

# The New Sumptuary Laws: How Massachusetts Consumption Taxes Keep the Poor Poor

by Cornelius J. Chapman, Jr.



---

*First in a series of white papers on Massachusetts Tax Policy*

*The New Sumptuary Laws: How Massachusetts Consumption Taxes Keep the Poor, Poor* is the first in a series of studies on Massachusetts Tax Policy. The second paper of the series will model the economic effects of reducing or repealing the state sales tax. The third paper of the series will outline an alternative to the current tax system -- one that promises more neutrality and less regressivity.

# Table of Contents

<b>Preface.....</b>	<b>3</b>
<b>Executive Summary.....</b>	<b>4</b>
<b>Introduction.....</b>	<b>7</b>
<b>The New Sumptuary Laws.....</b>	<b>9</b>
<b>General Consumption Taxes.....</b>	<b>10</b>
<b>The Sales Tax.....</b>	<b>11</b>
<b>Transportation.....</b>	<b>14</b>
<b>Withholding Taxes.....</b>	<b>16</b>
<b>A Few Modest Proposals.....</b>	<b>19</b>
<b>Reduction or Elimination of the Sales Tax.....</b>	<b>19</b>
<b>Transportation Levies.....</b>	<b>22</b>
<b>Withholding.....</b>	<b>23</b>
<b>Consumption Taxes Versus Income Taxes.....</b>	<b>25</b>
<b>Taxation of Sales Over the Internet.....</b>	<b>28</b>
<b>Conclusion.....</b>	<b>30</b>

## **About the Author**

Cornelius Chapman is a lawyer in Boston. He wishes to thank Lisa Blout and Robert Boulrice for their comments on an earlier version of this article, and Economist Tija A. Kurian of the Beacon Hill Institute for her extensive contributions to the current version. The conclusions expressed herein and any errors, substantive or otherwise, are solely those of the author.

# **The New Sumptuary Laws: How Massachusetts Consumption Taxes Keep the Poor Poor**

by Cornelius J. Chapman, Jr.

## **Preface**

Among the tenets of economics is the twofold principle that taxes should be economically neutral and fair. Taxes should be neutral in the sense that they do not interfere with taxpayer choices. They should not discriminate against work in favor of leisure, against saving in favor of consumption or against, say, consuming one packet of doughnuts in favor of another. Taxes should likewise be fair in the sense that they fall equally on all taxpayers. In particular, they should not discriminate against the poor in favor of the rich.

The paper that follows is the first of a three-part series of Beacon Hill Institute (BHI) papers on Massachusetts tax policy. The following paper by Cornelius Chapman identifies features of Massachusetts sales and excise taxes – broadly termed “consumption” taxes because of their nexus to purchases, rather than income – that discriminate against the poor. Mr. Chapman offers reasons why those taxes warrant either repeal or an overhaul and suggests reforms that would benefit, in particular, the poor.

The second part of the BHI series will provide estimates of the economic effects of reducing or repealing the state sales tax and of replacing the tax revenue thus sacrificed, in part, with revenue from other sources. BHI will use its Massachusetts State Tax Analysis Modeling Program (STAMP<sup>®</sup>) to provide this analysis. STAMP has been applied to several states in the past to trace the economic effects of tax and policy changes.<sup>1</sup>

Finally, BHI will publish a white paper in which it will offer a proposal for overall tax reform in Massachusetts. This third publication will show how the state can move toward a tax system that is both more neutral and less regressive than the tax system currently in place.

The institute is most pleased to be able to begin this series with Mr. Chapman’s contribution. Therein lies a series of recommendations for improving the lot of the Massachusetts poor without increased government expenditures or higher taxes – recommendations that should be most welcome in light of the current budget crisis.

David G. Tuerck  
Executive Director

*State sales and excise taxes are akin to the sumptuary laws of colonial Massachusetts, which strove to deny “immodest gaynes” to the working classes.*

## Executive Summary

Every few years, the Commonwealth of Massachusetts finds itself in the grip of a budget “crisis” that threatens the well being of its neediest citizens. The state is going through just such a crisis today.

As in the past, the debate over the fiscal crisis centers on a lose-lose proposition: The state can either cut spending and thus worsen the lot of its low-income residents, or it can raise taxes and thus threaten its economic competitiveness. What this dialogue overlooks is the possibility that the state could reduce – or at least reform – certain taxes and, in doing so, improve the lot of the poor. Most astonishingly, the debate ignores features of state tax policy that discriminate against the poor in good times and bad, and which are based on an antiquated view of the daily lives of taxpayers, and encumbered by an economically and morally indefensible hodgepodge of exemptions and administrative practices.

The tax policies at issue are state consumption taxes and the withholding feature of the state income tax. Though seldom examined, these features of state tax policy have the effect of limiting the upward mobility of low-income workers. State sales and excise taxes are akin to the sumptuary laws of colonial Massachusetts, which strove to deny “immodest gaynes” to the working classes.

Table A:

Incidence of Sales Tax by Income Group 2000-2001	
Household Income	Fraction of Pre-tax Income Paid in Sales Taxes
Less than \$30,000	2.22%
\$30,000 - \$49,999	1.33%
\$50,000 - \$69,999	1.14%
\$70,000 and more	0.82%

Source: Estimations based on the Consumer Expenditure Database, Northeast Region, United States Bureau of Labor Statistics, 2000-2001

## *How Consumption Taxes Hurt Low-Income Households*

The state’s most important consumption tax is the 5 percent sales tax. The state sales tax falls unevenly on consumption. It is imposed on restaurant meals, used car purchases and most clothing purchases but not on medicine and most groceries, as well as many luxury items. Other consumption taxes include the 2.5 percent excise tax on automobiles and the 21¢/gallon tax on gasoline. The harmful consequences for the poor of these taxes manifest themselves in their regressivity and in the way they discriminate against working mothers and low-income commuters.

### *Regressivity*

The sales tax falls most heavily on the poor. Table A shows how the fraction of pretax income paid in state sales taxes falls as household pretax income rises. This aspect of the sales tax makes it more difficult for low-income households to enjoy amenities commonly available to their high-income counterparts. It furthermore makes it more difficult to save for housing, opening a business or retirement.

### *Discrimination Against Working Women*

The “meals tax” portion of the sales tax falls most heavily on working women. The fraction of families with wives in the work rose from 37 percent in 1967 to 62 percent in 2001.<sup>2</sup> The percentage of women in the workforce is expected to reach nearly 64 percent by the year 2005.<sup>3</sup> Of all working women, 28 percent have irregular schedules or work evening or weekend hours. A much higher percentage of working women who earn less than \$25,000 per year – 42 percent – work such hours, which may cause them to be absent from the home during meal times and force them to rely on commercially-prepared meals. Married couples with only one person in the work force can enjoy the luxury of buying and preparing tax-exempt groceries. Working women often cannot.



## ***Discrimination Against Inner City Workers***

The sales tax and automobile excise tax discriminate against workers from the inner city. Jobs are shifting from downtown to the suburbs. This eases the commuting problem for workers who live in the suburbs but exacerbates it for workers who live in the inner city. The cost of housing in the suburbs and the paucity of public transportation from the inner city to the suburbs make it difficult for workers from the inner city to find jobs in suburbs, where, increasingly, the jobs are. These workers must own a car if they are going to find those jobs.

Massachusetts consumption taxes present an obstacle to car ownership. Anyone buying a car, new or used, pays a 5 percent sales tax. In addition, the car owner pays a 2.5 percent excise tax, which falls, not on the actual price paid for the car, but on a fraction of the often-higher manufacturer's list price. No matter how old the car and how many times it has been sold and then resold, the owner pays an excise tax on no less than 10 percent of the list price. Finally, the driver has to pay the 21¢ per gallon gasoline excise tax. These taxes can prove daunting to the low-income worker seeking to follow a job out of town to the suburbs.

## ***How Income Tax Withholding Hurts Low-Income Workers***

The withholding feature of the state income tax burdens low-income workers who have little or no tax liability. All Massachusetts employees are subject to income tax withholding at both the federal and the state level. In effect, the government forces each worker to make an interest-free loan from each paycheck. Workers who get a refund may wait a year or even longer to get back money thus overpaid in taxes.

Hourly wages are subject to withholding on each paycheck, issued on a weekly, biweekly or monthly basis. The worker gets no use from the withheld taxes until he or she gets a refund, while white-collar professionals whose income is derived from distributions by partnerships or corporations can defer estimated tax payments on their business income for up to three months, giving them the use of their money up until the time the estimated taxes are paid. This puts low-income taxpayers at a disadvantage relative to high-income taxpayers.

## ***Recommendations***

The state could redress the above-noted inequities by reducing or reforming state consumption taxes and the withholding feature of the state income tax. And it could do so without increasing the overall fiscal burden on the Commonwealth's taxpayers. The following changes are indicated:

Reduce or eliminate the sales tax. The state collected \$3.7 billion in FY 2002 from the general sales and use tax, which amounted to 25.8 percent of total state tax revenues.<sup>4</sup> Owing to the regressivity of the sales tax, reducing or eliminating the sales tax would be more beneficial to low-income than to high-income taxpayers. Massachusetts consumers would spend more and would shift their spending from New Hampshire, which currently has no sales tax, to Massachusetts, thus attenuating the loss in revenue to the state.

- Reduce the sales tax rate while broadening the base to make it more neutral with respect to different consumer goods and services. The state could help working women by cutting the rate on restaurant meals and take-out foods, even while it broadens the base to include groceries. It could help low-income workers get to their jobs by cutting the

*In effect, the government forces each worker to make an interest-free loan from each paycheck.*



*The inequities associated with state consumption taxes and income-tax withholding rules argue for reform of a kind that would help the poor, not by raising taxes, but, rather, by cutting taxes and reforming tax law.*

rate on currently-tax items, including car tires, while broadening the base to include cable TV and rare coins, for example.

- Base the automobile excise tax on the actual price paid rather than on the manufacturer's list price, and eliminate the sales tax on purchases of used cars. Both measures would make automobile transportation – and the jobs that increasingly require such transportation – more accessible to the working poor.
- Soften the burden of income tax withholding by creating Individual Withholding Accounts (IWAs). Employers would place withheld funds in an interest-paying account, from which the Commonwealth would draw tax payments on a quarterly basis. Once the worker's IWA had been debited for its quarterly payment, the worker would get back the unused funds and interest. This would eliminate a feature of current tax law that favors unearned over earned income, and high-income professionals over hourly-wage earners.

### **Conclusion**

In the furor over the current budget crisis, there has been scant attention paid to the way in which certain elements of the existing state tax system harm low-income residents. The inequities associated with state consumption taxes and income-tax withholding rules argue for reform of a kind that would help the poor, not by raising taxes, but, rather, by cutting taxes and reforming tax law. Therein lies the path to a win-win resolution of the fiscal crisis.



## Introduction

When Massachusetts residents think of taxes, they tend to think first of April 15th, the date when their most significant tax obligations – federal and state income taxes – come due. But for the first one hundred and thirty-seven years of the American republic there were no federal taxes on income,<sup>5</sup> and Massachusetts did not have a state income tax until three years later.<sup>6</sup> Instead, the principal sources of tax revenues prior to the passage of state and federal income tax laws in the early years of the twentieth century were state and federal levies on consumption, rather than income.

Consumption taxes are calculated on the value of the goods (and in rare cases, services) that an individual purchases, rather than his or her income. Such taxes do not currently generate a significant part of federal tax receipts, but they are widely used as a source of revenue by state and local governments; as of January, 2003, 47 states imposed a sales tax, and in 2001, sales and gross receipts taxes accounted for 46 percent of total state tax revenues.<sup>7</sup> Consumption taxes thus play an important role in state government finances. To the surprise of many in the state, an initiative petition to eliminate the Massachusetts income tax narrowly failed to pass in November of 2002, causing politicians, public policy groups and pundits to take a fresh look at the state's overall scheme of taxation.<sup>8</sup>

The question raised by the paper that follows is whether the state's various consumption taxes are a more appropriate candidate for repeal on economic and public policy grounds than the income tax. In an attempt to answer this question, this paper will examine three types of burdens that the Commonwealth of Massachusetts imposes on its citizens' current ability to buy goods and services they need or merely desire, and

to save for the future. Two take the form of direct charges payable by consumers; first, the general sales tax, and second, the various taxes and charges that increase the cost of transportation by car, and thus make travel to places of high-wage employment more expensive for low-income workers. Finally, this paper will examine income tax withholding rules that deprive citizens of current income without compensation for the time value of their money.

A tax on consumption "may take the form of a spending tax on the consumer or a tax on the sale of consumer goods imposed on the firm" that sells the goods.<sup>9</sup> There are several varieties of consumption taxes, the most familiar to Americans being state and local retail sales taxes. Retail sales taxes represent the taxing strategy that is most closely linked to consumption, since under this system people are literally taxed on their consumption by the addition of a charge to the retail purchase price of consumer goods, in most cases computed as a flat percentage of the price of the goods. The seller is usually responsible for the collection of this type of consumption tax.

