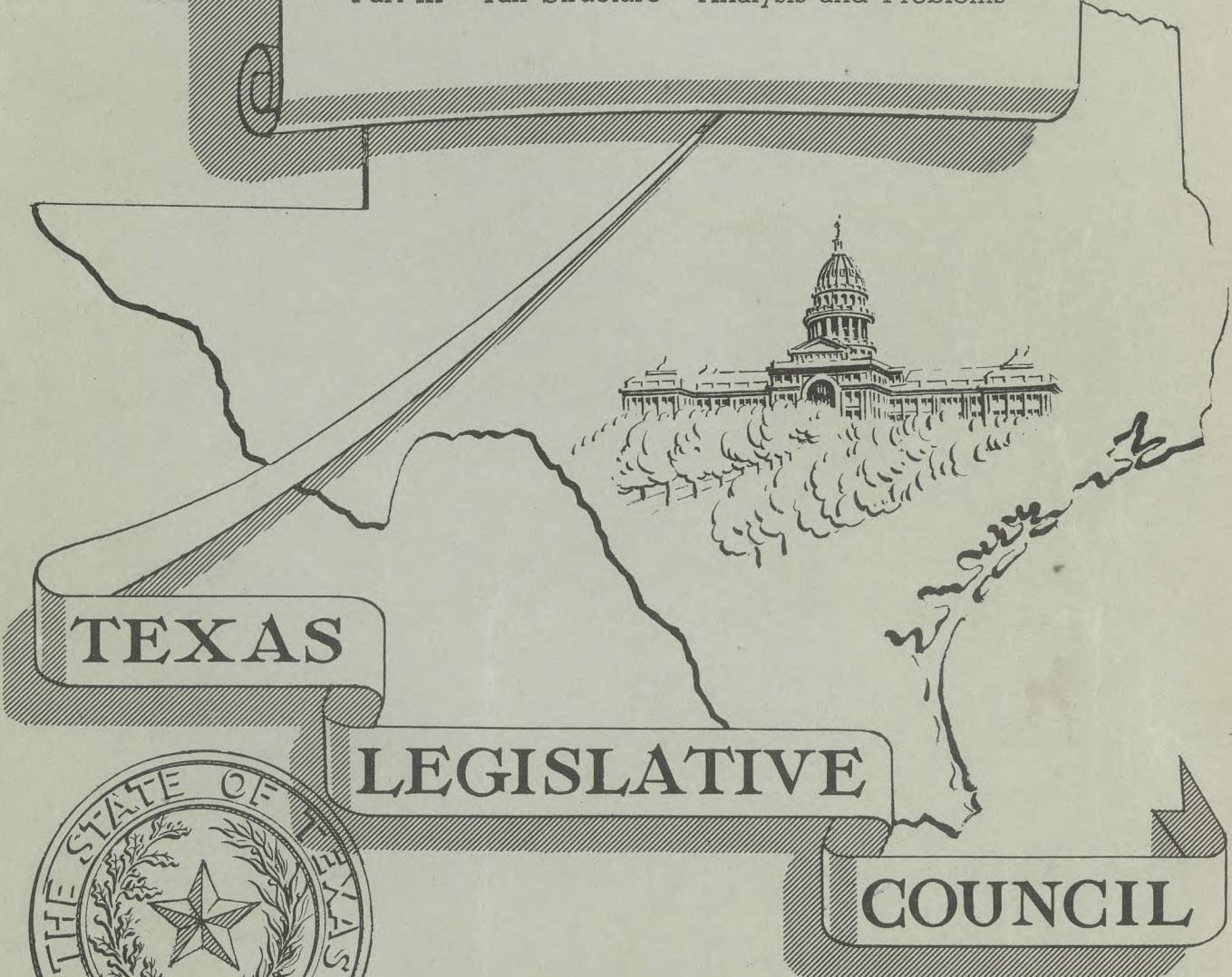
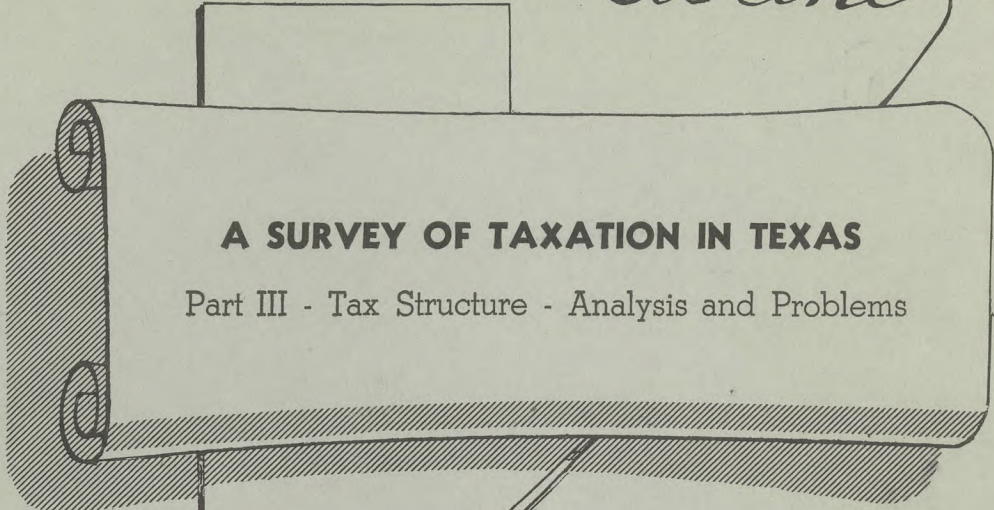


# STAFF RESEARCH REPORT

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A SURVEY OF TAXATION IN TEXAS

Part III Tax Structure - Analysis and Problems

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Prepared by the

STAFF OF THE TEXAS LEGISLATIVE COUNCIL

Austin, Texas  
November, 1952

6801307

TEXAS LEGISLATIVE COUNCIL

of the

52d Legislature of Texas

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The duty of the Legislative Council is:

- "(a) To investigate departments, agencies and officers of the State and to study their functions and problems;
- (b) To make studies for the use of the legislative branch of the State Government;
- (c) To gether information for the use of the Legislature;
- (d) To make such other investigations, studies, and reports as may be deemed useful to the Legislative branch of the State Government;
- (e) To sit and perform itsduties in the interim between sessions;
- (f) To report to the Legislature its recommendations from time to time and to accompany its reports with such drafts of legislation as it deems proper. "

The object of this staff research report is to assist the Legislative Council in carrying out this responsibility. Any recommendations concerning the subject of this research report that the Council may make will be trans-  
mitted to the 53d Legislature.

## TRANSMITTAL NOTE

This research report is submitted to provide background information, some general analyses of the problem, and some indication of areas of further study or action for the use of the Texas Legislative Council, its Study Committee on Taxation, and the Legislature of the State of Texas. This is a staff research report for which only the staff assumes responsibility. The Council staff stands ready to assist the Council, the study committee, and the Legislature in any additional work on this subject.

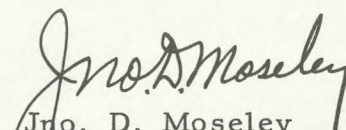
The 52d Legislature, through H. C. R. 69, requested a study of the tax structure and a report to the 53d Legislature. The Council directed the staff to proceed with such a study, indicating that the individual tax studies should be completed as a requisite for further consideration of the tax structure as a whole. This report undertakes to bring together the information on the tax structure and the problems involved. The introduction explains the perspective in which this volume was prepared and also how it is the culmination of an initial survey of the Texas tax structure.

This report is the product of the combined efforts of the Council staff. The principal research was done by Albert W. Worthy Jr., Thomas I. Dickson, William C. Foster, and Francis A. Miskell, each being responsible for major portions of work. James K. Howard also assisted in the research and preparation of the report.

The staff wishes to express its appreciation to various agencies for their invaluable co-operation, information, and help. Especially do we wish to thank the Comptroller of Public Accounts.

This volume concludes the series of A Survey of Taxation in Texas. Throughout this work, the staff has been impressed by the tremendous job involved in a really complete study of the Texas tax structure and recognizes that this series of reports has many shortcomings, some of which are due to limitations of time and staff. It is hoped, however, that this survey may be of assistance to the Legislative Council, its Study Committee on Taxation, and the Legislature of the State of Texas as it deals with this most important subject of the tax structure.

Respectfully submitted,

  
Jno. D. Moseley  
Executive Director

## INTRODUCTION

The subject of taxation has always been of great interest to the citizen and the legislator. In recent years, with taxes increasing, this topic has had even greater interest. Indeed, it has become one of the problem areas of government. From the very beginning of the Legislative Council it has been concerned with the subject of taxation.

In its initial year, the Council recognized "that the next legislature is going to face a problem of taxation and that there is insufficient time (before the 52d Legislature) and money to study the problem thoroughly." However, the Council instructed the staff "to make a survey of the taxation problem and collect as much information as possible. . . ." The problem was one of obtaining additional tax revenue; thus the information needed to be broader than the existing tax program. Yet solution of many problems concerning current taxes might also produce additional revenue.

Two broad approaches to the tax structure developed. The first involved a look at the development and changes in the Texas tax revenue structure over a 21-year period and relation of the structure to the state economy as a whole. It also involved a look at the tax structure of Texas as compared with nine selected states.

The second broad approach was to look at the tax structure in terms of individual taxes, how they operated, their effectiveness, and their problem areas. This did not include a total analysis of the tax because it omitted any study from the taxpayers standpoint.

The 52d Legislature not only had tax problems but requested further study of the tax structure by passing H. C. R. 69. The text of the resolution indicates the broad scope of legislative interest.

Whereas, the demands of the people for expanded State services, and the rising costs of State government as a result thereof, made it necessary for the Fifty-first Texas Legislature to pass a bill increasing the tax burden in this State; and

Whereas, it appears to be a foregone conclusion that the Fifty-second Legislature must enact additional tax bills in order to provide the people of this State with the services they demand and desire; and

Whereas, due to the complexities of the many problems with which the Legislature and the individual members thereof are confronted, it is impossible during the course of a regular session to study thoroughly the tax structure of this State and the need for its revision and amplification so that taxes levied by the Legislature may be, as required by the Constitution, "equal and uniform"; now, therefore be it

Resolved by the House of Representatives, the Senate concurring, That the Texas Legislative Council be, and the same is hereby directed, to study the tax structure of this State, including any loopholes therein, and to report back to the Fifty-third Legislature with specific proposals for the overhauling of the Texas tax structure, such proposals to be in the form of suggested bills to bring about a sound system of taxation designed to support the needs of the State government and to eliminate any inequalities found under existing laws. This resolution shall take precedence over all other matters now pending before the Legislative Council.

The Council adopted the recommendation of its Study Committee on Taxation that the staff complete the study of individual taxes, which had already begun under the previous Council, as a necessary first step to further work on the tax structure. Although the resolution indicates concern for particular problems, the resolving clause is couched in broad and general language. The intent appears to have been to permit the Council wide latitude, both in defining the scope of its study of tax structure and in formulating its recommendations concerning "a sound system of taxation designed to support the needs of the State government."

To understand this report and its role in the study of the tax structure, it may be helpful to review the information that has been presented to the Council and the Legislature. An easy way to accomplish this is to list the content of each volume in the series under the general title A Survey of Taxation in Texas.

Part I - Comparative Tax Revenue Analysis -- Texas and Selected States

Chapter I: Explanatory Notes and Definitions

Chapter II: Comparative Economic Survey of Texas and Selected States  
Introductory Note--Population--Employment--Income  
Payments to Individuals--Business Population--Agriculture--Mining--Manufacturing--Trade and Services--  
Summary

Chapter III: Comparative Analysis of Tax Revenues, State of Texas,  
1929-1949

Total Tax Revenues--Tax Revenues by Class of Tax--  
Tax Revenues by Sources of Collection--Federal Tax  
Collections in Texas

Chapter IV: Comparative Analysis of Tax Revenues, Texas and Selected  
States

Combined Tax Revenues--Total State Tax Revenues--  
State Tax Revenues by Class of Tax--Tax Revenues by  
Source of Collection--Federal Tax Collections in  
Selected States

This staff research report was submitted to the Legislative Council in October, 1950, and to the 52d Legislature. It is now out of print, but several copies are available in the State Library. Part I presents three main segments of information about tax structure. The first presents in profile broad characteristics of the Texas economy and compares them with economic characteristics of nine other states. The second segment analyzes Texas taxes by class and source over a 21-year period from 1929 through 1949. It also gives some information about federal tax collections in Texas. The third segment compares the revenue structures of Texas and the nine selected states. The information is presented in broad strokes. No attempt was made to develop analyses useful to consideration of particular tax problems or of comparative tax burden.

Parts II, IIA, and IIB contain analyses of individual taxes. These attempt to present uniformly certain information pertaining to each tax -- general background, statutory history, tax administration, collection and enforcement, and problems which have arisen in operation. Ad valorem taxes were not considered, since they are now primarily local revenue sources and have been dealt with in another study. Unemployment and pension contributions were also omitted, since they are related to governmental programs not ordinarily considered part of the tax system.

Part II: Analysis of Individual Taxes contains discussions of the following: Cigarette Tax, Cement Tax, Motor Vehicle Sales Tax, Chain Store Tax, Carbon Black Production Tax, Sulphur Production Tax, Oil Production Tax, Natural Gas Production Tax, and Motor Vehicle Fuel Tax.

Part IIA: Analysis of Individual Taxes Continued contains discussions of the following: Radio, Cosmetics, and Playing Cards Tax; Gross Premiums Tax; Inheritance Tax; Stock Transfer Tax; and Alcoholic Beverages Taxes.

Part IIB: Analysis of Individual Taxes Concluded contains discussions of the following: Business Taxes Based on Gross Receipts, Poll Tax, Motor Vehicle Registration Tax, Gas-Gathering Tax, Corporation Taxes, and Miscellaneous Taxes and Fees.

This report is designed to present approaches to consideration and analysis of the Texas tax structure as a whole. It examines, in the context of the total tax structure, problems arising from the form of the tax statutes, earmarking of tax revenues, tax administration, and determination of tax burden. In adopting this context, the report differs from previous tax studies made by the Council staff. With the exception of the comparative analysis of revenues made in Part I, previous studies have been devoted to individual taxes. No attempt was made to compare taxes, to weight the relative importance of problems raised to the total system, or to discuss tax burden or equity. These limitations were deemed necessary because of the short time



available for completion of the study and because reasonably detailed understanding of individual taxes appeared essential to any over-all look at the tax system. It was expected, moreover, that the information developed would be useful in making an over-all analysis. The individual studies might be thought of as taking a vertical approach to taxes -- examining each tax, its statutory base, administration, and problems as a unit. This report, on the other hand, might be considered as taking a horizontal approach -- examining statutory form, earmarking, administration, and burden as they pertain to the tax structure as a whole. For this purpose, the report draws heavily upon the previous studies and develops, in addition, some further information. The aim has not been to exhaust the subject matter but rather to aid appraisal of the total tax structure by analysis of available information and by consideration of possible lines of further study.

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## CHAPTER I

### A LEGAL VIEW OF THE TAX STRUCTURE

#### SECTION 1--SIGNIFICANCE OF FORM OF TAX STATUTES TO STRUCTURE

The statutes themselves as an embodiment of the legislative tax program are one aspect of the tax structure. Technical organization of tax statutes and clear, concise expression of the legislative rule are important to establishing a sound tax system. Professor Horack, author of the latest edition of one of the leading texts on statutory construction, states: "It is traditional that statutes are unreadable, indefinite, confusing and misleading."<sup>1</sup> Another writer expresses the point differently, observing that "Sound legislation is more than a matter of good intentions and enlightened policy choices. Hard technical work has to be done before even the best lawmaking idea can be made into a clear and enforceable statute."<sup>2</sup>

#### Status of Present Tax Laws

The broad scope of the tax laws as to the interests and activities taxed and the operational programs devised for collection is indicated in other portions of the study. Compare, for example, the relatively simple tax on cement production and the complex taxing programs on corporate privileges and alcoholic beverages. Such highly varied provisions comprise the basis of the state tax structure. It is apparent that the effectiveness of the provisions in establishing the tax program intended depends, in part, on two principles. (1) The legislative rule contained in particular provisions must be accessible to the persons affected by that provision--the tax administrator, the taxpayer, lawyers and the judiciary. (2) The statement of the legislative rule must be clear and concise.

Organization. There are drastic limitations on the accessibility of present tax laws. They were not enacted nor are they anywhere organized in a pattern logically developing the subject matter or indicative of the relationships between provisions. The task of finding an applicable provision in an authoritative source is itself sometimes a substantial one. A brief review of the sources where tax laws may be found illustrates the severity of these limitations.

<sup>1</sup> Conrad, New Ways to Write Laws, 56 Yale L. J. 458 (1947).

<sup>2</sup> Jones, Bill-drafting Services in Congress and the State Legislature, - 65 Harvard L. Rev. 441 (1952). While this remark was made with reference to drafting single legislative measures, it has equal or greater pertinence to consideration of an entire legislative program.

The only authoritative sources of present tax laws are the taxation portions of Revised Civil Statutes of 1925 and the session laws amending these and enacting new measures over a period of 27 years. Unofficial compilations prepared by the Vernon Law Book Company attempt organized presentation of the tax laws, along with other laws, by reflecting amendments to the 1925 revision and placing within the framework of that revision the new laws enacted since that time.

The revision of 1925 purported to be a complete restatement of the law. It was organized, drafted and broken into chapters and numbered sections in a manner unsuited to the insertion of new statutory programs. Comparison of Chapter 1 of the title on taxation in the 1925 revision with the same chapter as it appears in the 1943 compilation shows the difficulties and weaknesses of using the revision as a base.

The chapter, as it appears in the 1925 revision, consists of 17 articles numbered 7041 through 7057. Article 7047 on occupation taxes has 39 subsections. Since the preceding chapter ends with article 7040 and the succeeding one begins with article 7058, numbers for assignment to new legislation coming within the topics covered by this chapter were not available to the compilers.

The general subject matter of the chapter is the authority for and regulation of the levy and collection of certain taxes by county tax collectors. Thus, six of the articles deal with ad valorem taxes and the duties of the Comptroller and other state officials pertaining to them.<sup>3</sup> Others levy the poll tax and several occupation taxes such as those on itinerant merchants, peddlers and auctioneers.<sup>4</sup> The remaining provisions prescribe methods of payment and collection of all of the taxes dealt with and additional duties of county and state officers pertaining to them.<sup>5</sup> While this organization may be subject to criticism on the ground that the ad valorem tax provisions might have been more appropriately placed in other chapters devoted primarily to assessment and collection of ad valorem taxes, nevertheless a common thread of state regulation of local collection of state and county taxes ties the chapter together in a coherent presentation of the legislative rules on the subjects covered.

Vernon's 1948 edition of the Texas Civil Statutes adopts the form of the 1925 Revision and contains within chapter 1 of the taxation title the same 17 article numbers. There are inserted, however, numerous divisions and subdivisions of these articles to accommodate new statutory provisions. Provisions for collection of taxes by local officials have been amended to place some of them under the Comptroller. New taxes, some administered by the Comptroller and others by various

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<sup>3</sup> Arts. 7041, 7042, 7043, 7044, 7045, 7048.

<sup>4</sup> Arts. 7046, 7047.

<sup>5</sup> Arts. 7049, 7057.

state and local officials, have been inserted. Different and unrelated tax programs appear as subdivisions of the same article. General administrative provisions applicable to some of the taxes appear in juxtaposition with taxes to which they do not apply. This plethora of provisions follows no readily apparent order and particular problems often may be untangled only by careful search of the session laws affecting the tax under study. In many instances, therefore, the compilation is useful primarily as a more rapid means of entry into the session laws that the indices of the volumes containing those laws provide.

Clear Expression of the Legislative Rule. The second factor deserving technical attention is the clarity of statement of the legislative rule. The persons affected by a provision need to be able to find it as well as to understand it. Present tax laws fall short of the clarity that could be achieved. Brief review of some of the reasons for lack of clarity aids in understanding the manner in which the statutes become obscure.

The tax statutes are subjected to the constant attention of the Legislature. This attention is seldom directed at the tax system as a whole, however, but rather to amendment of particular provisions or to the addition of new taxes. It appears probable that one reason for this narrower approach is the lack of organization already discussed. With this approach, it is almost inevitable that over a period of years conflicting provisions will enter any group of statutes. Further, enacting new taxing statutes that are intended to be complete within themselves, each having a complete administrative plan, causes redundant and complex provisions, and may result in conflicts between specific administrative provisions and others generally applicable.

Other factors tend toward lack of clarity in statutes. The initial draftsmanship of new or amendatory bills is seldom consistent between bills. There is little uniformity of style or form. Some bills may be poorly drafted. Some contain long and complex sections devoted to several ideas. These may not present a clear and logical development of the particular tax. Others are amended during the process of passage without taking into full consideration all of the provisions, thereby causing conflicts within the particular bill. Amendments during passage for the purpose of compromising contested issues and "de-gutting" amendments also cause conflicts and reduce clarity.

A factor affecting clarity, but which is not necessarily a cause of lack of clarity, is the subjection of tax statutes to administrative and judicial interpretation. Through this means important gaps in the statutes are sometimes filled, and interpretations may be placed on provisions which are not readily apparent from reading the provision. Thus a person affected may not be able to find the basic provisions simply by reading the statute; he must also seek out rulings of tax administrators, the Attorney General and the courts.

## Finding and Understanding Tax Laws

Consider the effect of the present status of the laws on the task of finding and understanding them. If the search is limited to authoritative sources, the 1925 revision and the 30-odd volumes of the session laws, the index of each volume must be reviewed for legislation on the particular problem under investigation. The language of amendments must be carefully compared with prior and subsequent enactments in order that changes may be found and the presently effective law singled out. Assuming this search to be successful, the searcher would have found only those specific statutory provisions levying the tax in which he is interested. Extensive and more difficult examination is necessary if general provisions affecting other taxes and the tax under search are to be found. Further, the searcher would discover no hint that some of the provisions have been impliedly repealed or have been held unconstitutional. This route to finding and understanding the law is not feasible even for a skilled legal researcher.

The task is made substantially easier by use of the unofficial compilations. However, problems of moment arise in this approach as well. Brief review of the job of searching these volumes for the relatively simple tax on cement distributors may illustrate some of the problems.

The provisions levying the tax on cement distributors may be found quickly in the 1948 edition of Vernon's Texas Civil Statutes.<sup>6</sup> Amendments to the tax appear in both the 1950 and 1952 supplements to this compilation, and these must also be examined. Most of the basic provisions levying the tax are to be found here -- who is taxed, the tax rate, the time and place of payments and reports, penalties and sanctions for non-payment, and the method of allocating receipts. The searcher would not learn that the term "cement" is used in a broad sense and includes such substances as building mortar, nor would he learn what other statutory provisions are applicable to this tax. For the first he must seek out opinions of the Attorney General and the courts. For the second he must further examine the statutes.

A section by section examination of the chapter in which the cement tax appears reveals a number of provisions which may be applicable and some of the problems raised. For example, immediately following the cement tax provisions are three sections which appear to apply to occupation taxes generally.<sup>7</sup> Two of these require that receipts issued for occupation taxes be conspicuously displayed on the taxpayer's premises and provide a penalty for failure to do so. The cement tax provisions contain no mention of the issuance of receipts. Other

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<sup>6</sup> Art. 7047. 41a.

<sup>7</sup> Ibid., art. 7047 -- 41, 42, 43.

general provisions placed in another portion of the chapter require the Comptroller to prepare tax receipt books for the use of local collectors of occupation taxes and issuance of the receipts by the collectors to taxpayers.<sup>8</sup> Since the collection of occupation taxes is no longer the duty of local collectors these provisions are, at least in part, obsolete. The researcher is therefore faced with a construction problem of determining whether cement distributors are obligated to procure and display receipts.

The third section following the cement tax provisions is illustrative of several frequently recurring problems. It reads as follows:

If any person licensed under this Act shall purchase from any farmer or other producer of any of the commodities or other country produce described in Subdivision 4, Section 1, hereof, and give in payment thereof a check or draft or other written order intended to be in payment of any such commodities, which said check, draft, or written order intended to be in payment of any of such commodities is not promptly paid on presentation thereof in due course, the giver thereof shall forfeit the license as provided for herein and shall not be entitled to receive another license for one year after the giving of such check, draft, or other written order intended to be in payment of such commodities.

The difficulties posed for the researcher by this section are: (1) He must determine whether it applies to the cement tax, which contains no express licensing requirement. If the provisions respecting receipts are applicable, they might be construed as licensing provisions within the meaning of this section. Language suggesting this construction appears in the receipts provision which reads, "The collector . . . shall fill the blanks in the receipt and stub by writing thereon . . . the name of the licensee . . ." <sup>9</sup> (2) He must determine what is referred to by the terms "this Act" and "Subdivision 4, Section 1, hereof." For this purpose he must resort to the volume of the session laws in which the provision appears. (3) Finally, he must gain the sense of the provision from the unnecessarily redundant language in which it is cast. While this last difficulty may appear relatively unimportant when considering this single provision, in the aggregate poorly drafted provisions undoubtedly play a part in making understanding more difficult.

Some additional aids in finding and understanding the law are available in the annotated edition of Vernon's compilation. This set of books contains, in addition to the presently effective statutory provisions, some information on statutory history, notes of judicial decisions on each section, and helpful cross indices. Despite these aids it would seem that a reasonably detailed

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<sup>8</sup> Ibid., arts. 7050-7056.

<sup>9</sup> Ibid., art. 7047, sec. 43.

understanding of the tax system or of an individual tax may be gained only by one experienced in legal research and in statutory construction, and then only with difficulty and occasional failures.

### Effect of Organization and Clarity of Structure

With few exceptions, the tax statutes place the duty of initiating the tax collection process on the taxpayer. He must compute, report and pay the tax as a first step. Enforcement powers and activities are aimed primarily at finding and punishing the tax delinquent or evader. Consequently, the taxpayer's accurate knowledge of his tax obligation is necessary to the smooth operation of the tax system.

Some aid is given the taxpayer by tax administrators. Most statutes authorize the administrator to formulate rules and regulations and to determine to some extent the content of reports. Performance of these functions varies from tax to tax. In some instances forms which contain some instructions are prepared and made available to the taxpayer. Pamphlets are frequently made available which either summarize the statutory provisions levying particular taxes or print the statute verbatim. In no instance does it appear that a comprehensive set of rules or instructions has been formulated which informs the taxpayer of his obligation as determined by statute, by administrative rulings and by judicial decisions. The taxpayer, or someone acting for him, must ultimately find, read and understand the statutes if he is to be sure that he correctly pays his tax.

Since many taxpayers are affected, the failure of a substantial portion of them to understand the law and pay the tax in the correct amount results either in the state's not receiving the full tax due or in an increased enforcement effort. There are some indications that increased enforcement effort is not a practicable solution to the problem. There is competition between taxes for the time of persons enforcing the taxes. The administrator tends, with some justification, to devote his efforts to those taxes yielding the greatest revenue with the least expenditure of time and effort. Tax laws requiring greater enforcement activity generally receive less attention and, therefore, tend to yield less revenue.

It is difficult to assess the extent to which lack of technical proficiency causes litigation. It seems clear that it does to some extent. An example may be the recent litigation for the purpose of determining whether the \$2,500 limit placed on the entrance or permit fees of foreign corporations was applicable only for the ten-year life of the permit or was the maximum fee which could be charged as long as the corporation continued to do business in Texas.<sup>10</sup>

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<sup>10</sup> Chicago Corp. v. Sheppard, 248 SW 2d 261 (Tex. Civ. App. err. ref'd, 1952) holding the \$2,500 limitation applicable only for the 10-year life of the permit.



Certainly, the unintended conflicts which have arisen in the laws over the years are a potential source of expensive litigation.

Lack of organization and clarity also makes more difficult the legislative task of amending the tax laws. For example, the provisions levying franchise taxes on a few corporations which, unlike corporations generally, are authorized to pursue more than one purpose may be considered. Provisions inserted in the general statutes relating to corporations required these few, depending on the number of purposes for which they were chartered or granted permits, to pay double or triple the amount of tax paid by other corporations. Since this proved severe, the law was amended. It has since been further amended, but there is reason to doubt that a consistent rule has yet been established for taxation of these corporations.<sup>11</sup> The reasons for this may well have been that the provision requiring amendment were in various sections of the statutes and not easily found and that their purpose was obscure. Thus, inadequate statutory organization and lack of consistently clear legislative provisions tend not only to reduce the effectiveness of present laws but also of future legislation.

## SECTION 2 -- STATUTORY REVISION AS A MEANS OF IMPROVING TAX STRUCTURE

Because of the relationship between the organization and clarity of the tax laws and the effectiveness of the tax program, one approach to establishing a sound tax system would seem to be through statutory revision. There are many problems, of course, which revision would not solve. The clearest of enactments will not secure the compliance of every person affected. Difficult problems of the application of the law will inevitably arise. Nevertheless, it seems probable that careful organization and restatement of the tax laws would aid substantially in securing the necessarily widespread understanding and voluntary compliance which are essential to their effectiveness. It would also provide a base for legislative consideration of tax problems in the context of the entire tax system.

Much of the discussion respecting tax laws is applicable to statutory law generally. The need for revision of other portions of the statutes has resulted in codification of some segments of the laws in recent years including the election, banking and insurance codes. These took different approaches to the revision problem, however. A general revision taking a consistent

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<sup>11</sup> Texas Legislative Council, Staff Research Report No. 52-2, A Survey of Taxation in Texas. Part IIB Analysis of Individual Taxes, pp. 243-245.

approach to all the laws may well be needed. The Texas Constitution seems to recognize the need for regular revision of the statutes. Article III, Section 43, directed the first Legislature after adoption of the Constitution to provide for the revising, digesting and publishing of the laws, and stated that "a like revision, digest and publication may be made every ten years thereafter." Revision of the tax laws could be undertaken as a part of such a general effort. Their importance, however, would seem sufficient to justify singling them out even though no general revision is attempted.

