

The Sales Tax

ITS HISTORY, GROWTH, DEVELOPMENT,
PROBLEMS, AND POSSIBILITIES

a study by:

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The Sales Tax

ITS HISTORY -----

The predominance of English background and ancestry among the people of the thirteen original colonies not only paved the way for the adoption of the English language but also led to the early entrenchment of the English common law into our American system of jurisprudence. Agriculture was the principal industry and the need for the protection of land ownership combined with the English tradition that real property was the basis of wealth, soon caused the enactment of laws and the establishment of governmental agencies for the protection of property rights. Land and chattels having thus become early beneficiaries of the newly formed government were soon called upon to contribute to its maintenance and support. Hence it is little wonder that our present system of ad valorem taxation has been a principal source of revenue for a century and three-quarters in our American government.

Moreover, since property was a principal beneficiary of government, why should not the right to succeed to the ownership of that property also be taxed, and so, death taxes were added to the tax structures at relatively early dates. In North Carolina our State Inheritance Tax is our oldest state tax, having had its origin more than a century ago. Similar death taxes have been in effect for a long period of time. As industry began to develop, men associated themselves together into joint enterprises and created artificial entities, known as corporations. As the corporations began to grow and prosper, they were called upon to make a contribution toward the support of the government through which they came into existence and by which they continued to exist. And so the corporation commenced paying taxes for the privilege of being a corporation, which taxes were known as Franchise Taxes.

Through the years the Federal Government, for its support, had found it necessary to impose excise taxes on special commodities, such as tobacco and whiskey, but, it was not until 1913 that we had our first Federal Income Tax. Property itself had been taxed, the right of succession to the property had been taxed, but now the income from that property as well as the income from personal endeavor was to be taxed. Such a tax was not only resisted in the forum of Congress, which alone had the power to levy it, but when it was passed it was tested in the courts and it first was adjudged to be unconstitutional. Later it was upheld. When we survey the magnitude of this levy and its revenue value on a State and Federal level, it is difficult to realize that this principal source of revenue to our Federal Government, with its annual billions, has been in existence for only 37 years or about one-fifth of the period of this nation's history.

Amusement and luxury taxes of World War I had come and gone but all of our other revenue measures were still in effect when Mr. Average Citizen breathed a premature sigh of relief and surmised: "Surely there can be no other possible form of taxation which the proponents of a liberal government will now be able to devise", when,

to his dismay, he found his representatives in the legislative halls talking about a sales tax. If a tape recorder had been installed in some of the legislative halls during the early thirties, we might have heard such statements as these: (1) "Emergency or no emergency, I am afraid to ever let that type of levy become enacted" or (2) "It will drive our business out of the State" or (3) "What right has the State to make a tax collector out of every merchant" or (4) "The idea is absurd, no such levy could be effectually enforced" or (5) "This type of tax strikes at the very heart of commerce itself and if enacted will destroy our economy" or (6) "It is nothing but an effort on the part of the rich to saddle the tax burden on the poor." Such imaginary objections as I have described were real in our State Capitol in 1933.

In the year before, the State of Mississippi had Treasury Warrants of over seven million dollars outstanding and a bank balance of \$1,160.20 with which to make payment. The people of that State were ready to experiment with any form of taxation that might save the credit of the State and avert a financial collapse. Accordingly, the first State sales tax was enacted in that State and became effective on May 1, 1932. I have been informed that this levy was not in reality a sales tax but more in the nature of a merchant's privilege tax and that through the cooperation of the people of Mississippi and through the tenacity and resourcefulness of Mr. Alfred G. Stone, Chairman of the State Tax Commission of that State, the administration of this tax became successful and saved the credit of that State.

In 1933 our public school system in North Carolina, then supported principally on a local level, was threatened with collapse unless the State could take it over and find the money somewhere for its support. The property owners had reached the point where they were obliged to have some relief from ad valorem tax levies which they could not pay and who, by reason of their defaults, were threatened with tax foreclosures and mortgage foreclosures caused in part by tax defaults. Our legislature proceeded courageously but cautiously and in the face of bitter opposition, under the valiant leadership of Governor Ehringhaus, passed the retail sales tax as a temporary emergency measure, as will be indicated by words of preamble, such as "additional and extraordinary taxes" and "supreme emergencies in shrinkage of the ordinary revenues". In North Carolina our first sales tax became effective on July 1, 1933, followed very shortly by a similar levy in California, which became effective September 1st of that year.

In our State, the retail sales tax was accepted by the people as an emergency measure with the expectation that such a similar levy would not be enacted at the next session in 1935, but, when the legislature met in that year, the Revenue Act of 1935 contained a similar levy and although the levy at that time was still considered as an emergency measure, it did not have the resistance that had been evidenced two years before. The people had learned that the sales tax was paid by the average citizen in small installments involving a few cents at a time; that the payment had not resulted in any appreciable burden and that the revenue derived therefrom had not only greatly eased the burden of the small home owner but had provided a more solid foundation for our public school system and a means for prompt payment of teachers' salaries. Nevertheless, public resistance continued, in many instances with merchants and

consumers, but notwithstanding organized crusades for repeal, the levy persisted in our tax structure.

By 1937, the sales tax had become generally accepted by most of the citizens as a convenient means of paying small installments toward the support of their State government and many people had then come to realize that through the sales tax every citizen makes some contribution toward the support of his government just as every citizen receives the protection and benefit from governmental functions and services.

ITS GROWTH AND DEVELOPMENT IN NORTH CAROLINA-----

As previously stated our sales tax law became effective on July 1, 1933 and on June 30, 1934 we had collected and deposited to the credit of the State the sum of \$6,011,700. That money was so badly needed for the support of our public schools during those trying days of economic depression in the early 30's, it is difficult for us to measure the ultimate value of those collections to the people of this State. The purchasing power of the dollar at that time was perhaps more than double its present value and the distribution of those sales tax collections during the first year the law was in effect, not only bolstered the general economy of our State, but prevented the closing of many of the schools in our public school system. It is sufficient to say that many a young business man or woman or college student of the present day can look back with the feeling of gratitude toward the sales tax and how it prevented a collapse of our public school system or a delay in the continuation thereof. During the years that followed there was at first a steady rise, then a leveling off and then a further rise when at the end of the fiscal year of June 30, 1940 sales tax collections in North Carolina amounted to \$12,191,651. In seven years the revenue value of the levy had doubled. The following state will show the annual sales tax collections in North Carolina during that seven year period:

| Year Ended | Sales Tax Revenue |
|---------------|-------------------|
| June 30, 1934 | \$ 6,011,700 |
| June 30, 1935 | 7,654,244 |
| June 30, 1936 | 10,181,373 |
| June 30, 1937 | 11,320,245 |
| June 30, 1938 | 11,134,333 |
| June 30, 1939 | 10,994,744 |
| June 30, 1940 | 12,191,651 |

Then came the tragedy of World War II and with its accompanying economic upheaval, consisting of high income taxes, wage controls, price controls, hoarding, hysterical buying, black marketeering and all of the other by-products of a war economy. Tires were frozen in December, 1941, automobile production was stopped early in 1942, private building construction was stopped in April, 1942, with a resultant effect upon some of the various groups in our sales tax registration. Attached to this study you will find an analytical tabulation giving in detail the sales tax collections from all of the seven major groups together with the wholesale and use tax and the total collected

for the fiscal years ended June 1941 to June 30, 1950 inclusive. Here we have a running history of our sales tax collections commencing at the beginning of the war, extending through the war years into the post war boom and then into a somewhat more stabilized economy. Beginning with the fiscal year ended June 30, 1941 about six months prior to our entry into World War II when the total sales tax collections were slightly in excess of 14 million dollars, it will be observed that there was an average increase during the next four fiscal years of approximately 11% over each previous year. During that time collections declined in certain groups such as automotive, lumber, and building materials, but, on the whole, the trend of the graph was upward. Then immediately following the end of World War II and beginning with the fiscal year 1945-46, there was a sharp rise in sales tax collections. For the fiscal year ended June 30, 1946 the increase was 22% and the next year it was 33% and in the next year the increase, although not so great, amounted to 11%. During the past two fiscal years the annual increase has been approximately 3% for each year which was a strong indication that there was a general leveling off and stabilization in our merchandising activity in this State. Our sales tax collections for the fiscal year ended June 30, 1950 amounted to \$41,869,874. That amount is approximately seven times the amount collected during the first year our sales tax law was in effect and is almost three times the amount of our sales tax collections for the year immediately preceding our entry into the war.