Another form of consumption tax that is widely used in European countries but not in American jurisdictions is the "value added tax" (VAT). A VAT is collected from all firms, rather than only retailers, and is included in the price charged at each stage of the manufacturing process, rather than at the point of retail sale. The United States is now the only major country in the world without a VAT, and U.S. consumption taxes are a smaller share of government tax revenues here than in other developed countries as a result.

In colonial times, consumption taxes were favored by proponents of limited government on the grounds that they permitted taxpayers

*The question raised by the paper that follows is whether the state's various consumption taxes are a more appropriate candidate for repeal on economic and public policy grounds than the income tax.*



*The consensus among economic professionals as to the regressive nature of consumption taxes is reason enough to prompt a reconsideration of their role in raising the money Massachusetts spends every day.*

to restrict the size of the state by regulating their own levels of consumption. As Alexander Hamilton put it,

It is a signal advantage of taxes on articles of consumption that they contain in their own nature a security against excess. They prescribe their own limit; which cannot be exceeded without defeating the end proposed, that is, an extension of the revenue. When applied to this object, the saying is as just as it is witty, that ‘in political arithmetic, two and two do not always make four.’ If duties are too high they lessen the consumption; the collection is eluded; and the product to the treasury is not so great as when they are confined within proper and moderate bounds. This forms a complete barrier against any material oppression of the citizens by taxes of this class, and is itself a natural limitation of the power of imposing them. [...] <sup>10</sup>

a tax refers to the taxpayers who actually pay the tax, that is, whose disposable income is changed – and by how much – in response to a change in the tax. Several academic studies have found that the incidence of consumption taxes falls disproportionately on low-income taxpayers.<sup>11</sup> The consensus among economic professionals as to the regressive nature of consumption taxes is reason enough to prompt a reconsideration of their role in raising the money the Commonwealth spends every day.<sup>12</sup>

Under a more modern economic analysis, however, consumption taxes have been widely criticized as “regressive.” A tax is said to be regressive if the average tax rate decreases as the taxpayer’s income increases. The average tax rate is the ratio between an individual’s tax liability (total taxes) and his or her taxable income; thus, a regressive tax will result in lower-income taxpayers paying a higher percentage of their income in taxes than upper-income groups. Inasmuch as low-income families spend a greater part of their income (or borrow or use savings) to pay for current consumption than wealthier ones, consumption-based taxes are thus subject to the objection that they unfairly penalize the poor.

The regressive character of consumption taxes can be calibrated using a second principle of tax policy analysis, namely, “incidence of taxation.” The “incidence” of



## The New Sumptuary Laws

In 1633, just thirteen years after the Pilgrims landed at Plymouth Rock, the lower classes of Massachusetts society – “people of meane condition, educations, and callings”<sup>13</sup> – found themselves the beneficiaries of rising wages for their labor. The social and ecclesiastical elites of the Bay Colony first sought to end this wage inflation, and the economic mobility that came with it, by imposing wage and price controls on labor and its products. Later, when it became clear that these measures had failed, the colony’s ruling classes took a different approach that instead regulated what workers spent their new money on, rather than how much they made or charged for their wares; the legislature enacted a law that forbade ordinary working men and women from wearing “silver, golde, and silke laces, girdles and hatbands” on pain of forfeiture. The purpose of this law, its authors made clear, was to prevent the working classes from indulging in excessive consumption from the “immodest gaynes” that they had reaped.

To the ruling classes of Massachusetts, the newly-acquired wealth of the lower classes represented a disruption of the proper order of things, since a worker with wealth of his or her own was one who wanted to rise above an assigned place in the colony’s social hierarchy. The “garbe of gentlemen” was deemed appropriate only for “persons of greater estates, or more liberall education,” and a laborer who adopted the finery of the upper classes thereby revealed a desire to better his lot, and to display the wealth that he had gained. As one seventeenth-century Massachusetts minister put it, “How potent a temptation, the opening of an opportunity to the irregenerate and hungry multitude, of changing places with their Superiours.”<sup>14</sup>

Over the next forty years Massachusetts would enact a succession of similar statutes,

which have come to be known as “sumptuary” laws because they regulated individuals’ consumption. In 1651, lower class males were prohibited from wearing “buttons, poynts at their knees” and “greate bootes,” and women “of the same ranke” were barred from wearing “tiffany hoodes or scarfes.” Drawing the sort of fine distinction among degrees of wealth that legislatures sometimes feel qualified to make, the state’s General Court determined that those whose estates were worth more than £200 should be permitted to possess such items, while others should not.<sup>15</sup>

The Commonwealth abandoned sumptuary laws in the 1670’s, and with them the statutory embodiment of the notion that, as John Winthrop, the first governor of Massachusetts, put it in 1630, God had determined that “some must be rich, some poore, some highe and eminent in power and dignitie; others meane and in subjection.” Men and women were now free to work, save, and acquire property according to their own lights, and would no longer be restrained by laws founded on a theology of economic predestination.

Today, the sumptuary laws of the seventeenth century live on through a multitude of laws that tax the food that we eat, the clothes we wear, our travel to work and play, and our ability to buy the things we choose in the pursuit of our individual visions of happiness.<sup>16</sup> And, as in the seventeenth century, these exactions impose the heaviest toll on those who can least afford to pay them. They increase the cost of necessities and reduce low-income households’ available cash, thereby disproportionately burdening the discretionary income of poorer families and impairing their ability to save for the future and to afford those little niceties by which a family of today marks its financial progress, in much the same way that a

*The sumptuary laws of the seventeenth century live on through a multitude of laws that tax the food that we eat, the clothes we wear, our travel to work and play, and our ability to buy the things we choose in the pursuit of our individual visions of happiness.*



*The meals tax applies regardless of whether the diner purchases a high-fat meal at a fast food outlet or a lunch of tofu and brown rice at a natural food restaurant, and the motor vehicle excise tax applies to all vehicles regardless of their fuel efficiency or crash-worthiness.*

member of the working class of the seventeenth century might celebrate an increase in wealth by purchasing a button for his coat or a band for her hat.

### **General Consumption Taxes**

The types of taxes considered here<sup>17</sup> include both taxes levied at the time of sale of an item – whether denominated as a “sales” or an “excise” tax<sup>18</sup> – and taxes and fees that are charged on a recurring basis, such as the Massachusetts motor vehicles excise tax, as compensation to the state for the exercise of a privilege.<sup>19</sup> These taxes are distinguishable from so-called “sin” taxes, which are imposed on products such as alcohol and tobacco, in that they are levied on necessities whose use involves no health risk, or at least none that has formed the basis for a distinction in the laws of Massachusetts.<sup>20</sup> Thus, the meals tax applies regardless of whether the diner purchases a high-fat meal at a fast food outlet or a lunch of tofu and brown rice at a natural food restaurant, and the motor vehicle excise tax applies to all vehicles regardless of their fuel efficiency or crash-worthiness.

As a preliminary matter, it will be helpful to dispel some folklore current in Massachusetts regarding the subjects and uses of the state’s consumption taxes. Minimal consumption taxes such as those in question here are often justified on one of two grounds, both of which are revealed on closer examination to be spurious. First, proponents of consumption taxes justify such levies on the theory that they are akin to user fees, that is, specific charges that governments impose on those who use particular public assets and services, such as tolls charged to those who drive on certain highways or fees charged to camp at a national park. Second, those who favor consumption taxes argue that they generate earmarked revenues and therefore

transfer wealth from the private sector to the public treasury in rough proportion to the social costs imposed on government by individuals’ economic choices.<sup>21</sup>

Thus, the first argument goes, the consumer who ultimately bears the cost of the 10 percent federal excise tax on sport fishing equipment<sup>22</sup> is free to adopt a different hobby. The diner who chooses champagne over still wine incurs an additional cost of at least \$1.15 per wine gallon that results from the different rate at which these two types of beverages are taxed under the federal wine excise tax.<sup>23</sup> And the buyer of a vehicle that is subject to the federal “gas guzzler” tax could have avoided this excise tax in part or entirely had he or she purchased a car capable of traveling further on a gallon of gas.<sup>24</sup>

While certain federal excise taxes may thus fall solely on those who use discretionary income to purchase items generally viewed as luxuries, Massachusetts consumption taxes are nearly unavoidable regardless of a consumer’s tastes. The meals tax is assessed on a dinner whether eaten at a pricey restaurant in downtown Boston or an inner-city barbecue joint. The automobile excise tax applies both to luxury vehicles and economy cars. The state sales tax applies both to high-end television sets and no-frills washing machines.

The notion that sales and excise taxes are benign because they are earmarked for specific uses is also, with few exceptions, not relevant as to the Massachusetts tax system. The meals tax does not support a meals fund for those who are hungry; sales tax receipts, with the exception of the Massachusetts Bay Transportation Authority (MBTA) fund, do not subsidize any particular program or operation of state government; and the motor vehicle excise tax is not used exclusively to fund highway construction or mass



transportation. The few exceptions to the rule that Massachusetts taxes do not generate dedicated revenues arise in the context of cigarette taxes, a portion of which are credited to the Children's and Seniors' Health Care Assistance Fund,<sup>25</sup> the taxes imposed on motor vehicle fuels, which are credited to various particular funds or to the General Fund with a restriction on their use;<sup>26</sup> and sales tax receipts, a portion of which are credited to the Massachusetts Bay Transportation Authority (MBTA) State and Local Contribution Fund.<sup>27</sup>

### *The Sales Tax*

For gourmands of legislative reticulation, the Massachusetts sales tax is a smorgasbord of magnificent length and variety. By its general terms, the Massachusetts sales tax is an "excise. . . imposed upon sales at retail in the Commonwealth, by any vendor, of tangible personal property or of services performed in the Commonwealth at the rate of five per cent of the gross receipts of the vendor from all sales of such property or services."<sup>28</sup> There are numerous departures from this simple rule, however, and by a variety of routes. For example, not all sales of goods and services are treated as "sales" within the meaning of the sales tax statute,<sup>29</sup> and the term "services" is limited to telecommunications services.<sup>30</sup> Many transactions that would appear to be sales to retail buyers are not treated as "sales at retail" for purposes of the tax.<sup>31</sup> And finally, there are exemptions from the sales tax for purchases of articles ranging from the American flag to motor vehicles purchased by and for the use of a person who has lost "both legs or both arms or one leg and one arm."<sup>32</sup>

There is thus no particular logic to the path that the sales tax takes as it winds its way through the Massachusetts economy, a fact that even the state itself admits.<sup>33</sup> It is

nonetheless apparent that some effort was made at the time that the sales tax statute was first enacted to draw distinctions that would exempt necessities from its scope. Thus, the state's sales tax law has, since it was first enacted in 1967, imposed a tax on food sold as "meals," but not on other food products. The term "meals" is defined to include food and beverages prepared by restaurants, whether consumed on the premises or "sold on a 'take out' or 'to go' basis."<sup>34</sup> The elaboration of this principle in particular cases leads to some absurdities. For example, the General Court, which once imposed monetary penalties based on fine points of ecclesiastical law,<sup>35</sup> has drawn a distinction in the sales tax statute between a box of five doughnuts – which is treated as a meal subject to the tax – and a box of six doughnuts, which is deemed too large to be consumed in a single sitting and thus exempt from the meals tax. A barbecued chicken sold whole and unsliced in a delicatessen is, by the express terms of the sales tax statute, similarly exempt from the tax, but a barbecued chicken consumed at the counter in the same deli is not.<sup>36</sup>

The sales tax excludes other goods and services that would normally be considered necessities for individual consumers, including utility services, heating oil, medicine, articles of clothing whose price does not exceed \$175, and – at the end of an individual's days of consumption – coffins, caskets and burial garments.<sup>37</sup> More recent amendments to the statute seem to have abandoned the distinction between necessities and luxuries, however. For example, the law was amended in 1987 to exempt sales of rare coins, gold and silver coins or bullion with a value of up to \$1,000 from the tax's scope;<sup>38</sup> no argument for the necessity of these articles seems plausible.<sup>39</sup> The statute similarly exempts all articles of clothing costing less than \$175 from the scope of the tax, but makes no distinction

*For gourmands of legislative reticulation, the Massachusetts sales tax is a smorgasbord of magnificent length and variety.*



*To the extent that the sales tax appears to draw accurate distinctions between necessities and luxuries, it often does so on the basis of consumption habits that have changed since the tax was first imposed.*

between necessary but expensive items of apparel, such as winter coats and business suits for those seeking to enter the white-collar workforce, and discretionary spending on non-essential clothing such as souvenir jerseys and hats purchased at sports events. And while groceries are exempt from the sales tax, many necessities found in a family's shopping cart – including soap, trash bags, and toothpaste – are not.