### Possible Objects of Revision

Examination of possible aims and advantages in revising the tax statutes aids in understanding the revision process and may be helpful in selecting between possible approaches. Revision could assume a number of different forms varying from a compilation merely reorganizing and renumbering the statutes, making no change in language, to a revision designed to reform the tax structure in order to attain a more equitable system by changing rates, coverage and persons and activities taxed. Reorganization and renumbering alone, while not without value, would serve only limited purposes. The latter approach would require extensive examination of the economic base of taxation in Texas and is the subject of Chapter IV of this report. Such a study may be undertaken independently of a revision effort pitched at some less sweeping level. The following paragraphs discuss possible objectives between these extremes.

1. A revision could establish the general powers of the tax administrator. The present structure of the tax statutes, so organized that each tax is intended to be complete within itself, has several disadvantages. Tax statutes are made longer and more complex by the necessity of providing in each a complete administrative plan. Working out the administrative provisions independently for each tax prevents the development of a uniform administrative pattern. The necessity of considering administrative provisions of a tax bill at the same time that rates, basis and coverage are considered in the course of passage relegates administrative matters to the background and may induce errors of omission of needed administrative powers or admission of redundant or conflicting provisions which are enacted into law. Unnecessary special enforcement funds are frequently created. Collection of general administrative provisions in a chapter or portion of the code devoted solely to this purpose and applicable to the Comptroller, or other officer designated to administer the particular tax, could eliminate these disadvantages.

2. A revision could reorganize the law into a more logical form. Present tax statutes are composed of long and complex sections containing a variety of material. Many do not present a clear, consistent and logical development of the tax. This results in part from inadequate initial draftsmanship and the practice of amending a bill during the legislative process by

tacking a provision at the end of the section instead of restating the sentence or paragraph, the substance of which is intended to be changed. Dividing long sections into several short sections devoted to only one principle or thought and arrangement of these short sections in logical sequence would make the statutes clearer to the taxpayer and tax administrator and would permit a more clear-cut amendment process by the Legislature.

3. A revision could remove conflicting provisions from the tax laws and provide a clear and consistent rule. It is almost inevitable that over a period of years conflicting provisions will enter any group of statutes that is of such constant concern of the Legislature as the tax laws. Conflicts enter through inadvertence as a result of amending a bill without taking full consideration of all its provisions. They enter through attempts to formulate a compromise by stating both sides of a controversy in the statute. They also enter through "de-gutting" amendments. Removal of some conflicts would involve little judgment and could be accomplished by the draftsman, but others would have to be resolved by a policy-making group, such as the Legislative Council or its study committee. Even though not all conflicting provisions of the laws are removed in a revision, a great saving in effort, peace of mind, and money to the taxpayer and the tax administrator may be accomplished if a number of contradictory provisions are eliminated.

4. A revision could rewrite the tax laws in clear and meaningful English. The Texas tax laws, like other laws of this and other states, contain much redundant and imprecise language. Confusion and uncertainty in the administration of the law, lack of confidence in the written law arising from its obscurity, and unnecessary litigation which has for its purpose the determination of the meaning of statutes may all be greatly diminished by careful draftsmanship. If the maximum of convenience--that everyone is presumed to know the law--is to be employed with fairness and justification, an attempt should be made to draft a statute so that the citizen can read and understand its basic provisions. Several excellent guides for good draftsmanship have been recently published; these could guide the staff in writing the tax laws in more definite English. In rewriting the language of the laws to obtain clarity, it is perhaps inadvisable to tamper with the words of art in the laws even though they appear obscure and require consultation of authoritative interpretations to understand them. Caution must be exercised so that more problems are not created than are solved.

5. A revision could incorporate into the written law interpretations which fill gaps in its basic provisions. The statutes should give complete notice to the taxpayer; he should not be required to consult the opinions of the courts, the Attorney General and departmental rulings to get a full understanding of the basic provisions of the law. Interpretations which deal with administrative detail should, of course, be omitted; those performing the functions of gap-filling should be put into the statutes. A number of

policy questions may be encountered in accomplishing this objective. For example, certain interpretations may seem to the casual reader to be at variance with the general legislative intent. In such cases, it would seem appropriate for the Council study committee to re-examine the policy embodied in the interpretation.

6. A revision could facilitate legislative consideration of tax matters by organizing the tax laws so that the material on rates for each tax would be put in a separate section. Since 1941, the Legislature seems to have established the pattern of dealing with the problem of raising more dollars for state needs by use of the Omnibus Tax Bill. Legislative attention during the consideration of this measure is concentrated upon which taxes are to be included in the bill and what the new rate for the tax should be. This means that any changes in coverage, elimination of exemptions, and similar provisions included by the author may not receive full legislative consideration. Also it means that it is difficult to obtain attention during consideration of this measure or meritorious proposals for reform of provisions of a tax other than rate. Placing rate provision of the tax laws in a separate section would permit the Omnibus Tax Bill to be devoted solely to tax rates as it would amend only that section of each of the different tax laws relating to rates. If the Bill should deal with matters other than rates, then other sections of the law would have to be amended. In this process Legislators would be given notice that provisions other than rates are being amended, and surprise would thus be avoided.

#### Possible Scope of Substance of a Tax Revision

All of the objectives examined bring about in some degree greater clarity of the tax statutes, increased efficiency of tax administration, and facilitation of legislative approach to tax problems, each of which would seem to be desirable. With the exception of establishing a section composed of general administrative powers, the objectives are closely interrelated; the extent to which attainment of any of them is attempted should depend on the extent to which substantive problems are attacked. While it seems that a major contribution could be made by employing the device of having general powers for the tax administrator set out in one group of sections, this objective could be included or omitted without regard to the remaining purposes and objectives of revision. Hence it would seem that the possible forms which a revision might take could be stated in terms of levels of consideration of substantive problems. The following statements may be suggestive.

Level 1. The revision could be designed to restate the present law in a clear, concise and orderly fashion. This would involve reorganizing the material so that it would be presented logically. It would involve breaking some of the large and almost indigestible sections into short, succinct statements. It would involve eliminating unnecessary language and indirect

expression. For example, such statements as "shall have the authority to" would be converted to the simple and direct "may". Confused and illogical statements would be eliminated; for example, the use of the phrase "shall mean and be deemed to include" would be eliminated and "means" or "includes," whichever is appropriate, would be substituted. It could include the writing into the law of the interpretations which have filled important gaps in the basic provisions of the tax laws. In short, this level of codification would state the law as it is, but would present it in a more orderly form and in clearer language.

Level 2. The revision could be designed to accomplish all that is encompassed in Level 1 and, in addition, make certain minor policy changes in the tax laws. This level would involve the elimination of sensitive conflicts. It could involve the re-examination of the interpretation of the laws by the courts, Attorney General and departments, and where necessary correction of interpretations felt to be erroneous or undesirable.

Level 3. The revision could include the matter in Levels 1 and 2 and in addition make changes in the law making it more effective to achieve the present general purposes. This would involve a re-examination of exemptions and coverage and a search for loopholes in the tax laws. It would involve re-examination of the present sanctions and the inclusion of realistic devices in order to tighten the law and make it more effective.

It may be difficult to draw sharp lines between the levels of substance attempted to be dealt with in the work of revision. The handling of particular problems may be on the borderline between levels. Writing into the revised statute a judicial interpretation which fills a basic gap in the existing law might be considered a substantive change. It is a different kind of change, however, from the insertion of a new provision strengthening enforcement powers of the tax administrator. Thus the distinctions between levels represent real differences in approach. Level 1 would seem to be primarily a technical job of determining what the present law is and restating it clearly. Research would be largely confined to the statutes themselves and to administrative and judicial interpretations. The approach of Levels 2 and 3, on the other hand, has a broader scope. Full information on the background and operation of the tax must be available. Decisions must be made respecting changes designed to cure defects in the law.

These differences in approach suggest that it may be desirable, even though all three levels of approach are attempted, to separate technical revision from the other two. Since the revision bill or bills, when submitted to the Legislature, will embody a large and important segment of the law it would seem that consideration would be facilitated if there are few substantive changes to be weighed and passed upon. Substantive changes, toward which the survey of individual taxes has developed much information, could

receive more deliberate legislative consideration in individual bills designed either to amend presently existing law or the revised law when completed.

### Nature of the Revision Task

Preparation of a revision of the tax statutes would, in some respects, differ from the nature of past Council staff activities--preparation of basic research for Council consideration. It would be akin to bill drafting in which the staff role is that of a technician, putting into statutory form those policy decisions made by the Council or by individual legislators. This similarity points up the question of the participation of the Council or its study committee on taxation in the revision process. It seems advisable here, as in other staff activities, that the policy-making function be sharply differentiated, and that policy decisions be made by the Council or its study committee. Thus, depending on the level of revision attempted, more or less detailed participation of Council members will be necessary. If, as is here suggested, technical revision is pursued separately from the aims involving major substantive changes, this participation can be reduced to manageable proportions. Revision could then be accomplished through the following steps:

1. Preparation of a tentative classification and plan of organization of the tax statutes into chapters and articles and selection of a numbering system--preferably one which may later be fitted into a revision of the entire body of statutory law.
2. Accumulation of a file of the presently effective tax laws under consideration.
3. Examination of judicial opinions and other relevant interpretative materials affecting each section of the statutes to be revised and preparation of detailed revisor's notes.
4. Draft of the revision, reorganizing the statutes so that chapters and sections are presented in logical order and in uniform style. Detailed notes should be made of ambiguities and conflicts which cannot be resolved without substantive change in the law. These might be considered by the study committee and its decisions incorporated in the revision, or they might be held for later consideration looking toward amendment of the completed revision when enacted.
5. Submission of the revision as a bill or bills, together with a report containing the revisor's notes and a statement of any substantive changes by the Council to the Legislature.

## Subject Matter of Tax Statute Revision

If the revision is limited to the tax statutes, the specific statutes to be given attention may be tentatively selected. As it appears that the Fifty-first Legislature was primarily concerned with state taxes producing revenue available for the support of general state functions, inclusion and exclusion of specific statutes may be made on this basis. Those statutes relating to the tax activities of local units of government may be excluded as may unemployment compensation and retirement contributions. Since the Texas Constitution, Article VIII, section 1-a, adopted in 1948, terminates the State ad valorem taxes levied for general revenue purposes the statutes relating to these taxes might be excluded. The Confederate Pension program, which is nearing completion, and the available school fund derive support from ad valorem taxes, but for reasons of consistency it would seem advisable to exclude also provisions relating to them. Fees imposed by many licensing and regulating boards, which may be viewed as taxes, are imposed primarily for the purpose of financing regulation of the group licensed and could be excluded. These exclusions, if they are proper, would leave for the revision task the provisions imposing selected sales, gross receipts, occupation, and like taxes which directly produce revenue to the state. These taxes appear to be covered by the following provisions of Vernon's Texas Statutes (the Red Statutes):

### Revised Civil Statutes Title 122 Taxation

- Chap. 1 Occupation and Other Taxes  
Art. 7046-7057c Poll Tax to Oleo Tax  
pp. 1944-1892
  
- Chap. 2 Gross Receipts Taxes  
Art. 7058-7083b Express Companies to Telegraph Companies  
pp. 1983-2008
  
- Chap. 3 Franchise Tax  
Art. 7084-7097  
pp. 2009-2012
  
- Chap. 4 Intangible Tax Board  
Art. 7098-7116 Ferries, Pipeline Companies, etc.  
pp. 2012-2016
  
- Chap. 5 Inheritance Tax  
& 5a Art. 7117-7144a pp. 2016-2022

Penal Code

Title II

Offenses Against Public Policy and Economy

Chap. 8 Art. 666-20a pp. 100  
Art. 667-23 pp. 116-117  
Alcoholic Beverages Taxes

Title 14

Trade and Commerce

Chap. 11-A Art. 1111d Chain Store Tax  
pp. 249-251

If general revision of the statutes is not undertaken it appears both feasible and desirable to limit revision of the tax laws to this group, comprising about 82 pages of Vernon's Red Statutes. To accomplish this, other sections of the statutes will require examination and some revision. Provisions of Chapters 1 through 5a of the title on taxation should be placed in other chapters where they fit. Other sections of the statutes, both civil and penal, which affect taxes must be examined for possible inclusion. It would seem that a revision of this group would provide an organized statement of the laws comprising the basis of the tax structure.



## CHAPTER II

### EARMARKING IN THE TAX STRUCTURE

#### SECTION 1 -- INTRODUCTION

An understanding of the Texas tax structure encompasses more than an analysis of taxes as sources of revenue. Tax statutes in Texas generally not only specify the source from which the tax will be collected and the procedure by which it will be administered but also indicate the state activities which will be supported by the revenue received. The motor fuel tax statute, for instance, provides that the tax is to be paid by purchasers of motor fuels, administered primarily by the Comptroller, and spent largely on highways and public schools. The admissions tax is paid by amusement houses which charge for admission, administered by the Comptroller, and spent to support the state old-age assistance program and public schools. The practice of dedicating particular receipts to specified and limited expenditures has been termed earmarking. Because tax statutes in Texas not only name the taxpayer but also those ultimately spending the tax receipts, a study of the earmarking provision is necessary to understand the entire structure. The purpose of this study is to emphasize the importance of earmarking in the Texas tax structure, to describe the present earmarking practice, to consider some of the problems which have arisen, and to mention several approaches which might be used in meeting these problems. This will be accomplished in the following sections by considering (1) techniques of the earmarking process, (2) the importance of funds in earmarking, and (3) earmarking problems and approaches to their solution.

Although the practice of dedicating receipts in the tax statutes has been widespread in Texas, it has not been as fully adopted by some other states or by the federal government. An alternative approach has been to deposit tax receipts in a general revenue fund and to appropriate from the general fund. This approach avoids the necessity of considering tax expenditures as a portion of the state's tax structure. However, Texas' statutes do prescribe tax expenditures, and the tax structure can be understood more clearly within this framework. The individual tax studies previously published by the Legislative Council in "A Survey of Taxation in Texas, Part II," make repeated mention of statutory provisions prescribing the state activity which receives revenues from particular taxes. These references, because they are concerned with specific taxes, necessarily fall short of presenting a comprehensive view of this subject. A clearer understanding can be obtained by focusing attention on these provisions as a group.

## Definitions

Several terms used in public finance are found throughout this study, and an understanding of them may be helpful. These include earmarking, funds, appropriations, and budgeting.

### Earmarking

Earmarking is the designation of receipts from a tax or other revenue to support a certain public activity. Setting aside three-fourths of the admissions tax for old-age assistance is an example of tax earmarking in Texas. A Government usually taxes to obtain revenues needed to carry out some program, such as constructing highways or assisting the aged. It often results that certain tax revenues come to be tied to a particular public enterprise. Hence earmarking is the bridge connecting two governmental functions--taxing and spending. The major portion of Texas tax revenue is earmarked by either constitutional or legislative provisions.

### Funds

Funds are accounting entities which hold sums of money which may or may not be earmarked. Extensive earmarking ordinarily gives rise to additional funds, for the creation of a fund is a simple way of keeping track of earmarked revenues. From one viewpoint, funds are a by-product of earmarking.

### Appropriations

Appropriations are short-term legislative authorizations to spend money held in funds. In some states, earmarked money held in funds does not require appropriation beyond that found in the general law establishing the earmarking formula. In other states, including Texas, earmarking formulas are not self-appropriating. Therefore the fact that a tax receipt is earmarked for a particular type of expenditure in Texas does not guarantee that this amount of money will be spent. It does guarantee, however, that if any money is appropriated from the fund it will be spent only on the state activity for which the fund is earmarked. Therefore, the earmarking provisions designate only the source from which appropriations can be made. Appropriations of earmarked receipts can be made merely by appropriating all of a certain fund to the public activity for which it has been set aside without designating a dollar amount. On the other hand, appropriation of a specific amount of money may be made from an earmarked fund. Unearmarked money held in general revenue must also be appropriated before an authorized expenditure may be made.

## Budgeting

The process of estimating and controlling appropriated revenues is usually considered to consist of four basic steps: (1) preparation of a budget document, which includes a plan of expenditures and estimates of revenues to support the plan; (2) approval of the plan by the Legislature with whatever modifications it sees fit to make; (3) execution of the budget by spending for the purposes authorized; and (4) post-audit of these expenditures to determine compliance with legislative aims. In a very real sense the Legislature, in allocations to state agencies every two years, goes through a budgeting process. This offers the opportunity for changes in direction to keep pace with shifts in legislative policy. As used here, budgeting includes the first three of the steps outlined.

## Summary

Funds are accounting entities for holding state receipts. Generally, money held in funds other than the general revenue fund is earmarked. In either case, receipts in funds require an appropriation to authorize their expenditure in Texas. Unearmarked receipts in general revenue generally must be specifically appropriated before being authorized for expenditure. These expenditures usually receive budgetary consideration. Receipts to earmarked funds may be appropriated without stating any particular amount and without specific budgetary direction. Or these receipts may be appropriated with budgetary control within limits established by the earmarking formula.

## Fiscal Year

Unless otherwise stated, figures used are for the fiscal year 1950-1951. The 1950-1951 year is not necessarily typical or average. Rather, it was selected because it is recent. It should be remembered that the emphasis in this study is not on the actual fiscal transactions of the state for a particular year but on the method of earmarking.

## SECTION II -- EARMARKING

Orderly management of the operation of a state government requires that there be a system for dividing revenue among public purposes. Three different methods for directing expenditures have been followed in Texas. First, some revenues are deposited in a general revenue fund and appropriated with budgetary control to the types of expenditures deemed desirable by the Legislature. Second, other revenues are earmarked by the Constitution or by the statutes for specific state activities and appropriated with budgetary direction within the limits of the earmarking formula. Third, some revenues are earmarked to funds supporting particular state activities, and all money allocated

to the funds is appropriated without mention of any specific amount and without budgetary supervision. The second and third earmarking approaches, particularly the latter, have been the most common method of programming expenditures of Texas' taxes.

### Purposes of Earmarking

Earmarking serves a number of purposes. It may grow out of (1) the benefit and user theories of taxation, (2) the desire to provide incentive or restraint for a public activity, (3) the wish to protect a particular program from variations in legislative policy, or (4) an attempt to solve political differences.

When a tax is levied on persons who benefit directly from a government's facility, earmarking assures that the tax revenue is used for that facility. Earmarking is a way of guaranteeing that the revenue from a tax will be applied to support the purpose for which the tax was levied. The user or benefit theory is evident, for example, in the Texas gasoline and motor vehicle registration taxes, receipts from which are set aside primarily for the support of the highway system. The user principle is also recognized in the fact that motor fuel bought for a purpose other than propelling a vehicle over the roads is exempt from the tax. Similarly, a vehicle that will not be used on the roads is not subject to the registration tax.

The tendency to make regulatory agencies "self-supporting" by imposing fees on those who are regulated brings about the dedication of income from these fees to support the particular agency. The group taxed may be willing to pay the special fee or charge to finance the activity which affects them, but they are likely to want assurance that the charge is not a tax to support the general government of the state. A number of fees now collected by the state are set aside for the use of the agency collecting them. The activities of these agencies, such as the boards supervising the issuance of licenses to doctors or nurses, are regulatory but are considered beneficial to the group regulated.

Frequently, in the legislative establishment and earmarking of these fees for regulation, there is also the distinct intention to protect the general revenue. The Legislature is willing to establish another agency but is not willing to create a further drain on the general revenue to do so. Hence it authorizes the agency and specifies that it will be financed by fees paid by those directly concerned. This legislative attitude is manifest in a frequently recurring provision in the statutes that no money shall ever be spent out of general revenue for support of the agency.

Earmarking may be designed to supply either incentive or restraint to an administrative agency. Earmarking a percentage of the receipts from a tax for administering the tax might theoretically furnish an incentive in that the more the tax brings in, the larger the amount earmarked for the tax-collecting agency.

On the other hand, earmarking a percentage of a tax for costs of collection might stem from the Legislature's desire to see a tax administered economically. The Legislature could put a one-per-cent limit on collection costs, for example. In still other cases, earmarking for tax-collecting agencies may be done in the original tax measure because the appropriation bill has already passed or cannot easily be amended to compensate for the additional cost of administering the new tax. By earmarking and appropriating a per cent of the tax receipts, the author of the bill can allocate to the tax administrator money to pay the costs of collecting the tax for the next biennium.

Probably the most common reason for earmarking is the desire to provide a governmental activity with a guaranteed source of income. A recent report by the Legislative Reference Service of Alabama made this comment on "Why Earmark?": "The desire to guarantee to a state function or service a certain basic amount of revenue has been the real motive for earmarking."<sup>1</sup> There are several indications of the prevalence of this motive for earmarking in Texas. For example, there is no logical connection between an occupation tax and the public schools or between an oil production tax and assistance to the blind. However, portions of these taxes are earmarked for such expenditures.

When a movement is organized to work for some legislative action, its leaders are anxious to shore up their project against uncertainties of the future. Therefore they try to get tax revenues earmarked for that purpose. A frequent practice has been to incorporate the earmarking provision in the statutes on the assumption that this provision will be more difficult to change than a simple appropriation out of general revenue.

It is sometimes argued that tax earmarking is a practical device for raising revenue, since people are more willing to accept a new tax or a higher rate on an old one if they know where the money is going. In addition, connecting the tax and the expenditure may smooth the legislative path for an otherwise controversial bill.

#### Source of the Earmarking Formula

As previously mentioned the practice of earmarking is not confined to tax receipts in Texas. Other sources of revenue are also earmarked. The legal authority for earmarking is generally found in one of four places: the Texas Constitution, acts of the Legislature, conditions attached to federal grants-in-aid, or contracts between the state and private persons. The four vary in degree of permanence.

<sup>1</sup> Legislative Reference Service of Alabama, Earmarking State Revenues (undated), pp. 1-2.

The Constitution contains a number of earmarking provisions. Perhaps the best known is the allocation of one-fourth of revenues from occupation taxes for the support of the public free schools.<sup>2</sup> In most instances constitutional provisions on earmarking make a tax permissive; but if it is levied, its receipts must be divided in the prescribed way. Ordinarily the Legislature may change the rates of these taxes as well as abandon them entirely. It may not, of course, use constitutionally-earmarked money for any but the designated purpose.

Earmarking requirements are also found in statutory law. When the Legislature levies a tax, it may require that income from the tax be spent in a certain manner. This type of earmarking is more flexible than constitutional because it is easier to change a statute. Practical considerations make the difference between constitutional and legislative earmarking important. As constitutional earmarking becomes more extensive, the state's financial structure tends to become more rigid.

Federal grants represent earmarked receipts to the state because they are restricted in use. The grants, in other words, are not outright gifts to be spent as the state sees fit. They are for highways, old-age assistance, or other specified purposes. Not only do federal grants constitute a major portion of the state's expenditures, but they often influence the use of state-collected revenue. Matching with state funds may be a requisite to sharing in federal aid. Accepting less federal money than the maximum available might mean less earmarking of state revenues. However, the pressure to accept federal assistance is great. It is argued, moreover, that part of the federal grants-in-aid come from taxes collected within the state, the implication being that more is involved than mere refusal of a gift.

### Revenue Flow in Texas

To appreciate the role of earmarking in state finance it is helpful to regard it in relation to the revenue flow. Revenue flow may be described as the movement of state moneys from collection to expenditure. Although this discussion will consider where state moneys come from and where they go, it is primarily concerned with how they get to their destinations.

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<sup>2</sup> Art. VII, sec. 3. This section also sets aside a one-dollar poll tax and an ad valorem tax not to exceed 35 cents on the \$100 valuation for the public free schools; Art. VII, sec. 7, sets aside an ad valorem tax not to exceed two cents on the \$100 valuation for Confederate pensions; VIII, sec. 7a, sets aside all motor vehicle registration charges and three-fourths of all motor fuels taxes, except gross production and ad valorem, for the roads, the other one-fourth going to the public free schools.

Earmarking needs to be considered in relation to both income and expenditures. In this report, state income is classified by source and the earmarking requirements for each type of receipt are examined. Expenditures are grouped by function, and earmarking for each function is reviewed. This approach provides a survey of earmarkings from opposite ends of the revenue-flow stream.<sup>3</sup>

### Classifying State Receipts

The first step in a study of revenue flow is to determine where government money comes from. Texas receives income from taxes; federal grants; sales, rentals and royalties; unemployment compensation and retirement contributions; interest; liquidation of bond holdings; and miscellaneous sources. For purposes of this presentation, several taxes are considered as a group. This classification omits local funds from consideration.

<sup>3</sup> In governmental accounting, revenue and non-revenue receipts are separated. Non-revenue receipts add nothing to the value of state holdings. Revenue receipts are items of income which do not increase public liabilities nor represent the recovery of previous expenditures. See Lloyd Morey, Introduction to Governmental Accounting (New York: John Wiley & Sons, 1936), p. 55. See also Carl H. Chatters and Irving Tenner, Municipal and Government Accounting (New York: Prentice-Hall, 1947), pp. 226-227. An example of a non-revenue receipt is a payment made to the state to redeem bonds previously purchased by the state. The distinction between revenue and non-revenue receipts is important in evaluating the government's financial status. However, it need not be followed in a study of revenue flow. For instance, tax money placed in a fund from which one operating agency draws may be used to purchase bonds. The time of expenditure has been put off, and some gain is realized in interest. But the money has not been redirected; it will be spent ultimately by the same agency.

Similarly, a distinction is made between governmental cost and non-cost expenditures. Non-cost expenditures include such items as bond purchases and the payment of local government bonded debt in which the state acts only as an agent for local government units. Refunds from 1951 receipts have been deducted except for those made by the teachers' and state employees' retirement systems.

## Taxes

Like so many words in common usage, "tax" is difficult to define. Broadly speaking, a tax is a compulsory contribution exacted by a government to meet its costs.<sup>4</sup> Beyond that point, an almost limitless number of distinctions are possible.

For this study, fees are included in the category of taxes unless otherwise indicated. A fee is a charge made in connection with a service, regulatory, or protective function which is borne by those receiving the service or those being regulated or protected and which is intended to raise approximately enough revenue to cover costs of the functions.<sup>5</sup> Examples of fees are the licensing and examining charges paid by nurses, doctors, plumbers, and barbers, and inspection payments to the State Department of Agriculture for certification of fruits and seeds. During 1951, taxes and fees together accounted for about 60 per cent of a total state income of about \$690 million. In other words, taxes and fees produced about \$414 million for the Texas state government during 1951.

Total taxes and Fees in 1951:	\$414 million
Per Cent of State's Income	60%
Per Cent Earmarked	85%
Earmarked by Constitution	45%
Earmarked by Statute	40%

## Taxes--Constitutional Earmarking

The Constitution of Texas contains several provisions limiting the purposes for which particular tax revenues may be spent. Most of them specify precisely the tax to which they apply and the purpose for which the money is to be used.

<sup>4</sup> Jens P. Jensen, Government Finance (New York: Thomas Y. Crowell Co., 1937) pp. 99-100; Mayne S. Howard, Principles of Public Finance (New York: Commerce Clearing House, 1940), p. 39; Words and Phrases (St. Paul: West Publishing Co., 1940), vol. 41, pp. 116-121.

<sup>5</sup> This simple classification of taxes with a subdivision of fees is widely accepted in financial but not in legal literature. The legal categories are usually taxes, licenses, and fees, and different rules apply to each. 14 Tex. L. Rev. 278. It is well to remember that constitutional requirements on tax earmarking apply only to net receipts from levies generally classified as taxes. See, for example, H. Rouw Co. v. Texas Citrus Commission, 21 Tex. Sup. Ct. Rep. 179.



The allocation of "one-fourth of the revenue derived from the State Occupation taxes . . . for the benefit of the public free schools" is the most significant earmarking provision in the Constitution in terms of the number of taxes affected.<sup>6</sup> It also is important if measured by the amount of revenue involved. Considerable doubt has arisen concerning the definition of an occupation tax for purposes of this provision.<sup>7</sup> As a tax, its purpose is to raise revenue and not to regulate. The measure of the tax apparently may be units of production or gross income. It may also be levied at a flat rate. It is clear that this general definition is often not helpful in deciding whether a given tax is an occupation tax.

Business taxes computed on the basis of gross receipts, including gross receipts from a single activity of a business concern, are generally considered occupation taxes. The tax on gross insurance premiums, for example, falls into this category. Taxes on the gross production of a business, based either on quantity of units or their market value, are normally deemed occupation taxes. For instance, the tax on gross production of crude oil, based on its market value, seems to belong in this class. Another group of taxes, those levied expressly on the privilege of doing business in certain lines, are regarded as occupation taxes. Included in this group are taxes on pistol dealers, brokers, and circus owners.

Texas has about 50 taxes which are considered to fall within the provision allocating a share of occupation taxes to the public schools. These taxes, which grossed almost \$157 million during fiscal 1951, afforded the schools about \$36 million.<sup>8</sup> More than 30 of the 50 taxes are small in terms of revenue produced, some bringing in only a few hundred dollars a year. Others, such as the crude oil production tax and the natural gas production tax, stand tall on the Texas landscape.

Several taxes which are probably not occupation taxes have one-fourth of their revenue allotted to the public free schools. One interpretation of the powers of the Legislature is that the Constitution permits it to levy only occupation, property, poll, and income taxes. Rather than test the soundness

<sup>6</sup> Tex. Const., Art. VII, sec. 3.

<sup>7</sup> This discussion is based on Op. Tex. Atty. Gen. No. 0-4731 (Sept. 4, 1942); Op. Tex. Atty. Gen. No. 0-4847 (Oct. 19, 1942); Op. Tex. Atty. Gen. No. 0-1027 (April 3, 1950); 27 Tex. Jur. 894-904; 40 Tex. Jur. 1382; 7 Tex. Jur. Supp. 42-50; 7 Tex. Jur. Supp. (Pocket Part, 1951) 11-12.