ITS GROWTH AND DEVELOPMENT IN OTHER STATES-----

Beginning with Mississippi, then North Carolina, then California, the retail sales tax has found favor with many State legislatures. Its value as a revenue producer has been recognized. With the enactment of the sales tax law in Florida last year we now have a State-wide retail sales tax in 27 States and the District of Columbia. It is permitted in other States on a local level. The rates are 2% in some States and 3% in others. In 19 States the maximum rate is 2%, while in other States the maximum rate is 3%. The annual revenue value ranges from approximately \$7,000,000 in Wyoming to approximately \$327,000,000 in California. In 22 States, it is the largest single source of revenue, in two States it is the second largest and in two States it is the third largest. Its total revenue value to all states in 1950 was \$1,528,167,216 or an increase in two years of approximately \$300,000,000. Realizing the importance of this study to all of us entrusted with the grave responsibility of our State's finances and taxation, our Department has not been content to assemble from published data the pertinent information relating to sales tax laws and administration in other States. In the first place published data is generally about two years old when it is printed and secondly the scope of the sales tax is expanding so rapidly that scarcely any published statistics would reveal the true picture. We have therefore contacted the sales tax administrators in the other sales tax States and have obtained all pertinent information concerning collections for the last fiscal year, rate, per capita income, population, sales tax registration, revenue value, and exemptions. We have tabulated this information on the succeeding pages and your attention is respectfully invited to the comparative figures shown thereon. I think you will find almost without exception that where there are no exemptions or the exemptions are few, or negligible, the collections are all out of

proportion to the collections in comparable States, having many exemptions. Particular attention is invited to a comparison of our collections in North Carolina with the following States: (1) Alabama with a per capita income less than ours and a rate of 2%, and with a population three-fourths that of North Carolina, collected almost \$33,000,000. At our rate their collections would have been \$48,000,000 and compensating for the difference in the population their collections would have been \$60,000,000. (2) Arkansas with a per capita income less than North Carolina, at a rate of 2%, collected over \$23,000,000 last year. Had they imposed our rate, the collections would have amounted to \$36,000,000 and when we compensate for the difference in population, the collections would have been \$72,000,000. (3) California with a population two and one-half times that of North Carolina and with the same rate as ours collected almost \$327,000,000 last year. It is true that the per capita income is almost twice that of North Carolina but is difficult with the difference in population and per capita income to reconcile our collections in comparison with California to approximately one-eighth of the amount collected in that State. (4) Mississippi had collections, a rate, per capita income and population quite comparable and almost parallel to Arkansas. (5) Ohio with a rate the same as ours and population almost double, collected last year more than \$137,000,000 or almost three and one-half times that collected in North Carolina. Surely the difference in population and per capita income could not account for this wide discrepancy. The answer is found in the exemption column where you will observe there were no exemptions whatever. (6) Tennessee enacted its sales tax about three years ago. The per capita income is only slightly in excess of that in North Carolina. The population of the State is 80% of that in North Carolina, and yet with a rate of 2% they exceeded our collections last year by almost \$1,000,000.

When we consider the population of our State, the per capita income and the top rate of 3% and then compare our sales tax collections with those of other States and see what a relatively poor showing we make in point of revenue value, we might well pause to ask ourselves – Is the fault in our stars or in ourselves that we are underlings? An inquisition of this sort leads us to analyze the efficiency of our sales tax administration: We find that we have 100 deputies scattered throughout the State who are at all times on the alert for new sales tax registrations and are ever ready, willing and able, not only to assist the confused merchant but also to prod the recalcitrant one. We find our 100 field auditors diligent and thorough in their audit of merchandising records. We find our audit program designed in such manner as to periodically audit as promptly as possible the sales tax records of every merchant, both large and small. We find in our audit program a well-rounded plan of selectivity to determine where the deficiencies are most likely to be found. We find in our audit program willingness on the part of our field auditors to reconstruct faulty and deficient sales tax records so as to correctly determine the deficiency of a defaulting taxpayer. We find in our audit program a high degree of productivity in deficiencies as compared with other sales tax states. We find in our sales tax division a thoroughly experienced and able administrator and a corps of assistants who have worked with the schedule for a long period of years and are thoroughly familiar with the various problems that are presented by the variety of retail merchants. We find in our sales tax administration the most modern and up-to-date mechanized system for processing sales tax returns: a supply of blank returns

containing the merchant's name, address and registration number is sent to each merchant each six months and when those returns are received monthly in the State office, they are forthwith translated to a punched card and those cards are matched or collated with our master file, containing the name and address of each registered merchant so that prior to the end of each month we can determine those merchants in default. Our system not only balances each account but analyzes as to geographical location the revenue received from sales tax and also segregates into various business groups the revenue derived therefrom. This system is very flexible and will produce by machine sorting almost any information that may be desired with reference to our sales tax collections. The installation of this system about three years ago enabled the Sales Tax Division, with the same personnel to currently process 34,500 returns and now with a substantial decrease in office personnel, we are processing 63,100 returns monthly. We find in the Commissioner's office perhaps as many sales tax hearings and conferences as all of the other schedules combined and we listen with patience, understanding and consideration to the problems that are daily presented to us by the merchants against whom an assessment has been made, but, in most instances, there is no other alternative except to sustain the assessment. We freely admit that there are defects and loopholes in our sales tax administration but we assert that we are doing all we can to collect every dollar of sales tax due to the State of North Carolina. We heartily welcome any suggestions or constructive criticism which may lead to a more efficient and more equal enforcement of our sales tax law. We are, therefore, led to the conclusion that if the fault is in ourselves, we have not been able to find it or a remedy therefore which would render more efficient our enforcement of the law in a manner comparable to our sister States. The fault we believe then is not ourselves but considering the present provisions of the Revenue Act, we feel that we may justifiably point an accusing finger at our stars or more specifically our limitations under the law.

ITS PROBLEMS-----

It is not the province of the writer as a tax administrator and an arm of the executive branch of our State Government to invade the exclusive function of the function of the Legislature provided by our Constitution of 1868 which grants unto that branch of our State Government the sole and exclusive power to levy taxes or to determine tax policy. But, I feel that I would be remiss in my duty as a State official if I did not point out some of the apparent inequities in our Sales Tax Law together with many of the ambiguities and difficulties of administration. The difficulties and objections hereinafter set forth are not mere surmise, supposition or conjecture, but are based upon actual observation and experience in dealing with sales tax cases that have been presented to me during the past 15 months for administrative determination and decision. It is anything but pleasant to sit in conference with a fellow citizen who is a merchant and who, through misunderstanding, misclassification, inability to keep accurate records or for many other reasons, finds himself confronted with a large sales tax assessment, frequently for an amount which he cannot pay and even more frequently for an amount which he has not collected because he did not understand the liability under our sales tax law as now written. However, taxing statutes are rigidly written and necessarily so because of the rule of interpretation with respect to such

legislation. In most cases our auditors have followed and recognized audit procedures and have determined the liability of the taxpayers as nearly accurate as the taxpayer's records will permit, and there remains nothing to do by way of administrative action except to sustain the assessment with the penalty and interest as provided by law. Hundreds of such conferences have convinced me that Article V of the Revenue Act should be re-written almost in its entirety, not only from the standpoint of better clarity and understanding but also on the basis of tax policy itself, in order that many of the inequities, ambiguities, difficulties of compliance and problems of enforcement may be eliminated for the benefit of the average citizen, the retail merchant and the State. With such an attitude and approach, I now call your attention to the three major problems of sales tax enforcement in North Carolina.

Single Article

In the very heart of our sales tax law, that is Section 405 (b) which is the section that imposes the 3% retail sales tax there is a proviso as follows: "Provided however, the maximum tax that shall be imposed upon the sale of any single article of merchandise shall be \$15.00".

The previous section of the Revenue Act (Section 404) contains an elaborate glossary of the various terms used in the sales tax act, but alas we search in vain for a definition of the term 'single article' of merchandise. The entire chapter is silent except for the foregoing provision.

This provision has never been directly presented to our Supreme Court and therefore the legislative intent concerning the limitation of tax liability or the meaning of the term 'single article' cannot be found in the numerous opinions of that Court interpreting our tax laws.

North Carolina has the distinction of being the only one of the 28 sales tax states that has any such limitation of sales tax liability and hence we cannot expect to find any administrative precedent or ruling or any legal interpretation of the term 'single article.'

Surely there must be a definition somewhere in legal nomenclature. Let us continue our search through such standards works as 'Word and Phrases' wherein court definitions of all legal terms are compiled and given. There it is – the very term 'single article' and we turn to read the definition with the enthusiasm of Archimedes ready to exclaim "Eureka!" only to find that all the various definitions could not possibly be applied to an interpretation of sales tax liability.

But we are obliged to deal with this term and must have some reasonable interpretation of these words in common usage. At last we turn to Webster's New International Dictionary and find authentic literary definitions for each word as follows:

"single – from the Latin singulus, one only as distinguished from more than one, consisting of one alone, individual, separate.

"article – from the Latin articulus, a thing of a particular class or kind as distinct from a thing of another class or kind; a commodity; as an article of merchandise.

There you have it – combined is simply means one only of a commodity.

We now have the definition but what about the interpretation in respect to sales tax administration. There are two legal rules by which we must be guided: one is interpretation and the other construction.

Interpretation: Where the statute itself does not give the legislative intent we look back into the history of this proviso to see if we cannot find somewhere in the annals some words to indicate just why the General Assembly provided for such a limitation of sales tax liability. Section 404, Revenue Act of 1933, provides “the maximum tax that shall be imposed upon any single article of merchandise shall be \$10.00 and as an additional means of enforcement of the payment of the tax herein levied the Department of Revenue shall not issue a license plate for any new motor vehicle until the tax levied for the sale of same under this act has been paid.” As previously pointed out, North Carolina was second only to Mississippi in the enactment of a retail sales tax, so in 1933 Virginia on the North, Tennessee on the West and South Carolina on the South had no such levy and it was argued to the legislature that whereas people would not cross state lines expressly to purchase ordinary articles of merchandise, many would no doubt be tempted to do so in the case of the purchase of an expensive article such as an automobile, a fur coat, or a diamond ring particularly those who lived near the state border. This was before the enactment of our compensating use tax.

Construction: The limitation of tax proviso is in the taxing section and not in the exemption section but nevertheless it is an abatement of tax liability in excess of \$15.00 and hence to all intents and purposes the transaction to which the proviso is applicable is exempt from tax that would otherwise be collectible. For the purposes of construction the limitation must be construed as an exemption. Typical of his superb use of words and clarity of expression, Chief Justice Stacy has defined the rule of construction respecting exemptions as follows: “Taxation is the rule, exemption is the exception, with strict construction applicable to the latter.”

Thus the interpretation by definition and legislative intent of a ‘single article’ means one only of an article of merchandise and that interpretation must be construed strictly in favor of the taxability of the transaction and against the limitation of tax thereon.

If the single article limitation of tax could be effectually enforced as the legislature intended, it is estimated the loss in revenue to the State would amount to approximately \$10,000,000 with approximately \$7,500,000 involved in the sales of motor vehicles alone. But the estimated loss taken into account by the General Assembly is only a part of the actual loss, some of which has been discovered and assessed but much of which cannot be discovered until periodic audits have been made and then the merchant finds it too late to recoup the tax from his customers and must bear the loss himself.

