitation Committee. The Committee is a Sacramento-based organization with offices in New York and McLean, Virginia. The Committee was instrumental in gathering some 350,000 signatures in Michigan to allow a question concerning the approval of a tax limitation amendment to be placed on the ballot in that state.

As was stated, the basic concept is to limit the amount of taxes a state may collect to a specific percentage of the personal income of the state's residents. The figures used have varied from a high of 14% in Massachusetts to a low of 6.6% in Illinois. For the most part, the figure is generally around 8%. This limitation changes the legislative decision-making process from one of how much to spend to one of where to spend. The amendment also usually includes provisions which create a special fund from a set portion of the taxes collected

for use in emergencies. This fund is generally controlled by the state's governor.

STATE ACTIVITY

First suggested in California, the tax limitation amendment has been introduced in more than ten states. It passed both houses in the Arizona legislature and was signed by the governor of that state in 1974 only to be defeated on referendum. It appears that the amendment will be introduced in even more states this year, and it may have a chance of passage in some of them.

Each state's amendment varies slightly from the basic model. For example, in New York, monies collected through off-track betting and through the New York State Lottery are not included as income for the purpose of determining how much the state may collect. The New York amendment also exempts funds collected by the State University of New York for tuition. New York's amendment also provides that state indebtedness has to be considered prior to the consideration of any other expenditures.

The Illinois version of the amendment provided for a gradual roll back of taxes at the rate of 0.1% per year for between 10 and 15 years. It also provided a mechanism by which the percentage of personal income which determined the ceiling on taxes could be raised. This, however, was only after a two-thirds vote of the legislature and a statewide referendum. A third difference in the Illinois version was that a government agency which gave up a function was required to also give up the portion of taxes which funded that function. Similar to the New York amendment the Illinois amendment provided for the refund of any taxes collected in excess of allowable levels.

In Massachusetts the tax limitation amendment provided for a ceiling on tax collections equal to 14% of total personal income in the state. It also required that the state return any surplus funds to local jurisdictions for local programs. A third provision of the proposal prohibited the state from transferring the funding of any program from the state to the local level. The purpose for this provision was to prevent the state from merely discontinuing funding programs in order to keep within the bounds of the amendment's requirements while still requiring the spending for those programs at the local level.

As was mentioned previously, the Arizona tax limitation amendment--the only one which has passed both houses of a state's legislature to date--was among the simpler versions. It provided that the state could not collect taxes in excess of 8.4% of the

total personal income of the state's residents. The actual dollar figure was to be determined by an economic estimates commission each year. If any governmental function were transferred between jurisdictions, such as between local and state or between state and federal, the amendment provides that an adjustment be made in the rate of taxation to reflect the change. The jurisdiction giving up the function would have to reduce its taxes by the amount which would have funded the service.

The Arizona example serves to illustrate what can occur when such an idea is enacted. It has been pointed out that although passed by both legislative houses and signed by the governor the law was defeated on referendum. It is frequently forgotten that there are many individuals who benefit from government spending. The contractor who builds government buildings, the persons who work in those buildings, those who sell supplies to the workers in those buildings, and the recipients of benefits doled out in government buildings all see tax limitation amendments as a threat.

GOVERNMENT SERVICES AND PRIORITIES

In any state which plans to enact similar legislation, certain arguments in opposition to tax limitation amendments are bound to come up. The first of these is that vital services will curtailed if tax collections are limited. This argument is put forward most forcefully in areas such as education and criminal justice. For example, opponents might argue that in limiting tax collections, the legislature would be limiting the number of policemen on the street. Similarly, the argument in the area of education is that in limiting tax collection, the legislature would be limiting the schools' ability to keep pace with modern educational methods.

The fallacy in arguments of this nature, proponents of the legislation say, is that they ignore the basic purpose of tax limitation amendments. Their purpose is not to limit spending in any particular area but rather to limit the overall level of spending. When groups who have a particular area of interest state that theirs is the area which would suffer from declining financing in the event of tax limitation, they are really saying they may be overfunded at current levels. If their programs are truly critical, the legislature would allocate money from a less important service to cover their needs.