<sup>8</sup> The amount going to schools is about \$3 million short of being one-fourth of \$157 million. The difference is accounted for by allocations of gross revenue for enforcement and by receipts not distributed at the end of the fiscal year.

of this view, the Legislature has apparently labeled many levies "occupation taxes" so as to remove doubt of their validity. Such labeling has naturally led to the allocation prescribed in the Constitution.<sup>9</sup> The motor fuel tax law furnishes an interesting example of a tax that was designated "occupational or excise."<sup>10</sup> The courts were then called upon to determine whether it was an occupation tax for purposes of the constitutional provision exempting municipal corporations from occupation taxes. It was held that the motor fuel tax is an "indirect or excise tax," not an occupation tax.<sup>11</sup> The earmarking of one-fourth of the motor fuel tax has been in the Constitution since 1946.<sup>12</sup> Other taxes which seem not to be occupation taxes but which have one-fourth of their revenues allocated to the public schools include the cigarette tax and the motor vehicle sales tax.

The Constitution requires that a poll tax of one-dollar on every resident of the state between 21 and 60 be set aside each year for the benefit of the public free schools.<sup>13</sup> The state's net poll tax revenue for fiscal 1950-1951 was more than \$1.5 million, of which more than a million went to the schools.

The Constitution further provides that property taxes be used for special purposes--for the public free schools, a building program for state colleges, and Confederate veterans' pensions.<sup>14</sup> An ad valorem tax of not more than 35 cents on each \$100 valuation is to be collected so that, with revenue from all other sources, the public free schools may operate at least six months of the year and so that children will be supplied with text-books.<sup>15</sup>

To pay the interest and principal on building bonds issued by 14 colleges named in the constitutional amendment, a tax of five cents on each \$100 valuation is levied on property. This allocation will automatically expire after the college building bonds have been retired.<sup>16</sup> A tax of two cents on the \$100 valuation is earmarked for payment of Confederate pensions. The Legislature has power to reduce the two-cent rate at any time.<sup>17</sup>

<sup>9</sup> It seems fairly clear by now that the Legislature has authority to provide for taxes other than the four types enumerated in the Constitution. Another provision of that document has been interpreted to allow the Legislature the general power to tax. Tex. Const., Art VIII, sec. 17; State v. Wynne, 133 SW 2d 951 (Tex. Sup. Ct. 1939), 310 U.S. 610, dismissed for lack of substantial federal question; State v. Jones, 920 SW 244 (Tex. Civ. App., 1926).

<sup>10</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7065b-2.

<sup>11</sup> State v. City of El Paso, 135 Tex. 359, 363-364; 143 SW 2d 366 (1940).

<sup>12</sup> Tex. Const., Art. VIII, sec. 7a.

<sup>13</sup> Tex. Const., Art. VII, sec. 3.

<sup>14</sup> Tex. Const., Art. VII, secs. 3 and 17

<sup>15</sup> Tex. Const., Art. VII, Sec. 3.

<sup>16</sup> Ibid., sec. 17.

<sup>17</sup> Ibid.,

During the 1951 fiscal year, the state received almost \$34 million from property taxes. The public free schools received more than \$18 million of that amount, the colleges \$2.6 million, and Confederate pensions \$1.1 million. Thus more than \$22 million, or 65 per cent, of state ad valorem tax revenues for 1951 were earmarked by constitutional provisions.<sup>18</sup>

Net income from the motor vehicle registration and motor fuel taxes is allocated by the Constitution.<sup>19</sup> State revenue from these sources is assigned to roads and highways, except that one-fourth of the motor fuel tax is set aside for the public free schools. These constitutional provisions affected \$32 million in registration tax receipts in fiscal 1951.

In summary, the extent of constitutional earmarking is evidenced by the number of taxes involved and by the amount of money affected. About 55 Texas taxes of a total of approximately 63 collected are earmarked either wholly or in part by the Constitution. In 1951, the earmarked shares of occupation, poll, property, and highway-user taxes amounted to about \$185 million, or approximately 45 per cent of state revenue from taxes and fees combined. Roads and highways received the largest portion of that total, and the public free schools and certain state colleges the second largest amount.

#### Taxes--Statutory Earmarking

The Legislature extensively earmarks the revenue from taxes; in fact, almost all taxes not earmarked by the Constitution are earmarked by statute. During 1951, the inheritance tax was the only tax, excluding fees, not allocated in whole or in part by the Constitution or statutes.<sup>20</sup> Thus the Constitution and tax statutes in Texas not only designate the taxpayer but also the method of distributing tax revenue. About 40 per cent of total tax and fee revenue for 1951 was earmarked for specific purposes by legislative enactment.

Since about 85 per cent of all state tax and fee revenue was expressly allocated to particular activities in 1951, the Legislature could freely decide in appropriation bills how to spend only about \$70 million, or 15 per cent, of \$414 million. Although the Legislature is thus limited in the scope of its ability

<sup>18</sup> By a 1948 amendment to the Constitution, the ad valorem tax was discarded for general revenue purposes as of January 1, 1951. Tex. Const. Art. VIII, sec. 1a. All remaining state ad valorem taxes are earmarked.

<sup>19</sup> Tex. Const., Art. VIII, sec. 7a.

<sup>20</sup> The only earmarking provision attached to the franchise tax expired after the 1951 fiscal year, and all franchise taxes due and paid in 1952 are deposited to the General Revenue Fund.

to appropriate, it is not as severely restricted when the entire legislative process is considered.<sup>21</sup> As to the 40 per cent of tax revenue earmarked by statutes, the Legislature is of course free to change the general laws on which the statutory earmarking formulas rest. As a practical matter, however, these provisions are generally not as susceptible to biennial re-examination and revision as the directions in appropriation acts for disposition of moneys in general revenue. Being embodied in general law, they are regarded as more nearly permanent.

In discussing the allocation of tax receipts by the Constitution, each instance of constitutional tax apportionment was dealt with because the actual number of provisions is small. This is not the case with legislative earmarking; here the formulas are many.

Several characteristic methods appear in statutory allocations. The most common legislative earmarking technique is to set aside a percentage of the receipts from a tax for a particular purpose, following the method ordinarily used in the Constitution. The Legislature, for example, allocates one-fourth of the receipts from several taxes to the public free schools.

A second method is to set aside the entire proceeds from a particular levy for one activity. Fees are frequently treated in this manner. They are usually allocated to the regulatory, protective, or service agency which performs the function for which the fee is charged.

Since adoption of the Omnibus Tax Bill in 1941 another tax earmarking procedure has risen to prominence. The Omnibus Tax Clearance Fund established by that act receives revenues from a number of taxes. An allocation formula is attached to the net tax receipts not otherwise set aside by individual tax provisions, these portions of the taxes thereby losing their identity when they enter the clearance fund. This method eliminates a formula for each tax and revenues from this group of taxes can be distributed to a variety of activities. The probability of shortages or excesses is lessened by the fact that a decrease in one tax may be offset by an increase in another.

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<sup>21</sup> In fact, the Legislature is not without power to change the direction of moneys constitutionally earmarked. First, the discussion on constitutional earmarking of taxes above indicates that more may be considered to be earmarked by the Constitution than actually are. Second, the Legislature initiates constitutional amendments by joint resolution and so has a material influence on the content of the Constitution.

## A General View of Tax Earmarking

While the sheer number of tax and earmarking formulas prohibits a detailed consideration of each, it is possible to present in a table an outline of the constitutional and general law provisions on tax revenue allocation. To keep the table of reasonable size, the great number of fees collected by state agencies have been omitted. Columns one and two of the table show the amounts set aside for collection and enforcement. To increase the table's usefulness, earmarking formulas are given for the fiscal year 1951-1952 rather than the 1950-1951 year which has been cited elsewhere in this study. (See Table II-1)

### Federal Aid

Federal aid, next to taxes, is the most important source of state income, amounting to 19 per cent of the total in the fiscal year 1951. The entire amount is earmarked. The federal government does not make "block" grants; therefore all money allotted to the states must be expended for specified purposes. The matching requirements attached to some federal grants require the state to spend a certain amount of its own money to qualify for the federal aid available.

The largest share of the \$128 million in federal aid received by Texas for the 1951 fiscal year was devoted to health and welfare. The largest single item was more than \$57 million for old-age assistance. Next were roads with \$21 million, followed by veterans' education with \$12 million and hospital survey and planning with \$10 million.

Total federal aid in 1951:	
	\$128 million

Per cent of state's income	19 %
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Per cent of it earmarked:	100 %
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Earmarked principally for:	
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	Health & Welfare
	Roads
	Veterans' Education
	Hospital Planning

### Resale and Redemption of Bond Holdings

Liquidation of bonds does not bring the state new income but merely converts investments of earlier income. Bond redemption does not influence the purposes for which the money is spent. Bonds are ordinarily purchased with receipts set aside for designated activities. When the bonds are redeemed or sold, the money would be spent on those activities or reinvested. Of course, if the debtor defaults, the state loses money. When state agencies buy state bonds that cannot be redeemed, a diversion of revenue occurs.

Resale and redemption of bonds in 1951:	35 million
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Per cent of state's income:	5%
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Per cent of it earmarked:	100%
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Earmarked principally for:	
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	Public schools
	University of Texas
	Roads

Sales, Rentals, and Royalties.

Most of the state's income from sales, rentals, and royalties is earmarked by the Constitution for the public free schools and The University of Texas system<sup>22</sup> In the main the receipts in this category are from oil and gas royalties and mineral lease rentals on tracts of land set apart by the Constitution for the support of the public free schools and The University of Texas. Of the income gained from this land more than 90 per cent went to the public schools of The University in 1951.

State income from sales, rentals, and royalties in fiscal 1951 came to more than \$36 million, or about five per cent of state income. Most of this total was income from land.

Total income from sales, rentals and royalties in 1951:	\$36 million
Per cent of state's expendable income:	5%
Per cent of it earmarked:	100%
Earmarked principally for:	Public schools University of Texas system.

Unemployment Compensation and Retirement Contributions.

All income from unemployment compensation and retirement contributions is earmarked. It is in the form of insurance payments to guard against the hazards of unemployment and old age. Contributions are made under the joint state-federal unemployment compensation program and under state laws providing for retirement of teachers and state employees.

During fiscal 1951, total unemployment compensation and retirement contributions were approximately \$33 million. They represented about five per cent of state income.

Total income from unemployment compensation and retirement contributions for 1951:	\$33 million
Per cent of state's expendable income:	5%
Per cent of it earmarked:	100%
Earmarked principally for:	Unemployment compensation Teacher retirement State employees retirement

<sup>22</sup> Tex. Const., Art.VII, secs. 2,4,5,9-11, and 15.

Table II - 1

Earmarking Formulas for Texas Taxes  
As of Beginning of 1951-1952 Fiscal Year  
(Gross revenues for 1951 fiscal year are given for information)

Taxes (rounded to 1,000)	(1) Local Collection Fees	(2) En- force- ment	(3) Avail- able School Program	(4) Omnibus Tax Bill Alloca- tion 2/	(5) General Revenue	(6) Coun- ties	(7) State High- ways	(8) Other
1. Admis- sions (\$185,000)			1/4					3/4 to Old Age Assistance
2. Ad Val- orem (\$33,843,000)	1/		Computed annually by Automatic Tax Board					2¢ on \$100 to Confed. Pensions; 5¢ on \$100 to College Bldg. Pro- gram
3. Alcoholic Beverages (\$15,800,000)	2% of tax in stamp purchases exceeding \$500	As Approp- riated	1/4	3/4				
4. Carbon Black (\$2,451,000)			1/4	3/4				
5. Companies Carline (\$2,000)			1/4	3/4				
6. Cement (\$1,825,000)			1/4	3/4				





Earmarking Formulas for Texas Taxes

Provisions Operative as of Beginning of 1951-1952 Fiscal Year. (Gross revenues for 1951 fiscal year given for information.)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Taxes (rounded to 1,000)	Local Collection Fees	Enforcement	Available School Program	Omnibus Tax Bill Allocation	General Revenue	Counties	State Highways	Other
13. Gas Production (\$13,957,000)		1/2 of 1% Gross						
		(audit fees) 1/4	1/4	3/4				
14. Inheritance (\$5,074,000)					All			
15. Insurance (\$13,427,000)			1/4	3/4				
16. Motor Carriers (\$81,000)			1/4	3/4				
17. Motor Vehicle Fuel 1% of (\$95,684,000) tax 1/4		1% Gross (filling fees) 3/4 (Audit fees) 3/4	1/4	3/4			1/2 and balance	See Footnote 5
						7.3 million dollars		
18. Motor Vehicle Registration (\$54,310,000) See footnote 6							All	
							See footnote 7	state share
19. Motor Vehicle Sales (\$15,742,000) 5% gross (1/2 affidavit error fees) 3/4			1/4	3/4				
20. Occupation (\$166,000)			1/4	3/4				

**Earmarking Formulas for Texas Taxes**  
 Provisions Operative as of Beginning of 1951-1952 Fiscal Year. (Gross revenues for 1951 fiscal year given for information.)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Taxes	Local	En-	Avail-	Omnibus	General	Coun-	State	Other
(rounded to 1,000)	Collection Fees	forcement	able School Program	Tax Bill Allocation	Revenue	ties	High ways	
21. 011 Production (\$110,088,000)		1/4 of 1% Gross	1/4	3/4				
22. Poll (\$1,521,000)	5¢ assess- ing; 15¢ collecting <sup>8/</sup>		2/3		1/3			
23. Prizes and Awards (\$28,000)			1/4		3/4			
24. Pullman Companies (\$48,000)			1/4		3/4			
25. Radio, Cosmetics and Play- ing cards (\$1,252,000)		2% Gross	1/4	3/4				
26. Stock Transfer (\$202,000)			1/4	3/4				
27. Sulphur Production (\$5,569,000)			1/4	3/4				

Earmarking Formulas for Texas Taxes  
 Provisions Operative as of Beginning of 1951-1952 Fiscal Year. (Gross revenues for 1951 fiscal year given for information.)

	(1) Local Collection Fees	(2) En- force- ment	(3) Avail- able School Program	(4) Omnibus Tax Bill Alloca- tion <sup>2/</sup>	(5) General Revenue	(6) Cour- ties	(7) State High ways	(8) Other
28. Telegraph Companies			1/4		3/4			
(\$66,000)								
29. Telephone Companies			1/4	3/4				
(\$1,256,000)								
30. Textbook Publishers			1/4		3/4			
(\$73,000)								
31. Utility Companies			1/4		3/4			
(\$2,052,000)								
32. Well Servicing			1/4		3/4			
(\$886,000)								

1/ The following major fees are paid out of state ad valorem tax receipts to County Assessor-Collectors of taxes for their services in assessing and collecting the state ad valorem taxes. Poll tax receipts are added to ad valorem tax receipts in computing payments for collecting.

<u>For assessing</u>	
2.5¢	for each \$100 property assessed up to \$5,000,000
1.75¢	" " " between " and \$100,000,000
1.125¢	" " " over \$100,000,000

For collecting:  
 5% of first \$20,000 collected  
 2% of all amounts collected in excess of \$20,000

While these are the major fees received by Assessor-Collectors they are also entitled to some other amounts such as the cost of transmitting monthly reports to the State Treasury and of compiling delinquent tax records.

2/ The Omnibus Tax Bill Formula Allocation is as follows:

- (1) Blind Assistance - \$1,000,000
- (2) Children's Assistance - \$3,000,000
- (3) Teacher Retirement - an amount equivalent to contributions by the members
- (4) Old Age Assistance - An amount which, when added to all other receipts of the Old Age Assistance Fund, totals \$31,000,000
- (5) Foundation School Program - as certified by the Foundation School Fund Budget Committee
- (6) Farm-to-Market Roads - \$15,000,000
- (7) General Revenue - Excess.

3/ Enforcement items carried in parentheses are not deductions from the tax but are charges made in connection with the collection of the tax.

4/ This amount is received by the distributor to cover losses and collection costs.

5/ The County Road Bond retirement program receives as much of the Motor Vehicle Fuel Tax as the Board of County and District Road Indebtedness certifies is necessary to pay interest and principle on certain local road bonds assumed by the state.

6/ For their function as collectors of the Motor Vehicle Registration Tax County Assessor-Collectors receive the following fees:

60¢	each for every registration between 1 and 5,000
50¢	" " " " " 5,001 and 15,000
40¢	" " " " " 15,001 and 25,000
30¢	" " " " " in excess of 25,000.

7/ Counties share in Motor Vehicle Registration Tax Revenue on the following basis:

Each county receives all net collections up to \$50,000

" " " " " one-half net collections above \$50,000 until the county total is \$175,000, after which all collections go to the state.

8/ In the event the county collects its 25¢ poll tax the state pays 6/7 and the county 1/7 of the 15¢ collecting fee. Poll tax receipts are also added with ad valorem tax receipts in computing the base on which county collectors are compensated for collecting. See footnote 1 to this chart.

## Interest

Interest on bonds goes to the state agency holding the bonds or, to put it another way, into the fund out of which the bonds were purchased. Interest payments are important sources of income to agencies with large investments, especially the Texas Employment Commission, the Texas Education Agency, The University of Texas, the Employees Retirement System, and the Teacher Retirement System. Virtually all receipts from interest are dedicated to specific purposes.

In 1951, more than \$15 million was realized from interest, amounting to about two per cent of expendable income. Most of the interest was paid by the federal government.

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Total income from interest in 1951: 15 million

Per cent of state's expendable income 2%

Per cent of it earmarked: 100%

Earmarked principally for: Unemployment compensation  
Public Schools  
University of Texas system  
Teacher retirement

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## Miscellaneous Receipts

During 1951, \$26 million came from miscellaneous sources such as county aid, bond retirement payments, court costs, fines, and settlements. The chief item was county money paid the state for road construction and maintenance and for redemption of certain outstanding county bonds, in the payment of which the state acts as agent for the counties. Nearly all this income follows the general pattern--its use is determined before it is actually collected. A small amount, less than a quarter of a million dollars in 1951, went into general revenue for unrestricted appropriation.

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Total miscellaneous receipts in 1951: \$26 million

Per cent of state's expendable income: 4%

Per cent of it earmarked: 99%

Earmarked principally for: Roads

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## Borrowing

During fiscal 1951, borrowing by the State of Texas was all locally funded. As a result, none of it was included in the listing of state receipts. In the past, however, borrowing has played an important role in state finance on several occasions. In addition, some locally issued bonds, such as those for state college buildings, are tied to state receipts, since they are retired by state ad valorem taxes.

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All borrowing by state agencies was handled locally during 1951 and does not appear in Treasury receipts. But borrowing is an important source of government income. It has a bearing on earmarking.

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The most recent state bond sale was the \$25 million in veterans' land bonds issued in 1950. These bonds were authorized by constitutional amendment. Since the debt limit set for this program has been raised from \$25 to \$100 million,<sup>23</sup> other large issues may be in the offing.

Large amounts of state bonds are held by permanent funds and other trust funds, particularly the Permanent School Fund. Evidently it is widely accepted that these funds should be invested in state bonds because the amendment authorizing the veterans' land bond issue gave a preferential right of purchase to the Teacher Retirement System, the Permanent School Fund, and the Permanent University Fund. The state, however, has failed to pay several million dollars in principal and interest on bonds held by permanent funds. One result of the default has been that a sizeable amount of money, all of it constitutionally earmarked, has been diverted from its designated purpose.<sup>24</sup> In addition, the state's failure to make good a debt to itself is likely to affect its credit rating adversely.

From the viewpoint of revenue flow, the important features of borrowing are these: The state may borrow to support activities which it cannot or does not want to finance with other receipts. Creditors desire assurance, of course, that they will be repaid. To accomplish this, certain receipts may be set aside for retiring the bonds and paying interest. Moreover, although borrowing has been used in the past to meet a general revenue deficit, money is customarily earmarked in that it is borrowed for a specific purpose.

## Summary

The preceding review of state receipts for 1951 and the conditions attached to their use shows that a very large part of the state's income is earmarked for

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<sup>23</sup> Tex. Const., Art. III, sec. 49b.

<sup>24</sup> For a discussion of Texas debt see the Audit Reports, Outstanding Bonds, State of Texas, August 31, 1944, and August 31, 1950.

particular activities. About \$70 million of that year's income, out of a total of some \$690 million, was available for unconditional legislative appropriation. This undesignated money the Legislature could use to supplement earmarked amounts and to pay the expenses of governmental activities not supported by earmarked revenues. The \$70 million constituted only about 15 per cent of state receipts in 1951 and was obtained almost entirely from taxes.

### Classifying State Expenditures

The effect of earmarking state taxes and other revenue sources is reflected in amounts of various types of state expenditures. This not only indicates the close relationship between tax earmarking formulas and state expenditures but also reflects that a change in an earmarking formula can cause a corresponding change in expenditures. In effect, amounts of many types of state expenditures are determined largely by earmarking formulas. The following analysis of state expenditures will be concerned with purposes for which the money is spent and the earmarking basis for the distribution.

Classifications of state expenditures are generally made either by function, such as education or public welfare, or by objects, such as salaries or capital purchases. The functional classification is used in this presentation.<sup>25</sup>

### Education

The single function on which the state spends most money is education. In fiscal 1951, approximately \$240 million was spent for the public free schools, vocational education, higher education, eleemosynary education and teacher retirement.<sup>26</sup> Of total expenditures for education, approximately \$183 million, or about 73 per cent, went to the public schools and to vocational education. Expenditures for state-supported colleges and universities amounted to more than \$23 million.

Of the \$183 million spent for free public schools and vocational education, the state furnished about 90 per cent and the federal government about 10 per cent. As already mentioned, the Constitution earmarks one-fourth of all occupation taxes, along with a portion of property and poll tax revenues, for support of the public free schools. In addition, one-fourth of other important taxes--the motor fuel tax by constitutional amendment and the cigarette tax by legislative enactment--are set aside for primary and secondary education. The schools are also

<sup>25</sup> The attempt to classify governmental expenditures by function invariably gives rise to arbitrary decisions. For example, the Texas Liquor Control Board engages in tax collection, law enforcement, and business regulation. It is impossible to isolate the cost of each of these phases of its work. The classification scheme used here does not purport to have any finality.

<sup>26</sup> Although some teacher retirement funds were eventually spent (Cont'd. next page.)

given the largest single share of the revenues allocated by the Omnibus Tax Bill formula. Since most of the taxes involved in that formula also supply one-fourth of their net receipts to the schools, a number of taxes have substantially more than one-fourth of their revenues allocated for that purpose.

As a result of the operations of the Permanent School Fund, the public schools also obtain state money from interest, rentals, and other non-tax sources. Constitutional restrictions direct that much of the income from state lands held by the Permanent School Fund shall be invested rather than spent. Income from these investments is available for expenditure.

State money for maintaining institutions of higher learning is taken primarily from general revenue. The General Revenue Fund furnished more than 80 per cent of Texas expenditures for higher education in 1951. The remainder is derived chiefly from two sources--the ad valorem tax for college building and income from University of Texas lands and investments. As is true of the public school endowment, most of the income from University lands must be invested.

The cost of eleemosynary education was borne for the most part by the group of taxes earmarked for hospitals and special schools under legislation enacted in 1950. The remainder of the cost was paid from general revenue. Teacher retirement derives its funds from contributions made by teachers and from Omnibus Tax Bill taxes. Income from bond investments also provides teacher retirement revenues.

### Highways and Other Transportation

Highways ranked second among the objects of expenditure in fiscal 1951. Highway costs to the state totaled approximately \$160 million. By far the largest portion of state expenditures for this purpose, about \$131 million, was spent on construction and maintenance of state highways and farm-to-market roads and for administrative costs of the Highway Department. In addition, approximately \$16 million was distributed by the state in a trust capacity for counties to make county bond payments. The \$16 million was contributed by counties to the state, and the state acted primarily as agent in making the payment. More than \$7 million was dispensed in grants to counties for road construction, purchase of rights-of-way, and bond retirement. Another \$6 million was used for paying county road indebtedness. The State Aeronautics Commission and the Railroad Commission spent small parts of the money.

Highway-user taxes on motor fuel and motor vehicle registrations accounted for more than 60 per cent of state receipts used to finance highways

26 (concluded) to purchase bonds, all money spent from these funds during 1951 is considered educational expenditures for the purpose of this study.



during 1951. These taxes, it will be recalled, are earmarked by the Constitution for roads, except that one-fourth of the motor fuel tax goes to the schools. The motor fuel tax is the largest contributor to roads, bringing in about 40 per cent of the total. Registration receipts amounted to approximately 20 per cent, and federal aid provided approximately 13 per cent. The remaining 27 per cent was made available primarily from Omnibus Tax Bill taxes, county aid, receipts from bond redemption, and receipts from several miscellaneous sources. These percentages are calculated on the basis of receipts available for expenditure on transportation because actual expenditures were not available. However, they illustrate the general situation.

### Public Welfare

Public welfare, with expenditures of about \$145 million, ranked third among the major items of state expenditures. The greatest portion of expenditures for this function was made in connection with joint state-federal programs-- assistance to the aged, aid to the blind, aid to dependent children, and compensation to the temporarily unemployed. As a result, a large share of welfare expenditures, about 50 per cent, comes from federal money. The greatest part of state receipts for public welfare costs come from Omnibus Tax Bill taxes. A much smaller portion comes from general revenue, the property tax levied for Confederate pensions, and fines.

### Health and Sanitation

Expenditures for health and sanitation include costs of the State Health Department, costs of hospitals for the physically and mentally ill, and costs of several examining boards, such as those for dentists and chiropractors. During 1951, the state spent approximately \$18 million on these departments, boards, and institutions. Federal aid contributed approximately 60 per cent of the total. The multitude of taxes which supported the 1950 program for financing hospitals and special schools, these being essentially the same taxes as those in the Omnibus Tax Bill, accounted for about 20 per cent of the total. Most of the remaining 20 per cent was from general revenue, with slightly less than one per cent coming from fees supporting examining boards.

### Public Safety

Texas spent almost \$13 million for public safety in 1951, including costs of police, militia, and prisons. About 45 per cent of this money came from general revenue sources. The remainder was derived largely from motor fuel and registration taxes, operators' and chauffeurs' license fees, taxes in the 1950 special schools and hospitals bill, and sales. The Department of Public Safety obtained most of its money from the State Highway Fund, this accounting for about 22 per cent of the total outlay for public safety. This 22 per cent comes primarily from motor fuel and registration taxes. Operators' and chauffeurs' licenses, taxes levied to support special schools and hospitals, and sales by

the Texas Prison System contributed, in approximately equal amounts, the remaining one-third of the outlay for public safety.

### General Government

General government, a category including the Legislature, the judiciary, the Governor, departments such as Treasury, and General Land Office, retirement and administrative outlays by the Employees Retirement System, and the veterans' land program, involved an outlay of almost \$23 million during the 1951 fiscal year. Of the total, \$7.7 million was expended for purchases of land for resale to veterans. Approximately \$8 million, or 35 per cent, of the \$23 million was appropriated from general revenue. More than \$6 million was spent in connection with the state employees' retirement system.<sup>27</sup>

### Agriculture and the Conservation of Natural Resources

Included in this general group are Texas governmental costs for promotion and regulation of agriculture, game and fish and water conservation, and preservation of the natural beauty of Texas scenery and the state's points of historical interest. Total expenditure for all these items in 1951 was about \$9 million.

All costs for agriculture and the conservation of natural resources came from state sources, the largest segment, of about 65 per cent being general revenue. Because this function has an unusually large percentage of fee income, virtually all the remaining 35 per cent was fees, not including fee payments obtained indirectly through general revenue. Fees collected from fishermen and hunters by the Fish and Game Commission are the most important. In addition, there is a variety of fees for inspecting cottonseed, citrus fruit, vegetables, and other farm produce.

### Regulation of Business and Industry

Expenditures for the regulation of business and industry are the costs of state controls over concerns engaged in crude oil production and distribution, liquor manufacture and sale, sale of real estate, banking, and other commercial activities not included in any previously enumerated function. The 1951 outlay for regulating business and industry was about \$4 million, oil and liquor regulation being the most expensive single item. More than half of the money came from the oil and gas and alcoholic beverages taxes. About 30 per cent was attributable to special fees for examinations, inspections, or registrations. Most of the remainder was appropriated from general revenue.

<sup>27</sup> For this study, all expenditures from the State Employees' Retirement funds are considered expenditures for general government, although some of the funds' receipts were eventually spent for bond purchases.

## Bond Purchases

In addition, several outlays during 1951 cannot be classified as expenditures by function. Most important was the purchase of bonds, which represents an investment, or a change of character in the state's assets rather than an expenditure.

Of the \$60 million spent for bonds, more than \$58 million was expenditures from the Permanent School and Permanent University Funds. Although total expenditures from these funds were not immediately spent for bonds, the entire amount has been considered as such for the purpose of this study. No estimate is given for bond purchases with receipts from redeemed bonds. The Permanent University and School funds holds ever-increasing investments, the earnings from which go to the support of the public schools and The University of Texas. The remainder was spent primarily from the Veterans' Land Fund.

## Illustrations of Tax Earmarking in Operation

This summary of earmarking as it relates to state revenue and expenditures indicates the extent to which earmarking dominates the Texas tax structure. Although a detailed understanding of tax earmarking formulas and the results of their application is desirable, space does not permit a full presentation for all taxes, expenditure objects, and earmarking formulas. However, two examples are provided by examining the operation of earmarking formulas for the state's two major revenue-producing taxes, those on oil production and motor fuel.

The earmarking formulas are for the 1951 fiscal year and the pattern will not necessarily hold true for these taxes in other years. In fact, changes which took effect at the beginning of the 1952 fiscal year have already altered them.

### The Oil Production Tax

The oil production tax is levied on crude oil produced in the state. During the fiscal year 1950-1951, collections exceeded \$110 million, this being more than one-fourth of the state's total tax revenue. During 1951, oil tax receipts were earmarked for the public free schools, state hospitals and special schools, public welfare, teacher retirement, farm-to-market roads, and tax enforcement. A portion was deposited in general revenue. Earmarking Chart II-1 shows by percentage the initial distribution of the tax during the fiscal year 1951.