Further, to the extent that the sales tax appears to draw accurate distinctions between necessities and luxuries, it often does so on the basis of consumption habits that have changed since the tax was first imposed. To take one example from the list of exceptions that the statute recognizes, in 1967 most meals were eaten in the home, and the difference between the cost of a restaurant meal and the cost of eating at home was thus more likely to reflect a discretionary spending decision rather than satisfaction of a basic human need. Over the past three decades, however, the percentage of meals consumed outside the home has risen dramatically, doubling in the last three decades. At the time the Massachusetts sales tax was first passed, expenditures for meals prepared outside the home represented approximately 25 percent of the average household's total food budget,<sup>40</sup> a figure that had remained stable for more than a decade.<sup>41</sup> By 1994, that percentage had risen to 38 percent; and by 2001 the cost of meals prepared outside the home represented 40 percent of the average household's total food budget.<sup>42</sup> It is expected that the cost of meals prepared outside the home and consumed by a typical family – whether in restaurants or ordered on a take-out basis – will soon exceed the cost of meals prepared in the home.<sup>43</sup>

This change in consumption preferences has occurred alongside of, and at least in part because of, the simultaneous growth in the percentage of women in the American work

force. Dual-income families now represent more than one-half of all married households; in 1967 when the Massachusetts sales tax was first imposed, families with wives in the work force constituted only 37 percent of married couples as compared to 62 percent in 2001.<sup>44</sup> The percentage of women in the workforce is expected to reach nearly 64 percent by the year 2005.<sup>45</sup> Further, while high-income families tend to spend more on meals prepared outside the home than low-income families, a greater percentage of the total income of low-income families is spent on such meals,<sup>46</sup> since low-income workers – particularly women – are more likely to work variable hours that make the meals tax an inescapable burden on their families. Among all working women, 28 percent have irregular schedules or work evening or weekend hours. A much higher percentage of working women who earn less than \$25,000 per year – 42 percent – work such hours, which may cause them to be absent from the home during meal times and force them to rely on commercially-prepared meals.<sup>47</sup>

There are other examples among the exceptions to the sales tax that, while they appear to reflect the best of legislative intentions, do not mirror current consumption habits or market conditions. Sales of livestock and poultry for human consumption are exempt from the sales tax,<sup>48</sup> for example, but few families have the time, skills or temperament to practice home butchery as a means of making their daily meals, and a poor family of today is much more likely to live in an urban area where the most readily available source of cooked poultry is a fast food outlet rather than a chicken whose neck has been wrung in the backyard.

Finally, it should be noted that the taxability of many articles under the sales tax statute depends on whether the buyer intends to use the article for personal or business purposes. A motion picture film purchased for



**Table 1:  
Incidence of Sales Tax by Income Group, 2000-2001**

Household Income	Fraction of Pre-tax Income Paid in Sales Taxes	Fraction of After-tax Income Paid in Sales Taxes
Less than \$30,000	2.22%	2.27%
\$30,000 - \$49,999	1.33%	1.42%
\$50,000 - \$69,999	1.14%	1.21%
\$70,000 and more	0.82%	0.88%

Source: Estimations based on the Consumer Expenditure Database, Northeast Region, United States Bureau of Labor Statistics, 2000-2001

commercial exhibition is exempt from the sales tax, but a video purchased for home viewing is not; sales of building materials for use in government buildings are exempt from the sales tax, but purchase of building materials for home repairs are not; purchases of tools to be used in the manufacture of cast metal products are exempt from the sales tax, but tools purchased for use by an individual in his or her trade, or for home repairs, are not.<sup>49</sup> This distinction may owe less to logic than to lobbying, since buyers of these items for home use, who have only an attenuated and infrequent interest in the cost that they add to the articles in question, are less likely to form organizations to represent their interests, and to petition the legislature for relief, than commercial interests that purchase such items on a regular basis.

What is the effect of this minimal, yet pervasive, toll-taking on the cost of life's necessities to a Massachusetts family? Obviously, the sales tax increases the cost of any article to which it applies, but this additional burden will form a greater or lesser part of a family's total expenditures depending on the income and consumption habits of those who pay the tax. At lower income levels – for purposes of this analysis, households with a gross income of less than \$30,000 – the sales tax takes approximately 2.2 percent of a household's pre-tax income, and a slightly greater percentage of its after-tax income, since there is no Massachusetts

tax deduction or credit for sales tax expenditures, and since most taxpayers in lower-income brackets do not itemize deductions on their federal tax returns. The percentage of a household's total after-tax income that is used to pay sales taxes ranges from 2.7 percent in the case of families whose incomes are less than \$20,000, to 1.5 percent in the case of families whose incomes are greater than \$20,000 but less than \$30,000. In households where total income ranges from \$30,000 to \$50,000, the pre-tax impact of the sales tax on a family's pocketbook declines slightly to 1.4 percent. This downward trend continues as family incomes rise. A household with a total income of \$58,853 will pay approximately 1.1 percent of its pre-tax income in sales taxes, and approximately 1.2 percent of its after-tax income. A household with total income of over \$70,000 will pay approximately .82 percent of its pre-tax income in sales taxes, and approximately .88 percent of its after-tax income.<sup>50</sup> See Table 1 for details.

In other words, the sales tax is a counter-progressive or regressive levy; as a family's wealth increases, it can expect to pay less in sales taxes as a percentage of its income than it did at lower income levels. The irony of this presumably unintended result is obvious; as a family's income increases, the sales tax is less of a barrier to savings and, since the price of essential goods does not fluctuate

*What is the effect of this minimal, yet pervasive, toll-taking on the cost of life's necessities to a Massachusetts family?*



*The distorted public policy that we see after the refraction of family incomes through the medium of the sales tax would thus be comical – like an image in a fun-house mirror – if the welfare of real families weren't at stake.*

based on the buyer's income, the sales tax leaves poorer families with a smaller percentage of their income to use for the purchase of goods that cost the same to a wealthier family. The distorted public policy that we see after the refraction of family incomes through the medium of the sales tax would thus be comical – like an image in a fun-house mirror – if the welfare of real families weren't at stake.

One conventional objection to this analysis – that the percentages of household income siphoned off by the sales tax aren't large enough to bother about – is based on a patronizing assumption; namely, that a low-wage worker whose gross income is, say, \$25,000, would forego the opportunity to save \$375 in sales taxes each year in exchange for the chance to receive some portion of that amount back from the state through government programs. It also ignores the simple economical truth that a sales tax burden of 1.5 percent is less easily borne by a family whose gross income is low than is a tax burden of .82 percent on a family whose gross income exceeds \$100,000, since both families pay the same prices for basic necessities.

The disproportionate burden that the sales tax imposes on the poor affects not only their power to purchase everyday necessities, but also their ability to save for the future. As the above analysis demonstrates, Massachusetts families with lower income levels are more likely than families in higher income brackets to use disposable income on sales taxes that could otherwise be set aside as savings, a fact whose self-evident nature should not obscure its importance. Personal savings allow low-income families to escape poverty more quickly than would otherwise be the case,<sup>51</sup> and as a result benefits that the poor may ultimately receive from social programs funded by consumption tax

revenues are diluted, if not eliminated, by the disproportionate burden that consumption taxes place on their ability to accumulate wealth in the present. In view of this fact, the benefits of government assistance to which the poor might be entitled cannot logically be invoked to support such levies.

### ***Transportation***

There is at present in Massachusetts, as in other industrialized areas of the country, a mismatch between areas where job growth has been strongest and newly created jobs are plentiful – primarily the suburbs – and those areas where the largest number of unemployed workers reside – primarily the inner cities.<sup>52</sup> This disjunction between labor supply and labor demand is the result of a number of factors, some of which have historical roots whose present flowering is anachronistic, and all of which taken together have pernicious results. For example, current public transportation routes and schedules, which were originally designed to funnel workers from areas where housing costs were low to high-paying jobs in a central city core along a hub and spoke configuration of transit lines, are now obsolete. Thus, the MBTA's 500 express bus, which runs between the suburban Riverside Station in Newton and downtown Boston, makes twice as many inbound trips from Newton to Boston during the morning rush hour as outbound trip from Boston to the suburbs.<sup>53</sup> In testimony before Congress, Wendell Cox, Visiting Fellow at The Heritage Foundation reported among other things that in 1990, the average downtown area accounted for barely 10 percent of metropolitan employment in the U.S., and that people who use transit to non-downtown locations have much lower incomes than those able to access auto-competitive modes of transportation to downtown areas. In 1990, downtown transit commuters had an average household income



within six percent of the national average. Non-downtown transit commuters had an average household income 40 percent below average.<sup>54</sup>

Any attempt to reverse the pattern that was formed on the basis of the assumption that employment is concentrated in the downtown area would collide with laws designed to establish, by virtue of monopoly characteristics, a system of subsidized public transportation to serve this presumed need in perpetuity. Pursuant to chapter 159A of the General Laws, transportation of multiple passengers for hire along a fixed route within Massachusetts is subject to regulation both by the state's Department of Telecommunications and Energy (DTE)<sup>55</sup> and by the municipalities through which the route passes. A private operator who wished to establish a bus line running from, say, Dorchester to State Route 128, would need to obtain permission to operate from the cities and towns of Boston, Brookline, Newton and Wellesley in addition to the DTE. If any of the municipalities along the proposed route refused to grant approval, the DTE could act as the licensing authority with respect to the dissenting community, but the DTE's authority in such cases extends only to approval of passage through the municipality; it cannot authorize stops within the municipality for the admission or discharge of, say, Asian-Americans in Chinatown, African-Americans in the Roxbury or Dorchester areas of Boston, or Russian immigrants in Brookline or Newton.

In addition to these local approvals, if any portion of the proposed route included a public way subject to the jurisdiction of the Metropolitan District Commission or the Massachusetts Turnpike Authority, the approval of those entities would also be required. Since the only alternative route to the Massachusetts Turnpike and Storrow Drive, a roadway subject to regulation by the

Metropolitan District Commission, for the outward-bound commute described above is a non-express road with stoplights – State Route 9 –this additional layer of regulation is almost inevitable. Finally, Chapter 159A permits cities and towns along a route to adopt separate regulations concerning public transportation on matters that are not directly regulated by this general statute. A carrier that wanted to establish service from the inner city core of Boston or Lawrence to a suburban destination could thus be faced with different and conflicting requirements at every stop along its path of service.

In light of these impediments to the private movement of passengers by common carrier in Massachusetts, it is not surprising that few private companies are willing to commit their resources to the task of serving the potential market for urban-to-suburban commuting that exists as a result of the gap between old public transportation patterns and current job opportunities. In 1995, for example, there were only ten private carriers licensed to carry passengers on the public roads that could be used to transport labor from the inner cities of Massachusetts to suburban destinations. Those ten carriers included three sightseeing trolleys, two limousine services, one school bus company and one charter bus service; only two provided regular commuter service, and those carriers followed the traditional pattern of inbound service during the morning rush hour and outbound service during the evening.<sup>56</sup> In short, an inner city resident who seeks to move to a high-paying, knowledge-based job in the suburbs had better have a car before he or she starts looking; public transportation routes do not follow the paths that he or she will need to take, and heavy regulation of inter-city transport of passengers within Massachusetts discourages private operators from putting their capital to work to fulfill this unmet public need.<sup>57</sup>

*In short, an inner city resident who seeks to move to a high-paying, knowledge-based job in the suburbs had better have a car before he or she starts looking.*



*The sales tax does not apply to “casual sales” of property – that is, isolated sales by parties who are not retailers – except for sales of motor vehicles and trailers.*

The state-imposed costs of owning and operating a car in Massachusetts are significant, however. There is, as discussed briefly above, the annual motor vehicle excise tax, which is “assessed and levied in each calendar year on every motor vehicle and trailer registered” in the state “for the privilege of such registration.”<sup>58</sup> The motor vehicle excise tax is computed at the rate of \$25 per thousand dollars of the original manufacturer’s list price of a vehicle, regardless of whether a consumer buys a vehicle for less than this price through negotiations, or for more than this price as a result of a particularly fashionable model’s scarcity. The tax declines over the life of a vehicle from 90 percent of the list price in the designated year of manufacture to 60 percent in the year following the year of manufacture, 40 percent in the third year, 25 percent in the fourth year and 10 percent in each year thereafter. A ten-year old vehicle with a value of \$1,750 computed according to this formula would thus be subject to an annual excise tax of \$43 for as long as it is registered, even though it is likely to have been sold as a used car and passed into the hands of less wealthy driver by that time.

In addition to this annual excise tax, the Commonwealth levies the sales tax on the purchase price of a motor vehicle each time it is sold by one owner to another. The application of the sales tax to motor vehicles is governed by special provisions of the sales tax law. First, the tax is payable not to the seller but directly to the Registrar of Motor Vehicles.<sup>59</sup> As a practical matter, this requirement insures that the tax is in fact collected in all cases since the Registry of Motor Vehicles is the government agency that must issue a certificate of title to the purchaser in order to evidence his or her ownership of the vehicle. The sales tax does not apply to “casual sales” of property – that is, isolated sales by parties who are not

retailers – *except* for sales of motor vehicles and trailers.<sup>60</sup> Thus, a car is subject to the sales tax each time it is transferred for value, regardless of whether the seller is an automobile dealer or the first or subsequent user of the vehicle. The revenues derived from the sales tax on motor vehicles averaged \$508 million per year over the period FY1997-FY2002, or roughly 3.5 percent of the state’s total tax collections.<sup>61</sup>

The third broad-based excise tax applicable to the operation of a motor vehicle in Massachusetts is the tax on gasoline. This tax is currently set at 21¢ per gallon.<sup>62</sup> This tax generates on average \$650 million in revenues to the Commonwealth each year,<sup>63</sup> with only a limited exception available for purchases of gasoline used for purposes other than highway travel or farming.<sup>64</sup>

The gasoline tax has two features that disproportionately affect low-income families. First, like other consumption taxes, monies spent on the gas tax represent a greater share of the earnings of low-income families whose commuting needs are the same as a higher income family simply because the amount of the tax does not vary from one consumer to the other. Second, for most taxpayers there is no tax credit or deduction available for monies spent on the gas tax at either the state or federal level even when the gasoline purchased is used for the purpose of earning a livelihood, and thus should arguably be deducted from gross income in order to calculate a taxpayer’s net taxable income.