Unfortunately much confusion regarding the term ‘single article’ has arisen in the minds of merchants, jobbers, distributors and suppliers and their customers in

determining the tax liability of a retail sale. For some unknown reason the term has been taken to mean 'single order' 'single sale' 'single invoice' with resultant interpretations of the application of the law ranging from reasonable error to credulous absurdity. Some of the following cases requiring administrative determination on sales tax assessments involving single article will disclose the wide range and great variety of erroneous interpretations that have been placed upon this:

1. Is a roll of telephone cable 4200 feet in length a single article? No. Such material as well as electric cable, coaxial cable is merely a part of the material that goes into an electrical distribution or communications system which may extend for hundreds or even thousands of miles. Such material can never acquire the status of an article notwithstanding that for convenience in packing and shipping it is wound in standard lengths on rolls.
2. Is a farm tractor together with a plow, a harrow and a cultivator a single article? No. Each is a separate single article although we recognize that without the tractor the other equipment would be useless.
3. Is a radio tower constructed of steel beams, bars and cross bars riveted together a single article? No. Notwithstanding that the manufacturer sells through a catalog showing various heights and sizes with various prices, nevertheless the tower is a structure of structural steel riveted or bolted together the same as the steel framework for a fireproof building furnished according to specifications.
4. Is a carpet laid wall to wall on the entire second floor of a large department store a single article? No. It is merely a quantity of carpet measured, fitted and sewed together into a floor covering. It is no more a single article than thousands of squares of asphalt tile would be.
5. Is an installation of various display cases for poultry, dairy products, frozen foods, meats, and fish all refrigerated by one compressor a single article? No. Each case is a separate article but the compressor and one case might be so designed so as to constitute one article or unit.
6. Is a soda fountain with its electric mixers, toasters, sandwich makers all of which used together a single article? No. Each is a separate article.
7. Is a motion picture projector with its rewind equipment, sound track sound system, speakers and screen a single article? No. Each is separate unless design and manufacture would determine otherwise.
8. Is a large gas holder having a capacity of a million cubic feet of artificial gas a single article? No. Like a water tank, it is a fabrication of curved steel plate bolted or riveted together and is merely a structure made of taxable building materials.
9. A taxi fleet owner rents a cab by the day to a driver. Is the tax on the rental fully paid when it reaches an aggregate of \$500.00? No. Like the rental of bulldozers and other road machinery the single article limitation does not apply to an accumulation of rental cost.
10. A check for an elaborate banquet was paid by the genial host. Was he correct in insisting that the hotel accept \$15.00 in full payment of the tax? No. He was thinking about 'single check' instead of 'single article.'
11. A builder in Louisiana fabricates the outside walls, inside walls and roofing rafters of a small bungalow, loads it on a flat car from which it is unloaded in Greensboro and then the parts are assembled on a masonry foundation. In a matter

of hours it takes the shape of a house and in a few days it is occupied as a home. Is this house a single article? No. It is merely a prefabrication of taxable and non-taxable building materials.

There are many more such cases which perhaps would add to the variety and more clearly illustrate the problems of administration but the foregoing will be sufficient to demonstrate the inestimable loss of revenue to the State that is being sustained monthly. Losses that are a by-product of the provision itself; losses that were never in contemplation of the legislature; losses that we can discover only through audit; losses that we cannot guard against by regulation since we cannot foresee erroneous interpretation of still other varieties; and losses by way of sales tax assessments in enormous amounts sustained by merchants after audit.

The wisdom of the provision as a matter of tax policy is for the decision of the legislature. However, as a tax administrator dealing directly with hundreds of dismayed taxpayers with large assessments to pay, I can ascribe to this proviso a large measure of confusion and difficulty in the enforcement of our sales tax law. As a sounding board of opinions expressed at hearings in my office, I can say that the single article limitation is considered unjust, unfair, inequitable and discriminatory. Many taxpayers feel that the forgiveness, if any, should be on the other end of the line.

It has been argued to us that the affluent purchaser of the custom-built automobile that sells for \$4500, pays \$15.00 tax and is forgiven \$120.00 tax is better able to pay the full measure of the 3% levy than the industrial worker who buys a jalopy in which he rides to work, pays \$600 for it plus \$15.00 tax and is forgiven \$3.00 tax; that the mother who is trying to outfit junior for school, on a budget of \$25.00, finds it much more difficult to pay the full 3% tax of 75¢ than the lady who finds that a new mink coat at the bargain price of \$2500 is essential for her winter wardrobe, pays \$15.00 tax or about ½ of 1% and is forgiven \$60.00.

The single article limitation is as old as our sales tax law itself. It has been in the law since it was first enacted in 1933. In 1939 when our permanent Revenue Act was enacted there was added to our sales tax act a companion chapter known as Schedule I or Use Tax. The purpose of the new levy was to protect North Carolina merchants and to bolster the enforcement of the sales tax. It levies a tax not on sales but on the use of tangible personal property purchased outside of the State and brought into North Carolina for use, storage or consumption. There is a special provision respecting the collection of use tax on automobiles purchased outside the State for use in North Carolina and the means of enforcement is positive and effectual since the law requires the use tax to be paid before the license plates can be obtained. Hence the automobile dealer is now fully protected against competition for the sale of cars to residents of this State by dealers in other States. Although the use tax applies to all taxable merchandise purchased outside the State and is effectually enforced with respect to business organizations and industries, little hope can be held for enforcement of the use tax against individuals who buy clothing, luggage, jewelry and other items in large shopping centers in the North.

EXEMPTIONS:

Exemption is derived from the Latin exemptic and is defined as freedom from any charge, burden, evil, etc., to which others are subject; immunity; privilege. Practically speaking, an exemption in a taxing statute is the opening wedge which destroys the efficacy of enforcement. It is like a small hole in a dam and begins first with a drip, then a trickle, then a stream, then a flow, then a gush and finally a break which destroys the dam.

Generally speaking, exemptions in taxing statutes fall into two general classifications. In the first class are exemptions from liability by reason of the status of the person, organization or agency which might otherwise be taxed, such as federal, state or local governmental agencies, or religious, charitable, educational or eleemosynary institutions. The second class of exemptions may be divided into two groups: First, that property or transaction which has otherwise been taxed under some other taxing provision, and, secondly, that class of property or transaction which in the public interest and for the general common good, tax policy decrees that it would be unwise to levy a tax thereon.

In our sales tax law in North Carolina we have a total of 32 exemptions. Let us consider, analyze, and classify these exemptions and endeavor to ascertain, if possible, the reasons why the General Assembly excluded these items of merchandise or these sales transactions from the retail sales tax that would otherwise apply:

1. Sales to Governmental Agencies.

(a) Sales to the State or political subdivisions within the State are exempt because the payment and collection of the tax would simply mean the payment of the tax by a State or local governmental agency into the State Treasury and the ultimate expenditure of the tax with no net gain but with the added burden of administration.

(b) Sales to the Federal Government or any of its agencies are exempt by constitutional inhibition.

2. Sales to non-profit, religious and charitable organizations.

(a) Sales to non-profit, religious, charitable, and educational organizations are tax exempt because the general policy of the State is to encourage the development and promotion of such agencies and encourage the work performed by them and hence the sales tax follows the general policy of taxation in respect to income and ad valorem taxes.

(b) Sales to contractors of building materials to perform contracts for non-profit, religious and charitable organizations are tax exempt on the theory that if the contractor paid the tax on those materials, which otherwise would be taxable, he would necessarily add the amount thereof to his contract price to be paid by the exempt organizations and there the organization would be indirectly taxed whereas the policy of the State is against the direct taxation of such organizations.

3. Sales of Articles Otherwise Taxed.

(a) Sales of gasoline or other motor fuels taxed under the gasoline tax law are exempt from the sales tax for the reason that there is a road tax of 7¢ per gallon on motor fuels which is paid into the highway fund and a further levy of $\frac{1}{4}$ of 1¢ per gallon in the form of an inspection fee; however, kerosene not sold for highway or agricultural purposes is subject to the 3% sales tax inasmuch as the inspection fee is not considered strictly as a tax.

(b) Sales of alcoholic beverages by A. B. C. Stores are not subject to the retail sales tax because another taxing statute (819½) levies a beverage tax of 8½% on the sales price of the beverage and actually a large portion of the purchase price is the Federal Stamp Tax of \$9.00 per gallon.

(c) Sales of gas, electricity, water furnished through mains, lines or pipes are not taxed because the utility company pays a franchise tax of 6% on its gross receipts, which is recovered by it from the customer in its approved rates.

(d) Sales of motor vehicle bodies which enter the State for the purpose of having such body mounted on the vehicle are considered an integral part of the motor vehicle, which, when sold, will be taxable within the limitation provided by law.

(e) Used articles taken in trade have been exempted on the theory that whereas the new article was fully taxed at the time of the sale, the used article was merely given by way of barter or exchange instead of by payment of the cash value therefore and that the full measure of the transaction was taxed otherwise.

We next come to the general category of exempt sales which have been exempted from the sales tax by the General Assembly perhaps on the theory that if a retail sales tax were levied upon such articles, the effect would be regressive or might work an undue hardship upon the ultimate consumer.

1. Educational.

(a) The legislature in its wisdom has always exempted the sale of Holy Bibles, upon the well-grounded belief, in which the writer concurs, that the hope of the world is to follow the example of the ancient Bereans and "search the Scriptures daily"; that the wide distribution and dissemination of the Scriptures is the basic answer to the problems of a troubled world and that it should not be discouraged even by the imposition of a small amount of sales tax.

(b) The sale of public school books on the adopted list is a necessary adjunct for the hundreds of thousands of school children enrolled in the public schools and that the imposition of even a small amount of tax might work a hardship on the parents of those children, especially those of modest means.