The first deduction from oil tax revenue, as provided by general law, is one-half of one per cent of gross receipts. The general law provides that this amount is "subject to the use of the Comptroller in the administration and enforcement of the provisions of this Act."<sup>28</sup> The administration of 18 taxes, handled by the Gross Receipts Division of the Comptroller's Office, oil production tax, was financed in 1951 from three sources: (1) the enforcement allowance from the natural and casinghead gas tax, (2) audit fees, and (3) the crude oil tax enforcement allocation. The oil tax allocation represented approximately 88 per cent of the receipts set aside from these three sources for enforcement.

While a specific per cent of the oil tax is earmarked by general law for enforcement, the actual amount available for expenditure depends on biennial appropriations by the Legislature. Appropriations have tended to be about one-third of the dollars provided by the formula. The general law requires that excess from the oil tax enforcement allocation be reapportioned at the close of each fiscal year in the same manner as the net revenue from the tax. However, net revenue is held in a "fee account" in the General Revenue Fund, and the practice has been to dissolve the account into general revenue at the close of each fiscal year.

Since the oil production tax is believed to be an occupation tax, one-fourth of its net revenue is earmarked for the public free schools under provisions of the Constitution. About 25 per cent of the income to the Available School Fund was furnished by the oil tax in 1951, the other 75 per cent being contributed primarily by the ad valorem tax, the highway motor fuel tax, the motor vehicle sales tax, the cigarette tax, and other occupation taxes.

During 1951, while the special tax law for state hospitals and special schools was in effect, three-fourths of the ten-per-cent increase in the oil tax provided by that act, i. e., about 6.4 per cent of gross distributed collections, went initially to the State Hospital Fund. This fund received about 35 per cent of its 1951 income from the oil tax, the remainder coming from some 15 other taxes also included in the state hospitals and special schools financing program.

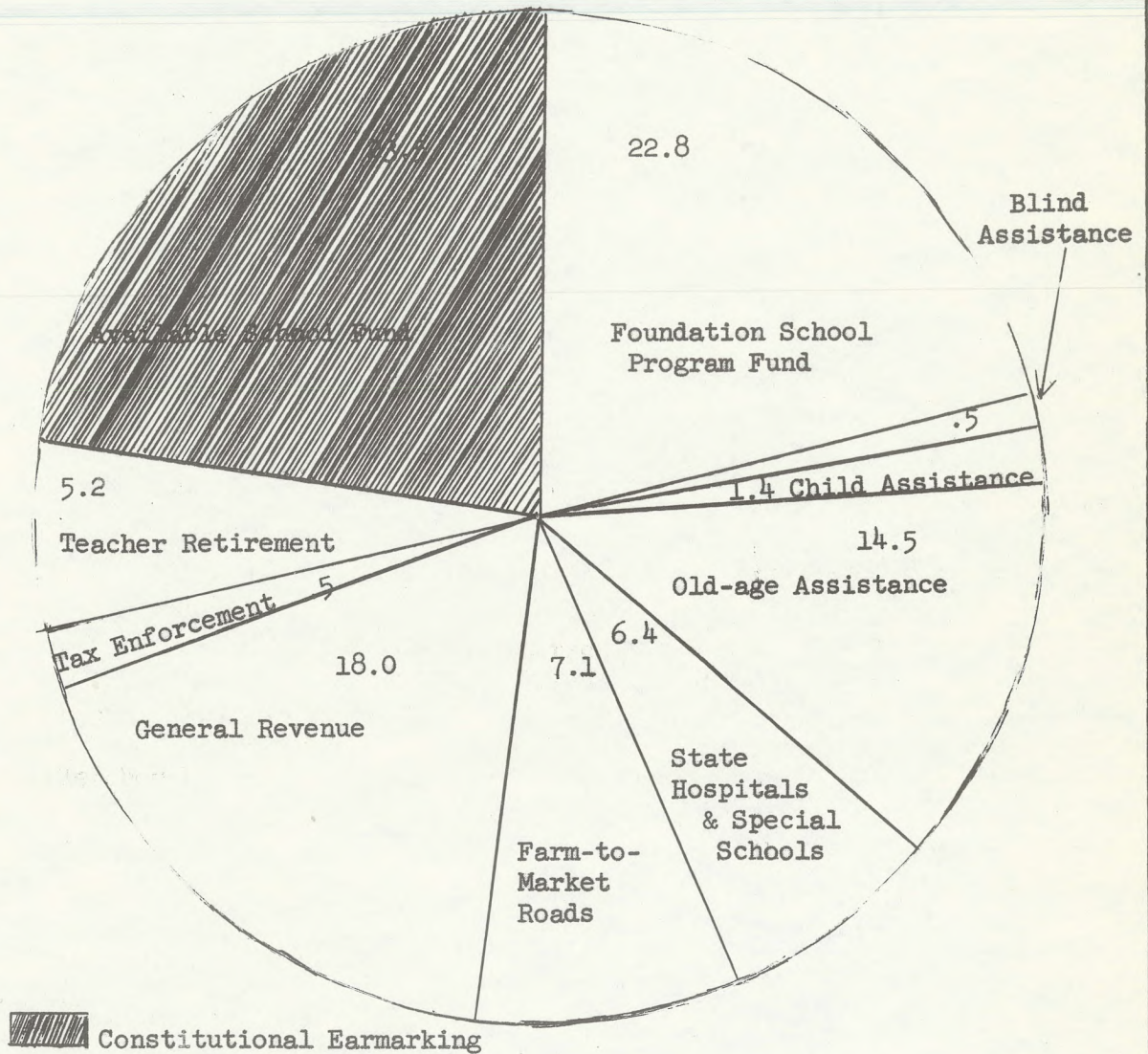
After all these deductions, the remainder of the oil tax was allocated according to the Omnibus Tax Bill Formula.<sup>29</sup> Slightly more than 50 per cent of the 1951 revenue deposited to the Omnibus Tax Clearance Fund came from the oil tax. Accordingly, this tax can be credited with about half of each allocation

<sup>28</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7057a, sec. 9.

<sup>29</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7083a, secs. 1-5; Tex. Civ. Stat. (Vernon, 1950 Supp.) art. 7083a, secs. 4a, rb.

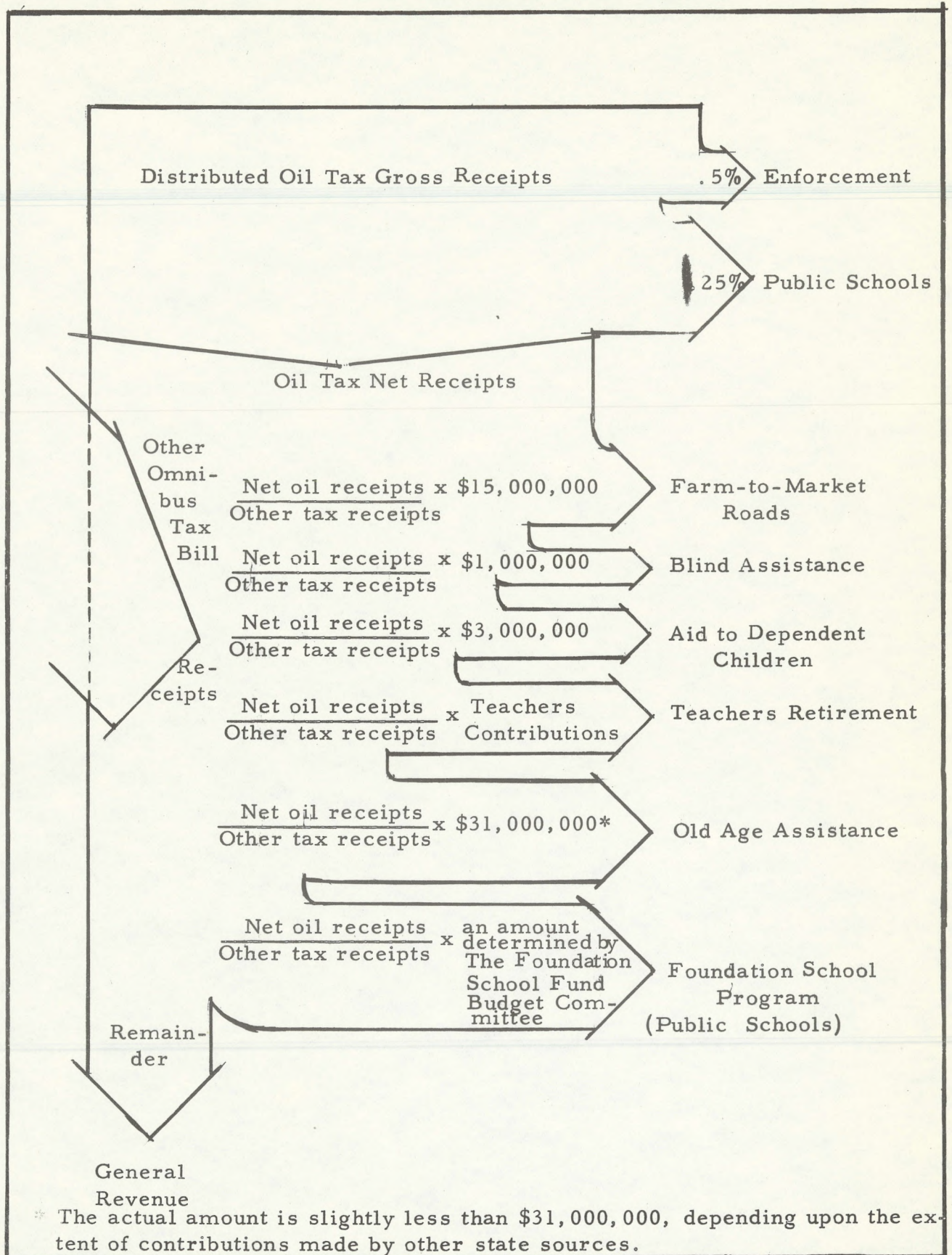
CHART II-1

THE OIL PRODUCTION TAX DOLLAR, 1951\*



\* This diagram represents the initial distribution of the Oil Production Tax according to the formulas applied to that tax as such and the Omnibus Tax Bill formula. About 69.6% of the tax was distributed under the Omnibus Tax Bill formula.

CHART II - 2  
 FLOW CHART ON OIL PRODUCTION TAX



made under the Omnibus Tax Bill formula under which it contributes to teacher retirement; assistance to the blind, the aged, and children; farm-to-market roads; the foundation school program; and the general revenue.<sup>30</sup>

The oil tax earmarking formula for fiscal 1952 is illustrated by Earmarking Chart II-2, which traces through the earmarking bases upon which oil tax receipts were distributed during that year.

### The Highway Motor Fuel Tax

The highway motor fuel tax is collected on the first sale of fuels to be used in propelling vehicles over the highways of the state. During 1951, it gained the state more than \$95 million, which was more than 23 per cent of tax revenue. The motor fuel tax is allocated primarily to roads and highways, but one-fourth of the net tax is set aside for the public free schools. Percentage distribution of this tax during the 1951 fiscal year is shown by Earmarking Chart II-3.

Before major allocations several deductions occur. Motor fuel distributors receive one per cent of the tax to defray losses and their costs of complying with provisions of the law. In addition, a sizeable amount--more than \$19 million during the 1951 fiscal year--is returned in the form of refunds. Both these items have been subtracted from the state income figure mentioned above. In addition, one per cent of receipts is set aside in an enforcement fund. However, actual amounts to be spent for enforcement are determined by appropriation bills, about half of the allowable usually being appropriated. In 1951, the Motor Fuel Tax Enforcement Fund received more than a million dollars, while the Motor Fuel Tax Division was appropriated about \$490,000. Although a substantial portion of the excess at the close of the biennium was distributed, more than \$700,000 was shown in the fund at the beginning of the fiscal year 1951-1952. The general law requires that unused portions of the enforcement fund be re-distributed biennially according to the formula for the net tax.

After deductions were made to pay motor fuel distribution refunds, and enforcement costs, net motor fuel tax revenues in 1952 were distributed according to the following formula. One-fourth was set aside for the public free schools. One-half was deposited in the State Highway Fund for highway construction and maintenance. The remaining one-fourth was subdivided three ways. An amount certified by the Board of County and District Road Indebtedness as required for payment of interest and principal on local road bonds assumed by the state was taken out. Next, \$7,300,000 of the remainder was distributed to the counties. The balance was deposited in Highway Department funds for farm-to-market roads.<sup>31</sup> This formula, insofar as it applies to the last one-fourth of net motor

<sup>30</sup> See the discussion of the Omnibus Tax Clearance Fund in Section III.

<sup>31</sup> Tex. Civ. Stat. (Vernon, Supp. 1952) art. 7065b-25.

fuel tax receipts, went into effect at the beginning of the 1952 fiscal year. Before that time, all the last one-fourth was placed in the County and Road District Highway Fund, which is administered by the Board of County and District Road Indebtedness. First, bond obligations were paid. Then the surplus in excess of \$2 million in the fund was divided between the Highway Department for use on farm-to-market roads and the counties for use on lateral roads.

The arrangement described above stems chiefly from the Constitution, with legislative elaboration. The Constitution requires that net motor fuel tax revenue be used for "acquiring rights-of-way, constructing, maintaining, and policing" public roads, for the payment of principal and interest on certain specified county and road district bonds, and for the public free schools.<sup>32</sup> One fourth is given to the schools. The amount spent for paying county and road district bonds depends on the principal and interest due on these bonds each year. Then, within the general limitations set by the Constitution, the Legislature distributes the part going to roads among several programs. As noted above, it has divided this portion of net receipts between the state highway program, the farm-to-market road program, and a program for assistance to counties in the construction and maintenance of lateral roads.

The motor fuel tax supplied more than one-third of the current income to the State Highway Department in 1951, the other major items being motor vehicle license fees, federal aid, and the portion of the Omnibus Tax Bill taxes set aside for the farm-to-market road program. It supported entirely the retirement of county and district road debts assumed by the state. It also accounted for about one-fourth of the current income to the Available School Fund. Under the present formula, the percentage of net collections going to farm-to-market roads increases as net collections increase, and the percentage going to counties for lateral roads and to bond retirement decreases. The percentage going to schools and to state highways remains the same. In terms of dollar amounts, net increases in revenue from the motor fuel tax supply more income for expenditures on the public schools, state highways, and farm to market roads. The dollar amount to counties for lateral roads and to the bond assumption program is not affected by an increase in tax revenues, nor as a practical matter, by a decrease in revenues.

The course motor fuel tax revenues take on their way to expenditure as laid out in the present law is shown in Earmarking Chart II-4.

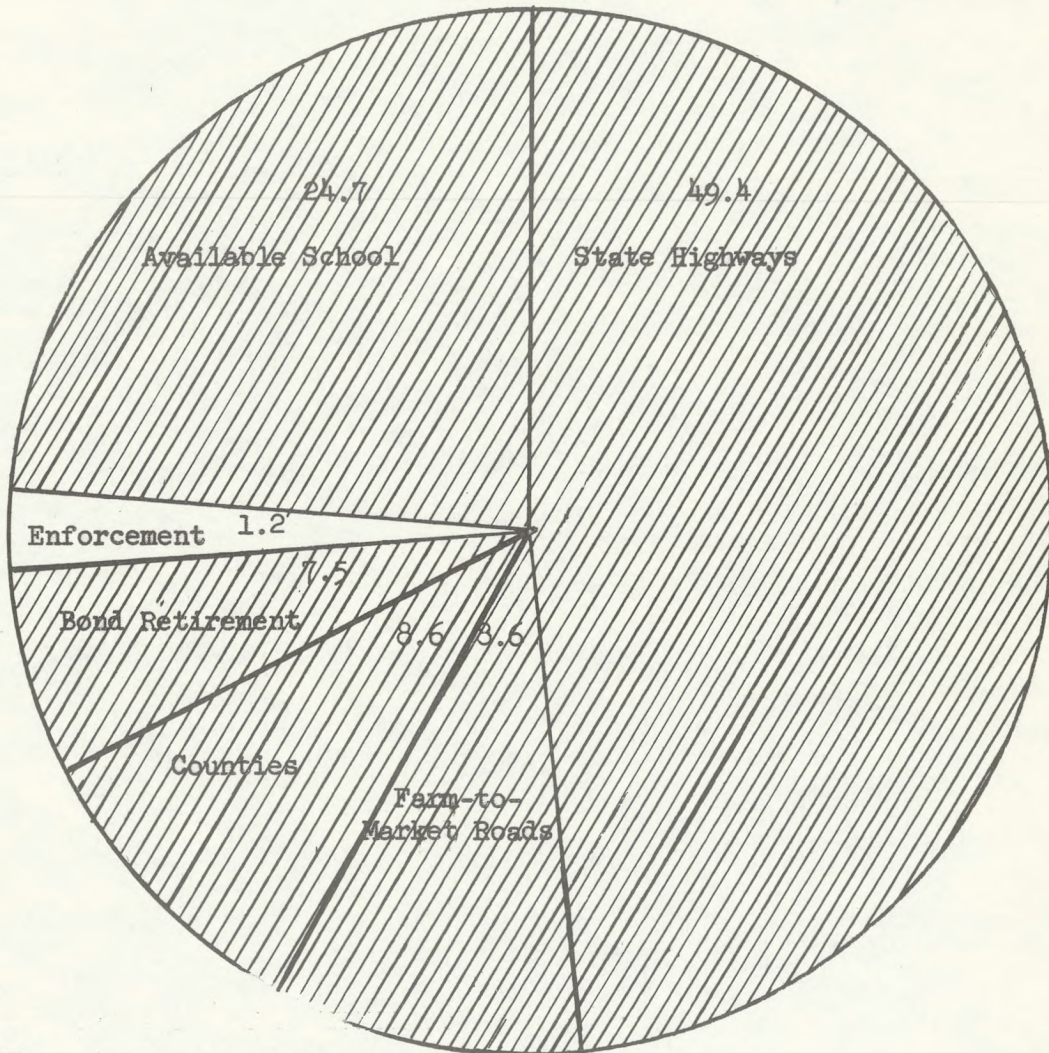
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<sup>32</sup> Tex. Const. Art VIII, sec. 7a



CHART II-3

THE HIGHWAY MOTOR FUEL TAX DOLLAR, 1951\*

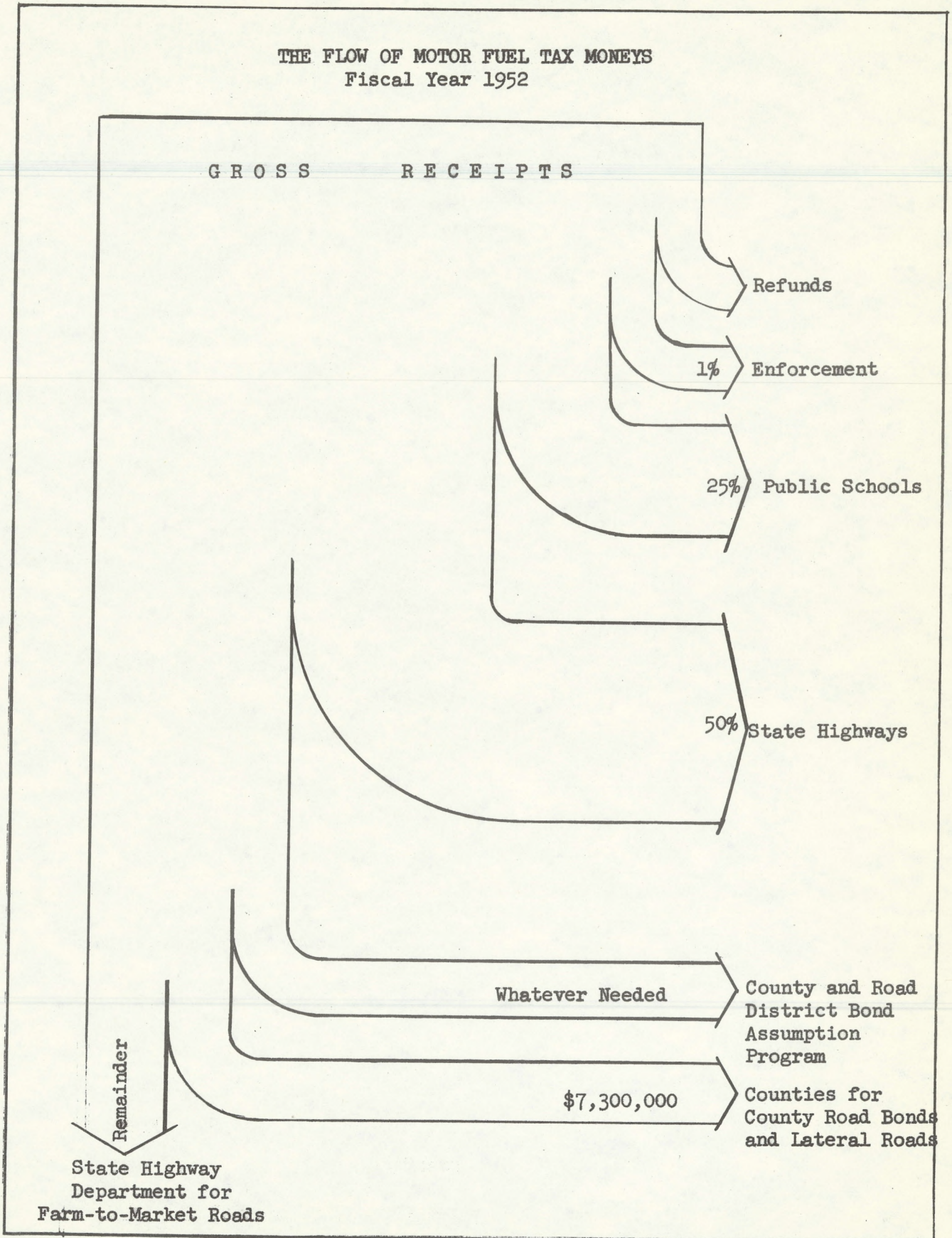


 Constitutional Earmarking

\* This diagram represents the distributed portion of the tax receipts after deductions had been made for payments to distributors and for refunds.

CHART II-4

THE FLOW OF MOTOR FUEL TAX MONEYS  
Fiscal Year 1952



The importance of tax earmarking to state expenditures can also be illustrated by looking at tax earmarking formulas from a different angle. By assuming that an activity partially supported by a tax is to be given an additional amount of money, which is to be raised by increasing the tax, results can be traced backward and forward.

Suppose expenditures on state highways are to be increased by an increase in the motor fuels tax. One-fourth of the net tax increase goes by constitutional mandate to the Available School Fund. One-half is allocated to state highways. Assuming that the income from the motor fuel tax was already sufficient to cover the cost of county road debt retirement and the \$7,300,000 share that goes to the counties, the remaining one-fourth would support farm-to-market roads. Since only one-half of motor fuel tax receipts is earmarked for the state highway system, it would be necessary to increase school money by \$5 million and farm-to-market road money by \$5 million in order to increase expenditures on state highways by \$10 million. The net increase in tax yield would have to be \$20 million rather than \$10 million.

#### Some Problems to Which Earmarking Gives Rise

After summary of some of the purposes which earmarking is apparently intended to serve and of the earmarking of state revenue and expenditures, together with illustrations of how earmarking affects particular taxes, it seems desirable to consider some of the more important problems which grow out of the earmarking practice.

#### The Over and Short Problem

Earmarking formulas are apparently intended to embody a judgment that the amount allocated by the formula bears a close relationship to the amount of revenue necessary to permit an economical and satisfactory discharge of the state program for which the receipts are earmarked. It also appears reasonable that the priorities established in the earmarking formula are intended to embody a judgment of the relative importance of the state programs included in the earmarking formulas. Therefore, earmarking receipts may be considered a long-range approach for programming state expenditures, and it becomes important to consider whether the long-range policy determinations made in the earmarking formulas are the most effective in executing the legislative expenditure program.

When a flat amount is earmarked, it might be assumed that the Legislature has decided to spend a specific number of dollars for the designated program over a period of time. The program will be protected from variations in state income. When instead a percentage is set aside, it might be assumed that the Legislature

has decided to finance the designated program over a long period but only at a level which bears a definite relationship to certain state receipts. If the income from the earmarked sources goes down, the program is to be contracted; if the income goes up, the program can be expanded.

However, whether the earmarking provisions are in terms of a flat amount or a percentage of receipts, there is a strong possibility that the state government may simultaneously experience feast and famine areas within particular state activities. One activity may have more earmarked funds than it needs, while another may not have enough. For example, during 1951, the amount earmarked for enforcing the oil tax exceeded the amount appropriated to the division administering the tax, but the amount earmarked from the Omnibus Tax Clearance Fund to the foundation school program was insufficient and the balance was contributed by the General Revenue Fund. Such experiences seem to be common in states which indulge heavily in the practice of tax earmarking.<sup>33</sup> Accordingly, various methods have been devised to modify the effects of at least some of the difficulties.

One of the most serious problems has been to adjust expenditures when earmarking provisions are allocating more to a state activity than the Legislature deems necessary. In some instances, the method has been to adopt budgetary control and appropriate less for a particular activity than was earmarked for it. The Texas Constitution requires that no money be drawn from the Treasury except pursuant to legislative appropriations made for not longer than two years.<sup>34</sup> As a result, the Legislature can allow less in the appropriation bill than the activity would be allowed under the earmarking formula. However, this approach creates the additional problem of reallocating the amount left over. If it is not reallocated, it will simple be sterile and will not serve the state. In a number of statutes, the Legislature has apparently anticipated that expenditures would not be as great as earmarking would permit and made provisions for distributing the remainder. For example, fees collected by the Secretary of State under the Texas Securities Act are set aside for administering the act, but annual excesses are to be transferred to the General Revenue Fund.<sup>35</sup> However, there are also cases in which less than the earmarked amount is spent and no provision is made concerning the excess. By the end of the 1951 fiscal year, the Confederate pension program had a balance in its fund which was more than over five times as great as the amount spent on the pension program during the year. Nothing can be done with this excess because

33 Jens. P. Jensen, Government Finance (New York: Thomas Y. Crowell, 1937), p. 176; Alabama Legislative Reference Service, Earmarking State Revenues, Report No. 3 (undated), p. 2.

34 Tex. Const., Art. VIII, sec. 6.

35 Tex. Civ. Stat. (Vernon, 1948) art. 600a, sec. 36.

of constitutional limitations.<sup>36</sup> The Legislature can decrease the amount of the tax to bring it in line with needs, but this has not yet been done.

The approach discussed is applicable only if the earmarking formula is too generous. If it produces too little, the Legislature has to find a way of filling the void. This can be done in four ways or through combinations of these four ways. First, the Legislature can appropriate extra money out of general revenue. Second, it can alter the earmarking formula to give that activity a larger share of the taxes already supporting it or to give it something from other taxes. Third, it can increase the tax or taxes supporting the activity. Fourth, it can levy new taxes or increase the rate of old taxes and designate the additional revenue to that purpose. All these approaches are used. At almost every session of the Legislature tax laws and their earmarking provisions are changed to put more money into programs which are not getting enough. In addition, the Legislature usually gives some general revenue money to programs which are also supported by earmarked portions of taxes.

Where the earmarking of fees is involved, the Legislature sometimes takes another approach and allows the agency collecting the fees to vary the rates within limits or not to exceed a statutory maximum to make revenues match expenditures. This approach is used by some occupational and professional boards and is often used when fees are charged for inspection of agricultural products.<sup>37</sup> Provided the maximum fee allowed is sufficient to cover costs, this approach meets the problem of overage and shortages by delegating the balancing job to an administrative agency.

Occasionally, the problem of balancing earmarked receipts and expenditures is approached by giving some agency responsibility for determining how much should be spent within limits established in the general law. An example of this method is found in the Omnibus Tax Bill formula. The earmarked allocation for the foundation school program is decided, within strict limits set by the Legislature, by the Foundation School Fund Budget Committee, and whatever amount is determined by the committee is earmarked from the Omnibus Tax Clearance Fund. When the Legislature allows a state agency or committee to determine, within legislative limits, the amount to be earmarked, it is setting up a flexible earmarking arrangement placing responsibility for determining the correct amount on an administrative agency. This approach permits the Legislature to establish guides as to expenditures by earmarking formulas but allows the specific amount earmarked to be determined and adjusted periodically in accordance with program requirements.

<sup>36</sup> Tex. Const., Art. VII, sec. 17.

<sup>37</sup> For example, the Plumbing License Law only sets the maximum license and renewal fees which may be charged, leaving it up to the Board of Plumbing Examiners to charge smaller fees if the maximums bring in more revenue than needed. Tex. Civ. Stat. (Vernon, 1948) art. 6243-101. The fee for bar examination is set by the Supreme Court not to exceed a statutory maximum. Tex. Civ. Stat. (Vernon, 1948) art. 310.

The preceding discussion indicates that earmarking often results in setting aside too much or too little to support a particular state function. There have been instances in Texas when the amount earmarked has been more or less than the amount appropriated. In either instance, problems have arisen in securing additional revenue or in averting or disposing of surpluses in earmarked accounts.

### The Problem of Complexity

The examples of tax earmarking discussed indicate the complexity of the tax structure. The numerous earmarking provisions in tax statutes present a problem for the Legislature as well as administrators. When a particular state activity needs additional revenue, the Legislature must not only decide the source from which the revenues will come but must also realize that some adjustment to the earmarking formula may be necessary. The same type of problem arises in authorizing expenditures in appropriation acts which are drafted within the scope of and with constant reference to earmarking formulas. In both instances, a detailed knowledge of earmarking formulas is necessary.