It is this point which is the key to the concept of tax limitation. The idea is based on the fact that many feel that

legislatures should begin to realize that while needs are unlimited, resources are extremely limited. This means that choices must be made and priorities must be established. As long as legislatures have no restraints on the amounts of money they may collect, there is no incentive for them to limit their spending. If they are limited to a specific amount of money, however, they will have to begin to operate within some system of priorities. If this can be made to happen, it is possible there may be some hope for an eventual lessening of the tax burden.

JOB CREATION

Another argument advanced by proponents of tax limitation legislation is that it serves to help get money into the private sector of the economy and thereby helps to create jobs. It has been demonstrated that the productivity of government employees is far below that of workers in the private sector. It, therefore, follows that it is far more productive to employ capital in the private sector than it is in the public sector. To the degree that legislation of this nature tends to encourage growth of private investment capital, it will have a favorable impact on the economy.

FLEXIBILITY UNDER TAX LIMITATION

Some of the opponents of tax limitation claim that it limits the flexibility of a state's tax structure. They contend that this flexibility is necessary to insure the ability of a state to raise revenues. The amendment's supporters, however, refute this contention. They point out that the amendment does nothing to change a state's tax structure. It merely prevents a state from constantly increasing the amount of revenues without regard to the impact increases have on the real income of the residents. It should be stressed that the amendment only applies to total collections without reference to what portion of those collections will come from a specific tax.

In conjunction with the contention that the amendment limits flexibility is the frequent assertion that the adoption of such a provision would result in a state's eliminating or reducing support to local jurisdictions. However, the language of the tax limitation amendment has specifically provided that this will not occur. The reason for the prohibition is to prevent a state from transferring the cost of functions to the localities. If such transfers were allowed, a state could raise taxes by such transfers and thus circumvent the purpose of the legislation.

In all of its current forms, the tax limitation amendment re-
quires that any transfer of function be accompanied with a corol-
lary reduction of state collections equivalent to the cost of
the function transferred.

A third aspect of flexibility which is frequently cited as
an argument against tax limitation is the advent of war or disas-
ter. Opponents of the measure state that there is no contingency
for increased needs for state expenditures which could result in
such situations. Here again, the various forms of the tax limita-
tion amendment take such occurences into account. There are two
basic vehicles for providing for emergencies included in the vari-
ous versions of the tax limitation amendment. The first is a
provision under which the state legislature could raise the ceil-
ing on state expenditures by a two-thirds vote of both houses.
The reason for requiring a two-thirds vote is to prevent it from
becoming a procedure which is taken lightly, while at the same
time not making the limitation too rigid to work. A second ap-
proach to this problem, which was included in the tax limitation
amendment introduced in Illinois, is what amounts to a state sav-
ings account. Each year a specified percentage of total state
collections would be placed in a fund. This fund would not be
available to the legislature for appropriations, but would rather
serve as a backstop against natural disasters. When and where
the funds would be spent would be totally at the discretion of
the governor with the condition that a state of emergency be de-
clared prior to their release. While the funds are dormant, they
would be placed in accounts where they could draw interest. It
has been suggested that if they were to reach a certain level,
some of the funds would be used to retire a state's debt.

SUMMARY

The basic concept of tax limitation is attracting increas-
ing attention. It places a cap on the amount of taxes a state
government may collect and thereby automatically limits the
amount of money available to the state to spend on various pro-
grams. It has been introduced in more than ten state legisla-
tures but has not as yet been enacted into law. It appears that
tax limitation amendments will be introduced in even more state
legislaturesin the next few years.

While the concept of tax limitation amendments has not as
yet been enacted into law, there are indications that the mood
of the public is such that chances for passage are getting bet-
ter. In many states, taxes have increased at rapidly escalating
rates in recent years. For example, Maryland residents have

experienced three successive years of increased property tax assessments and an additional increase in the sales tax was adopted in the 1977 session of the state legislature. As the burden on middle-income families gets larger, it is likely that there will be agitation for some form of relief. It may be that the form of relief chosen is the tax limitation amendment.

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