2. Undue Hardship.

(a) The sale of medicines sold by prescription, compounded by the druggist, has been exempted because illness is a misfortune to which the human flesh is heir and in many instances it is difficult for people to pay the purchase price of such prescriptions.

(b) Sales of crutches, artificial limbs, artificial eyes and hearing devices and orthopedic appliances are exempted because there again the purchaser of such a device has had the misfortune of losing an organ or member of his body and those artificial aids are necessary to enable him to overcome that hardship.

(c) The sale of coffins and caskets, which do not sell for more than \$100 has been declared exempt because death is a common enemy of all mankind and burial expenses must ultimately be borne by rich and poor alike.

3. Sale of Productive Equipment and Materials.

A. Industrial

(1) The sale of mill machinery or mill machinery parts or accessories to manufacturing plants and industries are classified as wholesale sales for the reason that such machinery is employed to produce a manufactured product which when offered for sale at retail is subject to the retail sales tax.

(2) The sale of cotton, tobacco, peanuts and/or other farm products, when sold to manufacturers for further manufacturing or processing, are exempt for the reason that those raw materials are converted, through the manufacturing process, into finished commodities which are sold at resale and upon which the tax will ultimately be paid.

(3) Sales of products of mines, forests and waters in the original form sold by the producer are generally made to manufacturing plants and industries and ultimately become manufactured products, such as terra cotta, lumber and fertilizer, which, if taxable, would otherwise be taxed in their finished state.

(4) Sale of fuel used directly in manufacturing or processing is taxable at the wholesale rate because such fuel is necessary in the manufacturing process and the finished product will ultimately be taxable.

B. Agricultural Group.

(1) The sale of commercial fertilizer is exempt because it is an essential ingredient in the production of crops.

(2) Sales of semen to be used in the artificial insemination of animals have been exempted to encourage the production of livestock.

(3) The sale of seed for agricultural purposes has been exempted in order to encourage the production of farm products.

(4) Sales of feed for livestock and poultry have been exempted inasmuch as such feeds are necessary and constitute a major part of the cost of raising livestock and poultry.

(5) Insecticides for livestock, poultry and agriculture have been exempted because without such protection for plants and animals the ultimate production of farm products would be seriously hampered and many plants and young animals would otherwise be blighted or diseased.

(6) The sale of horses and mules has been exempted because the vast majority of such animals are used on the farm for agricultural production. Such sales are otherwise taxed under Schedule B.

(7) The sale of fuel oil to farmers has been exempted because it is considered an essential commodity in preparing farm products for marketing.

C. Food Group.

(1) The sales of foods for human consumption have been exempted by reason of the adoption of the tax policy advocated by the late Governor Broughton to "take the tax off of the dinner table."

(2) Sales of fish and seafood sold by fishermen come within the general purview of exemption of tax for human consumption.

(3) Sales of products of farm and garden, when sold by farmer or producer, have likewise been exempt for the same reason.

(4) The sale of ice, which is used principally for preserving food and food products, has likewise been exempted for the same reason.

D. Building Materials.

(1) The sale of rough and dressed lumber (but not mill work) was not doubt exempted on the ground that it is a product of the forest.

(2) The sale of brick; hollow tile; cement, cinder and clinker blocks was no doubt exempted by reason of the fact that such products, or the aggregates of which they are composed, are to a large extent mineral products.

(3) The sale of sand, gravel, crushed stone, rock and granite has no doubt been exempted by reason of the fact that those are also products of the mines or quarries.

E. Unclassified Group.

(1) Worthless accounts charged off for income tax purposes have been exempted for the reason that the retail merchant not only did not collect the tax but also sustained a loss and did not recover his cost. Although the tax attached to sales transaction, it would work an undue hardship and inequity on the merchant to require him to pay a tax on a sales transaction which resulted in a complete loss to him.

F. Special Exemption.

(1) Sales of lubricants, repair parts and accessories for motor vehicles and airplanes to owners and operators of fleets of more than five motor vehicles are classified as wholesale sales and are, therefore, subject to a rate of tax at $1/20^{\text{th}}$ of 1% or $1/60^{\text{th}}$ of the retail rate. Strictly speaking, this is not an exemption but since it is a forgiveness of approximately 97% of the tax, it must be treated as such. Apparently the reasons supporting such a classification were founded upon the fact that such fleet owners were purchasing those commodities outside the State prior to the enactment of the compensating use tax.

There you have the 32 exemptions in our sales tax law as to classes of purchasers and types of merchandise. I have endeavored in the foregoing discussion to point out what I understand to be the underlying reasons why these various exemptions were excluded from our sales tax levy. Recognizing that tax policy is the primary, sole and constitutional function of the General Assembly, I reiterate that it is not the function of the administrator to pass upon the wisdom or lack of it in respect to a tax levy or the exemption from a tax levy, but I feel constrained as a State official to comment upon some of the practical administrative difficulties we have encountered in our endeavor to equally enforce our Revenue Act – difficulties that are well-nigh insurmountable because of the problems presented by some of the foregoing exemptions. As previously stated, problems of the taxpayer are mutually problems for the Revenue Department. We do not like to sustain large assessments on taxable transactions in many cases where the tax has not been collected, but, when the incidence of the sales tax has attached to a sales transaction, there is nothing for us to do administratively except to sustain the assessment. We are not permitted by law to forgive, reduce, or abate any portion of the tax. Categorically, some of the problems presented by the numerous exemptions are as follows:

1. Lack of Records.

(a) Section 415 of the Revenue Act requires every person engaged in business for which a privilege tax is imposed to preserve suitable records of gross income, gross receipts and/or gross receipts of sales in such business. It also requires such person to preserve all purchase invoices for a period of three years. There are literally thousands of small rural and suburban merchants maintaining small mercantile establishments in which they sell non-taxable merchandise, such as groceries, and taxable merchandise, such as clothing, supplies, soft drinks and tobacco. That merchant frequently has nothing more than a cash drawer and often times carries his money in his pocket. He thinks it is impossible for him to keep an accurate record of his volume of sales and especially so when he buys merchandise for resale from a wholesale delivery truck and makes payment either out of his pocket or cash drawer without recording the transaction. However, we do find many small merchants that have cash registers and keep an accurate record of the gross sales but they do not classify the taxable and exempt sales. In filing sales tax reports they guess at a figure of a small amount, generally grossly inadequate, and send a monthly report and token payment to the Department. A subsequent audit a few years later will frequently disclose that the total gross sales reports are less than the total invoices covering purchases of taxable merchandise. Our auditors then have to reconstruct from fragmentary evidence the sales transactions by examining the invoices and frequently, when the invoices are not complete, by contracting the nearby wholesale houses. The total gross sales are then determined necessarily in some instances by estimates and the ratio of taxable and exempt sales is determined by the ratio of purchase invoices which may be available or otherwise ascertained. The result is that the merchant finds to his consternation that he has a sales tax liability, ranging from one thousand dollars to six or seven thousand dollars. He will protest very strenuously that his volume could not have amounted to that much but the evidence shows the contrary. He will also urge that he did not collect any tax at all because the other merchants in the neighborhood do not believe in sales tax and, therefore, do not collect. The truth of the matter is that perhaps he has not collected but a very small portion of tax on any of his sales – taxable or nontaxable – for the reasons that (a) he is not sure what items are taxable and (b) he has no way of recording his taxable and exempt sales. Why it is that a small merchant selling on a gross markup of 20 to 40 per cent can rationalize himself into thinking that he can absorb a sales tax of 3% and stay in business is, indeed, a mystery to me. He is trying to absorb the very cream of his profit.

2. Misclassification

(a) Many an independent merchant maintaining a general store in an industrial community will have his store departmentalized into hardware, clothing and groceries. He knows that all of the hardware and clothing items are taxable but assumes that all of the items in his grocery department are exempt. Thus, when the housewife, with her grocery basket filled with food, soap, matches, mops, paper towels and toilet tissue, passes the cash register for a checkup, all of those items are treated as exempt sales when under the law only the food items are exempt and all the other household necessities are taxable. Many deficiencies have arisen by reason of this situation inasmuch as the thousands of small independent merchants do not have the

modern mechanized checking facilities we find in the large chain supermarkets where the clerk who checks the customer through the checking line is able by classification keys on the cash register to classify each individual sale respecting its taxability.

(b) A supplier of building materials knows that rough and dressed lumber are exempt but in his machine shop he has band and rip saws electrically powered and very frequently his customer will request that dressed lumber be cut to certain sizes. Immediately when that operation has been completed, he has converted dressed lumber into millwork and has rendered it taxable although he treats the sale as being exempt. He will observe from the law that hollow tile is exempt and his interpretation of hollow tile is any clay product that is not solid. The hollow tile exempted by the statute is the hollow building tile used in wall masonry, but, the supplier in interpreting the meaning of the law treats chimney flues, wall coping and drain tile as hollow tile, and when his records are examined, although he has kept accurate records and filed reports and paid tax promptly each month, he finds himself confronted with a sales tax assessment of several thousand dollars involving sales of drain pipe which he thought was exempt.

(c) The exemption of food and food products for human consumption does not include prepared meals or foods sold or served off or on the premises in restaurants and other places where prepared meals are sold or served. Nevertheless, many operators of small refreshment stands or snack bars have considered that the sale of packaged foods, wrapped sandwiches or a carton of milk is not taxable when taken by the customer and not consumed on the premises. Under the law, the sale of any food or food products by any establishment that serves food on the premises is taxable. Numerous assessments have arisen by reason of this confusing provision in the sales tax law resulting in losses to merchants of thousands of dollars of taxes which they cannot recoup from their customers.