The problem of adjusting appropriations to earmarking formulas has been mitigated in several instances. Frequently the Legislature appropriates earmarked receipts without reference to dollar-and-cent amounts, either by appropriating all money in a fund to a project or by appropriating all money coming in under a specified earmarking formula to a project. Indeed, a sizeable proportion of biennial appropriations take this form. To the extent that this wholly logical method of joining earmarking provisions with the constitutional requirement for biennial appropriations of state money is employed, the Legislature relaxes its close and continuous control of expenditures. It has been estimated that the 1951-53 appropriation act allocated about \$286 million in dollars-and-cents terms and about \$877 not in those terms.<sup>38</sup>

### Earmarking and Revenue Estimating

In 1942, Texas adopted a constitutional amendment which had as its purpose the limiting of expenditures to receipts and the avoidance of deficit spending except in emergencies.<sup>39</sup> In general the amendment provides as follows: At the beginning of the Regular Sessions of the Legislature and at various other times, the Comptroller is to submit to the Legislature and the Governor estimates of probable receipts and disbursements for the current fiscal year. He must also submit an estimate, based on the laws then operative, of the revenue to be received by the state during the next two years and the funds to which it will be credited. These items serve to predict the money available during the forthcoming biennium. On

<sup>38</sup> Texas Economy Commission, Actual and Estimated Appropriations--State of Texas (September 1, 1951-August 31, 1953), Bulletin No. 1 (August, 1951).

<sup>39</sup> Tex. Const., Art. III, sec. 49a.

the basis of that prediction, the financial policy of the state can be established. However, the amendment goes further than simply requiring that policy-making officers be supplied with estimates. It invalidates an appropriation from a fund which is in excess of the amount expected to be available from that fund during the appropriation period. The Comptroller must endorse all bills which include appropriations with his finding that it either does or does not provide for appropriations in excess of anticipated available resources. If the Comptroller does not approve, the Legislature must either reduce the appropriation or provide for additional revenue. However, "in the case of emergency and imperative public necessity," four-fifths of the total membership of each house may appropriate more than the anticipated amount.

Extensive earmarking not only adds to the difficulty of estimating revenue as required by the Constitution but to the possible margin for error in these estimates which are so important to the appropriation process. It is necessary to be reasonably accurate on both total state income and on some individual taxes or groups of taxes. If the entire state income went into one fund for distribution, overestimates on some taxes might be offset by underestimates on others. When a tax or a limited group of taxes is earmarked for an agency and the Legislature appropriates for that agency on the basis of an overestimate, the effect of the error is concentrated.

Even the earmarking formula established by the Omnibus Tax Bill, which combines revenues from a number of taxes, is so arranged that the General Revenue Fund, which receives the excess in the Omnibus Tax Clearance Fund after other allocations have been made, is at the mercy of one or two taxes. Since the General Revenue Fund receives the surplus, it also receives the full impact of overestimates. The result could be a deficit. The largest contributor to the Omnibus Tax Clearance Fund is the oil production tax, which is subject to violent fluctuations even in times of high economic activity.<sup>40</sup> Accordingly, general revenue appropriations are often uncertain pending determination of the accuracy of oil tax revenue estimates.

At present, the danger of overestimating revenue is not in the forefront of Texas governmental problems because the problem has not become serious in the rising economic activity since World War II.

Although the last decade has been characterized by rising prices, strong business activity and high tax receipts, continued high levels of tax receipts are not assured.

<sup>40</sup> This matter is discussed in Texas Legislative Council, Staff Research Report No. 51-5, The Texas Petroleum Industry and State Finances (1950).

## SECTION III -- FUNDS

The preceding section dealt with the earmarking of state taxes in order to show the important part this practice plays in state finances. To complete the picture, it is necessary to look at funds which hold the earmarked revenue. All state receipts flow through and are held in funds. Therefore funds form a part of the state tax structure which consists of a continuous network extending from collection to expenditure.

A close legal relationship has developed between taxes and funds, with frequent reference to particular funds appearing in tax laws. Some funds, such as those for tax enforcement, have actually been created by tax statutes. Since taxes and funds are closely inter-related, a proper understanding of one necessitates a knowledge of the other. The following discussion offers a general guide to funds in Texas, including their meaning and composition, methods of establishing and closing them, various types of funds, interrelationships of funds, and the significance of funds in revenue and expenditure problems. Analyses of three important Texas funds are also included as illustrations of the operation of funds.

### The Meaning of Funds

Funds are devices employed by governments for keeping records of assets and insuring that they are spent on designated activities. A fund is defined by the National Committee on Municipal Accounting as

a sum of money or other resources set aside for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations, and constituting an independent fiscal and accounting entity.<sup>41</sup>

As a separate accounting entity, each fund must balance. Therefore, a government must balance not only its total income and outgo but also the income and outgo for a number of segments of its resources.

Funds facilitate the handling of government finances by safeguarding resources and limiting and controlling expenditures.<sup>42</sup> They are a means of keeping records of and regulating governmental monetary and other financial assets from

<sup>41</sup> National Committee on Municipal accounting, Municipal Accounting Statements (Chicago, rev. ed., 1941), p. 168, quoted in Fladger F. Tannery, State Accounting Procedures (Chicago: Public Administration Service, 1943), p. 25.

<sup>42</sup> Francis Oakey, Principles of Government Accounting and Reporting (New York: D. Appleton and Co., 1921), p. 16.



the time they come into public hands until the time they leave them. The variety of types of funds makes it possible to keep detailed records on the different kinds of financial transactions in which governments are involved.

While no one would deny the value of funds, they also have defects. An excessive use of funds produces a rigid financial structure and confuses almost everyone.<sup>43</sup> In addition, employment of numerous special funds may create a situation in which one public activity is being amply supported out of a full fund, while an equally important activity is halted or seriously curtailed because its fund is temporarily depleted. Thus the state may have a surplus of revenue but be prevented from financing a particular agency.

The situation regarding funds varies, of course, from one government to another. The number of funds, their types, and the activities to which they are applied depend on provisions of constitutions, charters, statutes, and contracts. Two states engaged in essentially the same public activities may have a vastly different number of funds. For example, in 1951, Texas had more than 160 funds, while it is reported that Kentucky has only three funds of significance from a policy standpoint.<sup>44</sup> Since Texas makes extensive use of funds, it is necessary to understand the composition and assets of these funds and the relationship of funds to earmarking and appropriations.

### The Fund and Its Assets

The assets of a fund may take several forms. They may be cash, bonds, or physical property such as land. Receipts may come from a variety of immediate sources, including taxes, interest, sales, and transfers from other funds. A fund's assets may be held in smaller entities called accounts.

### Funds and Earmarking

Funds and earmarking are akin in that extensive earmarking tends to give rise to a complex array of funds. Earmarking channels the revenue into particular funds. For example, receipts from the Texas motor vehicle registration tax which are earmarked for roads and highways are put in road and highway funds. Receipts from doctor's registration fees, being earmarked for regulating the medical profession, are put in a fund designated for that activity. When a tax is earmarked, the usual practice is to set up a fund for handling the money unless a fund dedicated to that purpose already exists. Non-earmarked receipts are

<sup>43</sup> Tannery, op. cit., p. 27.

<sup>44</sup> Kentucky Legislative Research Committee, Taxation, The Over-all Picture (1951), pp. 19-20. The Texas total does not include local funds or certain trust funds in the Treasury which contain deposits in the form of guarantees to the state.

deposited to a general revenue fund from which they are appropriated as the Legislature sees fit.

### Establishing Funds

Funds are brought into being in a number of ways. They may result from constitutional mandates on the use of certain money. They may be established for handling federal grants. They may owe their existence to statute, to administrative action, or to agreements between the state and private persons.

### Constitutional Requirements

The Texas Constitution requires that certain moneys be used for particular state functions. To carry out this sort of provision, a fund is usually established into which the earmarked revenues can be placed and out of which the Legislature can appropriate. Sometimes the Constitution names the fund. This is true, for example, of the Veterans' Land Fund, which was created as part of the program for aiding veterans of World War II in buying land.<sup>45</sup>

### Federal Requirement

The federal government wants an accounting of the grant-in-aid money it makes available to the states. To keep records of federal contributions and to insure that they are spent for the designated purposes, the state often places federal grants in separate funds. Thus there are funds to accommodate federal grants for old age assistance, for child welfare, and for education, among others.

### Legislative Enactment

On many occasions the Legislature, in providing for financing a state activity, has established a new fund out of which the activity is to be supported and has designated revenues to go into that fund. The funds created for professional regulatory bodies illustrate this practice.

### Administrative Action

A fund may also be created by an administrative official. An example is the Comptroller's Tax Clearance Fund established by that official to expedite distribution of revenues from certain taxes and to avoid the bookkeeping problem in day-to-day allocation of these receipts.

<sup>45</sup> Tex. Const., Art. III, sec. 49b.

## Agreement With Private Persons

A fund can result from an agreement between the state and private persons. Endowment agreements, by which persons give the state money or other things of value with a proviso on how they shall be spent, often result in the setting up of endowment funds. Furthermore, in selling bonds, the state may sign an agreement calling for establishing a bond fund or an interest and sinking fund. The state did so for the bonds sold by state colleges under authority of the college building amendment. These college building interest and sinking funds are in a sense constitutionally produced, inasmuch as they hold tax revenues earmarked by the Constitution.

## Consolidating and Closing Funds

Funds may, by the authority which created them, be closed, consolidated with other funds, or modified in other ways. The Legislature has on several occasions taken action of this kind. For instance, in 1923, virtually all special funds which had been created under legislative authority were abolished and their assets transferred to the General Revenue Fund. Again in 1947, the Legislature consolidated into one the five funds supporting the Game, Fish, and Oyster Commission.<sup>46</sup> Beginning in September, 1951, more than a dozen federal funds contributing to the State Health Department were consolidated with the consent of the federal government.

The fact that funds can normally be abolished, consolidated, or otherwise modified only by the authority which created them points to some of the limitations on legislative action in this area.<sup>47</sup> Funds resulting from constitutional or federal requirements or from agreements with private persons may be beyond the authority of the Legislature. However, it is within the power of the Legislature to abolish funds which were brought into being by legislative action alone. Funds which depend on constitutional earmarking may possibly be subject to legislative modification--the Legislature may have some leeway to act within constitutional requirements. However, its field is hedged in by the Constitution, by federal limitations, and by contracts with private persons.

The Legislature has delegated authority to the Comptroller, with the consent of the Auditor and Treasurer, to transfer to the General Revenue Fund any balance in a dormant fund, "the source of which is unknown or the

<sup>46</sup> Acts 38th Leg., 2d C.S. 1923, ch. 27, p. 61; Acts 47th Leg., R.S. 1947, ch. 297, p. 503.

<sup>47</sup> The subject of the limitations of legislative action in abolishing funds is discussed at length in Op. Tex. Atty. Gen. No. 2890 (August 18, 1932).

purpose for which it was collected has become moot."<sup>48</sup> This delegation makes possible the closing out of funds which no longer have a purpose without need for a direct legislative enactment. During 1951, six transfers were made to the General Revenue Fund under authority of the dormant funds statute. The dollar amount, as would be expected, was very small.

The long-term trend in Texas has been to create new funds faster than old ones are being abolished, so that the total number of funds has considerably increased. In 1951, the State Auditor reported that during the previous decade the number of active funds in the Treasury had increased 45 per cent, from 108 to 157.<sup>49</sup> As a result of the abolition of some funds and the consolidation of others, a number of funds were closed out in the 1951 and 1952 fiscal years. At the same time, with the new requirement that state colleges deposit certain of their local revenues in the Treasury, a group of new funds was created. As a result of this process of addition and subtraction, the number of funds undergoes constant change, much of it the product of revisions in earmarking formulas. Expansion has so far been going on more rapidly than the shrinking.

### The Types and Purposes of Funds

The importance of funds to the state tax and financial situation can be more clearly understood after the types of funds and the purposes they serve have been considered. Money paid to the state or to state agencies is deposited in either state funds or local funds. Most of it is deposited in the State Treasury, on which the Treasurer and Comptroller prepare annual reports. Since these state funds are more important in the aggregate, they will receive primary attention. Each state fund has characteristics in keeping with its role. Local funds will be given separate consideration.

It is not the intent of this study to present a complete accounting classification of funds nor to approach the subject from the accountant's viewpoint. It is hoped that this treatment will contribute to an understanding of what funds are and how they are related to legislative decisions on state taxation and finance.

### The General Revenue Fund

As a rule, general revenue fund collects non-earmarked receipts. The money in this fund may ordinarily be appropriated by the Legislature

<sup>48</sup> Tex. Civ. Stat. (Vernon, 1948) art. 4344a.

<sup>49</sup> Audit Report, State Treasury Department, August 31, 1951, p. 3.

subject only to general constitutional limitations. The fund is set up when the government goes into operation and remains as long as the government exists. An important distinction in Texas between the General Revenue Fund and other funds is that it is the practice to write warrants on General Revenue even if the fund is exhausted. The state, in other words, issues warrants on anticipated revenues of the General Revenue Fund. It does not do so customarily when other funds are empty.

It has been aptly said of the General Revenue Fund that "it has few friends when being filled, but many when being depleted."<sup>50</sup> In 1951, more than 90 departments, institutions, or other agencies spent general revenue money. While the General Revenue Fund is not the largest in the Treasury, it is used for the widest variety of purposes.

Not all money deposited in the General Revenue Fund is, strictly speaking, general revenue. The fund contains a number of so-called fee accounts, such as those for inspection fees, anti-freeze fees, or tax enforcement allocations. Money held in fee accounts, like other money in the fund, cannot be spent without being first appropriated. Fee accounts are unlike general revenue in that the accounts are earmarked by statute for specific expenditures. All income to the General Revenue Fund, including that in fee accounts, represents a surety against warrants drawn on the fund. Accordingly, earmarked fee-account money may be spent for general revenue purposes if the General Revenue Fund is being depleted.

A distinction between special funds and General Revenue fee accounts is that state agencies financed from these fee accounts may receive deficit warrants before all the money earmarked and appropriated to the agencies has been spent. A second distinction is that if the provision establishing the fee account does not call for its allocation at the close of each biennium or fiscal year, the practice has been to dissolve the account into the General Revenue Fund, to be freed from its earmarking and made available for general expenditure. On the other hand, the practice regarding special funds under similar circumstances is to hold the unexpended amount in the fund unless directed otherwise. Thus, in several respects, earmarked fee accounts in the General Revenue Fund are treated differently from general revenue and special funds. The fee account should be recognized as an earmarked part of the General Revenue Fund. When a figure is given for the assets of the General Revenue Fund, it should be remembered that some of the money included in that figure is dedicated by statute to specific expenditures.

Either fee accounts or special funds may be set up to hold tax enforcement money. When the Legislature has merely provided that an

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<sup>50</sup> Op. Tex. Atty. Gen. No. 2890 (August 18, 1932).

enforcement allotment be "set aside" or has made no provision for the exact status of the earmarked enforcement money, the general practice has been to set up fee accounts within the General Revenue Fund. At other times, the Legislature has specified in the tax act that a separate fund be created. For example, the radio, cosmetics, and playing cards tax contains a clause stating that "the Comptroller is authorized to set aside in a special fund . . ."<sup>51</sup> Yet during 1951 the enforcement allocation for that tax was placed in a fee account in the General Revenue Fund rather than in a fund of its own. Apparently no consistent policy has been followed on setting up fee accounts and special funds.

The general revenue fund in many state governments receives and disburses the major part of revenues. The General Revenue Fund in Texas occupies a lesser position. As the practice of earmarking has spread, the share of state receipts remaining for general revenue has naturally decreased. Nevertheless, even in Texas where the bulk of state income is dedicated, the General Revenue Fund has a substantial role. During fiscal 1951, approximately \$63 million was spent from the fund. Though this amount represents less than ten per cent of total state expenditures, the money was used to care for emergencies and to pay the costs of vital governmental activities not sustained by earmarked revenues.<sup>52</sup>

### Special Revenue Funds

Special revenue funds, as the name suggests, contain money intended to be used only for specific purposes. Each fund is closely connected with one public activity and typically with a single agency.<sup>53</sup> However, several types of funds restricted to special functions have been separately classified--for instance, interest and sinking funds.

During 1951, more than \$300 million was spent from the state's special revenue funds. Funds of this type are the most numerous, there being about 90 in the Treasury.

Although special revenue funds usually support, wholly or partially, the activities of a particular agency, the breadth of the activity supported

<sup>51</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 6. This fact received attention in the 1950 Auditor's Report of the Comptroller, which stated, "We feel that the enforcement fund derived from the Radio, Cosmetics, and Playing Cards Tax should be carried as a special fund and not as a fee account." See Audit Report, State Comptroller of Public Accounts, August 31, 1950, p. 57.

<sup>52</sup> For discussions of general revenue funds see Carl H. Chatters and Irving Tenner, Municipal and Governmental Accounting (New York: John Wiley and Sons, 2nd ed., 1936), p. 19; Oakey, op. cit., pp. 18-19; Tannery, op. cit., pp. 28-30.

<sup>53</sup> Morey, Ibid.; Oakey, Ibid.; Tannery, op. cit., pp. 30-31.

varies a great deal. The State Highway Fund is a case in point. Practically all the work of the Highway Department is financed from this source. At the other end of the scale, a large number of special revenue funds serve activities of limited scope. One example is the Herbicide Fund, which finances the State Department of Agriculture's regulation of the sale and use of hormone-type herbicides. The prolific growth of special funds for highly restricted activities is one of the main causes for the great number of funds Texas has today. Because of the narrowness of some funds, several agencies pay for their operation out of a whole group of funds. For example, during 1951, the Board of Insurance Commissioners used 11 funds and the Department of Agriculture five.

Differences occur not only in the breadth or narrowness of the functions supported but also in the sources of income for these funds. Many special revenue funds depend almost entirely on a single source. The Game Fund, which receives principally hunting and fishing license fees, and the various registration funds such as those for doctors, dentist, and architects, which depend almost altogether on examination and registration fees, are examples. In addition, several special funds, particularly those connected with health or welfare programs, are supported in large measure by federal grants. The use of a separate fund for nearly every federal grant-in-aid program is a second major cause for Texas' large number of funds.

On the other hand, special revenue funds sometimes obtain receipts from several sources, as in the case of the State Old-Age Assistance Fund. During 1951, this fund obtained its income primarily from the Omnibus Tax Clearance Fund, the Comptroller's Tax Clearance Fund, the admissions tax, and the vending machine tax. In effect, its money comes from about 25 taxes, counting the ones that are partly earmarked to the clearance funds. Similarly, the State Highway Fund has several sources of income. The advantage of relying on more than one source is, of course, that if one source produces less than expected, another may compensate for it.

These considerations suggest some of the decisions faced by the Legislature if earmarking is widely used. When the Legislature wants to support an activity at a stable level, it can do so by allocating to it either a single dependable source of income or a number of sources which will not all react in the same way to changing economic conditions.

### Clearance Funds

Clearance funds ordinarily make disbursements only to pay refunds. Money entering these funds is transferred to other funds before being spent. During 1951, about 30 funds in use by the state acted primarily as clearance funds. About \$300 million, or somewhat less than half of the state's receipts, cleared through them. Clearance funds simplify the handling of income by supplying a place where receipts are held until it is convenient to distribute

them or until a need for them arises. When payments are received every day, it becomes bothersome to allocate each day's collections among the various funds for which they are earmarked. It is simpler to deposit the money in a clearance fund and make the distribution once a month. Probably the best-known example of this in Texas is the Omnibus Tax Clearance Fund, through which receipts from 15 taxes flow to the funds from which they are spent.

Clearance funds are sometimes used to hold federal grants which are to be eventually matched by and spent with state money. To avoid drawing two warrants for each payment, one from a state and another from a federal fund, the funds to which federal grant money is deposited initially may serve only to hold it until it is transferred to the state fund. Warrants then are actually drawn only on the state fund. Examples of this type of clearance fund are the Federal Blind Assistance and the Federal Old-Age Funds.

A number of clearance funds have developed as a result of the constitutional amendment under which an ad valorem tax is earmarked to pay the interest and principal on building bonds which 14 state colleges are authorized by the amendment to issue. All receipts from this earmarked tax are placed in the College Building Fund, from which they are cleared to 14 college funds. The money is then further cleared to a number of interest and sinking funds. Warrants to pay interest and principal on the bonds are drawn against these interest and sinking funds. Accordingly, these tax receipts must clear twice before they reach the funds from which they are spent. This is an instance in which one constitutional amendment has given rise to 26 funds. The transaction is illustrated by Chart II-5.

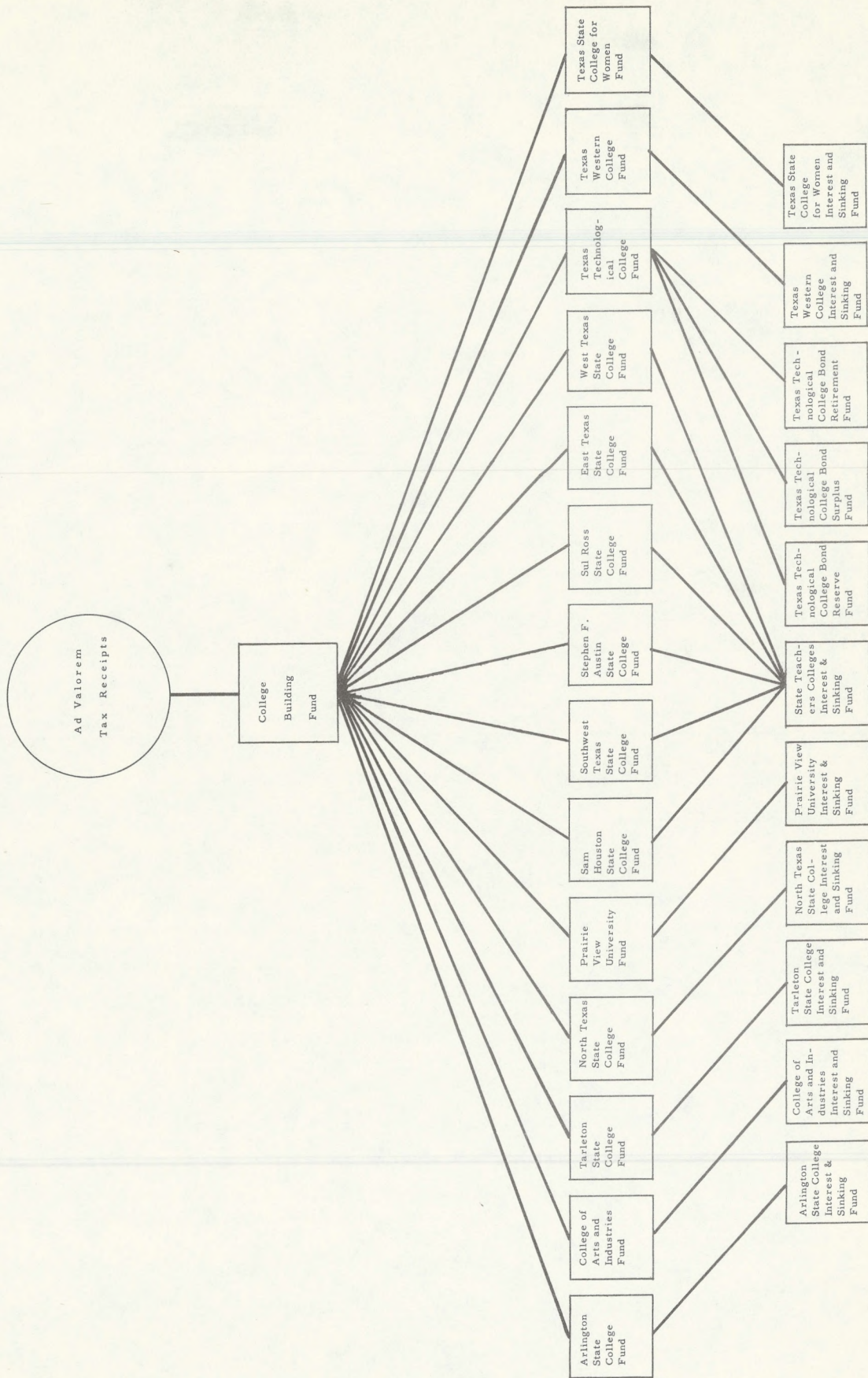
### Trust Funds

Trust funds are composed of amounts held in trust by the state or by the state as an agent for individuals, organizations, or governmental units.<sup>54</sup> The state acts as custodian for the assets of the fund. Trust funds normally come into being as a result of one of the following: (1) Gifts made for specific purposes, such as endowments; (2) Individual contributions to be returned to those individuals under the terms creating the fund, as in an employees' retirement system; (3) Public property, the income from which is set aside for a specific purpose, as when public land is dedicated to support the public free schools; (4) Security deposits with the state to guarantee performance of a contract or for other purposes. During 1951, more than \$290 million was spent from approximately 29 trust funds in Texas.

<sup>54</sup> Chatters and Tenner, op. cit., pp. 170-176; Morey, op. cit., pp. 155-168; Oakey, op. cit., pp. 20-22; Tannery, op. cit., pp. 37-39.



CLEARANCE OF AD VALOREM TAX EARMARKED FOR COLLEGE BUILDING



Trust funds are classed as either expendable or non-expendable, depending on whether their principal may be spent. Earnings of the principal may be spent in certain types of non-expendable trust funds. The Permanent School Fund and the Permanent University Fund are examples of non-expendable trust funds. While the principal of these funds, which consists primarily of land and securities set aside by the state, must be kept intact, the income derived from that principal in the form of interest and payments for surface leases may be spent for the support of the public schools and for the Texas A. & M. College and The University of Texas systems. Expendable trust funds are exemplified in Texas by those in which teacher retirement and state employee retirement system contributions are held.

### Bond and Interest and Sinking Funds

Governments issue bonds to finance projects they do not choose to support from current income. A state bond issue normally results in the establishment of two funds. The first, called a bond fund, receives money obtained from the sale of the bonds and disburses it according to the purpose of the bond issue. The second handles the retirement of the issue and possibly the interest payments. The latter is a sinking or an interest and sinking fund.<sup>55</sup> However, bonds are not always separately funded. For example, when a number of state colleges issued bonds under authority of the college building amendment, receipts from the bond sales were held in local plant funds, though interest and sinking funds were set up by the state for retirement of bonds.

### Revolving Funds

During 1951, Texas had two funds which might be classified as revolving funds. However, during the fiscal year, the Prison Industrial Revolving Fund, one of the two, had no receipts. At the close of the year, its balance was transferred to general revenue. The second, the Texas Prison Fund, indicated receipts exceeding a million dollars, most of which came from the sale of agricultural products. Although receipts in this fund were also transferred to general revenue at the close of the fiscal year 1952, a relatively small account of \$25,000 remains outside the State Treasury. This so-called revolving account has been established to make payments to persons completing their terms of imprisonment in the State Prison at Huntsville. Although it is frequently referred to as a revolving account, it actually gets its receipts from periodic transfers from the General Revenue Fund. Several tax audit funds such as the Natural and Casinghead Gas Audit Fund and the Cigarette Tax Audit Fund have similarities to revolving funds, but in this discussion they have been classified as special funds.

<sup>55</sup> Chatters and Tenner, op. cit., pp. 103-129; Morey, op. cit., pp. 133-141; Tannery, op. cit., pp. 34-37.

Revolving funds, as the term is usually understood, originate from a single grant of money and are intended to be self-supporting. They should not, therefore, require allocations of cash beyond that needed for the original investment. In accounting terms, receipts for revolving funds do not actually represent income, and transfers out are not expenditures.

Revolving funds have been particularly popular in helping finance prison systems. In several states, prison systems have been financed by requiring the inmates to work producing food or license plates for sale to other agencies of government.<sup>56</sup> Although this practice was followed in Texas in 1951, income from prison system farms and manufacturing is now deposited in general revenue.

### Summary on Types and Purposes of Funds

The preceding discussion makes no attempt to present a complete accounting classification. Instead, it is designed to point out some of the purposes that funds serve and some of the characteristic features of funds maintained by the State of Texas. Obviously, these classifications do not rest on a uniform criterion. General and special revenue funds are distinguished from one another by the more extensive restrictions placed on the use of special funds; bond funds are distinguished by the source of their receipts; and so on. However, the value of the classifications does not depend on their constancy but on the light they throw on state finances and revenue flow. Simply stated, the vital points are these: (1) A general revenue fund contains money which is available for the Legislature to use as it sees fit, within the scope of general constitutional provisions; (2) special revenue funds the state must spend on a specific activity or related group of activities; (3) clearance funds facilitate the handling of receipts and may be used as the base for earmarking formulas; (4) bond funds and interest and sinking funds serve to keep account of debt and the transactions concerning debt; (5) trust funds contain moneys held by the state as custodian, the moneys ordinarily being passed on to someone else for spending or being held under agreements with other parties; (6) revolving funds finance internal service activities of the government and operate in such a way that they are self-supporting. These are the types of state funds presently in use. However, the picture of funds in Texas is incomplete until the subject of local funds is taken up and reviewed.

### Local Funds

The term local funds applies to funds financing state agencies but not held in the State Treasury. Agencies place local fund receipts in

<sup>56</sup> Chatters and Tenner, op. cit., pp. 130-144; Tannery, op. cit., pp. 31-33.

convenient banks and draw checks on the accounts. Ordinarily, the purposes for which local funds may be spent are stipulated by law, as is true for fees collected and held locally by the Board of Pharmacy or the Board of Plumbing Examiners. Although receipts placed in local funds are used almost solely by the agencies holding them, excesses are occasionally transferred to the General Revenue Fund. Neither expenditures nor receipts from local funds are reported in the Treasurer's or Comptroller's reports.

The fact that certain state income is kept in local funds does not necessarily mean that it goes unchecked or that its proper use is left solely to the discretion of agencies possessing the funds. Money held in local funds is usually subject to provisions of general law, which limit activities on which it may be spent. In addition, the Legislature usually subjects some part of the assets of local funds to appropriation control, and the State Auditor audits many of these funds. Some agencies are required to make reports, usually to the Governor, giving an account of transactions involving their local funds. However, under present conditions, this segment of state financing is largely lost from the view of the public and even of the Legislature. As an illustration, many restrictions on expenditures, such as those placed on the use of money for travel expenses, are found in appropriation acts rather than general law. Hence local funds to which appropriation control is not applied are free from these restrictions.

Local funds follow no set pattern as to where they appear, for which they are expended. In some cases they represent the entire financial resources of a state agency; in others they are only a part. They may obtain income from fees, from bond sales, from services rendered, and so on. In short, local funds present as much variety as funds in the Treasury. The following comments are intended to suggest some of the areas in which local funds are found and the sources from which they receive income.