### ***Withholding Taxes***

The policy of withholding sums from taxpayers’ wages as an aid to collection of income taxes dates from the Second World War, when Congress raised taxes in an effort to increase government revenues available to pay for increased defense expenditures. The



technique of withholding was patterned after an innovation of finance that was closely tied to household consumption – namely, the installment purchase of goods on credit. In the early years of the war, Beardsley Ruml, the treasurer of the R.H. Macy department store chain, was also chairman of the New York Federal Reserve Bank’s board of directors. Ruml knew from his experience in the consumer products industry that customers were more likely to buy expensive products if they were given the option of paying the price in installments, even if they were required to pay interest for the privilege of doing so. The installment purchase plan lightened the weight of “big ticket” items on family budgets, thereby lowering consumers’ resistance to expensive purchases.

The changes in the federal tax laws that were passed in 1942 both increased tax rates and expanded the reach of the tax code so that tens of millions of Americans would be subject to the income tax who had never paid it before. For these reasons, Treasury secretary Henry Morgenthau began to entertain serious doubts as to whether the federal government would in fact be able to collect the increased taxes from an unwilling public. Ruml did not invent the concept of tax withholding, but he gave it a marketer’s packaging that made it palatable to the masses. Instead of dry technical terms by which the practice had previously been known, such as “collection at source” or “withholding,” Ruml proposed the name “pay as you go,” which suggested a friendly accommodation on the part of government that was designed to assist taxpayers rather than insure collection of higher taxes.<sup>65</sup> The federal government adopted the practice out of expediency – since it shifted the burden of collecting newly-increased taxes from the government to employers – but retained it for reasons of efficiency, since it produced the intended result of collecting the additional tax revenues that the government needed.

Tax withholding was supposed to be a war-time phenomenon that would end once defense expenditures receded to pre-war levels. Instead, tax withholding proved to be a tool too useful to be discarded, and because of the lack of taxpayer opposition to the practice, it remains in place today.<sup>66</sup> State governments inevitably followed Washington’s example; in Massachusetts a withholding statute was first adopted in 1959.<sup>67</sup>

The installment purchase model has a superficial similarity to withholding of taxes from wages, but there is (at least) one essential difference. In the case of installment financing of consumer products, the buyer is required to pay interest because the seller has deferred payment in full, and the seller will thus normally require additional financial consideration as compensation for the time value of the payments that it agrees to defer. In the case of withholding tax deductions from wages, however, the shoe is on the other foot. The person who makes the payment prior to the time when payment in full is due receives no compensation for the lost time value of his or her money. The taxpayer, in effect, makes an interest-free loan to the government. And, as in the case of the sales tax, this aspect of withholding has a counter-progressive element. Under the withholding statute, employers are required to withhold taxes from wages of employees, and by another statute, employers are required to pay wages to employees on a weekly, bi-weekly or monthly basis. Self-employed professionals and those who receive their compensation not as wages but as distributions from business entities (such as partnerships, corporations and other types of limited liability organizations) need only make estimated tax payments on a quarterly basis. Thus, while both low-income wage earners and higher-income professionals and investors must make advance tax payments

*Tax withholding was supposed to be a war-time phenomenon that would end once defense expenditures receded to pre-war levels.*



*Lower-income taxpayers must make weekly or bi-weekly disbursements to the government, thereby further reducing their disposable income.*

to the Commonwealth without receiving compensation in recognition of the time value of their money, many higher-income taxpayers can defer their estimated tax payments for as much as three months, while lower-income taxpayers must make weekly or bi-weekly disbursements to the government, thereby further reducing their disposable income and further increasing the lost investment value of the amount that is transferred to the government in advance of the due date of the related tax obligation.

Thus, as in the case of excise taxes on consumable goods, tax-withholding rules impose a current burden on disposable income in a way that discriminates against lower-income taxpayers. There are, of course, differences between the two types of levies. Consumption taxes are not refundable in Massachusetts while income taxes are, if one has paid more in withheld or estimated taxes than one's final tax liability. Taxpayers do not receive compensation for the use of their money by the Commonwealth for the period from the time of withholding or payment until the day that income taxes are due, however, a burden that falls more heavily on poor and low-income families who could otherwise accumulate savings and pay taxes only when and to the extent due.

In assessing the cost of consumption and withholding taxes on the citizens of the Commonwealth, we come lastly to the labor involved in calculating and collecting such taxes in both the public and the private sectors. In the case of consumption taxes generally, this work includes the differentiation of a retailer's goods into taxable and non-taxable items; the collection of taxes at the point of sale; the remittance of tax collections to the Commonwealth; and, if there is a dispute as to the amount payable, the negotiation of a settlement with the state's

Department of Revenue or litigation over the amount in controversy. The state does not compensate private businesses for their assistance in collecting these taxes. In the public sector, there is a corresponding involvement by tax authorities that mirrors each stage of this cycle.

In the case of income tax withholding, there is a similar pattern of public sector personnel responsible for collection of the tax, and private sector manpower dedicated to computing and paying it. By contrast with consumption taxes, however, the state compensates employers for their assistance in collecting income taxes required to be withheld. Under regulations of the Department of Revenue, employers are authorized to retain from withheld taxes certain amounts intended as compensation for their labor, computed as a small percentage of the amounts withheld.<sup>68</sup>



## A Few Modest Proposals

Despite the wide variety of taxes that are imposed on consumption by the Commonwealth of Massachusetts, the state is less dependent on such taxes for its total revenues than the average of all states. In 2001 (the last year for which data is available) Massachusetts derived 21.8 percent of its total revenues from sales taxes and 8.7 percent of its total revenues from other excise taxes; the national averages for state revenues derived from these categories of taxes were 32.1 percent and 14.1 percent, respectively.<sup>69</sup> The state's level of revenues derived from personal income tax exceeds the national average, however – by 20.4 percentage points in FY 2001.<sup>70</sup> The Massachusetts income tax is responsible for more than half of the state's tax receipts, thereby reducing the need for consumption taxes as a source of revenue.

Since Massachusetts is not heavily dependent on consumption taxes, there is reason to believe that the state could reduce or eliminate many such levies in order to better the lives of low-income families who suffer the most from such measures. And because income tax rates in Massachusetts are high, there is a plausible argument to be made that the state should make some allowance in its scheme of tax withholding to account for differences in income levels and to extend to low-income wage earners the ability to defer payment of taxes that is currently enjoyed by those who pay estimated taxes on a quarterly basis. What follows is a compendium of potential reforms to our system of consumption taxes and encumbrances on current income such as withholding, each of which would provide a direct and immediate benefit to low-income consumers and taxpayers. The potential impact of such reforms on the state's overall revenue needs will be considered further on in this paper.

### *Reduction or Elimination of the Sales Tax*

To those who would argue that the Commonwealth cannot forego even the relatively meager revenues that are derived from the state's consumption taxes, there are a number of counter-arguments. First, there are the documented instances in which states with sales taxes have suspended them and experienced dramatic increases in commercial activity. Increases in sales result in increased revenues to businesses that are taxable in the hands of the seller, and not at the point of sale to the consumer, and thus subject in Massachusetts to the corporate excise tax.<sup>71</sup> Texas, Florida and New York, three states that depend to a significant extent on sales taxes (in Florida's case because it has no income tax), have all experimented with sales tax "holidays" for limited periods of time or with respect to particular types of necessities. In 2002 Texas suspended its 6.25 percent sales tax, along with all local sales taxes, on items of clothing and footwear costing less than \$100, for three days from August 2<sup>nd</sup> – 4<sup>th</sup>, in order to allow families that needed to buy clothes for school-age children to purchase clothing free of the sales tax during a period when large-scale purchases of clothing for such families are unavoidable.<sup>72</sup> Florida declared a similar one-week holiday from its 6 percent sales tax in the summer of 1999 to coincide with the back-to-school shopping season and saw sales to Georgia residents increase dramatically.<sup>73</sup> In New York, a two-week suspension of the state tax on sales of clothing in 1999, coupled with parallel suspensions of local sales taxes, caused New York residents to forego shopping trips to New Jersey, where there is no tax on clothing.<sup>74</sup> In each of these cases, merchants experienced a net increase in sales, rather than a mere shift in a static level of spending from a time when the tax applied to a period when it did not.<sup>75</sup>

*The Massachusetts income tax is responsible for more than half of the state's tax receipts, thereby reducing the need for consumption taxes as a source of revenue.*



*Reduction or elimination of consumption taxes produces an immediate benefit to low-income consumers without placing professional transaction costs in the way of obtaining them.*

Thus, a state will not necessarily lose revenue as a result of a reduction or elimination of its sales taxes: if it reduces the sales tax, it can expect to make up its lost revenues in the form of increased sales activity; if it eliminates the sales tax, it may still recoup the foregone tax receipts if its armament of tax weapons permits it to tax sales receipts in the hands of sellers, as is the case in Massachusetts.

If Massachusetts were to reduce or repeal its sales tax, it could thus expect to benefit from increased consumer spending within its borders as buyers shifted their spending from New Hampshire, which has no sales tax, to Massachusetts merchants. In addition, shoppers who live in New York, Connecticut and Rhode Island near the Massachusetts border could be expected to bring their business to this state, in much the same manner that Massachusetts consumers now take their business to New Hampshire. This enhanced regional competitiveness could be expected to fuel an increase in taxable income within the Massachusetts retail sector.

The effect on consumers of thus eliminating the sales tax, even temporarily, is more immediate than that which would result from the creation of a tax credit for sales taxes spent on necessities or another type of tax relief tied to personal income taxes. This is so for a number of reasons: First, when sales taxes are eliminated, the consumer is permitted to keep a portion of his or her income that would otherwise be collected as a tax and potentially refunded at the end of the tax year; the taxpayer thus receives both money that would have been spent and the time value of the money that would be lost if one receives a refund of consumption taxes months after their collection. Consumers can thus put foregone sales tax revenues to work

immediately, either in consumption or savings; as a result, the consumer has a greater incentive to take advantage of the benefits of lower sales taxes in order to achieve compounding of interest on savings, or to take advantage of temporary fluctuations in the prices of essential goods due to seasonal reductions in demand or temporary excesses in retail inventories.

Second, the consumer obtains the benefit of lower sales taxes without resorting to professional help or the time required to complete tax return forms; there is thus no transactional cost to obtaining this form of relief. A recent survey by the Internal Revenue Service indicates that, despite periodic movements to simplify U.S. tax laws, the number of taxpayers who must resort to professional assistance in order to prepare their income tax returns is rising steadily. In 2000, 58 percent of taxpayers used a paid preparer; and if returns prepared electronically are included that percentage jumps to an astounding 80.2 percent.<sup>76</sup> Since the poor by definition have less disposable income to hire accountants than others, attempts to ameliorate poverty through the use of deductions from pre-tax income or credits against income tax liabilities should be viewed with skepticism; the more a tax benefit costs to obtain, the less it can be used by those who need it most. Reduction or elimination of consumption taxes produces an immediate benefit to low-income consumers without placing professional transaction costs in the way of obtaining them.

Third, the immediate impact of a reduction in rates, or the elimination of consumption taxes altogether, enables the taxpayer to determine with certainty that he or she will in fact derive a benefit from them, and thus taxpayers are motivated to avail themselves



of these forms of relief. Other forms of tax relief, including tax credits and deductions, often go unused because the link between current behavior and future benefits is uncertain; if, for example, a low-income family is unlikely to earn enough in wages during the course of year to generate income beyond the applicable exemption, they will be unlikely to engage in the record-keeping and other activities required in order to take advantage of the benefit, and will fail to take advantage of it even when they are entitled to do so. Sales tax relief, on the other hand, produces a tangible benefit whose value can be assessed currently by taxpayers at the point of sale, and is thus more likely to be used by its intended recipients. This accounts in large part for the enthusiasm with which sales tax holidays have been received where they have been tried.

Reform of the Massachusetts sales tax in order to reduce or eliminate its regressive character, and to bring it into line with current conditions, could proceed along a number of avenues. First, if we are to have a sales tax, it should be revisited from time to time in order to ensure that it matches current consumption patterns. If we are to have an exemption from the tax for animals to be butchered for home consumption, there should also be an exemption for food prepared by restaurants whether or not the food is eaten on its premises. If we are to have an exemption for cable television and on-line services, there should also be an exemption for television signals received by antennae from a satellite, since they are functionally equivalent.