(d) Under the law, rock is exempt from sales tax and, therefore, the supplier of polished limestone, granite or marble for building construction is not required to collect the tax thereon; however, there has developed in recent years a similar product known as precast stone or Mosai-stone which resembles limestone, granite or marble in appearance but is a synthetic product and is made of various aggregates in a cast. That material does not come within the exemption of 'rock' since the exemption must be construed strictly in favor of the tax and the molded stone is not included in the exemption with natural rock. The supplier of that type of building material finds himself in the awkward position of trying to compete with the supplier of the natural stone carved and polished to specifications. He must either reduce his price or absorb the tax.

(e) Sand, gravel, crushed stone, rock and granite are all aggregates generally used in making up a mixture of concrete. Those items are all exempt but there can be no cohesion or solidarity without the addition of Portland cement. Generally the supplier of those exempt items also carries in stock Portland cement and mortar mix and it has proven to be confusing in many instances to the invoice clerk why only one of the aggregates in the concrete mixture is taxable and all the others exempt. Actually the Portland cement is composed principally of pulverized limestone and like all the other aggregates is a mineral from the earth.

Brick and hollow tile are made of clay and both are used as masonry products; however, the Portland cement or mortar mix used to bond those products together into a wall or chimney is a taxable item of building material. Cement blocks are Portland cement and water, cinder blocks are made of cinders, Portland cement and water, clinker blocks are made of clinkers, Portland cement and water. In each instance the aggregates are pored into molds, allowed to set and harden and are then used in wall masonry. In each instance the bulk and body of the product is inexpensive while the cohesive ingredient of Portland cement is the expensive ingredient. These items are all exempt from the sales tax, although the most valuable ingredient in each of them, if sold separately in a bag, is taxable. The man who builds a concrete retaining wall must pay the tax on the Portland cement used therein whereas the man who builds a wall made of any of these blocks is required to pay only for the mortar mix used in bonding the blocks together.

The homeowner who builds a house with the outside walls of brick veneer or weatherboard is not required to pay a tax on the materials in his exterior wall, whereas, the homeowner who decides to use asbestos or asphalt siding must pay the 3% retail sales tax on his outside wall.

When we consider the enormous postwar building boom that has taken place in North Carolina since the close of World War II and find scores of large scale housing projects, F.H.A. financed, each of which, in many instances, will amount to 100 or more separate housing units, in the light of the highly confused and nebulous condition of our sales tax law relating to building materials, it is little wonder that many of the reputable suppliers of those materials have been confronted with numerous assessments of large amounts and many contractors have been called upon to pay large sales tax assessments arising either out of negligence or confusion.

3. Use Articles.

As previously stated, it was no doubt the purpose of the Legislature to exempt used articles taken in trade from the retail sales tax on the theory that the new article was wholly taxable. However, common knowledge and observation reveals that the merchant who accepts a refrigerator, electric stove, typewriter, adding machine or suit of furniture, will more than likely refinish and recondition that article, add a markup to it and sell it at a substantial profit. Assuredly, this has been true with the automobile dealer, especially during the early years following World War II, when he preferred a trade rather than an outright sale. There is certainly no reason why a merchant or dealer should handle used articles on the basis of cost. He is entitled to a reasonable profit thereon, but neither is there any reason why such sale when made should not be taxable.

4. Medical Supplies.

The individual who, by reason of illness, is obliged to purchase medicine is deserving of sympathy but his one item means a substantial loss of revenue to the State and adds to the confusion and difficulty of administration. Some of the proprietary drugs and standard U.S.P. remedies, such as aspirin, are just as efficacious in healing pain or curing human ills as drugs sold by prescription only. Yet a patient who purchases his remedy on prescription is not taxed while the other patient must pay the tax thereon.

Likewise, artificial members, organs and aids are exempt whereas under the law dentures and eyeglasses, much more in common usage, are not specifically exempt. Eyeglasses are an artificial aid to vision whereas a hearing aid is an artificial aid to audition. Each of these is an aid to one of the five senses of human nature.

5. Special Exemptions.

Sales of lubricants, repair parts and accessories to fleet owners of five or more vehicles are virtually exempt, whereas, the owner of a fleet of less than five vehicles must pay the full rate of three per cent sales tax. Thus, the bus company, trucking line, large commercial operator is able to buy his lubricants and repair parts almost tax free because he buys in large quantities; whereas, the small merchant, farmer and independent trucker must pay the full measure of the retail sales tax. If the tax policy is determined by benefits derived and the ability to pay, it would appear that there should be no classification of this character.

6. Productive Equipment and Raw Materials.

Much has been said and written by tax scholars and policy makers on the exemption of productive equipment, agricultural and industrial, from retail sales tax on the ground that such equipment produces manufactured products which, when sold, will be taxable. I have heretofore discussed the various classifications of industrial and agricultural productive equipment and raw materials used in manufacturing and agriculture. Perhaps the most prolific sources of sales tax assessments, particularly those assessments of large amounts, are the reclassification of wholesale sales made by jobbers, distributors and suppliers of hardware, plumbing, electrical and heating materials. During the postwar period, when building construction in North Carolina was at an alltime high and scores of large scale housing projects were under construction, most of the contractors bought their materials from suppliers in large quantities. The sale of such materials in large quantities gave the contractor the benefit of the wholesale price. However, many of the wholesale merchants and suppliers determined a wholesale sale by trade standards and not by the Revenue Act. In their minds, a wholesale sale was determined by quantity and price and consequently only the wholesale tax was charged. Under our Revenue Act, Section 405, in order for a wholesale sale to meet the test as such as defined therein, it must have two essential features: First, it must be a registered retail merchant, and, secondly, it must be for the purpose of resale. Neither quantity nor price is a determining factor. The problem was further complicated by the fact that frequently an electrical, plumbing or heating contractor maintained a small retail outlet, most generally for the display of samples, and so these retailer-contractors or so-called 'dual dealers' purchased vast quantities of taxable merchandise for the fulfillment of contracts whereas the wholesale merchant or jobber earnestly insisted that he understood the sale was for the purpose of resale. We have had numerous assessments ranging from 5 to 60 thousand dollars caused by this condition. In an effort to clarify the situation and to cooperate with the wholesaler and dual dealer, we promulgated a regulation, known as Regulation No. 16, which authorizes the use of a resale certificate. When a licensed dual dealer attaches a resale certificate to his purchase order, a wholesale merchant may conclusively treat the sale as a wholesale sale and we will look to the dual dealer for the payment of the tax. An

individual certificate is issued for each purchase order and we are therefore, by that method, able to trace the flow of the merchandise.

ITS POSSIBILITIES

The United States of America is entering upon a rearmament program for national defense and for the protection of a free people that will probably remain in effect for a long period of years. General Hershey estimates that it will last a generation. Certainly it will continue as long as we have a foreign power like the Soviet Union, which for 300 years, from Emperor Ivan to Emperor Joe, has had an aggressive foreign policy, not only by way of military might but now by way of infiltration of the insidious communist doctrines into our social order, industry and national government itself. The traditional freedoms of this nation, as never before, are dependent upon eternal vigilance and formidable and effective military preparation. It is estimated that during the next three years additional expenditures necessary for national defense will amount to approximately 120 billion dollars or an average of 40 billion dollars per year. This enormous defense budget can be raised in only three ways: (1) By printing money (2) By borrowing (3) By taxation. In previous wars during the past century and a half, we have raised the money in part by borrowing and in part by taxation. In the War of 1812 we borrowed 57% and raised 43% by taxation. The Civil War was financed with 77% of borrowed money and 23% of current taxes; 72% of World War I was financed with borrowed money and 28% with tax receipts. In World War II when we experienced taxation on the level few citizens had never experienced before, we paid only 45% through taxes and borrowed 55%. Although we raised more than 150 billion dollars during that war by taxation we necessarily added another 170 billion to the national debt. There is a determined effort on the part of the Federal Government, business, industry and planners of taxation to put our current and future needs for military expenditures on a pay-as-you-go basis. For, indeed, how much further beyond the existing national debt of 248 billion dollars can this nation go and maintain our national credit and prevent the disaster of inflation. These are sobering thoughts for every American citizen and, to be sure, present serious problems to shoe of us who are charged with the duty and responsibility of public finance and taxation.

Last year we embarked upon a program of enforcement of our State income tax law and we installed the most modern mechanized system that has yet been devised by mechanical ingenuity. We visited several States and adopted every feasible suggestion or idea respecting the installation of our system. We believe that we have set a pattern of our efficiency in that Division, at least, our colleagues in other States have looked upon our installation with interest and many of them are now making studies preparatory to similar installations. We increased the number of individual income tax returns last year by approximately 42,000 but the increase in individual income tax revenue remained approximately the same. The total number of income tax returns amounted to approximately 508,000. According to our 1950 census, only one citizen out of eight filed an income tax return. It is indeed hard to believe that the single individuals who had more than \$1,000 in net income combined with married individuals

who had more than \$2,000 of such income did not comprise more than one-eighth of our State's population. We attribute this condition to two reasons: (1) Some of the larger individual incomes reported in 1948 had declined, and (2) the increase in the allowance of dependents of \$100, authorized by the 1949 Legislature, created a loss of approximately \$1,000,000. Our machine collation will discover and ferret out every salaried person or wage earner and we shall perhaps recover a large amount in deficiencies. With the aid of appropriate legislation we shall hope to extend the functions of this system to help us discover the defaulting professional man, business man and farmer, but our income tax administration, how efficient it may ultimately be rendered, cannot produce the amount of revenue needed for the maintenance of our State services and institutions nor can we hope to raise additional revenue by increasing income tax rates or lowering personal exemptions. Article V, Section 3 of our State Constitution provides that the tax on income shall not exceed 10% and we have already reached a rate of 7% on taxable income in excess of \$8,000. Likewise the same provision of our Constitution prescribes minimum exemptions of \$1,000 for a single person and \$2,000 for a married person or the head of a household, which provisions are now a part of our existing law. With the prospect of substantially increased Federal income taxes for individuals and corporations together with an excess profits tax for corporations, it hardly seems feasible for the State to increase its existing rates on individual and corporate incomes although such a course may ultimately become necessary. When we study the history of our State revenue structure and the conditions that led to the imposition of our various taxes in our general fund, we find that from 1921 to 1933 we had only four general fund schedules and from 1933 to 1939 we added six new schedules or an average of one each year. There are very few forms of State taxation in other States which we do not have in North Carolina, the principal ones being property taxes and tobacco taxes. By comparison with other States, our rates on income, franchise and sales might generally be considered to be in the higher brackets. There is no doubt a general feeling of opposition to the levy of any new form of tax in our State.