A number of local funds which together handle many millions of dollars annually have been maintained by institutions of higher learning. Each state college or university has local funds, usually designated in their reports as current funds to pay running expenses of the institutions, such as the costs of administration, instructional salaries, operating auxiliary enterprises, and operating and maintaining the physical plant. During 1951, income to these funds came largely from student fees, sales, services, and appropriations. University and college current funds are, in essence, special revenue funds maintained on the local level. The local character of university and college current funds was modified substantially by a requirement, adopted by the 52d Legislature, that some hitherto locally-funded receipts, particularly tuition fees, be placed in the State Treasury.<sup>57</sup>

<sup>57</sup> Acts 52d Leg., R.S. 1951, ch. 474, p. 841.

The second type of local college and university fund is the plant fund, in which money is kept for capital improvements. While plant funds receive income from a variety of sources, including transfers from current funds, one notable source is the issuance of bonds. These bonds are usually either those authorized by the college building amendment or revenue bonds to be amortized by the earnings of dormitories or other installations. In either instance, receipts from the bond sales are placed in local plant funds. College and university trust funds usually take the form of student loan or endowment funds. Loan funds are non-expendable trust funds, as are certain accounts in some of the endowment funds. These funds usually originate from private gifts.

Another area in which a large amount of local fund money is involved is that of water control and conservation. Several conservation and reclamation districts, flood control districts, and river authorities which have been set up by law are, in a sense, state rather than strictly local agencies of government because their boards of directors are appointed by state officials. Usually the Governor exercises the appointive power. The funds which most of these enterprises maintain locally could be classified broadly as utility funds, since they finance the activities of public utilities. However, within each district or authority, income and expenditures are handled in several funds, the most common being a fund for operating expenses and one for bonds and their retirement. These districts and authorities receive income from a variety of sources, but most of their continuing revenue is from sales, as, for example, the sale of electricity or water. They also issue bonds, primarily to obtain money for capital outlays.

Several examining boards maintain local funds which receive revenues from examination and registration fees charged by the board to support its activities. Examples are the Boards of Law Examiners, Public Accountancy, Veterinary Medical Examiners, and Nurse Examiners. Other examining and registration agencies, such as the Boards of Medical Examiners, Dental Examiners, Chiropractic Examiners, and Registration of Professional Engineers keep their money in the State Treasury. There is no reason on the face of the situation which would explain this difference of treatment.

In addition to the instances of local funds mentioned above, several state agencies, financed for the most part out of the Treasury, also have local funds. For example, the Board of Water Engineers, largely supported by general revenue appropriations, also receives payments which it puts in local funds for such services as measuring streams and underground water.<sup>58</sup> During 1950, it was reported that local funds were maintained by the Department of Agriculture in connection with the Texas-federal inspection service. These local funds were supported by fees collected under such acts as the Citrus Grading and Inspection Law.<sup>59</sup>

<sup>58</sup> Audit Report, Texas Board of Water Engineers, August 31, 1950; pp. 12-13.

<sup>59</sup> Audit Report, State Department of Agriculture, December 31, 1950, pp. 37-38.

Local funds obviously are found in a variety of places and in the aggregate represent a sizable amount of money. Information on how much money is deposited in local funds is hard to obtain. A fair estimate would be that, excluding water and conservation authorities and control districts, about \$65 million was spent from local funds in 1951. Of course, the total revenue passing through local funds falls far short of that which flows through the State Treasury. Nevertheless, in view of the facts that local funds collectively do amount to a considerable sum each year, that these funds are a part of state finance, and that they frequently affect state appropriations, they should be given consideration.

### Relationships of Funds

Funds are not isolated entities; rather they are bound together by close ties. The existence of ties or relationships among funds is an important feature of state financing. Failure to recognize these relationships prevents an understanding of what actually happens to the revenue received and spent by the state. It would not, for example, help greatly to know the number of millions of dollars deposited in the Omnibus Clearance Fund in 1951 without knowing the facts on transfer of this money to other funds. This is only a simple example of the relationships among funds. There are others more difficult to comprehend but just as important.

Three aspects of interfund relationships are considered. First, different funds will depend in whole or in part on the same source or sources of revenue. This generally means that factors affecting the sources will influence all these funds. Second, funds have an affinity based on a mutual connection with major functional areas of government or even with single agencies, a feature which substantially influences the pattern of appropriations. A third prominent feature of interfund relationships is the transfer of receipts between funds. A great number of such transactions takes place each year, and the dollar amount involved is sizable.

These three features--common sources of receipts, connection with common functional areas or with the same agency, and interfund transfers--may also be connected. For example, the fact that several funds depend upon the same sources of revenue may have a bearing on interfund transfers, as may the fact that a group of funds serve a common functional purpose.

Relationship Expressed in Common Sources of Receipts. Two or more funds may be related because they depend on the same revenue source or sources. It usually follows that variations in income from these sources are reflected in all dependent funds. For example, the Available School Fund, the Confederate Pension Fund, and the College Building Fund all receive ad valorem tax revenue. Variations in property valuations will affect each of them and may result in rate adjustments. The Available School Fund and the State Highway Fund depend on the motor fuel tax for large parts of their income,

and changes in net receipts from that tax will result in a loss or gain to both.

On the other hand, tax revenues distributed according to the Omnibus Tax Bill formula support a number of funds but are so allocated that variations in their yields will probably show up entirely in the General Revenue Fund. This result is achieved because all funds which receive an allocation under the Omnibus Tax Clearance Fund formula, except the General Revenue Fund, get a determinate rather than a percentage share. Hence increases in the yields of taxes distributed by the Omnibus Tax Clearance Fund formula will ordinarily benefit the General Revenue Fund and decreases will affect it adversely, in each case by the entire amount of the increase or decrease. Here the effect of common sources of income for several funds is to concentrate rather than to diversify results of changes.

In the light of the preceding discussion, it is evident that, if two or more funds depend wholly or partially on receipts from the same tax or taxes, the Legislature can hardly avoid taking that fact into account in considering policies affecting the yield from these taxes. The effect of a change in the rates or in coverage may be to modify the financing of several programs. Unless the effect on each of them is traced to its end, results not originally contemplated may ensue.

Relationship Expressed in a Common Major Purpose. Funds financing the same governmental function or agency are related by that fact. In many cases, the relationship is made closer by interfund transfers between, or common sources of receipts of, these funds. However, even if a share in financing one governmental activity or agency were the only connection, that would be important when expenditures for that activity or agency are considered.

Employing the functional classifications previously used, the number of funds serving each major functional area during 1951 were approximately as follows:<sup>60</sup>

<u>Functional Area</u>	<u>Approximate Number of Funds</u>
Education	51
Transportation	5
Public Welfare	30
General Government	21
Health and Sanitation	20
Public Safety	3
Agriculture and Conservation	13
Regulation of Business and Industry	23

<sup>60</sup> Local funds and funds holding guarantee deposits are not included.

Since the functional areas are listed generally in the order of money expended on them, it is evident that there is no correlation between the amount of money spent and the number of funds utilized. What, then, are some of the factors influencing the number of funds in each functional area? In education a crucial factor is the college building amendment. About half of the funds serving educational activities are the clearance and interest and sinking funds created to handle the financing of bonds issued under provisions of this amendment. These funds have already been described as interrelated by serving a common function of government, by their dependence on a common source of receipts, and by a number of interfund transfers. Responsibility for establishing these funds was not left to the discretion of the Comptroller but was determined in bond agreements made at the time of sale.

In education, public welfare, and health and sanitation, the large number of funds is mainly attributable to separate funds for federal grants-in-aid. In some instances, as has been noted, when federal and state funds used in the same program are placed in companion funds, the federal fund is simply a clearance fund, its receipts being transferred to the state fund upon which the warrants are drawn. Federal and state blind assistance to dependent children are examples of companion funds.

In agriculture and conservation, general government, and regulation of business and industry, fee funds supporting examination and registration activities are common. Examples of this type of fund include Pure Bred Cottonseed Inspection Fund, Citrus Fruit Inspection Fund, and Boiler Inspection Fund.

### Interfund Transfers

The importance of interfund transfers is evidenced by the number of transfers made each year as well as by the amount of money involved. For example, during the 1951 fiscal year, about 125 transfers involving more than \$220 million were made.<sup>61</sup> Moreover, the income from several major funds is derived primarily from interfund transfers, and a number of funds have as their prime function the transfer of state moneys. Most important, in terms of money, are transfers through the various clearance funds, particularly the

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<sup>61</sup> In computing the number of transfers, the word transfer means all sums of money moved out of one fund and into another during the year. The number of actual transactions is much higher, since transfers might be made each month instead of once during the year. In computing the dollar amount, bookkeeping transfers not listed in the Comptroller's report have been excluded. For example, the major portion of the tax money which goes into the Available School Fund is first deposited to the Omnibus Tax Clearance Fund and then transferred. In like manner, a large amount of money is transferred through the Comptroller's Tax Clearance Fund. These are not included. These items, involving millions of dollars, are reported by the Comptroller as direct receipts to the fund in which they are ultimately placed.



## Omnibus Tax Clearance Fund.

Transfers between funds, except those made merely for bookkeeping purposes, may be made only after certain conditions are met. A deficit in one fund is not in itself sufficient justification for transferring money from another fund. The conditions governing transfers must be set out in the appropriation bill, the general law, or the Constitution and must accord with the requirements of any law superior to that providing for the transfer. Transfers by appropriation bills are, of course, effective for only one or two years.

Once the legal conditions for transfers have been fulfilled, the basis which determines the amount of money to be transferred may vary. Several of these bases will be described for purposes of illustration.<sup>62</sup> A recurring general law requirement is that excesses in certain funds be shifted to the General Revenue Fund at the end of each year or each biennium. This kind of provision is found in several laws establishing licensing and examining agencies such as those for real estate dealers and for architects.<sup>63</sup> The General Revenue Fund also usually receives every year a large residue transfer from the Omnibus Tax Clearance Fund.

Occasionally, a provision will be found which directs an interfund transfer to meet the needs of a particular activity or to match contributions by individuals. When transfers are made in amounts sufficient to meet the needs of a particular activity, the agency exercising authority over that activity calculates, according to the rules established by law, the amount to be transferred. Transfers from the Omnibus Tax Fund are made to the Foundation School Fund on the basis of the needs as determined by the Foundation School Fund Budget Committee and to the State Membership Accumulation Fund in the Teacher Retirement System on the basis of matching contributions.<sup>64</sup> Numerous funds transfer amounts determined by the Employees Retirement System to the State Membership Accumulation Fund for the system.<sup>65</sup>

The examples cited are not the only bases on which interfund transfers are made, but they serve to illustrate some of the methods currently in use. A myriad of transfers among funds have developed as by-products of the extensive use of earmarking and funds. In some instances, as in the case of the Omnibus Tax Clearance Fund, the transfers were part of the simplification of an excessively complex situation. In others, they

<sup>62</sup> Many interfund transfers result from the manner of handling earmarking formulas for taxes but since tax earmarking has been considered at some length in the previous section, it will not be treated again here.

<sup>63</sup> Tex. Civ. Stat. (Vernon, Supp. 1950) art. 6573a, sec. 18; Tex. Civ. Stat. (Vernon, Supp. 1952) art. 249a, sec. 4.

<sup>64</sup> Tex. Civ. Stat. (Vernon, Supp. 1950) art. 7083a.

<sup>65</sup> Tex. Civ. Stat. (Vernon, 1948) art. 6228a, sec. 8.

were appendages to and a further extension of this complex situation. Financing a proposed program often presents a real challenge to persons faced with the Texas financial maze. Grafting onto established arrangements a design capable of achieving desired results has brought forth many plans which incorporated transfers between funds.

### Analyses of Individual Funds

To describe in more detail the operation of certain funds, three important Texas funds, each of a distinct type, have been chosen for analysis. Although a magnified view is given in this approach, even a fund-at-a-time inspection does not allow minute attention to every detail. Included here are the General Revenue, the Omnibus Tax Clearance, and the State Highway Funds. During 1951, each of them handled receipts exceeding \$70 million. Their transactions are on a larger scale and are often more complex than those including the numerous little funds which thicken the state's financial reports. Nevertheless, they are similar in form; so these descriptions should help clarify the operations of funds as a whole.

### The General Revenue Fund

A general revenue fund, usually, at least during the early history of a government, is at the center of public finance. However, expansion of the earmarking practice has changed the relative position of the general revenue funds in many jurisdictions, including Texas. In 1847, general revenue income in Texas included all income not earmarked for schools.<sup>66</sup> The General Revenue Fund no longer holds such prominence because the major portion of state income goes into a multitude of dedicated funds. However, the General Revenue Fund has not been losing ground at a constant rate. For the last 25 years, the portion of state money placed in the General Revenue Fund, figured as a percentage of state income, has varied from year to year, but the general trend has been down.

During the 1951 fiscal year, the General Revenue Fund received approximately \$72.5 million, while transfers out and expenditures totaled about \$74.9 million. At the close of the fiscal year, the General Revenue Fund retained a cash balance of more than \$29 million, which is comparable to the cash balance of more than \$31 million in the fund at the beginning of the fiscal year. Major sources of its income were the ad valorem, inheritance, and franchise taxes, together with transfers from the Omnibus Tax Clearance Fund.<sup>67</sup> General revenue money is used primarily to finance education, but substantial expenditures are also made for general government, public welfare,

<sup>66</sup> Edmund T. Miller, A Financial History of Texas (Austin: A. C. Baldwin and Sons, 1916), p. 416.

<sup>67</sup> State ad valorem levies for general revenue purposes were ended by a constitutional amendment effective January 1, 1951. Tex. Const., Art. VII, sec. 1a.

health and sanitation, agriculture and conservation, and public safety.

Chart II-6 illustrates the transactions involving the General Revenue Fund in the 1951 fiscal year. Due to the many items of income received, they have been grouped by type.

### Income.

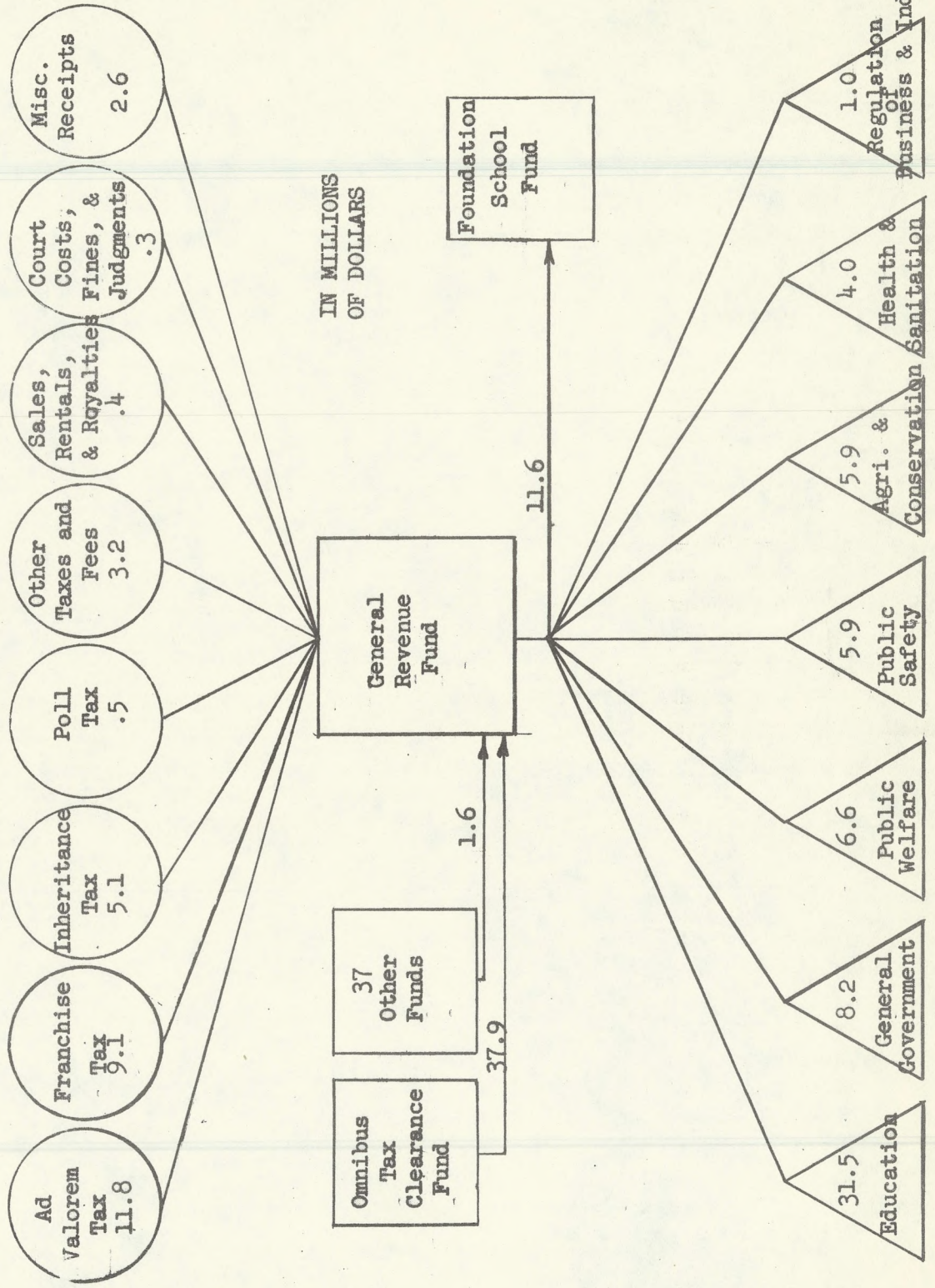
Taxes and fees are the primary contributors to this fund, both directly and through transfers from other funds. Tax revenues originally deposited to the fund were from the ad valorem, inheritance, franchise, and poll taxes. Together, they accounted for about 35 per cent of the fund's total income in 1951. Inheritance and franchise tax receipts are primarily general revenue, but only one-third of state poll tax receipts are deposited in this fund. The other two-thirds of the poll tax goes to the Available School Fund. The ad valorem tax is collected at different rates for general revenue, Confederate pensions, college building, and public schools. During 1951, approximately one-third of the state ad valorem tax collections were deposited to the General Revenue Fund as well as portions of several occupation taxes. Fees deposited directly to the General Revenue Fund came from a variety of sources including insecticide registrations, insurance agent licenses, motor carrier permits, and teacher examinations. As indicated by Chart II-6, a relatively small amount is contributed by sales, rentals, royalties, fines, and judgments. Undoubtedly this fund receives income from a far greater number of sources than any other, but a few large items dominate.

During 1951, almost 40 funds made transfers to the General Revenue Fund. However, the Omnibus Tax Clearance Fund alone supplied about 50 per cent of the total income of the General Revenue Fund. Among the transfers were balances remaining in dormant funds, unexpended balances required to be transferred by general laws, and payments for services transferred by appropriation bills. The largest number of transfers came from funds maintained for licensing and examining agencies.

### Outgo

More than half of the General Revenue Fund was spent for education in 1951. This includes amounts directly spent from the fund and money transferred to funds established for educational purposes. Most of the outlay for higher education was disbursed by warrants drawn against the fund, while most of the outlay for the public free schools was transferred to the Foundation School Fund. The General Revenue Fund contributed, in all, about \$43 million to the support of Texas education in 1951. Well behind education was general government at \$8.2 million, public welfare and hospitals and institutions for the handicapped at \$7.9 million, public safety at \$5.9 million, agriculture and conservation of natural resources at \$5.9

Chart II-6  
 GENERAL REVENUE FUND, 1951  
 (Figures Rounded to Nearest Million)



million, and health and sanitation at \$3.5 million. Expenditures for the regulation of business and industry amounted to slightly less than a million dollars.

A general revenue fund would usually be expected to handle only non-earmarked money. However, in 1951, about \$3 million deposited to the Texas General Revenue Fund was credited for tax enforcement and for supporting certain regulatory, licensing, and examining activities. This money was deposited to special fee accounts. Although accounts are credited with all money allocated to them, the money is not fully segregated. It stands as security behind general revenue warrants.

### The Omnibus Tax Clearance Fund

The Omnibus Tax Clearance Fund, created by the Omnibus Tax Act of 1941, receives and distributes taxes levied and allocated by that act and subsequent amendments to it.<sup>68</sup> It receives no transfers, and no warrants are drawn against it except for occasional refunds. It is a reservoir into which receipts flow from a number of taxes and fees through which these receipts are distributed to the activities they finance. Allocations from the fund in 1951 were first made to several enforcement funds and accounts, to the Available School Fund, the State Hospital Fund, and the State Hospitals and Special Schools Building Fund. After initial allocations were made, \$153.5 million was held in this fund and, under the Omnibus Tax Clearance Fund formula, about \$146 million was transferred from it. Transfers were made to the State Blind Assistance, State Children Assistance, Teacher Retirement State Membership Accumulation, Teacher Retirement Prior Service Annuity Reserve, State Old-Age Assistance, Farm-to-Market Road, Foundation School, and General Revenue Funds. Chart II-7 summarizes the operation of the Omnibus Tax Clearance Fund for fiscal 1951. The presentation has been simplified by grouping taxes under similar allocations.

### Allocations by Tax Formulas.

To understand the operation of the Omnibus Tax Clearance Fund and the nature of its job in distributing state revenue, it is necessary to look first at allocations of all receipts from taxes, some portion of which are distributed by the fund formula, and then to look at the fund formula itself. The transactions described here, based on the law in effect during the 1951 fiscal year, are more complex than under the present situation. This is because most of the elaborate arrangements for financing hospitals and special schools were terminated at the beginning of the 1952 fiscal year. In 1950, rate increases, generally ten per cent of the tax, were added to Omnibus Tax Bill taxes. This

<sup>68</sup> Acts 47th Leg., R.S. 1941, ch. 184, p. 269.

additional tax was set aside for financing hospitals and special schools.<sup>69</sup> In 1951, the rate increase was essentially retained but was separated from the hospital and special school program. Only the new cigarette tax provisions continue unchanged, and these are scheduled to expire at the end of the 1957 fiscal year.

Under Group I, the flow of revenue from liquor, wine, and beer permits is outlined. After refunds are deducted, the balance of the revenue from these items is deposited to the Omnibus Tax Clearance Fund for distribution by the fund formula.

Receipts from cigarette permits, penalties, and interest, shown in Group II, are not distributed in the same manner as cigarette stamp tax revenues. From them, two and one-half per cent of three-fourths of the gross income is set aside for the Cigarette Tax Enforcement Fund. One-fourth of the net revenue goes to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund for subsequent disposition.

Item III is the cigarette stamp tax, second largest contributor to the Omnibus Tax Clearance Fund. It is exceeded only by the tax on crude oil production. Two and one-half per cent of three-fourths of the gross revenue collected is deposited to the Cigarette Tax Enforcement Fund, One-fourth of the net revenue from cigarettes weighing less than three pounds per 1,000 and 5/41 of the net revenue from cigarettes weighing more than three pounds per 1,000 are allocated to the State Hospital and Special Schools Building Fund. However, the law stipulates that if an amount exceeding \$5 million is credited to the State Hospital and Special Schools Building Fund for the biennium ending August 31, 1951, or more than \$5 million for any fiscal year thereafter, the excess is to be placed in the State Hospital Fund. As a result of this provision almost \$7 million from the cigarette tax was deposited to the State Hospital Fund in 1951. One-fourth of the remaining net revenue is allocated to the Available School Fund and three-fourths to the Omnibus Tax Fund.

The next four groups of taxes all contributed,\* under the 1950 tax law, a percentage of their receipts to the State Hospital Fund. They have been classified by whether they are occupation taxes and by whether they have enforcement funds.

Taxes in Groups IV and V are not occupation taxes. Group IV taxes have enforcement funds; Group V taxes do not. Group IV includes the radio, cosmetics, and playing cards sales tax and the liquor, wine, ale, and beer

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<sup>69</sup> Acts, 51st Leg., 1st C.S. 1950, ch. 2, p. 10; Acts 51st Leg., 1st C.S. 1950, ch. 1, p. 1.

stamp taxes. An enforcement allotment is deducted from the gross receipts from each of them. Enforcement deductions from the radio, cosmetics, and playing cards tax are at the rate of two per cent. Enforcement deductions from liquor, wine, ale, and beer taxes are as appropriated. Net revenues are divided as follows: The increase provided in 1950 goes entirely to the State Hospital Fund. One-fourth of the receipts from the tax at the pre-1950 rate is assigned to the Available School Fund and three-fourths of receipts at the pre-1950 rate to the Omnibus Tax Fund.

The motor vehicle sales, stock transfer, and prescription taxes make up Group V. None of the laws providing for these taxes establishes an enforcement fund; consequently all collections other than those resulting from the 1950 increase are divided one-fourth to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund.

Taxes in Groups VI and VII are occupation taxes. Those in Group VI have enforcement funds; those in Group VII do not. The fact that they are occupation taxes determines the way in which revenues from the additional rates levied in 1950 are distributed. The law provided that all revenues derived from the tax increase, except such portions as the Constitution required be set aside for the benefit of the public free schools, be placed in the State Hospital Fund.<sup>70</sup> An opinion of the Attorney General declared that the taxes in these two groups are occupation taxes and that, for that reason, one-fourth of the increase must be deposited in the Available School Fund.<sup>71</sup>

Taxes on crude oil production and on natural gas and casinghead gas comprise Group VI. Attached to each tax is a provision which allows one-half of one per cent for enforcement costs. After these amounts have been subtracted from the gross receipts, the net tax is allocated as follows: Three-fourths of the amount raised by authority of the 1950 increase in the tax rate is placed in the State Hospital Fund. The Available School Fund receives one-fourth of the amount attributable to the increase and one-fourth of the amount attributable to the regular rate. Three-fourths of collections under the pre-1950 rate go to the Omnibus Tax Clearance Fund.

Taxes on the gross receipts of utility, telephone, oil-well servicing, and motor carrier companies, on the production of sulphur and carbon black, on the sale of cement, and on the gross premiums of insurance companies are included in Group VII. None of the laws providing for these taxes set aside any receipts for enforcement. Accordingly, the revenue attributable

<sup>70</sup> Acts, 51st Leg., 1st C.S. 1950, ch. 2, p. 10.

<sup>71</sup> Op. Tex. Atty. Gen. No. V-1027 (April 3, 1950).

to the 1950 rate increase is allocated one-fourth to the Available School Fund and three-fourths to the State Hospital Fund. Revenue from the pre-1950 rate is allocated one-fourth to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund.

Group VIII traces revenue collected as penalties and interest from taxpayers liable for the gross premiums tax on insurance companies. Since no rate increase was provided for this tax in 1951, no money was allocated from them to the State Hospital Fund. One-fourth of collections was allocated to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund.

#### Allocations by the Fund Formula.

After all amounts mentioned above have been taken from receipts of taxes contributing to the Omnibus Tax Clearance Fund, the remainder is put together and distributed according to a formula attached to the Omnibus Tax Clearance Fund itself.<sup>72</sup>

Chart II-7 shows the monetary allocation of the Omnibus Tax Clearance Fund formula during 1951; Chart II-8 indicates the bases upon which the allocation was made.

The Farm-to-Market Road Fund receives as its only income \$15 million a year from this fund. Actually, the Farm-to-Market Road Fund is simply a transfer station for money eventually to be expended from the State Highway Fund.

Two flat-rate allocations are made from the Omnibus Tax Clearance Fund for the support of assistance programs in which the state and federal governments share. One million dollars annually goes to the State Blind Assistance Fund. These constitute the state's contributions to those programs.

The Teacher Retirement System received a sum approximating the amount contributed annually by the members. Transfers are made to the State Membership Accumulation Fund the the Prior Service Annuity Reserve Fund. The Omnibus Tax Clearance Fund is the only important source of

<sup>72</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7083a, sec. 1-2; Tex. Civ. Stat. (Vernon, Supp. 1950) art. 7083a, sec. 2.