A second mode of reform that comes to mind is to broaden the base of the sales tax so that it includes articles that the poor are less dependent on, while at the same time significantly lowering the rate of the sales

tax so that those who must pay it for necessities of life and livelihood of the type described in this article – prepared food, automobile tires and batteries, soap – can do so without unduly burdening their current income or their ability to save for the future. The current collection of items that are exempt from the sales tax statute include numerous instances of items that low-income families are unlikely to purchase or to spend significant sums on, such as rare coins and bullion, as well as distinctions between business and consumer uses that cause the sales tax to be imposed on purchases by low-income families that a profitable business buying the same item avoids. By broadening the base of the sales tax to correct this sort of irrationality, the Commonwealth could afford to lower the rate of the sales tax and thereby lighten the load currently carried by some of its less fortunate citizens.

A third tack that sales tax reform could take in Massachusetts would be to bring the tax's exceptions and exemptions into line with current consumption habits. Food prepared in the home and food purchased outside the home have come to play largely fungible roles in the lives of many working families, and a functioning automobile is an essential element of most families' personal and job-related transportation requirements. Tax discrimination against restaurant or take-out meals, or against personal automotive travel, runs counter both to individual choice and to current realities; if a job that would lift a family out of poverty is located beyond the reach of public transit, and if time spent in commuting makes home preparation of meals difficult or impossible for a family, the Commonwealth should not burden their hopes of economic advancement with a tax on choices that are compelled by economic circumstances. To do so may cause the Commonwealth to take on a greater governmental burden at some later date, since

*If a job that would lift a family out of poverty is located beyond the reach of public transit, and if time spent in commuting makes home preparation of meals difficult or impossible for a family, the Commonwealth should not burden their hopes of economic advancement with a tax on choices that are compelled by economic circumstances.*



*The state should get out of the business of trying to make such judgments, since when it does so it inevitably draws distinctions that favor organized interests over the atomized appetites of many consumers, or that simply make no sense.*

the family that cannot accumulate wealth today may be one that, because of financial reversals such as divorce, loss of employment or lack of health insurance, becomes a recipient of public assistance in the future.

A fourth – and perhaps politically convenient – course to take in reforming the state’s sales tax would be to establish high thresholds for particular types of goods that must be exceeded before a consumption tax applies. Thus, the meals tax could be applied only to restaurant meals costing more than a specified dollar amount, and the sales tax as applied to motor vehicles could be adjusted so that it included only more expensive cars and trucks. The difficulty with this model of reform is that consumption taxes are unwieldy tools. If a government specifies that restaurant meals are subject to tax only if they exceed \$100, how does the tax collector treat the buyer that spends far in excess of this amount, but on many more mouths, such as a busload of students? Do we really want the Great and General Court of Massachusetts declaring separate checks for each member of such a group to be a matter of public policy?

Finally, there is the alternative of eliminating the sales tax in its entirety. Since its enactment, the sales tax statute has been reduced by thin slices carved off to appease particular interests,<sup>77</sup> or to respond to sympathetic but minor portions of the marketplace. The first trend is exemplified by the many exemptions available for business uses of products that are taxable when purchased by consumers, the second by the exception from the sales tax for motor vehicles for the use of a person who has lost an arm and a leg.<sup>78</sup>

A company that benefits from an exemption of the former type may have no greater claim to virtue than the homeowner who, for example, buys two-by-fours to make repairs to his or her home. A person who would benefit from the latter exemption has undeniably suffered a grievous loss, but why should a legislature make a distinction between such an individual, who may be compensated by insurance or have significant financial resources with which to purchase a new car, and a resident of Boston or another urban area of Massachusetts who loses a used car in an accident and cannot replace it because he or she could not afford insurance coverage for its full replacement value? The state should get out of the business of trying to make such judgments, since when it does so it inevitably draws distinctions that favor organized interests over the atomized appetites of many consumers, or that simply make no sense.

### ***Transportation Levies***

Regardless of one’s view as to the proper balance to strike between governmental policies that fund mass transit or further its use, and those – such as expenditures for highway construction and repair – that support or encourage the use of the automobile – it is beyond cavil that many people need an automobile to get to work because they are ill-served by public transportation, and that some of those people are poor.<sup>79</sup> It is also true that the burden of consumption taxes on the ownership and use of an automobile in Massachusetts – such as auto excise taxes, gasoline taxes, sales taxes and inspection and registration fees – falls heavier on the poor than the rich, with the possible exception of the auto excise tax on new cars, which is calibrated by reference to the purchase price of a vehicle.

In a nation where large sums are spent by both state and federal governments to



promote self-sufficiency among the poor, it is counterintuitive to tax the mode of transportation that is often most essential to their ability to earn a livelihood, especially when, as noted above, it is so rarely true that the proceeds of taxes on the ownership and use of an automobile are dedicated towards transportation expenditures.<sup>80</sup>

In Massachusetts, reform of the state's consumption taxes applicable to motor vehicles could focus on a number of links in the fence that currently stands in the way of automobile use and ownership by the poor. The excise tax could, for instance, be based on the actual cash sale price of a vehicle rather than the manufacturer's list price. In this manner, low and middle-income individuals who trade in an old vehicle or negotiate a price below the list price would not be taxed on the gap between what they paid and the price at which the vehicle was offered for sale, and high-income individuals who pay more than the list price for scarce luxury or sport vehicles would pay an excise tax based on the actual value, as determined by the price they were willing to pay, for the vehicles they purchase.

A second piecemeal reform of the state's consumption taxes on automotive use and ownership would be to exempt vehicles subject to the excise tax from the general sales tax; taxing the purchase of an item based on its value may make sense from some policy perspective, but taxing an item's value twice surely does not. This change would be consistent with the philosophy – often expressed but rarely followed – that sales taxes should not be imposed on necessities. As argued above, the automobile is a necessity even in states such as Massachusetts where an extensive public transportation system exists. The elimination of the sales tax on sales between consumers would be a less sweeping reform, but it would have the additional benefit of relieving

consumers, auto insurance agents and employees of the Registry of Motor Vehicles of the burden of establishing and collecting the tax in isolated transactions; from the perspective of the state's budget, the burden of salaries and benefits paid to state employees to collect the tax in such circumstances may outweigh the miniscule benefits that flow from such small, but widespread, "casual" transactions.

A third approach would be the elimination of the excise tax on a vehicle after a certain period of time so that ownership of a used car, which is more likely to be purchased by a low-income driver, does not carry the additional burden of this tax. Massachusetts law provides for the gradual reduction of the motor vehicle excise tax, but not its elimination.<sup>81</sup> The tax declines to 10 percent of the list price of a vehicle in the fifth year after its manufacture, but there are no further reductions in the rate of assessment thereafter. Thus, even though the value of a vehicle declines the longer it is owned, the owner continues to pay excise taxes at a rate determined as if the value of the vehicle had been preserved like a cod in brine at some earlier time. This is contrary to the philosophy that forms the basis of excise taxes – namely, that they should be calibrated according to the value of articles on which they are payable – and is counter-progressive, to boot. The person who cannot afford to own a particular car until its useful life is almost over is the one who, under Massachusetts law, must pay a fixed rate regardless of the vehicle's value, rather than the purchaser of a new car, who is assessed on a declining basis that reflects his or her vehicle's depreciating value.<sup>82</sup>

### ***Withholding***

Wage withholding laws, first enacted to ensure tax collections, have produced a wide array of unintended consequences. They

*Thus, even though the value of a vehicle declines the longer it is owned, the owner continues to pay excise taxes at a rate determined as if the value of the vehicle had been preserved like a cod in brine at some earlier time.*



*If individuals are forced, due to withheld taxes, to purchase essential goods with borrowed money, they typically pay interest rates on consumer credit at or near the state's usury limit.*

require tax-paying citizens to make interest-free loans to governments that adopt such laws; they require periodic advance tax payments from individuals who will ultimately owe nothing in taxes; and, because they reduce taxpayers' disposable income available for other needs, they impose borrowing costs on tax-paying individuals that are much greater on a per capita basis than those that would be borne by the taxing governments themselves. Interest on obligations of the Commonwealth of Massachusetts and its cities, town and agencies are exempt from state and federal income taxation pursuant to relevant provisions of state and federal law, and for this and other reasons rates paid on such debt are much lower than those paid by individuals.<sup>83</sup> If individuals are forced, due to withheld taxes, to purchase essential goods with borrowed money, they typically pay interest rates on consumer credit at or near the state's usury limit, especially if they are less creditworthy due to their lack of current income.<sup>84</sup> The Commonwealth's need to ensure a stream of collections to pay its bills is undeniably an important social purpose, but whether the state should force low-income families to borrow money at high rates to pay expenses that the state could finance at much lower rates – less than half, in most cases – is a question that one intuitively answers in the negative.

Any attempt to repeal the state's withholding laws would be met with the objection that their elimination would jeopardize state tax collections. There are a number of ways in which tax collections could be protected while conferring on individuals – particularly low-income families – the benefit of the time value of their money. One solution that suggests itself would be to allow individuals to exempt themselves from withholding requirements if they will not earn enough on an annualized basis to incur an income tax liability to the Commonwealth. An

employee's entitlement to this benefit could be verified by a requirement that those individuals who wished to avail themselves of it file a copy of their prior year's tax return with their employer, just as employees currently declare the number of exemptions to which they are entitled.

This proposal would have the disadvantage of reaching only those who pay no taxes, however, and would not benefit those who can expect to pay some income taxes, but who may be entitled to a refund. For the latter individuals, a different approach is needed. At various points on the spectrum of possible solutions lie at least three alternatives. First, both for those who would pay no taxes and those who may be entitled to a refund, simple equity would appear to require at a minimum they be permitted to make payments on a quarterly basis, as are taxpayers who pay estimated taxes. Second, the Commonwealth could compensate both "no tax status" taxpayers and those who will be entitled to a refund by paying them a modest rate of return on their prepaid taxes. And third, the state could eliminate withholding requirements altogether.

Requiring the Commonwealth to provide compensation directly to taxpayers would deny them the freedom to choose an investment offered by a private sector entity such as a bank or a mutual fund, and could affect the state's credit rating; it is also not unreasonable to assume that the state would pay a lower rate of return than private entities, to the detriment of taxpayers, because the state would not have to compete for consumers' deposits. Permitting all taxpayers to exempt themselves from withholding requirements would expose withholding reform to the objection that its benefits would accrue to upper-income taxpayers. While this argument ignores the fact that some high-income individuals currently avoid weekly,



bi-weekly or monthly withholding requirements because they make quarterly estimated tax payments, its rhetorical value in any debate over reforming the state's withholding requirements is obvious.

Perhaps the best method of insuring the certainty of the Commonwealth's tax collections while at the same time providing taxpayers with a return on the investment of their withheld wages would be to create secure accounts – for want of a better term, "IWAs" for Individual Withholding Accounts – to which deposits of withheld wages would be made by employers, and from which direct deductions could be made by the Commonwealth on a quarterly basis to pay estimated taxes. Any balance remaining (such as accrued interest paid by the deposit holder) would be made available to the taxpayer upon satisfaction of quarterly withholding requirements. The ordinary taxpayer would thereby achieve some small degree of parity with high-income professionals and investors who avoid weekly withholding through quarterly estimated tax payments by permitting them to earn interest or dividends on monies that would otherwise be advanced to the Commonwealth without compensation.

### ***Consumption Taxes Versus Income Taxes***

Much has been written regarding the relative merits of taxing income as opposed to taxing consumption. The discussion of this issue has proceeded, for the most part, along non-partisan lines; that is, conservatives can be found who favor consumption taxes as a means of simplifying the tax collection system and encouraging savings, and conservatives can be found who oppose such taxes as a drag on economic activity. Conversely, there are liberals who favor consumption taxes as a means of increasing

governmental revenues or discouraging consumption of particular articles with adverse social consequences, and there are liberals who oppose such taxes on the grounds that they impose a disproportionate burden on lower-income groups, who must devote a greater percentage of their disposable income to consumption, and less to savings, than upper-income groups.<sup>85</sup>

An inquiry into whether Massachusetts should reduce its dependence on consumption taxes, or eliminate such taxes in their entirety, in favor of a greater dependence on income taxes, can for the most part be conducted independently of this larger, national debate because the Massachusetts sales tax is a tax on sales at retail but not on wholesale transactions, and is subject to numerous exceptions. It is accordingly not the sort of broad-based "value added" tax that is usually offered as an alternative to a state or national income tax, and much of the debate on this issue has little relevance to one's view as to whether Massachusetts' consumption taxes are too high in relation to the state's other taxes.