This Honorable Body has sat patiently during the past ten days and listened attentively to the requests for appropriations presented by the heads of various State Department and institutions and it is apparent that the people of North Carolina do not wish to have a retrenchment in the progress of our State not a curtailment of State services and functions. The school teachers so long delayed in receiving adequate compensation commensurate with their education and training are asking for higher salaries lest they be driven into some other field of endeavor. The completion of our building program of new and enlarged educational and hospital facilities will require funds for maintenance and personnel to equip and man those institutions. The expanding economy of our State will require a greater expenditure of funds for the efficient administration of our various State departments. The needs are great but under our existing tax schedules and provisions of our Revenue Act we cannot, with a realistic view, find the funds necessary for what this Honorable Body may determine to be our minimum budgetary requirements.

Where then shall we turn for the much needed revenue? It is the firm and sincere belief of the writer that the solution to the problem and the answer to the

question may be readily found in a sweeping revision of our sales tax law. First, by the elimination of the statutory limitation of tax on any single article so that the retail rate of tax shall apply without limitation to any article of taxable merchandise of whatever nature, kind or description the same may be. Our sales tax division does not have nor would it be feasible to install a system that would reveal with any reasonable degree of accuracy the amount of revenue that would be gained by such a change in the law because there are so many items other than the ones mentioned which are included in the general volume of sales reported to which the single article limitation has been properly applied. Then there is the inestimable and intangible loss in revenue the State has sustained by reason of confusion in interpretation heretofore commented upon, but, we conservatively estimate that if this provision should be eliminated, the increase in sales tax collections would amount to approximately \$10,000,000 and the current production and sales of motor vehicles, approximately \$7,500,000 would be involved in that class of merchandise alone.

In addition to the elimination of the single article limitation, not only for the sake of fair tax policy respecting various kinds of merchandise but also for a more efficient administration of the sale tax on items now taxable, it is my conviction that all exemptions now in our sales tax law should be eliminated except (a) sales in interstate commerce; sales to Federal, State and local governmental agencies; sales to educational, hospital and charitable institution. (b) Sales of productive equipment actually used by farmers in producing agricultural products and by industry in actual manufacturing or processing manufactured or processed goods. (c) Raw materials becoming an ingredient or component part of agricultural or industrial production.

With only those exemptions in our sales tax law, we would have a sales tax levy of 3% on every item of every kind, nature and description that might be bought or sold at retail by any registered merchant. Such a levy would require everyone who sells anything at retail, whether he be a wholesale merchant, retail merchant, peddler, order taker, farmer, magazine salesman, house-to-house canvasser or any other method whereby any article of tangible personal property irrespective of the nature, character, design, or material, would be required to register and file a monthly report. We do not consider it feasible to try to break down into an analytical study all of the various items in our several commodity groups because there are so many items that are not now taxed and in many instances registered retail merchants fail to report their gross volume of sales. In some commodities we could make an estimate with some degree of accuracy but for the most part a breakdown disclosing the estimated gain in revenue from the hundreds of different commodities sold at retail, the result would be pure guess work. We do have, however, a reasonable certain measurement of the estimated increase in revenue by the proposed elimination of exemptions set out above. In each of the 63,100 reports received in our Sales Tax Division there is a space on which the registered merchant is required to set out his gross sales. Immediately under that line is a space for exempt sales. The difference is the volume of taxable sales on which the tax is computed and paid. For the fiscal year ended June 30, 1950 we determined that the gross volume of sales reported to us by the 63,100 merchants in North Carolina amounted to \$2,268,713,439. The tax at 3% on this volume of sales would amount to

\$68,061,403.17 or a gross difference of approximately 26 million dollars above the approximate 42 million dollars which we collected.

Included in that volume was farm machinery, feeds, seed and fertilizer. It is estimated that the volume of sales involved in the farm machinery (to which the \$15.00 tax applied in most instances) amounted to 1½ million dollars. The amount involved in seeds, feeds, fertilizers and insecticides cannot be accurately estimated since those commodities are sold by a great variety of merchants many of whom are not required to report but a liberal portion of that included in the total sales tax revenue would probably not exceed \$1,000,000. To place the tax involved in productive equipment and raw materials for agriculture at \$2,500,000 would still leave an estimated increase of \$23,500,000 by eliminating all other exemptions.

With respect to Section 406 (m) of the Revenue Act which levies a wholesale tax on mill machinery, mill machinery parts and accessories, it is virtually impossible to arrive at any reasonable estimate on the potential gain in revenue that would be experienced if such productive equipment were taxed at the retail rate. The reason is obvious. Most of the textile machinery is manufactured in other States and shipped into North Carolina. This is also true, with some exceptions, respecting wood-working machinery used by furniture plants and the various types of machinery used by the tobacco industry. We recognize of course that some suppliers of industrial machinery have sales offices or manufacturing plants in North Carolina. No doubt some items, such as electric motors, belting, tanks and air conditioning systems and the like are manufactured and sold in North Carolina but the more expensive machinery purchased by industry outside the State makes a reasonable estimate virtually impossible. However, we estimate that perhaps not more than \$1,200,000 in potential taxes on industrial machinery is included in the total volume of gross sales. Raw materials, such as, cotton, tobacco, peanuts and other farm products are not now reported to us and need not be taken into account in arriving at the estimated increase in revenue.

Quite apart from our existing sales tax laws (except the tax on rental of tangible personal property) and as an adjunct and addition thereto, I advocate the imposition of a retail sales or service tax on all forms of amusement and entertainment, on lodging accommodations provided by hotels, inns, tourist homes and tourist camps which are now required to procure a hotel license under Schedule 'B'; a tax on all automotive service and repairs; a tax on all services and repairs to tangible personal property, such as shoes, clothing, appliances and household furnishings; a tax on all repair services to plumbing, electrical, heating and air conditioning equipment; a tax on the entire invoice of the undertaker. We now have a tax on the materials used in furnishing those services. All those service and repair organizations collect a tax on materials but not on labor. The tax should be extended so that the 3% retail rate shall apply to the entire invoice. This is an extension of our existing sales tax levy that we have not heretofore had in North Carolina, but which has proven successful in other States. There again we have no accurate means of determining the amount of revenue that would be derived, but, in order to give some idea of the vast scope and extent of this new levy, I wish to

point out that according to our records in the License Tax Division for the current fiscal year, Schedule 'B' licenses have been issued to the following business enterprises:

| | |
|--|--------|
| Hotels | 488 |
| Automatic Machines (Cash Registers, Adding Machines, Typewriters, Refrigerating Machines, Washing Machines) | 3,172 |
| Plumbing | 1,085 |
| Heating | 365 |
| Electricians | 700 |
| Service Stations and Garages | 19,545 |
| Undertakers | 505 |

Under this proposal each of these businesses would be required to register for sales tax, if it is not now so registered, and would be required to collect a tax of 3% on all services as well as materials. While we recognize that only a rough approximation may be given, we might suggest as a guide to planning that if we were able to obtain an additional net registration of 15 thousand merchants from this source and applied the average amount of tax paid last year by the existing number of our registered merchants, it is estimated that the increase in revenue from this source alone would amount to approximately \$10,000,000.

There you have it gentlemen. Possible additional revenue from our sales tax schedule: (1) By elimination of the single article limitation of tax \$10,000,000. (2) By elimination of all exemptions except the three classes set out above \$22,200,000. (3) By taxing services as well as sales \$10,000,000. This amounts to a total of \$42,200,000 or about double our present revenue from this source. Each of the existing exemptions has a compelling reason for its place in the law. There is no doubt that those seeking further exemptions could present clear, cogent, convincing and compelling reasons why other items or transactions should not be added to the list. The imposition of taxes by the State and payment thereof by its citizens is not a pleasant function of duty. It is scarcely ever convenient for a citizen to make payment of his taxes, and the tax dollar is rarely paid without some hardship or deprivation sustained by the taxpayer. But that is not the test. Taxation is based upon the power of the sovereign to exact contributions for its support from its citizens. Personal hardship or inconvenience must yield so long as the levy is equally applied without discrimination. By removing all exemptions and limitations from the sales tax levy and making it applicable to everyone alike, no one can be heard to complain. This function of government is everybody's business. The support of government is every citizen's

responsibility. Rarely is there any serious complaint about taxes so long as the levy is equally imposed and equally enforced. The sales tax, properly enforced, is the only inescapable levy to which every citizen, rich and poor, must conform. And it is fair because it is measured by the purchasing power of the individual. I am not a crusader for additional taxes or higher rates, but I sincerely believe that the State's eminent need for substantially larger revenue can be effectually met by a sweeping revision in our sales tax law. I further believe that such change will not be seriously felt by any citizen. I know that it will enable us to better achieve our major objective: Equality of enforcement is not only a solid foundation for a successful tax administration but also provides a suitable cornerstone for a wise tax policy.