# OMNIBUS TAX CLEARANCE FUND - 1951

CHART II - 7

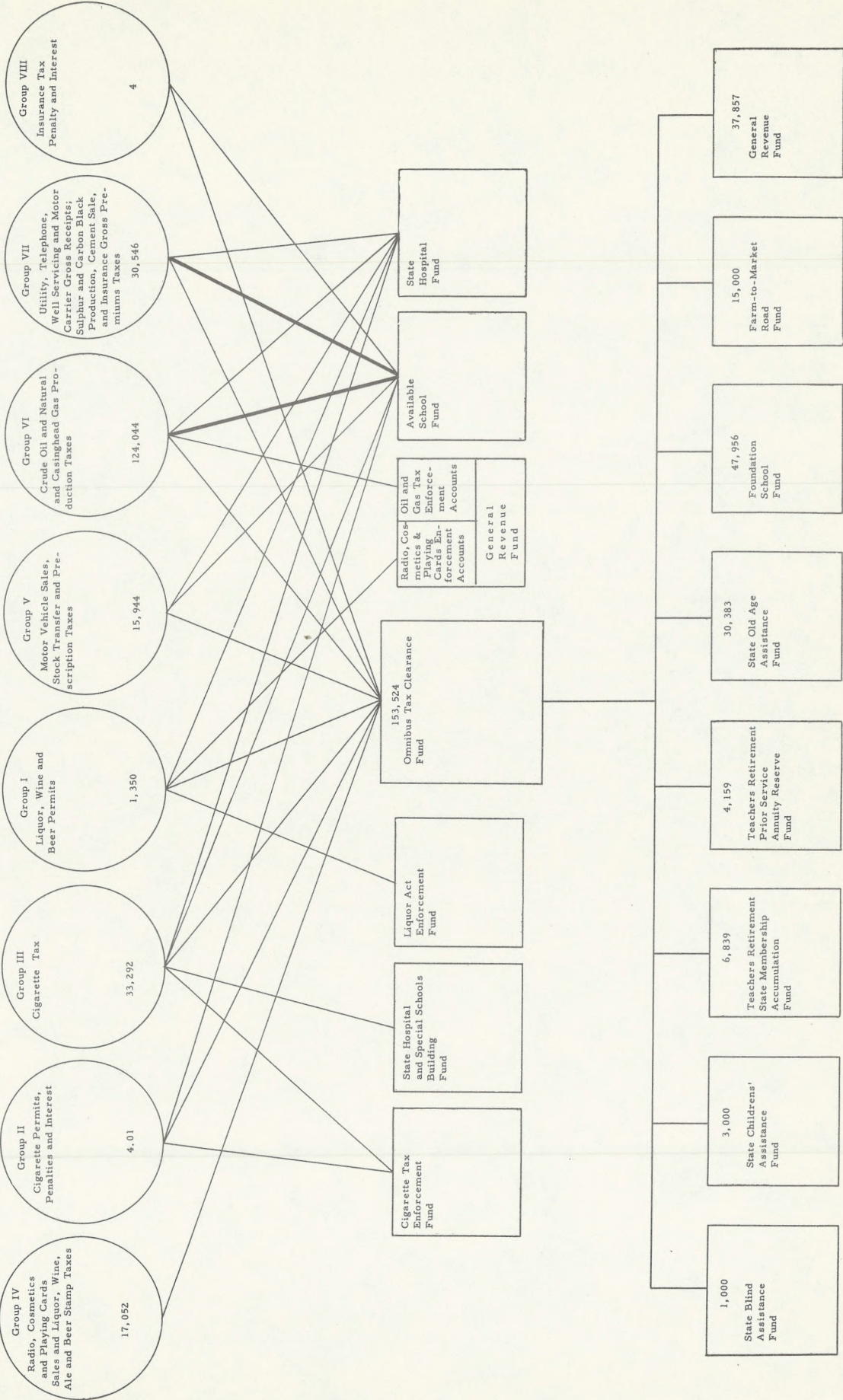
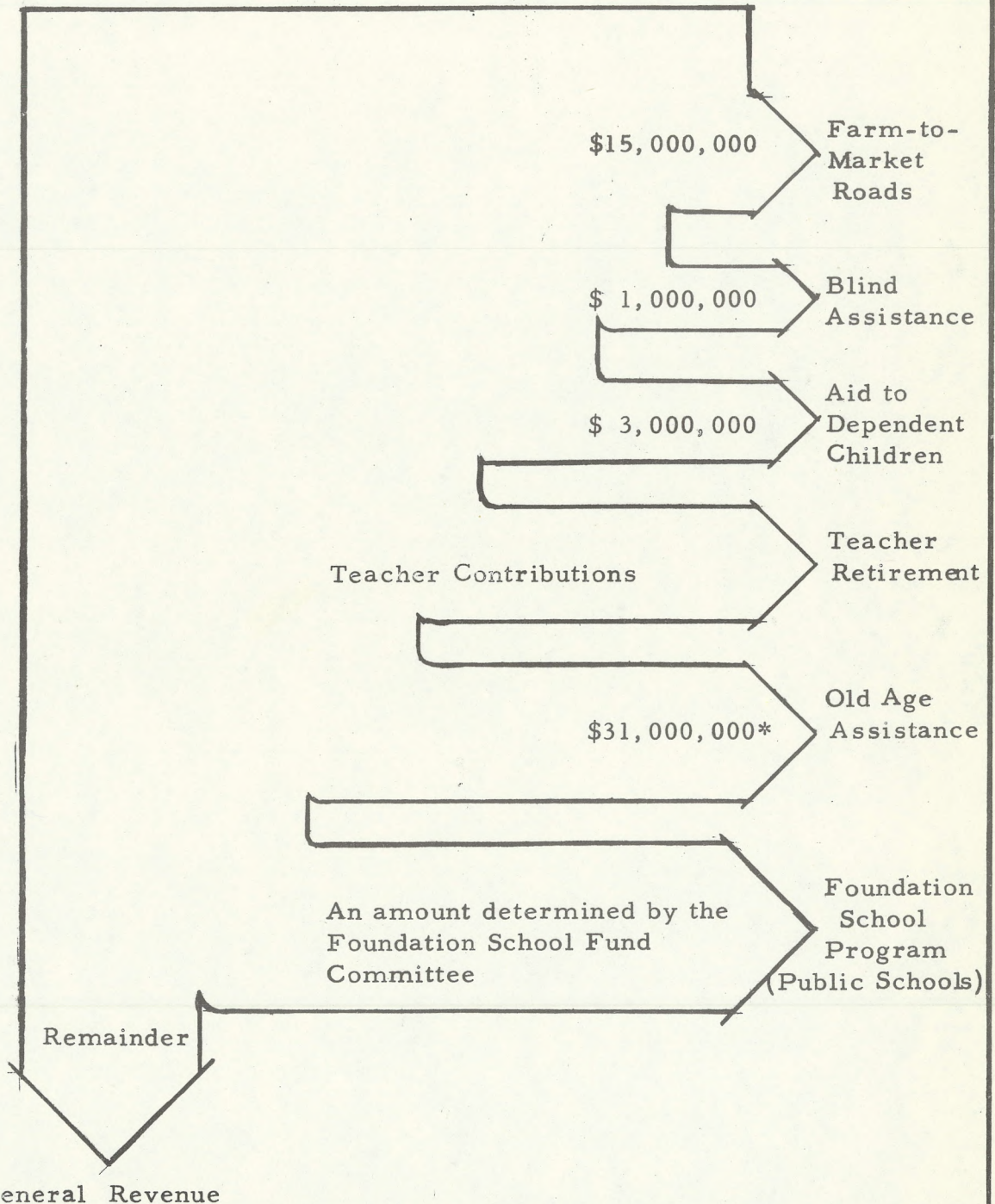


CHART II - 8  
BASES OF OMNIBUS TAX CLEARANCE FUND , ALLOCATION 1951

Omnibus Tax Bill Receipts



\* The actual amount is slightly less than \$31,000,000, depending upon the extent of contributions made by other state sources.

income to these funds, and these transfers comprise the state's contributions to the Teacher Retirement System.

The Texas Constitution provides that "the total amount of money to be expended out of state funds for such assistance to the needy aged, needy blind, and needy children shall never exceed the sum of Thirty-five Million Dollars (\$35, 000, 000) per year."<sup>73</sup> With \$4 million allocated annually to the State Blind and State Children Assistance Funds, a maximum of \$31 million may be allocated to the State Old-Age Assistance Fund. The amount which must be transferred to the Old-Age Assistance Fund is calculated by subtracting all contributions made by the state from other sources to the fund from the maximum of \$31 million. During the 1951 fiscal year, portions of the coin-operated machine and admissions taxes were earmarked for old-age assistance. But, since these provided less than a million dollars, the Omnibus Tax Clearance Fund supplied more than \$30 million. In 1951, the Legislature amended the coin-operated machine tax law so that the three-fourths of net collections formerly going to the State Old-Age Assistance Fund now goes into the Omnibus Tax Clearance Fund.<sup>74</sup> Since collections under the admissions tax are small, transfers from the Omnibus Tax Clearance Fund account for almost the full \$31 million.

The Foundation School Fund Budget Committee decides the annual amount to be transferred from the Omnibus Tax Clearance Fund to the Foundation School Fund in accordance with the provisions of the act establishing the program. This, which is the biggest transfer from the Omnibus Tax Clearance Fund, along with the transfer to the Teacher Retirement System and the residue transfer to the General Revenue Fund, are the least definite items. Other transfers are flat amounts, except the transfer to the State Old-Age Assistance Fund, which under present conditions is very close to being a flat amount.

When all other money required by law to be transferred from the Omnibus Tax Clearance Fund has been transferred, the remainder is sent to the General Revenue Fund. The balance transferred to the General Revenue Fund from the clearance fund in 1951, as already noted, amounted to more than 50 per cent of total General Revenue Fund Receipts.

It is important to understand not only the legal provisions surrounding the operation of the Omnibus Tax Clearance Fund but also the administration of the fund on a day-by-day basis. As previously mentioned, transfers are supposed to be made from the fund at the close of every month rather than only at the end of the fiscal year. This practice is desirable primarily

<sup>73</sup> Tex. Const., Art. III, sec. 51a.

<sup>74</sup> Tex. Civ. Stat. (Vernon, Supp. 1952) art. 7047a-15.

because it permits receipts from these taxes to be used soon after being collected instead of merely being held in the fund during the year. The Foundation School Fund, unlike other funds receiving transfers, is supposed to get its share in nine monthly installments beginning with the first month of each fiscal year.

Because monthly installments are to be met, the question arises as to the possibility of monthly receipts falling below the predetermined amount to be allocated and what would occur if collections were insufficient. An insufficient amount is likely to be collected for a single month, even when annual receipts are high. There are indications that the Legislature realized the possibility of this danger by (1) establishing a system of priorities listing the order in which funds or groups of funds receive their allotments,<sup>75</sup> and (2) providing that particular funds will receive their monthly proportions from the first revenue of the General Revenue Fund when there is an insufficient amount in the clearance fund.<sup>76</sup>

Six activities and general revenue receive allocations from the clearance fund. The first three items mentioned in the formula are assistance to the blind, assistance to children, and teacher retirement. No mention is made of priorities. The fourth item is old-age assistance. This allocation is to be made after "the above allocations and payments have been made from such 'Clearance Fund'." The fifth item is the Foundation School Program. This allocation is to be made after all preceding allocations and those in the farm-to-market road program have been made. There is a contradiction in provisions relating to the farm-to-market road program. This section of the law begins with the words, "After the above allocations and payments have been made . . ." and finishes with the sentence, "The above allocation shall be made irrespective of any other sub-section of this section of this Article." The seventh item is the allocation to the General Revenue Fund, which receives the excess.

Although the answer to the question of priorities has not received administrative interpretation, canons of statutory interpretation would seem to give the allocation to farm-to-market roads first priority. This interpretation assumes that the term "Article" in the farm-to-market road allocation refers to Article 7083a in Vernon's Civil Statutes and that the last provision concerning priorities in the allocation is construed as effective. As previously mentioned, two other allocations make reference to the time sequence in which they are to receive allotments. First, the Old-Age Assistance Fund receives

<sup>75</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7083a, sec. 2 (1),(2),(3),(4); Tex. Civ. Stat. (Vernon, 1950 Supp.) art. 7083a, sec. 2 (4-a), (4-b).

<sup>76</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7083a.1; Acts 51st Leg., R.S. 1949, ch. 615, sec. 2 (34); Acts 52d Leg., R.S. 1952, ch. 499, sec. 2(33).

its share after the first three allocations mentioned in the statute have been made. Second, the Foundation School Fund receives its allocation last. From these indications, it appears that the Farm-to-Market Road Fund has first priority. Assistance funds for the blind and children and the teacher retirement allotment are paid next and immediately before the Old-Age Assistance Fund. The Foundation School Program receives its share after all other allocations have been made. General Revenue Fund is given the balance, if any remains.

As previously mentioned, the Legislature has provided the procedure to be followed when there is not a sufficient amount in the Omnibus Tax Clearance Fund to meet the monthly demands of the three assistance funds.<sup>77</sup> The provision stipulates that if the amount available for transfer to the assistance funds is not sufficient to meet the monthly allocation, the deficit is to be made up by the first revenues collected which would otherwise go into the General Revenue Fund. The general law does not mention what is to happen to other funds under similar circumstances. This means that the three assistance funds are guaranteed their allocations by general law, even if it is necessary to take general revenue receipts. However, since the assistance funds are among the first in priority as established by the Omnibus Tax Clearance Fund formula and the clearance fund has experienced no serious shortage, there has been no situation requiring that these funds receive allotments from general revenue.

Although general law guarantees only the three assistance funds their allocation, legislative practice has been to give the same guarantee to the Foundation School Fund. However, the provision has been placed in the appropriation bills of 1949 and 1951 rather than in general law. Since the Foundation School Fund is last to receive its proportion through the Omnibus Tax Fund formula, the burden of monthly shortages which have occasionally developed in the past has fallen on the Foundation School Program. However, the real problem of priorities has not arisen because the shortage did not exceed the Foundation School Fund's monthly allotment, and the deficit was made up, as directed in the appropriation bill, from general revenue. Since the General Revenue Fund is the last-named in the Omnibus Tax Clearance Fund formula, it receives the full impact of fluctuations in revenues allocated by that formula. For example, when oil tax receipts go down, one-fourth of the loss is to the Available School Fund and three-fourths normally is to the General Revenue Fund. The portion going to the General Revenue Fund would have to shrink to zero before any other fund receiving allocations from the Omnibus Tax Clearance Fund formula would lose. With general revenue also guaranteeing the three assistance funds, the possibilities of "crises" in the General Revenue Fund are substantial.

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<sup>77</sup> Tex. Civ. Stat. (Vernon, 1948), art. 7083a-1. This provision applies to the Blind Assistance Fund, the Children's Assistance Fund, and the Old-Age Assistance Fund.

## The State Highway Fund

The State Highway Fund is a special revenue fund maintained primarily to finance programs carried out by the Highway Department. It was established in 1917 when Texas created a Highway Department.<sup>78</sup> At that time, receipts were almost wholly from motor vehicle registrations and federal grants. The fund's major source of income in later years, the motor fuel tax, was added in 1923.<sup>79</sup> Another large source of income was created in 1949 with the adoption of the law setting aside \$15 million a year of Omnibus Tax Bill revenues for construction of farm-to-market roads.<sup>80</sup> During the 1951 fiscal year, the State Highway Fund received \$141.9 million and disbursed \$133.4 million.

Income and outgo of the State Highway Fund for 1951 are shown in Charts II-9 and II-10, which also indicate the relative importance during 1951 of various items of income and outgo. Transactions of this fund, which have been telescoped here, are simple compared to those of several other state funds.

Income. These four items -- motor fuel and motor vehicle registration taxes, federal aid, and omnibus tax revenues -- accounted for approximately 86 per cent of the State Highway Fund income in 1951. The motor fuel tax brought in about 33 per cent, registrations about 23 per cent, federal aid about 15 per cent, and omnibus tax revenues another 15 per cent. Among other sources of income were county and city aid, redemption of bonds purchased by the fund, and fees.

During fiscal 1951, about one-fourth of the net tax was deposited to the County and Road District Highway Fund, and, after costs of administration and state-assumed bonds were met, the surplus was distributed equally to the State Highway Fund and to the county lateral road account. However, as of the 1952 fiscal year, the system of distribution was changed.

At present, the State Highway Fund receives about one-half of the net motor fuel tax plus any balance that remains from the one-fourth contributed to retire county road bonds assumed by the state and to cover a \$7.3 million annual grant to the counties.

Net motor vehicle registration receipts -- those remaining after local collection fees have been deducted -- are divided between the counties in which the taxes are collected and the state. Each county keeps all net collections until it has \$50,000 and one-half of net collections thereafter until it has \$175,000.

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<sup>78</sup> Acts 35th Leg., R.S. 1917, ch. 190, p. 416, sec. 23.

<sup>79</sup> Acts 38th Leg., R.S. 1923, ch. 134, p. 275.

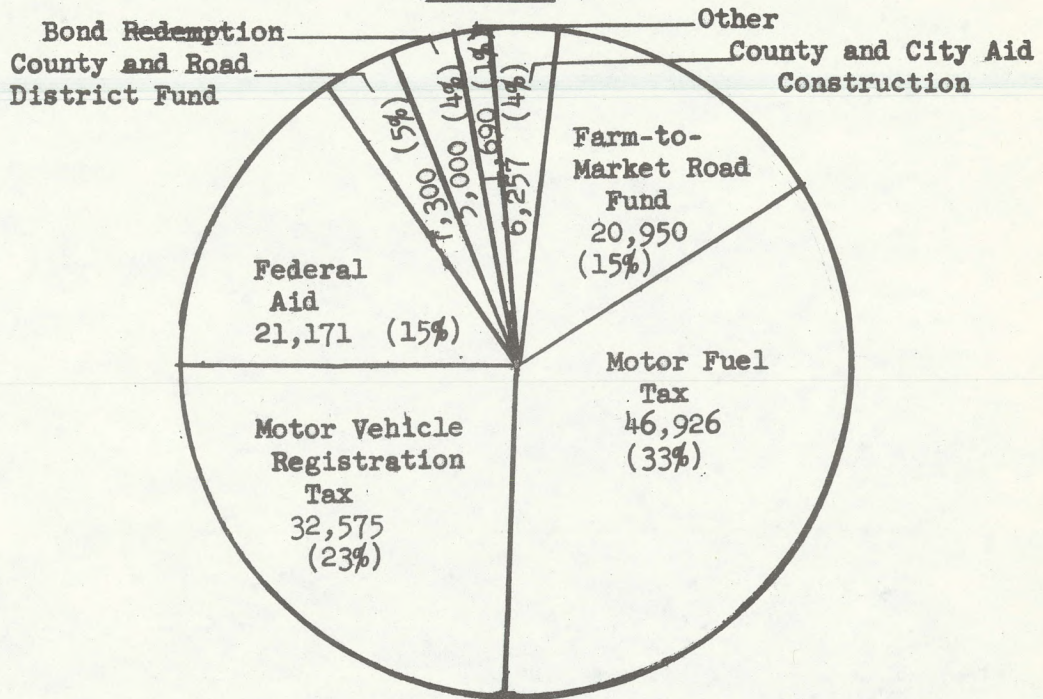
<sup>80</sup> Acts 51st Leg., R.S. 1951, ch. 51, p. 85.

CHART II - 10

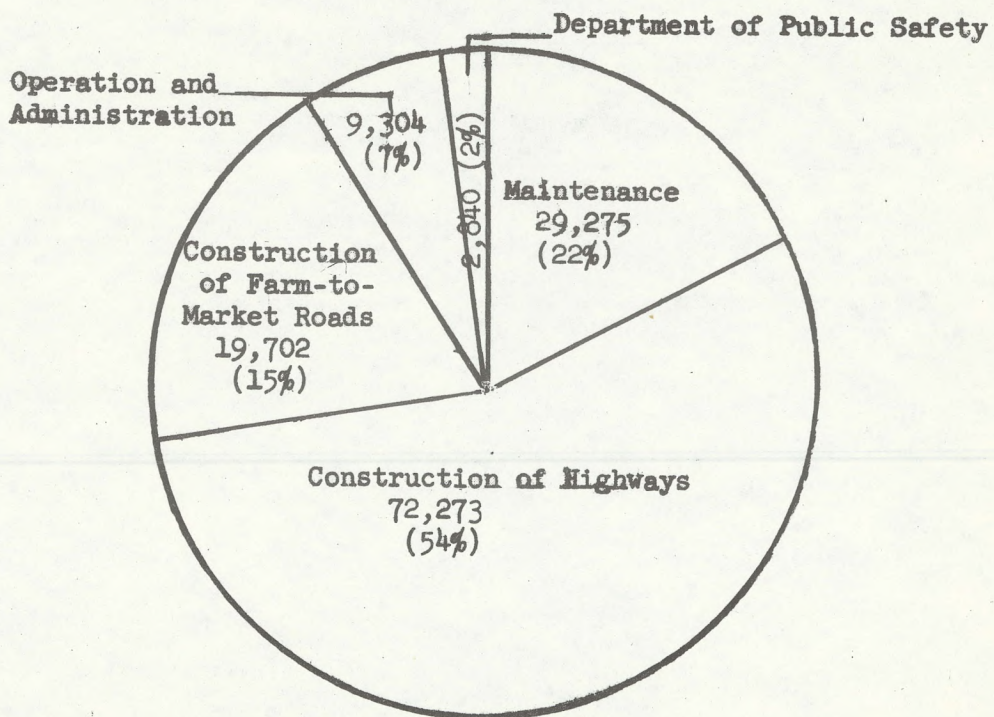
RECEIPTS AND EXPENDITURES FOR HIGHWAYS, 1951

TEXAS HIGHWAY FUND, 1951  
 (Figures Rounded to Nearest 1,000)  
 000's omitted

RECEIPTS



EXPENDITURES



The rest goes to the state. The state's share, which in recent years has been 55 to 60 per cent of net collections, is allotted to the Highway Fund.

Federal money enters the State Highway Fund under the grant-in-aid programs for building a system of national highways and better local roads. Federal grants for health, welfare, and education are ordinarily placed in separate "federal" funds in the Treasury, but historically this practice has not been followed with highway aid money.

Out of revenues deposited to the Omnibus Tax Clearance Fund and distributed by the fund formula, \$15 million is transferred annually to the Farm-to-Market Road Fund. Eventually this money is further transferred to the State Highway Fund to pay for construction.

The Highway Department builds roads for or in conjunction with local units of government. The local share of the cost is placed in the State Highway Fund to reimburse the department. This item is listed as county and city aid.

In 1951, the Highway Fund redeemed \$5 million in United States Government bonds, completing the redemption of federal securities held by the fund. The Highway Department receives fees from several activities, the most important being the issuance of certificates of title and permits for oversized and overweight vehicles. Fees brought in about a million dollars in 1951. In addition, the State Highway Fund receives some miscellaneous items of income, among them interest, sales, and damages.

Outgo. Most Highway Fund money is spent by the Highway Department. The largest part, approximately 90 percent, is for construction and maintenance of roads and highways. The Highway Patrol in the Department of Public Safety is also financed by this fund. More than half the expenditures of the Department of Public Safety are derived from the Highway Fund.

Although only one fund is involved and although expenditures are for the same general purpose, Highway Fund income is not all available to be appropriated for such road or highway programs as the Legislature thinks wise. Certain receipts are earmarked by law for designated activities. For example, transfers from the Farm-to-Market Road Fund and part of the gasoline tax are set aside for farm-to-market road building. Certificate of title fees are used exclusively to administer the Certificate of Title Act. Federal grants are for particular programs. This situation is especially interesting in view of the fact that many times divisions of purpose no greater than these have brought forth several separate funds.



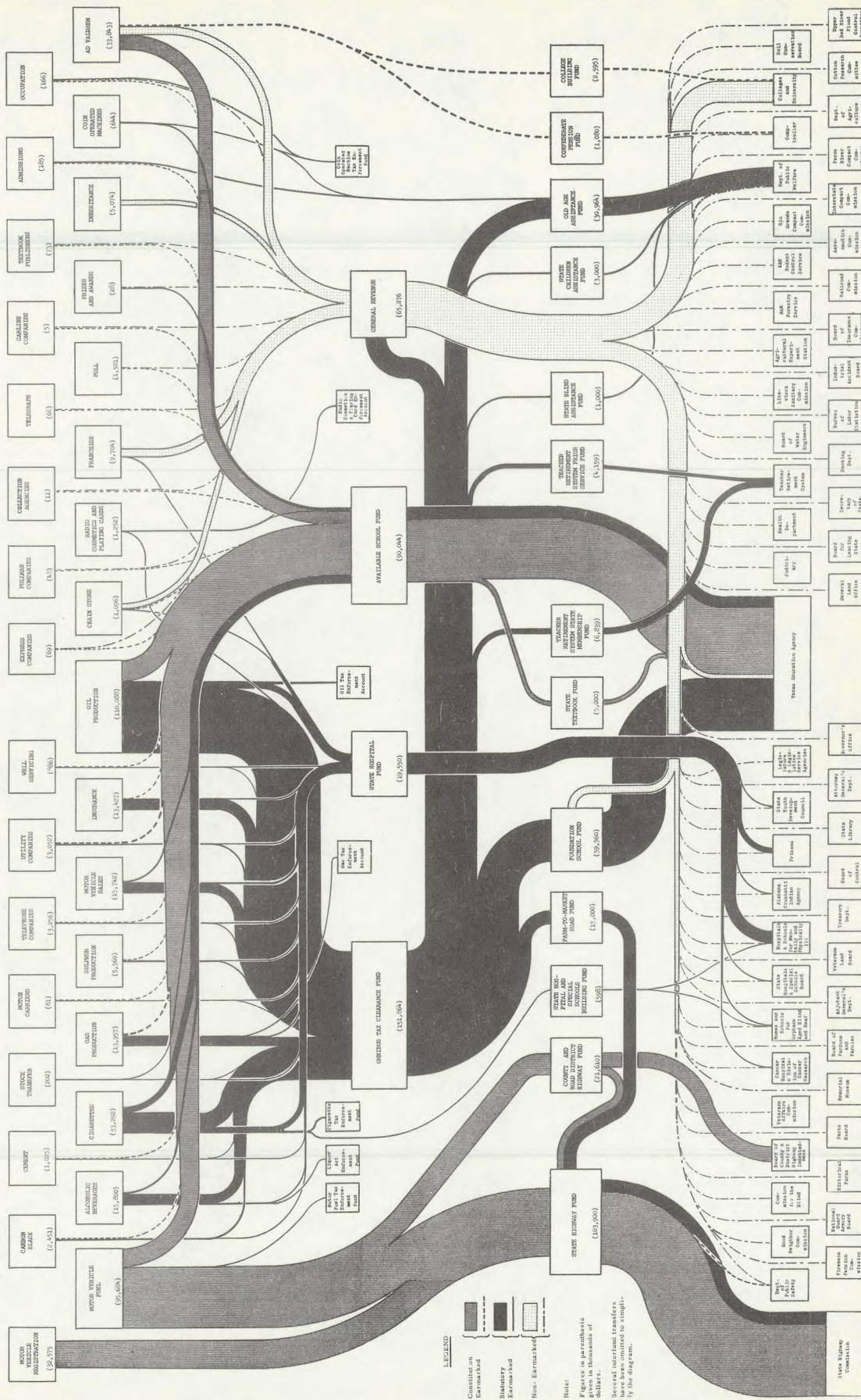
## SECTION 4--SUMMARY

In the preceding sections, earmarking and funds have been dealt with separately and in some detail. Their close connection has been noted on several occasions. In view of this kinship, action taken with regard to one is almost certain to affect the other. Therefore both need to be considered when matters of financial policy are being studied. In this section, an attempt is made to summarize and put into proper relationship some of the information in the foregoing discussion and to review the problems which result from the conditions described. Earmarking and the creation of funds have a close relationship. Funds often result from earmarking provisions. The fund is a device by which earmarking restrictions can be put into effect. Furthermore, the fund can be used as the basis for an earmarking formula, as was done in the case of the Omnibus Tax Clearance Fund. When the Legislature appropriates earmarked receipts, it can do so by simply authorizing the expenditure of the receipts of a particular fund, the receipts consisting primarily of revenues from an earmarked source. Thus changes in earmarking provisions will frequently result in changes in funds, in the form of appropriations, and even in the approach which is taken to appropriating state money. The discussion of earmarking provisions and funds in Sections II and III has brought out the legal requirements and described generally the operation of earmarking provisions and funds. It is now possible to consolidate some of the material in those sections. This consolidation can probably be best accomplished through charts. However the vast complexity of the total situation requires that the charts either be limited to parts of the whole or that extreme measures of simplification be taken. Even in charts representing a limited part of the pattern, it is often necessary to simplify and bypass steps in the process. Otherwise, the charts would almost defy understanding.

The following chart is an attempt to diagram the income to the state from its many taxes, the placing of this tax income into funds and its expenditure. Receipts from about 50 taxes are actually shown in Chart II-11, since some 28 occupation taxes which yielded revenue to the state during fiscal 1951 have been grouped together. The initial distribution of the revenue from these taxes, disregarding millions of dollars of interfund transfers made primarily for accounting purposes, was to ten major funds in the amounts shown and to several enforcement funds and accounts. From the ten major funds, much of the money was further transferred to seven additional funds. By this time most of the tax receipts were in funds from which they might legally be spent. They were distributed to approximately 100 governmental agencies which, with simplifications, are shown at the bottom of the chart. Throughout the whole chart the vital part played by constitutional and statutory earmarking is distinguished. The difficulty of understanding the whole is one of the problems to which extensive earmarking gives rise.

A further chart might be used to put the tax revenues included in this study in their proper perspective in relation to other state receipts. By adopting the classification of receipts, funds, and expenditures, established in Sections II and III, it is possible to make a revenue flow chart for Texas for the 1951 fiscal year, designating earmarked and non-earmarked receipts.

CHART I-II TEXAS TAX REVENUE FLOW - 1951



In Chart II-12, receipts from about 150 sources are consolidated into a dozen items, with the five major state taxes being shown individually and other receipts placed in seven categories. The 160 or more funds used by the state are grouped under 13 headings. Expenditures have been condensed to eight functional areas of government. This chart does no more than summarize in graphic form the broad over-all picture of revenue flow in Texas. A glance at the chart will emphasize that taxes, and particularly a few highly productive ones, dominate the income side of state financing. It also makes clear that special revenue funds and trust funds, both containing entirely earmarked money, far overshadow the General Revenue Fund. Actually, relatively few funds among the many employed by the state handle the vast bulk of the money in the Treasury. At the expenditure end of the flow of state revenue, three major functions--education, highways, and public welfare--are, in dollars and cents terms, by far the most important. Their central position is evidenced by the continued attention given to these subjects by the Legislature.

The preceding charts indicate the importance of earmarking to the Texas tax structure, both in terms of the large number of tax statutes which include earmarking provisions and the amount of tax receipts influenced by these provisions. During 1951, the inheritance tax was the only tax that was not partly or wholly earmarked, and earmarking provisions allocated well above 80 per cent of the state's total tax receipts. The non-earmarked tax receipts contributed all but a small percentage of general revenue, but most of these flowed in as surplus from the Omnibus Tax Clearance Fund rather than directly. The preceding sections not only describe several important earmarking provisions but also mention that different methods of earmarking give rise to different types of problems. With one exception, the approach to earmarking tax receipts in Texas has been to allocate all or a portion of a tax directly to particular types of state expenditures. However, there are several variations regarding the basis for allocation. For example, some are based on the nature of the fund or accounts in which receipts are deposited. Another difference is whether the earmarking provision is found in general law or the Constitution. Although in a few isolated instances the amount earmarked is given in the statutes as a specific dollar amount, most earmarking provides a percentage of tax receipts as the base for determining the amount allocated.