It is clear, however, that sales and excise tax revenues make up only a small part of the Commonwealth's total tax revenues. Massachusetts Department of Revenue numbers for FY 2002 show that sales and excise taxes *together* account for only 36.1 percent of the Commonwealth's total revenues. In 2001 Massachusetts ranked second lowest in its reliance upon sales taxes among the other states where such levies are imposed.<sup>86</sup> As such, the support that sales and excise taxes give to the overall edifice of Massachusetts governmental revenues is not that of a load-bearing wall, and the boundaries of these taxes may be moved without structural damage to the whole. The question to be considered in this section is whether a reduction in consumption tax

*In 2001 Massachusetts ranked second lowest in its reliance upon sales taxes among the other states where such levies are imposed.*



*Massachusetts sales and meals taxes are imposed on many goods that are necessities, and are imposed without regard to the purchaser's income.*

revenues would produce adverse effects for Massachusetts that would outweigh the benefits that the state's lower-income citizens would derive from such a reform.<sup>87</sup>

There is first of all a different degree of elasticity in each type of tax – consumption and income – that makes income taxes a more malleable tool of social policy. The legislature may, by manipulation of a number of concepts used in determining taxable income, respond to changing revenue needs in a manner that effects low-income taxpayers at the margin of a subsistence level of income, and not at its core. For example, the legislature may raise or lower the level at which low-income taxpayers qualify for “no tax status” without significant consequences for state revenues. In 1996, the last year for which the relevant statistics are available, the number of Massachusetts taxpayers claiming “no tax status” and the limited income credit (a tax credit designed to benefit taxpayers whose income is slightly above the “no tax status” threshold) both declined at a time when tax revenues from a number of categories of taxable income increased.<sup>88</sup> The Commonwealth could thus make an adjustment in the “no tax status” threshold that would benefit low-income taxpayers in those years when receipts from income sources that accrue primarily to upper-income taxpayers are plentiful.<sup>89</sup>

No such comfort is available with respect to increases in consumption tax rates since, as previously noted in this paper, Massachusetts sales and meals taxes are imposed on many goods that are necessities, and are imposed without regard to the purchaser's income.<sup>90</sup> On this basis, income taxes would appear to be preferable as a source of revenue for the Commonwealth given the assumption inherent in the state's income tax law<sup>91</sup> that some portion of individual or family income should be exempt from the tax.

Second, to the extent that we value simplicity and efficiency in the operation of revenue collection schemes, the state's income tax is – for better or worse – a more effective mechanism than the collection of consumption taxes at the point of retail sale. While this paper has criticized the practice of withholding taxes from the paychecks of low-income wage-earners on various grounds, it is nonetheless true that, assuming current inequities in the application of withholding rules can be remedied, withholding results in the collection of revenues with lower transaction costs and less uncompensated private sector labor.<sup>92</sup> Income taxes are thus potentially preferable to consumption taxes on this score as well.

Third, there is the moral dimension to consider. There are no truly progressive Massachusetts taxes, if by “progressive” one means that individuals pay taxes at different rates depending on their respective incomes. This is so because the state's constitution provides that taxes on income “shall be levied at a uniform rate throughout the commonwealth upon incomes derived from the same class of property,” subject to such “reasonable exemptions and abatements” as the legislature may choose to recognize.<sup>93</sup> There are, however, governmental revenues in Massachusetts that are raised by methods that are more regressive in practice than others. Foremost among these must be counted lottery revenues, a disproportionate percentage of which are paid by poor individuals, and a disproportionate percentage of which are put to use in cities and towns that have per capita income levels above the average for the state.<sup>94</sup> It may thus help to bring some perspective to an assessment of the relative morality of income versus consumption taxes to look at another source of government revenues outside of this dichotomy that is derived primarily from the poor.



Conservatives and liberals can argue for different reasons that the state's lottery games should be retained despite their regressive character. From a liberal's point of view, the greater the revenues generated by the lottery, the greater the resources available to support government programs for the relief of social ills. From a conservative's point of view, the choice to play the lottery is a voluntary one and the revenues that the lottery generates relieve political pressure that might otherwise be channeled into a successful effort to increase the state's income tax rate, thereby diminishing incentives to work. None of these arguments is responsive to the objection that the government of Massachusetts should, consistent with the constitutional notion that it was "instituted for the Common good," refrain from encouraging its poorer citizens to gamble away their limited resources, especially where their chances of winning are slight.<sup>95</sup>

The moral dilemma in the case of consumption taxes is not quite so stark, but it is an unavoidable element of any honest debate over their utility. Liberals can find in consumption taxes a source of additional revenues that insulates favored programs from reduction or elimination in times of straitened circumstances, and conservatives can view them as voluntary charges that keep budgets balanced and rates for other taxes stable. None of these arguments is responsive to the central objection that consumption taxes increase the cost of basic necessities to those who can least afford them, and that no tax credit or deduction can replace what consumption taxes take away, namely, the ability to save for the future and to survive in the present.

Finally, there is the fact that any discussion of which form of tax – income or consumption – is better or worse for Massachusetts begs the questions, what

things should our state government do and how much money does it need to do them effectively? If the Commonwealth is engaged in activities that are not proper functions of government, or if it fails to go about its business efficiently, its appetite for tax revenues will be larger than it should be.<sup>96</sup> In that case, the debate over income versus consumption taxes will not illuminate that which needs to be examined, and the debaters will be engaged in a search as bootless as that of the drunk who looks for his lost car keys under the street lamp, not because that's where he dropped them but because that's where the light shines.

*None of these arguments is responsive to the central objection that consumption taxes increase the cost of basic necessities to those who can least afford them.*



*Sellers to on-line buyers are not required to collect state and local sales taxes unless the seller has a physical presence in the state where the buyer is located.*

## **Taxation of Sales Over the Internet**

With many states facing budget deficits,<sup>97</sup> the development of a method by which states can effectively collect taxes on purchases of goods by their residents over the Internet from out-of-state sellers is under active consideration by state legislatures. While a detailed analysis of this topic is beyond the scope of this paper, the possible taxation of Internet sales is relevant to the discussion of the regressive character of state sales taxes.

In 1998 Congress passed the Internet Tax Freedom Act,<sup>98</sup> which temporarily barred states and local taxing authorities from levying taxes on Internet access, and barred multiple or discriminatory taxes on electronic commerce.<sup>99</sup> The rationale for this prohibition was that the Internet was in its infancy, and conflicting and complicated state tax laws would have impeded the development of electronic commerce.

The moratorium imposed by the Internet Tax Freedom Act, while motivated by legitimate public policy considerations, has been criticized as giving Internet sellers an unfair advantage over so-called “brick-and-mortar” retailers, who must collect sales taxes from consumers who purchase their goods in person. Under the U.S. Constitution as currently interpreted, states cannot compel retailers to collect taxes from customers unless the retailer has a physical presence in the state.<sup>100</sup> Thus, sellers to on-line buyers are not required to collect state and local sales taxes unless the seller has a physical presence in the state where the buyer is located.<sup>101</sup>

In November of 2002, in an effort to alleviate the burden of complying with numerous state and local sales tax laws,<sup>102</sup> 32 states formed the Streamlined Sales Tax Project and adopted the Streamlined Sales and Use Tax Agreement, which establishes uniform national procedures for the collection and

remittance of sales and use taxes on Internet sales.<sup>103</sup> Massachusetts Governor Romney signed legislation on March 5, 2003 authorizing the state to join the Streamlined Sales Tax Project, which now has over 40 state signatories.<sup>104</sup>

There has been little academic literature on the subject of Internet taxes and the existing literature on the subject has concentrated on conceptual discussions and legal analyses. The underlying reason behind this lack of interest in this topic may owe to the fact that Internet sales up till recently constituted a minuscule part of total sales. This trend however, is fast changing. At present, sales conducted over the Internet represent only a small part of total retail sales, but the share of total retail sales represented by on-line purchases is increasing rapidly. According to the May 2002 Census report, Internet sales accounted for 0.5 percent of total retail sales in 1999 and 0.9 percent of such sales in 2000.<sup>105</sup> By the fourth quarter of 2001, however, this percentage had risen to 1.3 percent, and by the fourth quarter of 2002 Internet sales stood at 1.6 percent of total retail sales.<sup>106</sup> More striking is the fact that during 2001 and 2002, when retail sales were down due to overall economic conditions, sales on the Internet experienced robust growth. From the fourth quarter of 2001 to the same period in 2002, total retail sales grew by a mere 1.6 percent, while Internet sales grew by 28.2 percent.<sup>107</sup>

For purposes of this paper, the question raised by this data is whether the exemption from state and local sales taxes that Internet sales currently enjoy amplifies the already-regressive nature of consumption taxes. Since Internet shopping requires a computer and access to the Internet, the intuitive conclusion one draws is that higher-income families are more likely to benefit from the current exemption of on-line purchases from sales taxes since such families have more



disposable income than the poor. While there is a dearth of data on this issue, what research there is indicates that the average user of the Internet has almost two more years of formal education, and \$22,000 more family income, than the average individual who does not use the Internet,<sup>108</sup> lending support to the claim that the exempt status of on-line purchases exacerbates the regressive nature of sales taxes. In the long run, this “brick and mortar penalty” may disappear since the same research indicates that use of the Internet by low-income users has been increasing rapidly with the corresponding decrease in the cost of Internet access and computers.



*Our current system of sales and consumption taxes violates fundamental principles of tax policy – fairness, flexibility and transparency.*

## **Conclusion**

A billion here and a billion there, noted Everett Dirksen, the late senator from Illinois, in discussing government expenditures, and pretty soon you're talking real money. The justification for consumption taxes and tax withholding laws is perhaps best expressed as a converse of this rule; namely, a nickel here and a nickel there, and no one will ever care.<sup>109</sup> At the lower end of the economic scale, however, when a nickel is added to the cost of a necessity, or is taken out of the pocket of a consumer on the grounds that he or she might owe it as taxes at a later date, it crimps both the present and the future of a family that could otherwise afford additional comforts today or save for a better life tomorrow.

Consumption taxes are by their very nature regressive, burdening the poor whom governments seek to protect by other means. The Commonwealth undermines its own efforts in this fashion by sales and excise taxes that fall disproportionately on the poor. Although the state's sales tax statute reflects some attempt on the part of legislators to exempt necessities from its scope, these exemptions have not kept pace with changing consumption habits. Many recent exemptions – rare coins, private and corporate aircraft – have no plausible connection to the consumption habits of the great majority of the Commonwealth's citizens.

Our current system of sales and consumption taxes violates fundamental principles of tax policy – fairness, flexibility and transparency. The sales tax is unfair in that it is regressive, and inflexible in that it has not kept pace with changes in our economy. The sales tax lacks transparency in that its many exemptions and exceptions follow no logical pattern.

The crude quality of the Commonwealth's consumption tax system and wage withholding practices as tools of tax policy has gone unnoticed for too long, as has the harm they inflict on those who struggle to earn their daily bread. The time for the overhaul of these features of our laws has come. James Otis, a Boston lawyer who opposed British excise taxes in colonial times, criticized those who supported such taxes by saying that their maxim seemed to be "that the common people in this town live too well." He took the position (as should we), that the people of modest incomes who bear the brunt of such taxes "do not live half well enough."<sup>110</sup>



## ENDNOTES

---

<sup>1</sup> For further information on Beacon Hill Institute’s STAMP go to: <http://www.beaconhill.org/BHI-STAMP-Brochure.pdf>.

<sup>2</sup> U.S. Census Bureau, Historical Income Tables – Families: 1947-2001.

<sup>3</sup> “Nothing to Crow About Yet,” *The Denver Post*, May 4, 1998, citing McKinsey & Co. report prepared for International Foodservice Distributors Association and Food Distributors International.

<sup>4</sup> Office of Massachusetts State Comptroller, Statutory Basis Financial Report, Fiscal Year Ended June 30, 2002.

<sup>5</sup> The Sixteenth Amendment to the U.S. Constitution, which authorized Congress “to lay and collect taxes on income, from whatever source derived,” was ratified February 3, 1913.

<sup>6</sup> St. 1916, c. 269.

<sup>7</sup> U.S. Census Bureau, State Government Tax Collections: 2001, revised July 2002.

<sup>8</sup> Forty-five percent of voters responding to Question 1 on the 2002 statewide ballot, which would have repealed the state’s income tax, voted “yes,” surprising even the sponsors of the initiative. “Voters Antitax Sentiments Seen Altering Agendas,” *Boston Globe*, November 7, 2002.

<sup>9</sup> Richard A. Musgrave, *The Theory of Public Finance: A Study in Public Economy*, McGraw-Hill Book Company, Inc., 1959, p. 249.

<sup>10</sup> Alexander Hamilton to the People of the State of New York, “The Federalist No. 21: Other Defects of the Present Confederation,” *Independent Journal*, December 12, 1787.

<sup>11</sup> J.A. Pechman, “Who Bears the Tax Burden?” Brookings Institution, Washington, D.C., 1985; William Gale, Scott Houser, and J. Karl Scholz, “Distributional Effects of Fundamental Tax Reform,” *Economic Effects of Fundamental Tax Reform*, edited by Henry Aaron and William Gale, Brookings Institution, Washington, D.C., 1996, p. 281-315.

<sup>12</sup> A 2002 study by the Institute on Taxation and Economic Policy found that Massachusetts families with incomes of less than \$19,000 per year – the poorest families in Massachusetts – paid 9.3% of their total income in taxes, which is more than double the effective tax rate on the wealthiest taxpayers in the state.

<sup>13</sup> Massachusetts Records, 1:111, cited in Stephen Innes, *Creating the Commonwealth: The Economic Culture of Puritan New England*, W.W. Norton & Company, 1995, p. 102. Those who benefited from this tightened labor market included apprentices and other indentured servants. B. Bailyn, “Education in the Forming of American Society,” W.W. Norton & Company, 1972, pp. 29,30.

<sup>14</sup> John Norton, “The Heart of New England Rent,” *Evans Early American Imprints*, Cambridge, Mass., 1659, No. 56, p. 39.