NORTH CAROLINA DEPARTMENT OF REVENUE
SCHEDULES E AND I – SALES AND USE TAX COLLECTION
FISCAL YEARS 1949-50

| | <u>1940-41</u> | <u>1941-42</u> | <u>1942-43</u> | <u>1943-44</u> | <u>1944-45</u> | <u>1945-46</u> | <u>1946-47</u> | <u>1947-48</u> | <u>1948-49</u> | <u>1949-50</u> | <u>Group % of Total</u> |
|-------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------------------|
| 1. Apparel | \$1,119,775 | \$1,407,665 | \$1,928,329 | \$2,141,814 | \$2,479,588 | \$3,037,559 | \$3,622,506 | \$3,723,361 | \$3,827,663 | \$3,651,806 | 8.72% |
| 2. Automotive | 2,237,089 | 1,994,950 | 1,398,596 | 1,775,014 | 2,108,511 | 3,021,322 | 4,780,388 | 5,825,170 | 6,009,080 | 6,650,438 | 15.90% |
| 3. Food | 2,503,061 | 2,092,981 | 2,602,907 | 3,074,464 | 3,150,712 | 3,577,145 | 4,370,012 | 4,807,061 | 4,869,356 | 5,337,223 | 12.75% |
| 4. Furniture | 957,425 | 1,296,579 | 1,346,514 | 1,217,801 | 1,373,186 | 1,850,771 | 2,985,609 | 3,626,117 | 3,777,146 | 3,877,497 | 9.26% |
| 5. General Merchandise | 4,762,855 | 6,039,864 | 7,631,676 | 8,377,416 | 9,317,419 | 10,668,050 | 13,326,864 | 13,372,891 | 13,893,958 | 13,760,268 | 32.8% |
| 6. Lumber & Bldg. Material | 701,017 | 768,474 | 388,449 | 493,800 | 654,146 | 1,117,203 | 1,954,160 | 2,672,153 | 2,878,427 | 3,003,064 | 7.17% |
| 7. Unclassified | <u>1,050,787</u> | <u>1,088,860</u> | <u>1,406,725</u> | <u>1,697,742</u> | <u>1,859,927</u> | <u>2,317,781</u> | <u>2,919,222</u> | <u>3,262,701</u> | <u>3,213,510</u> | <u>3,232,844</u> | <u>7.70%</u> |
| Total Retail | \$13,332,009 | \$14,689,373 | \$16,703,196 | \$18,778,051 | \$20,943,489 | \$25,589,831 | \$33,958,761 | \$37,289,454 | \$38,469,140 | \$39,513,140 | 94.37% |
| 8. Wholesale | \$194,640 | \$230,681 | \$225,064 | \$229,581 | \$257,157 | \$313,413 | \$412,258 | \$588,175 | \$645,094 | \$747,921 | 1.78% |
| 9. Use Tax | <u>\$730,292</u> | <u>\$755,677</u> | <u>\$627,074</u> | <u>\$667,306</u> | <u>\$640,856</u> | <u>\$695,617</u> | <u>\$1,137,025</u> | <u>\$1,539,146</u> | <u>\$1,561,383</u> | <u>\$1,608,813</u> | <u>3.85%</u> |
| Grand Total | <u>\$14,256,941</u> | <u>\$15,675,731</u> | <u>\$17,555,334</u> | <u>\$19,674,938</u> | <u>\$21,841,502</u> | <u>\$26,598,861</u> | <u>\$35,508,044</u> | <u>\$39,416,775</u> | <u>\$40,675,617</u> | <u>\$41,869,874</u> | <u>100%</u> |
| 10. | | <u>10%</u> | <u>12%</u> | <u>12%</u> | <u>11%</u> | <u>22%</u> | <u>33%</u> | <u>11%</u> | <u>3%</u> | <u>3%</u> | |

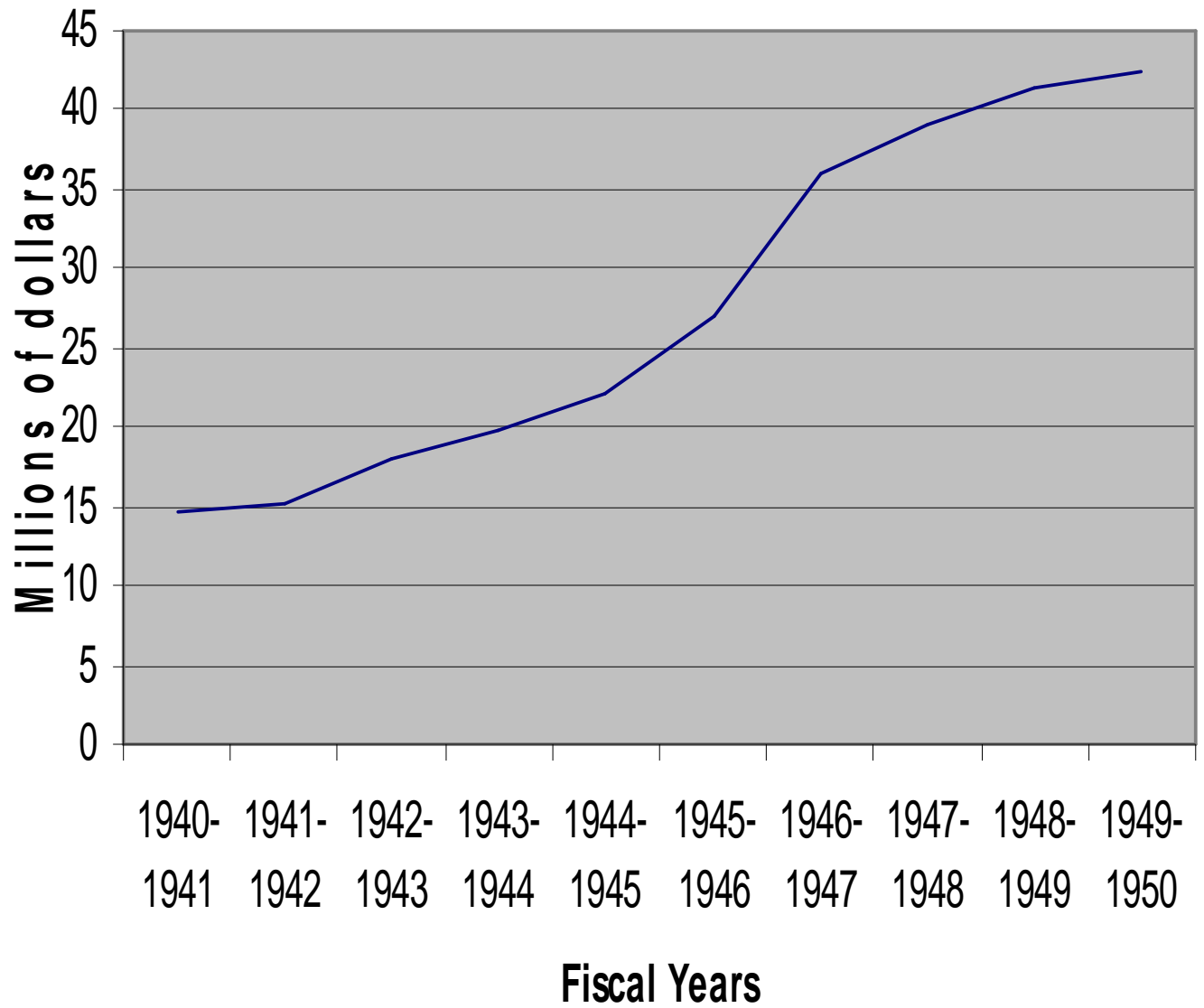
1. Boots & Shoes, Clothing, Furriers, Haberdasheries, Millinery, Shoe Repair Shops, Etc.
2. Automobiles & Trucks, Filling & Service Stations, Garages, Motorcycles, Parts, Accessories, Batteries, Tires, Etc.
3. Bakeries & Dairy Products, Candy & Confectionery, Fruit & Vegetable Markets, Lunch rooms, Restaurants, Cafes, Grocery Stores, Etc.
4. Furniture Stores, Household Appliances, Musical Instruments, Music, Phonographs, Radios, Etc.
5. Department, Drug & Dry Goods Stores, Farm Implements, Hardware Stores, Jewelry Stores, Leather Goods, Machinery & Road Building Supplies, Sporting Goods Stores, Etc.
6. Building & Construction Hardware & Machine Stores, Electrical & Plumbing Supply Dealers, Etc.
7. Beauty & Barber Shops, Book, Stationery, School Supplies stores, Cigar Stores & News Stands, Coal, Wood, Fuel, Feed Stores, Florists, Monuments, Mule, Horse & Cattle Dealers, Etc.
8. Automobiles & Trucks, Auto Parts, Batteries, Tires, Etc, Beer, Building Materials, Clothing, Drugs, Dry Goods, Electrical Supplies, Furniture, General Merchandise, Groceries & Food, Hardware, Farm Implements, Machinery and Mill Supplies, Petroleum Products, Tobacco, Candies, Etc.
9. Use Tax
10. Percentage Increase over the previous year