<sup>15</sup> The punishment for conduct prohibited by sumptuary laws gradually evolved from loss of the offending article to fines. Jonas Fairbanks, a skilled forge helper at an ironworks in Lynn, was one of the first to face the prospect of monetary loss under this new regime when, in November of 1652, he was presented before the Essex County Quarterly Court for the offense of wearing gentleman’s boots. *Records and Files of the Quarterly Courts of Essex County, Massachusetts*, edited by George Francis Dow, 8 vols., Salem, Mass., 1911-21, cited in Innis, *supra*, p. 344. The charges against Fairbanks were eventually dismissed on a technicality, namely, he had worn the boots before the sumptuary law of 1651 that imposed such fines had been published.

<sup>16</sup> Sydney, Australia, where prostitution is legal, has extended the reach of consumption taxes to perhaps its furthest extreme. Under the “Disorderly Houses Act,” prostitutes are required to collect, on behalf of the government, a 10% tax on goods and services that they sell. *The Wall Street Journal*, September 19, 2000.

<sup>17</sup> The Commonwealth’s power to levy excise taxes is found in Part the Second, Article IV, Chapter I, Section I, of the Massachusetts Constitution, which provides in pertinent part that “full power and authority are hereby given and granted to the said General Court . . . to impose and levy, reasonable duties and excises, upon any produce, goods, wares, merchandize and commodities, whatsoever, brought into, produced, manufactured, or being within” the Commonwealth. A precursor to this constitutional provision is found in the laws adopted by the original colonists, which provided for an annual “estimation of all personall & real estates” by “Commissioners and Select men,” with the property so determined to be assessed at specified rates. Thus, for example, “everie cow of four years olde and upward” was valued at five pounds, and assessed at the current rate. *The Laws and Liberties of Massachusetts*, Cambridge, Harvard University Press, 1929.

<sup>18</sup> Excise taxes that are imposed at the time of sale appear to be simply sales taxes under an older name. The term “sales tax” did not enter the language until the 1920’s, while the word “excise” has ancient Latin roots. “Excise” may be derived from “excisus,” meaning “to cut,” but its use in the context of taxation probably stems more directly from “assidere,” meaning “to sit beside” or “assist in the office of a judge.” “Assidere” gave rise to “assize,” a word that formerly referred to laws regulating weights and measures.

<sup>19</sup> G.L. c. 60A §1. The motor vehicle excise tax is assessed on the value of a vehicle but is stated to be a charge for the privilege of operating a motor vehicle in the state, and is thus an example of a secondary meaning of the word “excise,” namely, “any of various taxes on privileges often assessed in the form of a license or fee,” *Webster’s Ninth New Collegiate Dictionary*, 1986.

<sup>20</sup> R.A. McGowan, “Lotteries and Sin Taxes: Painful Revenue or Painful Mirage,” *America*, vol. 170, p. 4, April 30, 1994. McGowan defines a sin tax as an excise tax “on products and services with limited public political support.”

<sup>21</sup> A third, more legitimate argument holds that consumption taxes fall only on consumption and not on saving and are therefore, to that extent, more economically neutral than ordinary income taxes. An income tax can be designed, however, to fall only on consumption and not on saving, while providing a large personal exemption. An income tax so designed would be more neutral but less regressive than the existing sales tax. See L. S. Seidman, “A Progressive Consumption Tax,” *Challenge*, v. 40, Nov-Dec, 1997.

<sup>22</sup> A tax equal to 10 percent of the manufacturer’s price is imposed by the federal government on sport fishing equipment, 26 U.S.C. §4161. Among the items of “sport fishing equipment” subject to this tax are rods, poles, reels, fly fishing lines and fishing lines under 130 pounds test, fishing spears, spear guns and spear tips and items of “terminal tackle” including leaders; artificial lures, baits and flies; and fishing hooks, bobbers, sinkers, snaps, drayles and swivels, 26 U.S.C. §4162.

<sup>23</sup> The federal wine excise tax ranges from \$1.07 per wine gallon on still wines containing not more than 14 percent of alcohol by volume, to \$3.15 per wine gallon on still wines containing more than 21% and not more than 24% of alcohol by volume. Once a consumer makes the fateful decision to switch from still wine to champagne, the tax increases to \$3.40 per wine gallon, 26 U.S.C. §5041(b).

<sup>24</sup> The federal “gas guzzler” excise imposed by 26 U.S.C. §4064 rises from no tax on vehicles with a fuel economy rating of at least 22.5 to \$7,700 on vehicles with a fuel economy rating of less than 12.5.

<sup>25</sup> Under G.L. c. 64C §6, an excise is imposed on the sale of cigarettes at the rate of \$1.51 per pack of 20 cigarettes, 40% of monies received from the base tax on cigarettes in excess of \$169,800,000 are credited to the Local Aid Fund, with the balance being credited to the state’s General Fund. The 12.5 mill supplementary tax on cigarettes and the 15% tax on the price of cigars and smoking tobacco are credited to the Children’s and Seniors’ Health Care Assistance Fund established pursuant to G.L. c. 29, §2FF.

<sup>26</sup> G.L. c. 64A §13. An early example of an earmarked excise tax in Massachusetts is the tax on carriages and other luxuries that was imposed in the 18th century in order to finance a school to teach the spinning of linen. G. Weston, *Boston Ways: High, By and Folk*, p. 224, Beacon Press, 1957.

<sup>27</sup> G.L. c. 10 §35T.

<sup>28</sup> G.L. c. 64H §2.

<sup>29</sup> G.L. c. 64H §1, defining “sale” and “selling.” The definition of “sale” excludes services performed by an employee for an employer, services performed by a general partner for a partnership, the performance of services for which compensation in the form of an honorarium is received, services performed by investment advisors and securities brokers, and trust, custody, cash management and securities services performed by Massachusetts trust companies.

<sup>30</sup> G.L. c. 64H §1, defining “services.” There was some doubt as to the legislature’s power to tax services, since the provision of the Massachusetts Constitution that authorizes excises refers only to “goods, wares, merchandize, and commodities” as permissible subjects of such taxes. Massachusetts Constitution, Part the Second, Article IV, Chapter I, Section I. An opinion of the state’s Supreme Judicial Court in 1990 held that services fell within the meaning of the term “commodities” as used in the above-cited section of the state’s constitution, and could thus be taxed. *Opinions of the Justices to the Governor*, 556 N.E. 2d 1002 (1990).

<sup>31</sup> G.L. c. 64H §1, defining “sale at retail” or “retail sale.”

<sup>32</sup> G.L. c. 64H §6(w) and (u).

<sup>33</sup> Massachusetts Tax Expenditure Budget, Fiscal Year 2002, January 2001, Executive Office for Administration and Finance, p. 3.

<sup>34</sup> G.L. c. 64H §6(h).

<sup>35</sup> On November 7, 1646, for example, the General Court passed laws imposing fines of 20 shillings per month on any person “denying the imortality of the soule, or the resurrection of the body. . . or denying that Christ gave himself a ransome for our sinns,” with the penalty to be increased to 40 shillings per month if the heresy was not recanted within six months, Nathaniel B. Shurtleff, ed., *The Records of the Governor and Company of the Massachusetts Bay in New England* (Boston, 1853), 2:177, quoted in Darren Staloff, *The Making of an American Thinking Class: Intellectuals & Intelligentsia in Puritan Massachusetts* (Oxford University Press, 1998), p. 125. Dissemination of such views was subject to a much heftier fine – £5 per offense.

<sup>36</sup> G.L. c. 64H(h), defining the term “restaurant.”

<sup>37</sup> G.L. c. 64H, §6(i), (j), (k), (l) and (n).

<sup>38</sup> G.L. c. 64H §6(ll).

<sup>39</sup> The sales tax statute was further amended in 2002 to exempt sales of private and corporate aircraft from its scope, as well as parts and labor for maintenance of such aircraft. The Massachusetts Department of Revenue estimates that the exemption will result in an annual revenue loss of \$8 million to the Commonwealth. Beneficiaries of this amendment, sponsored by Rep. Cele Hahn (D.-Westfield) include comedian Bill Cosby. A. Beam, "Air Cosby," *Boston Globe*, May 16, 2002. Cosby's annual earnings are estimated at \$3 million. Forbes 100 Top Celebrities, 2001, 2002, Forbes.com.

<sup>40</sup> B. H. Lin and Joanne Guthrie, *Food Review*, U.S. Department of Agriculture, vol. 18, no. 2, May 17, 1996.

<sup>41</sup> "Why People Eat Out," *Health Tab: Vital Statistics*, The Washington Post, July 30, 1996, citing a level of 25% for such expenditures in 1955.

<sup>42</sup> Bureau of Labor Statistics, Consumer Expenditure Survey for 2000-01: Northeast Region.

<sup>43</sup> Knight-Ridder Tribune Business News: *The Orlando Sentinel*, May 31, 1999.

<sup>44</sup> U.S. Census Bureau, Historical Income Tables – Families: 1947-2001.

<sup>45</sup> "Nothing to Crow About Yet," *The Denver Post*, May 4, 1998, citing McKinsey & Co. report prepared for International Foodservice Distributors Association and Food Distributors International.

<sup>46</sup> Bureau of Labor Statistics, Consumer Expenditure Survey for 2000-01: Northeast Region.

<sup>47</sup> "Ask a Working Woman," telephone survey conducted by Lake Snell Perry & Associates, Inc. reported at AFL-CIO. Internet: "www.aflcio.org/women/survey1.htm" as of March 13, 2000.

<sup>48</sup> G.L. c. 64H §6(p)(1).

<sup>49</sup> G.L. c. 64H §6(m), (f) and (ee).

<sup>50</sup> The figures in the proceeding portion of this article are taken from an analysis of the Consumer Expenditure Data Base, Northeast Region, United States Bureau of Labor Statistics, 2000-2001, which describes the relative percentages spent by consumers in different income brackets on food (in home and out of home), utilities, occupancy costs, clothing, transportation, health and medicine, insurance and other categories of consumer goods and services. The data was analyzed by applying Massachusetts consumption tax rates to those expenditures that would be subject to such levies, and then computing total consumption taxes as a percentage of household income.

<sup>51</sup> L. S. Seidman, "A Progressive Consumption Tax," *Challenge*, v. 40, Nov-Dec, 1997.

<sup>52</sup> *The Wall Street Journal*, "Labor Letter: A Special Report on People and Their Jobs in Offices, Fields and Factories," April 13, 1993, Kevin G. Salwen; "The Suburban Life: Trees, Grass Plus Noise, Traffic and Pollution, Joann S. Lublin, *The Wall Street Journal*, June 20, 1985.

<sup>53</sup> MBTA 500 bus schedule as of March 19, 2003, appearing on the MBTA's web site, www.mbta.com. See also "Urban nightmare inspires dream," T. Weisend, *Boston Herald*, March 24, 1997; "The Urban Ring: Architectural fancy becomes a priority," A. Lupo, *Boston Globe*, November 19, 1995; "A Call to Rally Around An Urban Ring," M.D. Lee, *Banker & Tradesman*, December 11, 1995; and "Suburbs say they're left at the station: MBTA's lack of 'reverse commuter' trains criticized," *Boston Globe*, September 23, 2001.

<sup>54</sup> W. Cox, "Reasonable Expectations for Transit in the Modern Urban Area," Congressional Testimony before the Senate Committee on Banking, Housing and Urban Affairs, October 8, 2002.

<sup>55</sup> The Department of Telecommunications and Energy was formerly the Department of Public Utilities. See G.L. c. 25 §1, amended by St. 1997, c. 164, §28.

<sup>56</sup> DTE list of bus companies providing inter-city service within Massachusetts, December 27, 1995. Since that list was published, the number of companies providing inter-city bus service has increased from 10 to 21 without any corresponding improvement in the availability of private transportation options for “reverse” commuters. DTE Bus List dated May 11, 2000.

<sup>57</sup> The role that public transportation should play in getting low-wage workers to jobs that could lift them out of poverty, and that private for-profit carriers would play in this arena if the state would let them, is being assumed of necessity by private employers. See “Starts and Stops: Shuttle Program Launched,” *Boston Globe*, March 20, 2000, describing a shuttle service established by the Route 128 Business Council linking the MBTA’s Green Line with the New England Business Center in Needham.

<sup>58</sup> G.L. c. 60A §1 defining the assessment of motor vehicle excise tax.

<sup>59</sup> G.L. c. 64H §3(c).

<sup>60</sup> G.L. c. 64H §6 provides as follows: “The following sales and the gross receipts therefrom shall be exempt from the tax imposed by this chapter: ( . . . ) (c) Casual and isolated sales by a vendor who is not regularly engaged in the business of making sales at retail; provided, however, that nothing contained in this paragraph shall be construed to exempt any such sale of a motor vehicle or trailer.”

<sup>61</sup> Massachusetts Department of Revenue, Monthly Revenue Reports. Internet: <http://www.dor.state.ma.us/stats/monthly.htm>.

<sup>62</sup> G.L. c. 64A sec. 1(l).

<sup>63</sup> See note 61, *supra*.

<sup>64</sup> G.L. c. 64A §7 defining exemptions on the gasoline tax.

<sup>65</sup> A. Shlaes, “The Greedy Hand in a Velvet Glove,” *The Wall Street Journal*, April 15, 1999.