| State | Collections 1949-1950 | Rate | Per Capita Income | Population | Registered Merchants | Revenue Producer | Exemptions |
|-------------|--------------------------|-----------------------------------|----------------------|------------|-------------------------|---------------------|---|
| Alabama | \$32,703,320 | 2% | \$773 | 3,050,000 | 50,000 | 1 | Lubricating oil, gasoline, textbooks, livestock, planting seed, fertilizer, farm & dairy products, agricultural containers, newspapers, coal & coke to manufactures, transportation, machinery used in mines or manufacturing. |
| Arizona | \$16,147,407 | 2% | 1,165 | 745,000 | 24,835 | 1 | Contractor labor, Federal Government. |
| Arkansas | \$23,203,890 | 2% | \$778 | 1,900,246 | 35,246 | 1 | Cigarettes, gasoline, newspapers, public school cafeterias, hospital or charitable institutions, isolated sales, farm produce when sold by producers. |
| California | \$326,285,000 | 3% | \$1,665 | 10,472,348 | 263,000 | 1 | Sales to utilities, motor vehicle fuel, food for off premises consumption, animals & feed, seeds, fertilizer & plants, certain containers, certain aircraft. |
| Colorado | \$24,538,263 | 2% | \$1,386 | 1,314,388 | 27,806 | 1 | Sales for resale, sales to manufacturers, sales of labels, cases, etc., sales of fuel in manufacturing, sales of feed, seed, goats, lambs, etc., Sales to U.S. Government, sales to religious or charitable institutions. |
| Connecticut | \$27,489,000 | 2% | \$1,591 | 2,000,000 | 57,000 | | Food, children's clothing, gasoline, cigarettes, newspapers, trade in value of automobiles, production materials, charitable or Government organizations, services, rentals, admissions. |
| Florida | \$23,569,000 | 3% | \$1,102 | 1,897,414 | 90,000 | 2 | Food for home consumption, clothing up to \$10.00, petroleum products, motor vehicles, cigarettes, alcoholic beverages, medicines, electric power, communication services, natural or artificial gases, nets, fertilizer, field or garden seeds, newspapers, school books & lunches, machinery for farming, soap, powders, detergents, churches, educational or charitable organizations. |
| Illinois | \$167,947,110 | 2% of 98% gross receipts | \$1,618 | 8,696,490 | 141,000 | 1 | Construction contractors, articles produced as per specifications, including machinery, clothes, cabinets, etc., newspapers, graphic arts, rentals, leases. |
| Iowa | \$46,920,350 | 2% | \$1,292 | 2,612,598 | 82,000 | 1 | Constitutional exemptions-transportation, tangible personal property used in public works, sales to State, County and Local Government, Federal Government, non-profit organizations. |
| Kansas | \$37,450,000 | 2% | \$1,210 | 1,912,445 | 49,447 | | Educational & charitable organizations. |

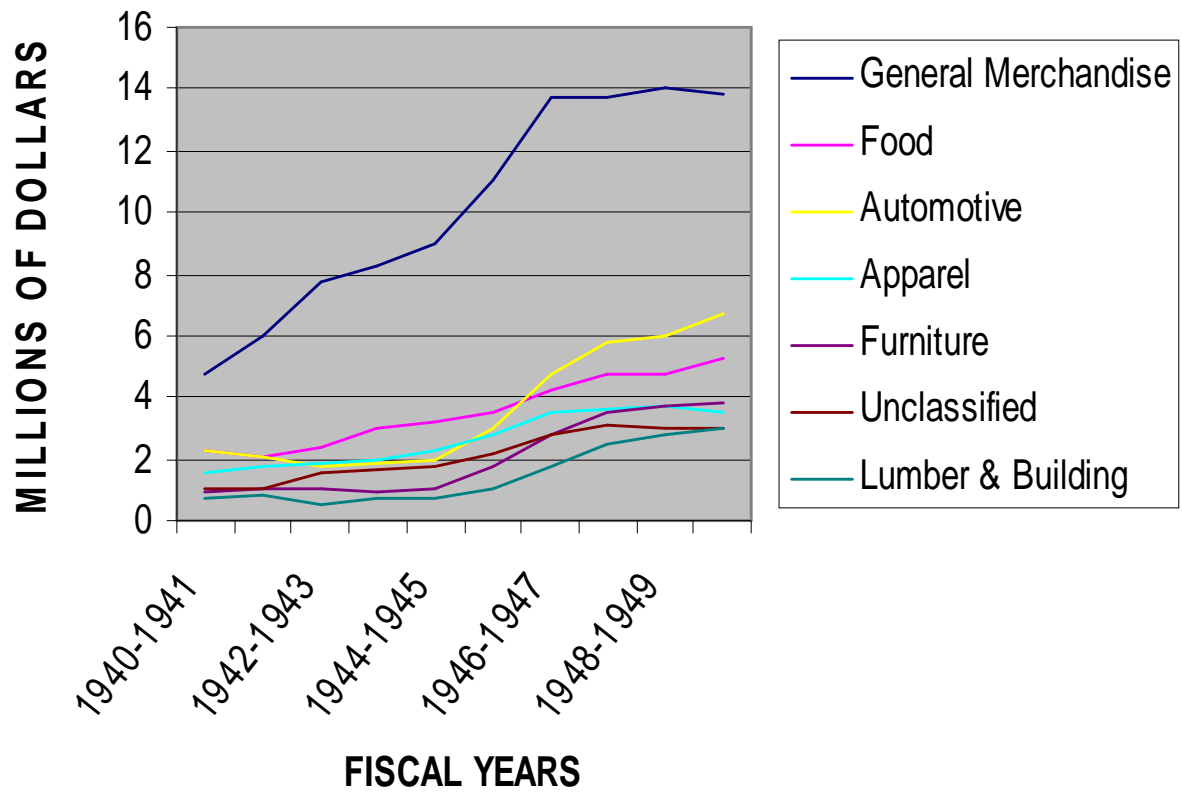
| State | Collections 1949-1950 | Rate | Per Capita Income | Population | Registered Merchants | Revenue Producer | Exemptions |
|----------------|--------------------------|------|----------------------|------------|-------------------------|-----------------------|---|
| Louisiana | \$45,002,152 | 2% | \$1,002 | 2,699,040 | 60,000 | 21% of total yield | Gasoline, natural gas, electricity, fertilizer, containers. |
| Maryland | \$28,402,000 | 2% | \$1,401 | 1,200,000 | 45,000 | | Sales up to 14¢, casual sales, food for home consumption, new and used cars (title tax), sales for agricultural purposes (feeds, seeds, etc.), hospitals, schools, etc., personal service transactions (rentals, insurance, etc.) sales for resale, raw materials for manufacturing, orthopedic appliances, transportation services, advertising space in newspapers & magazines, water (except bottled water). |
| Mississippi | \$25,048,150 | 2% | \$634 | 2,173,000 | 33,000 | 1 | Sales for resale, materials to contractors, property involving interstate shipments, agricultural cooperatives, REA, public schools, cotton, school books, fertilizer, insecticides, seeds, livestock, coffins. |
| Michigan | \$199,467,243 | 3% | \$1,443 | 5,256,106 | 116,055 | 1 | Sales to U.S.A. or any of its agencies or instrumentalities. |
| Missouri | \$71,743,884 | 2% | \$1,286 | 3,784,664 | | 1 | Sales for resale, interstate, motor fuel, sales to Federal Government, State, County & cities, State relief agencies, religious & charitable organization, feed and grain, fuel for manufacturing, seed, limestone or fertilizer, goods returned. |
| New Mexico | \$16,137,998 | 2% | \$1,033 | 672,982 | 27,000 | 1 | Federal & State Government, Non-profit organizations, agricultural implements, stock feed, livestock, newspapers, magazines. |
| North Carolina | \$41,869,874 | 3% | \$854 | 4,015,000 | 63,092 | 2 | Sales by manufacturers, gasoline, fuels to farmers, fertilizer, semen, Sales to State or local governments, sales prohibited from taxation under the Constitution, worthless accounts, school books, and Holy Bibles, used articles taken in trade, food, ice, medicines, horses or mules, coffins selling for less than \$100, cotton, tobacco and peanuts, sales to charitable & non-profit institutions. Orthopedic appliances, seed, feeds and insecticides, fleet owners, products of farms, mill machinery. |
| North Dakota | \$11,404,147 | 2% | \$1,202 | 625,000 | 17,550 | 1 | Federal Government, State, County & City, certain relief & religious organizations. |
| Oklahoma | \$33,450,000 | 2% | \$1,068 | 2,230,253 | 40,000 | 2 | Gasoline, cigarettes, tobacco products, beer, manufacturing machinery. |

| State | Collections 1949-1950 | Rate | Per Capita Income | Population | Registered Merchants | Revenue Producer | Exemptions |
|---------------|--------------------------|------|----------------------|------------|-------------------------|---------------------|---|
| Ohio | \$137,720,000 | 3% | \$1,436 | 7,901,791 | 237,433 | 1 | None |
| Rhode Island | \$5,799,000 | 3% | \$1,403 | 755,000 | 19,000 | 13% of revenue | Meals served by schools, containers, education & charitable organizations, cigarettes, gasoline, electricity, State & political subdivisions. |
| South Dakota | \$19,487,324 | 3% | \$1,174 | 650,025 | 17,000 | 1 | Governmental agencies, interstate sales, services, motor fuel (subject to other taxation). |
| Tennessee | \$42,505,420 | 2% | \$873 | 3,282,730 | 56,197 | | Gasoline, tobacco products, alcoholic beverages, water, electricity, newspapers, fertilizer, farm produce containers, field & garden seeds, school books, school lunches, religious & non-profit organizations. |
| Utah | \$14,014,232 | 2% | \$1,213 | 686,839 | 13,500 | 1 | Governmental agencies, non-profit religious & charitable institutions, sales by public utilities. |
| Washington | \$81,400,000 | 3% | \$1,469 | 2,361,261 | 92,000 | 42% of revenue | Casual sales, newspapers, Federal Government, motor vehicle fuel, Red Cross, livestock. |
| West Virginia | \$21,485,559 | 2% | \$998 | 1,998,470 | 32,794 | 2 | Motor vehicles, gasoline, utilities, school books, State & Federal Government, Sales for resale, certain services. |
| Wyoming | \$6,976,893 | 2% | \$1,481 | 288,000 | 8,521 | 1 | Sales for Resale, Federal Government, State & political subdivisions, religious charitable organizations, ingredient parts for manufacturing, fuel for manufacturing, feeds, seeds, bulbs & fertilizer. |

V. SCHEDULES E AND I SALES AND USE TAXES
TOTAL NET COLLECTIONS FOR FISCAL YEARS SINCE 1940-1941



V. SCHEDULE E - SALES TAXES
GROSS COLLECTIONS BY BUSINESS GROUPS FOR
FISCAL YEARS SINCE 1940-1941



V. SCHEDULES E AND I - SALES AND USE TAXES
GROSS COLLECTIONS FROM THE USE TAX AND THE WHOLESALE
SALES TAX FOR FISCAL YEARS SINCE 1940-1941