<sup>66</sup> In the early years of tax withholding there were several objectors to the practice, most notably Vivien Kellems, a Connecticut cable-grip maker, who refused to withhold taxes from the wages of her employees. She ultimately wrote a book about her resistance to withholding titled “Toil, Taxes and Trouble.” A. Shlaes, *supra*. While compliance is now largely universal, there remain a few holdouts, such as the Indianapolis Baptist Temple, an Indiana congregation that faces the seizure of its church by the Internal Revenue Service for refusing to withhold taxes from employee paychecks on religious grounds, *Boston Globe*, November 18, 2000; *The Wall Street Journal*, November 15, 2000.

<sup>67</sup> G.L. c. 62B.

<sup>68</sup> 830 CMR §62B.2.1(4).

<sup>69</sup> “2001 State Tax Collection by Source,” Federation of Tax Administrators. Internet: <http://www.taxadmin.org/fta/rate/01taxdis.html>.

<sup>70</sup> *Ibid*.

<sup>71</sup> The excise tax on corporations other than banks, insurance companies and utilities in Massachusetts includes as one of its components a levy of 8.33% on the net income of the corporation, G.L. c. 63 §32.

<sup>72</sup> Texas Comptroller of Public Accounts. Internet: [http://www.window.state.tx.us/taxinfo/taxpubs/tx98\\_490/tx98\\_490.html](http://www.window.state.tx.us/taxinfo/taxpubs/tx98_490/tx98_490.html).

<sup>73</sup> Due to declining revenues, the state did not give its residents a tax holiday in 2002. This was the first time since the holiday was first observed in 1998 that taxpayers did not receive this benefit.

<sup>74</sup> “Shopping for School Isn’t a Taxing Ordeal for Some Parents,” *The Wall Street Journal*, September 3, 1999.

<sup>75</sup> *Ibid.*

<sup>76</sup> David L. Keating, “A Taxing Trend: The Rise in Complexity, Forms and Paperwork Burdens,” National Taxpayers Union, *Policy Paper 105*, April 11, 2001.

<sup>77</sup> See text at note 39, *supra*.

<sup>78</sup> G.L. c. 64H §6(u).

<sup>79</sup> See text at notes 52-60, *supra*.

<sup>80</sup> See text at note 27, *supra*.

<sup>81</sup> See text at notes 58-60, *supra*.

<sup>82</sup> An additional benefit of reducing the cost of automobile ownership to the poor, but one not analyzed here, is that it would give low-income drivers additional income with which to maintain their cars, thereby increasing the safety of both those who use them and passengers in other vehicles.

<sup>83</sup> U.S. Internal Revenue Code §103(a); G.L. c. 62 §2(a)(1)(A). Recent state and municipal general obligation bonds maturing in thirty years bore nominal “coupon” rates of 5.25% and 5.375%, Bond Market Data Bank, *The Wall Street Journal*, March 18, 2003.

<sup>84</sup> Rates on unsecured consumer credit cards range, as this is written, from a nation-wide low of 4.75% per annum to a high of 23.99% per annum. CardTrak Online, March, 2003 Low Rate and Standard Card Surveys, [www.cardweb.com](http://www.cardweb.com). The state’s criminal usury law provides for a maximum charge of 20% per annum on borrowed money, G.L. c. 271 §49, subject to exemptions for regulated financial institutions and those who register with the Attorney General. The state’s consumer credit laws provide for a variety of different limits on the rates that lenders may charge on particular loans to consumers, *see* G.L. c. 140 §§86-114C, but the maximum rate applicable to credit card balances, the most readily-available form of consumer credit, is 18% per annum unless the rate derived by doubling the average auction rates for 90-day U.S. Treasury bills during the three preceding calendar months exceeds 18% per annum, in which case the creditor may “charge such daily, monthly or other periodic rate or rates as may be established by the lender,” G.L. c. 140 §114B.

<sup>85</sup> See, e.g., “The Next New Tax,” W.H. Miller, *Industry Week*, June 9, 1986; “On the Matter of Consumption,” G.P. Brockaway, *The New Leader*, April 4, 1988; “A Progressive Consumption Tax,” L.S. Seidman, *Challenge*, Nov.-Dec. 1997; “The Case for a Consumption Tax,” A. Kupfer, *Fortune*, August 15, 1988; “A Consumption Tax: More Injustice for the Poor,” A. Etzioni, *The Nation*, October 10, 1988; “Should We Tax Consumption?,” M.L. Weidenbaum, *USA Today Magazine*, March, 1993; “Next: An All-Consuming Tax Debate,” *U.S. News & World Report*, February 8, 1993; “Consumption Taxes: Do They Spur Growth?,” S. Wieler, *Challenge*, Nov.-Dec. 1998; “Taxing the Poor: Another Bright Republican Idea,” R.S. McIntyre, *The New Republic*, January 30, 1995; “The Next Tax Bill,” J.A. Schnepfer, B. Leduc, *USA Today Magazine*, September 1993; “The Consumption Tax’s Time Has Come,” W.H. Miller, *Industry Week*, January 23, 1995; “A Tax that Tax Haters Can Tolerate,” A. Reilly, *Fortune*, September 17, 1984; “A Better Way to Tax?,” S. Lee, *Forbes*, July 30, 1984.

<sup>86</sup> Rankings computed based on the State Government Tax Collections: 2001, U.S. Census Bureau, revised July 2002.

<sup>87</sup> The author is aware that the use of the word “reform” implicitly suggests that a reduction in consumption taxes would result in a net benefit to the Commonwealth. As Roscoe Conkling, a New York machine politician of the nineteenth century, put it, “When Dr. Johnson defined patriotism as the last refuge of a scoundrel, he was unconscious of the then undeveloped capabilities of the word reform.” (Quoted in R. Hofstadter, *The American Political Tradition*, Vintage Books edition, p. 174.)

<sup>88</sup> Massachusetts Department of Revenue, 1996 Individual Income Tax Returns, Massachusetts Statistics of Income, September, 2000, p. 19.

<sup>89</sup> The most recent adjustment by the Massachusetts legislature to the personal exemptions from the state’s income tax *reduced* the number of poor people who qualify for no-tax status. On August 12, 2002, the General Court voted to override then-Governor Jane Swift’s veto of a \$1.1 billion tax package (House 5250), which reduced the personal exemptions for single taxpayers to \$3,300, for heads of households to \$5,100, and for married taxpayers filing joint returns to \$6,600. *State and Local Taxes Weekly*, August 12, 2002.

<sup>90</sup> One possibility, not pursued here, is to place consumption taxes on an equal footing with graduated income taxes by adjusting the rates at which such taxes are imposed according to the consumer’s income or financial strength. While the author knows of no instance in which a taxing authority has pursued this result, Finland has for decades imposed different traffic fines on drivers according to both the severity of the offense and the driver’s income. “Helsinki on Wheels: Fast Finns Find Fines Fit Their Finances,” *The Wall Street Journal*, January 2, 2001. With the advent of technology that permits remote access to income tax records, resistance to this method of assessing fines has increased dramatically as drivers’ ability to deceive police officers as to their incomes has decreased. *See also* “Highway Robbery,” *The Wall Street Journal*, February 11, 2002.

<sup>91</sup> G.L. c. 62 §1 *et seq.* The exemptions appear in G.L. c. 62 §5.

<sup>92</sup> See text at note 69, *supra*.

<sup>93</sup> Constitution of the Commonwealth of Massachusetts, Amendment Article XLIV.

<sup>94</sup> The balance of revenues remaining in the State Lottery Fund after payment of prizes and expenses of the state lottery commission are expended for the purposes of the Local Aid Fund, G.L. c. 10 §35. Monies credited to the Local Aid Fund are distributed to cities, towns and districts without regard to, in the case of lottery receipts, the city or town in which a losing ticket is purchased, G.L. c. 29 §2CΩ. As a result, a city or town whose residents purchase a disproportionate number of lottery tickets does not receive an equivalent share of local aid monies.

<sup>95</sup> Constitution of the Commonwealth of Massachusetts, Declaration of Rights, Article VII. With the passage of the state lottery law (G.L. c. 10, §§23-35, 37-40, 56-58) in 1971, Massachusetts reversed a policy of official disapproval of gambling that dated from the seventeenth century. The Book of the General Laws and Liberties Concerning the Inhabitants of Massachusetts of 1647 contained the following general prohibition against gaming: “Nor shall any person at any time play or game for any monie, or mony-worth upon penalty of forfeiting treble the value thereof.” Whether governments should encourage or discourage gambling is a question for another day, but one recalls that Edward II, the English monarch whose excesses provoked a rebellion led by a young archer named Robin Hood,

forced his subjects to gamble with him for petty sums. *Robin Hood's England*, S.M. Davis, TimeTraveler Press 1991, p. 11.

<sup>96</sup> An Analect of Confucius on this point goes as follows: “Let those who produce the revenue be many and those who consume the revenue be few and let the consumers practice economy.”

<sup>97</sup> The fifty states face collective shortfalls of from \$40 to \$50 billion this fiscal year, and as much as \$75 billion in 2004, according to the National Governors Association. “States circle Net,” *Boston Globe*, January 2, 2003.

<sup>98</sup> Internet Tax Freedom Act, Pub. L. 105-277, Div. C, Title XI, §§1101 to 1104, Oct., 21, 1998, 112 Stat. 2681-719, as amended by Pub. L. 107-75, §2, Nov. 28, 2001, 115 Stat. 703.

<sup>99</sup> 47 U.S.C. §151 note barring discriminatory taxing of e-commerce. The moratorium originally expired October 20, 2001, but was extended to November 30, 2003.

<sup>100</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). That case involved a “use” tax, a tax imposed on the use by a state resident within the taxing state of goods or services purchased from an out-of-state seller. The Massachusetts use tax of 5% of the sales price of goods and services “purchased from any vendor” is codified at G.L. c. 64I; sales on which the sales tax is collected are exempt from the use tax, G.L. c. 64I §7(a).

<sup>101</sup> The on-line units of larger retailers such as Wal-Mart Stores, Inc., Toys “R” Us, Target Corp. and Marshall Fields, which have stores in numerous states, have recently informed on-line customers that they must pay state sales taxes on their on-line purchases. “Online sellers bow to state taxes,” *Boston Herald*, February 7, 2003; “More Web Retailers Collect Sales Tax,” *The Wall Street Journal*, February 10, 2003. Retailers who allow customers to return online purchases to local stores have previously collected state sales taxes where applicable since the use of the retail outlet for returns creates a nexus with the state sufficient under the *Quill* decision to permit states to enforce collection of retail sales taxes.

<sup>102</sup> There are an estimated 7,000 separate taxing jurisdictions in the United States. “No Internet tax yet, but we’re closer,” Philipp Harper, MSN bCentral, December 30, 2002, Internet: [www.bcentral.com/articles/harper/146.asp](http://www.bcentral.com/articles/harper/146.asp).

<sup>103</sup> Streamlined Sales and Use Tax Agreement, November 12, 2002. For a copy of the full report go to: <http://66.28.69.53/sline/Final%20Agreement%20Adopted%2011-12-02.pdf>.

<sup>104</sup> “State edges toward possibly allowing Net sales tax,” *Boston Globe*, March 15, 2003, p. C1.

<sup>105</sup> U.S. Census Bureau, 2000 Annual Retail Trade Survey (Revised May 2002).

<sup>106</sup> U.S. Census Bureau, Retail 4Q, 2002 E-Commerce Report, February 24, 2003.

<sup>107</sup> *Ibid.*

<sup>108</sup> A. Goolsbee and J. Zittrain, “Evaluating the Costs and Benefits of Taxing Internet Commerce,” *National Tax Journal*, September 1999, v. 52, iss. 3, pp. 413-428.

<sup>109</sup> The seeming insignificance of levies on consumption when each taxable transaction is viewed in isolation makes them attractive to lawmakers who seek solutions to periodic budget shortfalls, since a slight increase in the amount of taxes raised in a great number of transactions can be expected to draw less popular opposition than a large increase in a smaller number of cases. *See, for example*, recent proposals to increase the state’s gasoline tax (*Boston*

*Herald*, March 19, 2003), state and federal taxes on beer (*Wall Street Journal*, January 6, 2003, *Boston Globe*, March 27, 2001, state sales taxes, *Boston Herald*, February 5, 6, 2001).

<sup>110</sup> Writing in the *Boston Gazette*, an anti-British weekly. Quoted in A.J. Langguth, “Patriots: The Men Who Started the American Revolution,” Touchstone Books ed., 1988, p. 26.

The Beacon Hill Institute at Suffolk University in Boston focuses on federal, state and local economic policies as they affect citizens and businesses. The institute conducts research and educational programs to provide timely, concise and readable analyses that help voters, policymakers and opinion leaders understand today's leading public policy issues.

©April 2003 by the Beacon Hill Institute at Suffolk University



**The Beacon Hill Institute for Public Policy Research  
Suffolk University**

**8 Ashburton Place**

**Boston, MA 02108**

**Phone: 617-573-8750 Fax: 617-720-4272**

**[bhi@beaconhill.org](mailto:bhi@beaconhill.org)**

**<http://www.beaconhill.org>**

ISBN 1-886320-17-9