In most instances, earmarked receipts are deposited directly in special funds which support particular agencies. However, variations of this practice are also found. For example, the oil production and natural gas tax enforcement allocations are held in so-called "fee accounts" in the General Revenue Fund rather than in special funds. The fee account is only credited for the earmarked amount, and actual receipts may be spent for general revenue purposes when general revenues are depleted. There has been no established policy as to whether these tax receipts earmarked for enforcement should be deposited in special funds or in fee accounts in general revenue. Variations are also found in the funds and accounts holding earmarked receipts in that balances in some special funds and accounts are transferred to general revenue at the close of each fiscal year, while others

are not. In most instances, earmarked balances remaining in special funds at the close of the year are held in the fund.

Whether earmarking provisions are found in general law or in the Constitution is important in that earmarking provisions in the Constitution are beyond the immediate reach of the Legislature. Those in the statutes may be altered at will. Chart II-11 indicates that all the motor vehicle registration tax and three-fourths of the net motor fuel tax is earmarked by the Constitution to the state highway and county road programs. Other taxes earmarked by the Constitution include the occupation taxes, one-fourth of which are contributed to the Available School Fund, and percentages of the ad-valorem tax allocated to the Confederate pension and college building programs. The importance of this method of earmarking is indicated in Chart II-11 by the large number of taxes partly earmarked directly to particular types of expenditures. Notice, also, that most earmarking provisions which tie particular taxes directly to particular agency funds are found in the Constitution.

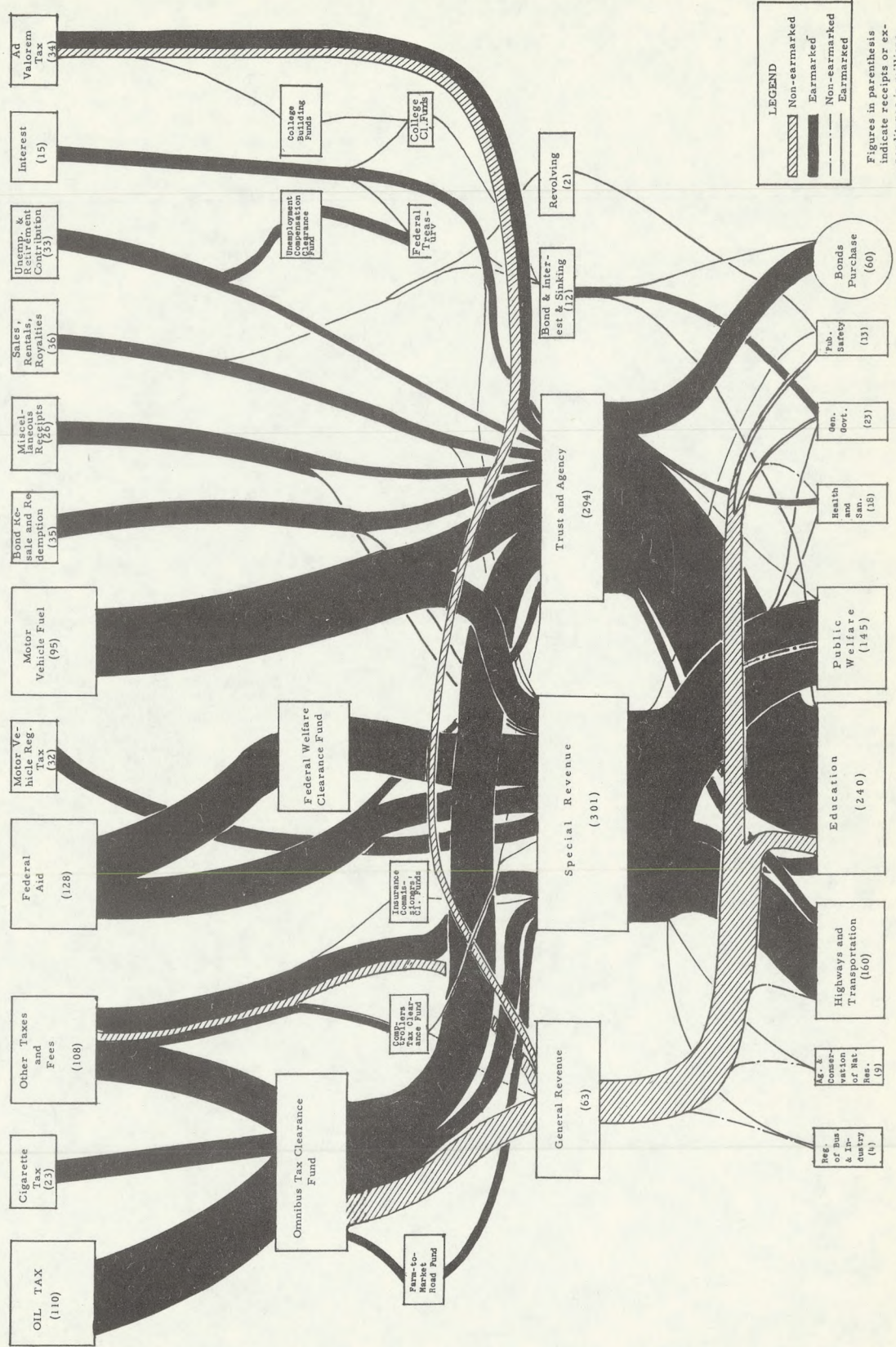
The one exception to this general approach of earmarking taxes to particular expenditures is found in earmarking in provisions regarding the Omnibus Tax Clearance Fund. Although this is but one exception, it is important because approximately one-third of state tax receipts are earmarked in this manner. This approach differs from the more common method in several respects. It does not provide a direct contact between particular taxes and particular state agencies. Rather, it earmarks a portion of numerous taxes to a clearance fund from which several state programs are financed. This involves a double earmarking approach: (1) from taxes to the clearance fund and (2) from the fund to different state programs. There are several characteristics of this method of earmarking. It is not used in the Constitution and is used in only one instance in the statutes. A percentage of tax receipts is the basis upon which the amount of the several taxes earmarked from the clearance fund is determined by program requirements. However, there are also variations within the earmarking allocations from the clearance fund. For example, allocations for old-age assistance, blind assistance, aid to dependent children, and farm-to-market road programs are set in terms of annual dollar amounts. On the other hand, the earmarked allocations for the teacher retirement and foundation school programs are determined by immediate program demands as established in the statutes rather than by a specific amount.

The many variations within each approach to earmarking suggests that the Legislature has, in the past, followed several different concepts regarding methods of insuring adequate revenue support for particular programs. This, in turn, has tended to create problems which stem from the various methods used.

### Rigid Tax Structure

One of the most serious problems is that tax earmarking tends to fix expenditure programs in perpetuity. In turn, state agencies

TEXAS REVENUE FLOW & FUNCTIONAL EXPENDITURES - 1951



LEGEND  
 [Hatched Box] Non-earmarked  
 [Solid Black Box] Earmarked  
 [Dashed Line] Non-earmarked  
 [Solid Line] Earmarked

Figures in parenthesis indicate receipts or expenditures in millions of dollars.

which have taxes earmarked for their expenditure may develop a proprietary interest in the earmarked tax. If all state agencies thought it necessary to secure a private source of tax revenue, the state's financial structure would become increasingly rigid. The difficult problem of changing the flow of tax receipts within an extensive tax earmarking structure is aggravated when taxes are singly earmarked to particular expenditures by general law and the Constitution. Changes in expenditure patterns under these conditions may require an amendment to the Constitution or to numerous tax statutes or both. However, the problem can be met with less difficulty in the double earmarking approach, which involves portions of numerous taxes earmarked to a clearance fund with their combined receipts earmarked for expenditures. To change expenditure patterns under these conditions requires only a single amendment which establishes the program and provides for its support from receipts in the clearance fund.

### Complex Tax Structure

Extensive tax earmarking also tends to create an extremely complex picture of interrelated taxes and expenditures and encourages the establishment of numerous funds. In turn, the number of funds and the complexity of extensive earmarking tends to confuse and often promotes a misunderstanding of the tax structure. It seems that the problem is the most serious in instances where numerous taxes have separate earmarking provisions to particular expenditures. An understanding of the earmarking structure can be attained more readily when numerous taxes are earmarked to one fund from which transfers are made to several large agency funds. In either approach, extensive earmarking may encourage complexity through the creation of numerous funds. However, there is little need for a separate fund for each type of earmarked receipt. For example, the State Highway Fund holds receipts earmarked for several types of expenditures. The consolidation of funds, apart from earmarking, also offers a possibility for helping to alleviate the problem of complexity. Several state agencies are financed in part out of numerous relatively small funds which might be subject to consolidation. Examples are the Liquor Control Board, the Department of Agriculture, the Comptroller's Office, the Board of Insurance Commissioners, the Railroad Commission, and the Bureau of Labor Statistics. Minor funds supporting these agencies were often established to hold fees charged for particular activities. For example, the Department of Agriculture has five funds, each of which represents inspection fees collected by that department. There are several instances in which a fund seems to serve no real function except making a double clearance transaction out of what could be a single clearance. These instances might be investigated further to determine the possibilities in this approach to alleviating the complexity problem in the Texas tax structure.

### Unbalanced Receipts and Expenditures

An additional problem arises when earmarking requires that receipts from individual taxes and particular agency expenditures be considered jointly. Under these conditions, legislative decisions regarding taxes and expenditures cannot be made separately and cannot always be made on the basis of the best independent taxing and the best independent spending policies. This

problem is most often present when a per cent of a tax is earmarked to a specific type of expenditure. It becomes particularly acute when the tax is constitutionally earmarked. The problem of balancing earmarked receipts and appropriated expenditures has continually plagued several tax enforcement funds which receive a fixed per cent of tax receipts each year, regardless of whether collections are high or low.

### Stagnated Balances

The problem of attempting to match earmarked receipts and expenditures has in many instances caused a surplus of revenue to concentrate in one fund without permitting it to be used to meet other current monetary demands. Such unintended revenue allocations may result from fluctuations in the business cycle. This problem has been most prevalent in earmarking provisions which allocate a per cent of a particular tax to a fund supporting a specific state program. Of course, the problem is aggravated when earmarking provisions are in the Constitution. This type of problem arose in 1951 when the Confederate Pension Fund, which receives a portion of the constitutionally-earmarked ad-valorem tax, had on deposit more than \$3 million at the close of the fiscal year and program expenditures of less than \$900,000. A constitutional amendment would be necessary to allow money deposited in the Confederate Pension Fund to be used to meet other program requirements.

### Appropriation by Fund

One aspect of earmarking which deserves attention is not so much a problem as a characteristic or result of the numerous earmarking provisions. Earmarking offers the possibility for appropriations by reference to specific agency funds, thereby allowing all money flowing into particular funds to be spent without specific budgetary authorization. This method of appropriation does not require the concentration of legislative attention needed in determining the exact specific dollar-amount allocations. Thus the Legislature avoids the necessity of determining the exact money to be appropriated or the amount needed to support the activity. This may be considered either an advantage or a disadvantage.

These problem areas have been mentioned to indicate some of the difficulties involved in the earmarking methods used to program state expenditures. Possible approaches to these problems are considered in the context of the entire tax structure as summarized in the final chapter of this report.

CHAPTER III  
THE STRUCTURE OF TAX ADMINISTRATION  
IN TEXAS

Texas tax statutes prescribe the administrative structure within which state taxes are assessed, collected, and enforced. Although the administrative structure supporting each tax received attention in the individual tax studies,<sup>1</sup> this chapter consolidates that information and supplements it to offer a more complete description. One purpose of this study is to describe tax administration in terms of organization and to mention several prominent administrative problem areas. The study is also concerned with methods of financing tax administration and attempts to estimate administrative costs. In conclusion, the Texas tax administrative structure will be compared with those of other states, and approaches to several administrative problem areas will be considered.

Authority for and limitations on tax administrators are found in the Constitution, in numerous statutes, in court cases, and in opinions of the Attorney General. Administrators must at all times be cognizant of and conform to the body of law relating to their activities. This law can either facilitate or hinder good tax administration. While not all problems of tax administration can be solved by legislation, statute law prescribes the structure within which economical and efficient administration is made possible. No attempt is made to measure efficiency within tax administrative units or to determine whether the present laws are being administered effectively. Rather, this study is directed toward presenting material which will be useful in determining where the present laws controlling tax administration are inadequate or troublesome and where legislative changes might be considered.

SECTION I - THE ORGANIZATION OF TAX ADMINISTRATION

In Texas a multitude of state agencies and numerous county officials and trade groups are responsible for administering the state tax program. The Comptroller of Public Accounts, the Board of Insurance Commissioners, the State Highway Department, the Liquor Control Board, and the Secretary of State are given primary responsibility for the collection and enforcement of one or more taxes. In addition, the State Treasurer, county tax collectors, and county clerks have direct collection duties for several state taxes, under the general supervision of one or another of the state agencies listed above. Besides these agencies, which are engaged in what might be described as primary tax administration, a number of other officials and agencies, both state and local, are also directly concerned with particular aspects of tax administration. Included in this group are the Governor, the Attorney General, the State Auditor, the Department of Public Safety, the State

<sup>1</sup> Texas Legislative Council, Staff Research Report Nos. 51-8, 52-1, 52-2, A Survey of Taxation in Texas, Part II, IIA, IIB--Analysis of Individual Taxes, (Austin, 1951-52).



Tax Board (Intangible Tax Board), the Automatic Tax Board, the Cigarette Tax Stamp Board (Board of Control), county judges, commissioners' courts, district and county attorneys, local peace officers, and representatives of several business and trade groups. It should also be noted that the taxpayers themselves bear a large share of the responsibility of tax administration, since in most cases they have to determine the bases and amounts of the taxes they pay and have to comply with various regulations established by statutory law and by administrative action. This list of agencies, boards, groups and individuals indicates the complexity of the administrative structure in Texas. Widely decentralized tax administration has been a common phenomenon among the states. Texas is by no means unique in the dispersion of the assignments of tax administration duties.

### General Administrative Structure

The major administrative responsibilities of state agencies, officials, and trade groups concerned with the execution of Texas tax laws are summarized in Chart III-1. The five state agencies with primary tax administration duties are on the top line of the chart, the other state agencies with important tax administration duties are immediately below. The activities of ex-officio boards are also shown. The lower half of the chart pictures the major tax administration function of particular departments of these agencies, indicating also that certain local officials, wholesalers, retailers, and producers are, for purposes of tax administration, under the supervision of state agencies. Of course, a summary chart of this kind cannot show clearly all the tax activities of these agencies and their interrelationships. It should be realized that only the broad situation has been described. The subsequent analysis will outline in more detail the part each of these officials and agencies plays in tax administration.

In several agencies tax administration is only an incidental activity. This is true of the Department of Public Safety, for instance. It is important to note that the estimate of the number of employees within division engaged in some aspect of tax administration is nothing more than a rough indication of the size of the field force. The full number of employees of a division which has some tax functions is given, rather than attempting to determine how many full-time workers within that division work at other tasks. These estimates of personnel are usually those of the governmental unit itself or those given in budget requests for recent years.

The relative importance of the several agencies engaged in primary tax administration duties in terms of the amount of tax revenue each handled during the fiscal year 1950-1951 is indicated in Table III-1. It can be seen that, in dollar terms, the collection activities of the Comptroller's Office far outweigh those of other tax-collecting agencies. Within the Comptroller's Office, the table reflects, there are substantial differences between the divisions in the amount of revenue collected. The number of taxes assigned to a division varies a great deal.



Table III-1

Tax Collections By Agencies and Divisions, 1951

State Agency	Administrative Division	Taxes	Collections (1951)	Per Cent
Comptroller	Cigarette & Occupation Tax Division	Cigarette	\$ 33,292,320	
		Occupation	165,736	
		Admissions	184,988	
		Awards	27,715	
		Vending Mach.	643,616	
Total . . . . .			34,314,375	8%
	Gross Receipts Tax Division	Oil	111,848,855	
		Natural Gas	13,956,736	
		Sulphur	5,568,695	
		Cement	1,824,689	
		Carbon Black	2,450,757	
		Stock Transfer	202,249	
		Textbook Pblshrs.	72,835	
		Express Co. s	69,079	
		Telegraph Co.	66,376	
		Utility Co. s	3,051,566	
		Collection Agen.	11,181	
		Carline Co. s	5,376	
		Telephone Co. s	3,256,220	
		Pullman Co. s	48,093	
		Motor Carriers	80,588	
		Beginners	315	
		Well Servicing	886,223	
Total . . . . .			143,399,833	35%
	Store Tax Division	Chain Store	1,095,849	
		Radio, Cos. & Playing Cards	1,252,205	
Total . . . . .			2,348,054	1%
	Inheritance Tax Division	Inheritance	5,074,443	1%
Total . . . . .			5,074,443	
	Motor Fuel Tax Division	Motor Fuel	95,683,795	
Total . . . . .			95,683,795	24%

Table III-1 (Cont'd) -2

	Ad valorem Tax Division	Poll Motor Vehicle Sales	1,520,871 15,741,670	
		Ad valorem	<u>33,843,359</u>	13%
	Total . . . . .		<u>51,105,900</u>	82%
	Total . . . . .		<u>331,926,400</u>	
Board of Insurance Commission	Life Ins. Div.	Insurance	<u>14,196,912</u>	
	Total . . . . .		14,196,912	4%
Liquor Control Board	Executive Div.	Liquor stamps Wine stamps Ale Stamps Beer Prescription	9,668,090 694,780 125,725 5,310,975 193	
	Total . . . . .		<u>15,799,763</u>	4%
Secretary of State	Franchise Tax Division	Franchise, Foreign Franchise, Domestic	5,032,394 <u>4,671,377</u>	
	Total . . . . .		<u>9,703,771</u>	2%
State Highway Department	Motor Vehicle Division	Motor Vehicle Registration	<u>32,576,399</u>	
	Total . . . . .		<u>32,576,399</u>	8%
Grand Total			404,203,245	

## Office of the Comptroller of Public Accounts

The major tax-administering agency in the State of Texas, both from the standpoint of the number of taxes in its charge and of the amount of revenue collected, is the Office of the Comptroller of Public Accounts. The Comptroller is assigned by law a multitude of duties.<sup>2</sup> He has chief responsibility for tax administration, fiscal control (pre-audit of vouchers) and reporting, and revenue estimating. Though this chapter is mainly concerned with tax administration, it will also devote some attention to revenue estimating because that subject is closely connected with fiscal policy-making by the Legislature, both in spending and taxing.

The organizational arrangement of the Office of the Comptroller of Public Accounts is illustrated by Chart III-2, emphasis being laid on those parts concerned with tax collection and enforcement. This chart makes clear that tax collection duties represent a large part of the responsibility of the Comptroller, particularly since some of the other functions listed are minor ones. The Comptroller's Office usually has slightly more than 400 employees during the year, about three-fourths of whom are in tax revenue divisions.

Since this study concerns taxation, only brief attention will be given non-tax divisions of the Comptroller's office. The chart indicates that most tax divisions have separate field enforcement sections which are not co-ordinated under a central field enforcement division. Although this practice possibly implies some problem of communication and co-ordination among individual field force sections, the question is beyond the scope of this study.

Ad Valorem and Intangible Tax Divisions. The Ad Valorem Tax Division is charged with administering, at the state level, most of the state taxes collected by county tax collectors. The division is responsible for the ad valorem, poll, and motor vehicle sales taxes. One other tax collected by county tax collectors, that on motor vehicle registrations, is placed under the Highway Department. The Intangible Tax Division has the duty of computing the intangible value for ad valorem tax purposes of railroads and certain other public utilities and of prorating that value among the counties for taxation. Actually, this division comprises the staff of the State Tax Board, which is not a part of the Comptroller's Office. Accordingly, it will be discussed when that board is dealt with.

<sup>2</sup> Tex. Civ. Stat. (Vernon, 1948) arts. 4342-4366a outlines many of the functions of the Comptroller. Other duties are to be found through out the statutes, particularly in the tax laws, and in the Constitution.

The ad valorem tax, during the fiscal year 1950-1951, represented the largest of the three taxes with which the Ad Valorem Division is charged. The state received about \$33,8 million from the ad valorem levy and about half that amount from the motor vehicle sales and poll taxes combined. Since the division is concerned with locally-collected taxes, it has little direct relationship with the taxpayer. Its dealings instead are with the 254 county officials who collect the taxes. It sends instructions to these officials, receives reports from them, and reviews their work. It keeps check on the activities of local officials by office review of reports submitted and audits of certain county records by the ad valorem tax field force, which is under direct supervision of the head of the division.

The chief of the Ad Valorem Tax Division has charge of about 30 employees, half of whom work in the Austin office. The others are field auditors. Until recently, the field auditors operated out of Austin, but they are now assigned to districts which were set up after a study of the man-days required for the annual audits of county records.

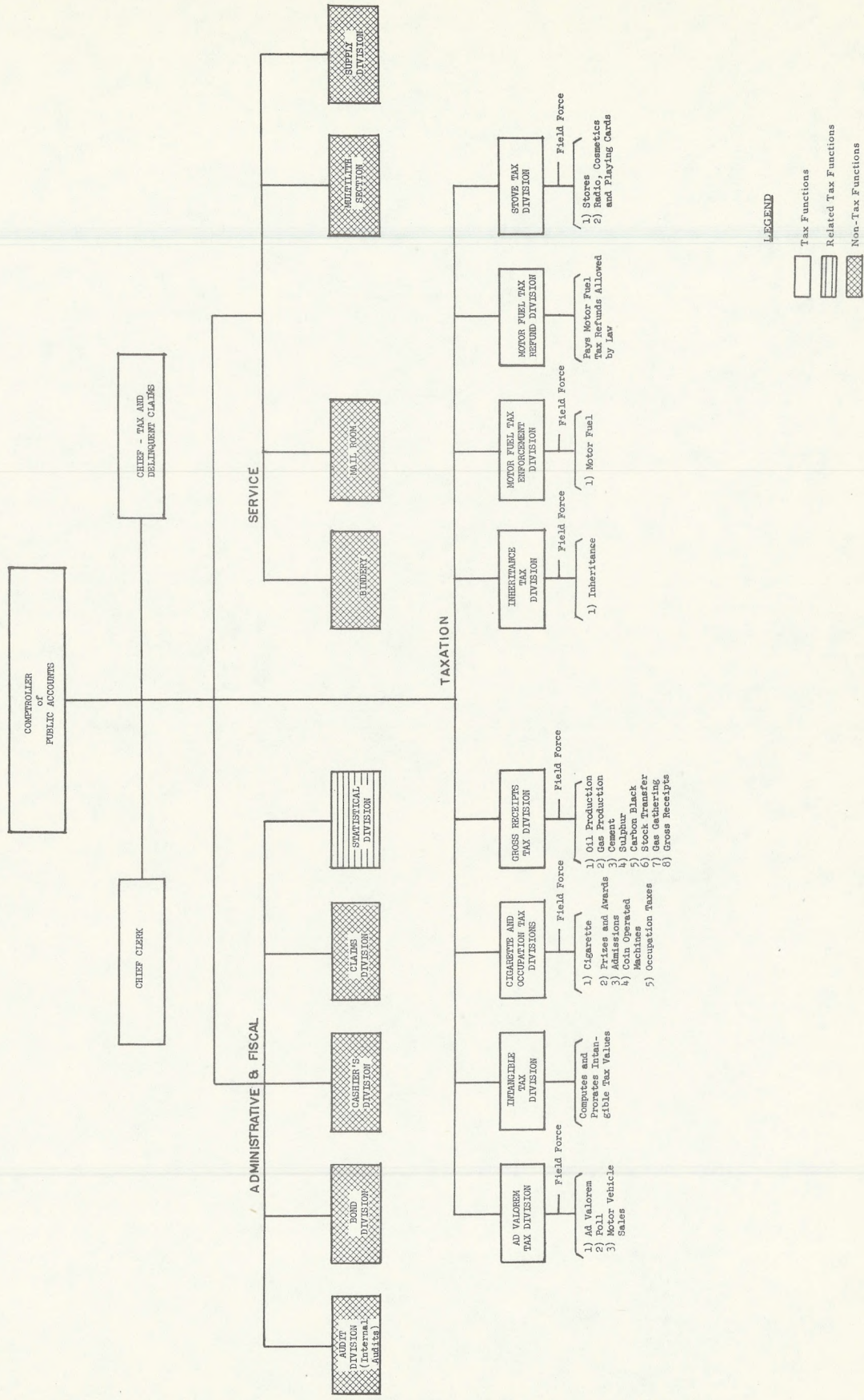
Cigarette and Occupation Tax Division. The Cigarette and Occupation Tax Division is responsible for the collection of about 35 taxes, including the cigarette, prizes, admissions, and coin-operated machines taxes and some 31 other levies ordinarily grouped together under the heading of occupation taxes. The occupation taxes present a particularly difficult problem of locating the taxpayer and keeping in contact with him from year to year. As a practical matter the main effort of the division is devoted to the cigarette tax, which alone brought in \$33.3 million of the \$34,3 million obtained through these taxes in 1951.

The field force of the Cigarette and Occupation Tax Division also handles the extensive field work of the Store Tax Division. The field force is divided among nine geographic areas, with a concentration of personnel in the more populous sections of the state. The store tax and the radio, cosmetics, and playing cards taxes (which are administered by the Store Tax Division) are paid by a large number of taxpayers and therefore create a sizable problem of field enforcement. The problem of field auditing within this division is aggravated by the lack of any provision in the store tax requiring maintenance of records by taxpayers.

The Cigarette and Occupation Tax Division has about 75 employees, of whom approximately 15 work in the Austin office, the remainder being field force personnel. In view of the large number of taxpayers who are encompassed by the cigarette, prizes and awards, admissions, vending machine, occupation, store and radio, cosmetics, and playing cards taxes, considerable attention is devoted to field enforcement.

# OFFICE OF THE COMPTROLLER OF PUBLIC ACCOUNTS

CHART III-2



### LEGEND

- Tax Functions
- Related Tax Functions
- Non-Tax Functions

Gross Receipts Tax Division. The Gross Receipts Tax Division is charged with the collection of 18 taxes--the oil production, gas production, sulphur, carbon black, stock transfer, cement, oil and gas regulation, gas-gathering, and ten gross receipts taxes. The so-called oil and gas regulation tax is really a fee rather than a tax, being designed to cover certain administrative costs of regulating the petroleum industry.

The Gross Receipts Tax Division employs about 40 people, about half of whom belong to the field force. The state's largest revenue-raiser, the oil tax, receives the divisions's primary attention. The oil tax brought in about \$110 million of the approximately \$143 million collected by this division in the fiscal year 1951. The oil tax is not only a major revenue-raiser but is also complex and requires considerable time to administer properly, particularly in its field enforcement. In addition, many of the gross receipts taxes have presented problems in field audits, since several do not require taxpayers to maintain records. The field force is divided among ten offices located in the principal Texas cities. Office personnel within the division are chiefly concerned with accepting tax reports and payments, checking and reporting tax returns, and solving individual taxpayers' problems. In performing this last function, administrative problems have arisen on several occasions as a result of the lack of any provision in certain gross receipts taxes for refunding taxes paid by mistake in excess of the amount due.

Inheritance Tax Division. The Inheritance Tax Division is responsible for the collection of the inheritance tax, including the tax on gifts in contemplation of death. It is the smallest of the divisions directly engaged in tax collection, having about 15 employees, two-thirds of whom are field men. Each field examiner operates within a specific district or over the state. While the inheritance tax is by comparison not a large revenue-producer, it brought in about five million dollars in 1951. It is a difficult tax to administer because of the complexity of the tax act itself and the large body of statutory and case law surrounding the transfer of property at death. Probably more than any other tax for which the Comptroller's Office is responsible, this tax requires a substantial legal knowledge on the part of those engaged in administering it.

Motor Fuel Enforcement and Motor Fuel Tax Refund Divisions. The Motor Fuel Tax Enforcement and Motor Fuel Tax Refund Divisions are both concerned with administration of the motor fuel tax, which is levied on gasoline and other fuels used in motor vehicles. Neither of the divisions has any connection with any other tax. The two divisions of the Comptroller's Office handling the motor fuel tax have a large share of the total number of employees of the Comptroller's Office engaged in tax-collecting activities.



The primary reason for this is the large field force of approximately 90, maintained by the Motor Fuel Tax Enforcement Division to serve both divisions. The field divisions maintains offices in ten of the larger cities, and from seven to ten field auditors are stationed at each office.

The Motr Fuel Tax Enforcement Division has responsibility for collecting the tax and generally enforcing the motor fuel laws. The Motor Fuel Tax Refund Division, as the name indicates, is charged with reviewing requests for refunds on motor fuel taxes. Since the motor fuel tax is paid on fuel used in propelling vehicles over the highways, much fuel, such as that used in stationary engines or on farms, is not taxed. As a result, a large refund program is necessary. Its magnitude is indicated by the fact that approximately \$19 million was refunded during the 1951 fiscal year. The motor fuel tax is the only state tax for which refunding is a major operation.

Store Tax Division. The Store Tax Division is responsible for primary administrative activities for the chain store and the radio, cosmetics, and playing cards taxes. The division has about 30 employees, all working in the office. While this division is not responsible for any of the large revenue raising taxes of the state, it is responsible for taxes which involve a large number of taxpayers. However, the division has no field force as do many other tax divisions, and the Cigarette and Occupation Tax Division field force spends a portion of its time auditing taxpayers who report to the Store Tax Division.

Office employees are primarily concerned with receiving tax payments and reports and meeting problems of individual taxpayers as they arise. There are indications that a sound relationship between taxpayers and tax administrators has been somewhat hampered by the fact that no provision is made in the chain store tax for refunding overpayments. The presence of this problem has been noted in the study of other tax administrative units.

Administrative, Fiscal, and Service Divisions. Except for the Statistical Division, most of the other administrative, fiscal and service divisions of the Comptroller's Office are primarily concerned with activities other than tax administration. However, the Statistical Division is responsible for estimating anticipated tax revenue for the Comptroller. The Comptroller is directed by the Constitution to submit to the Legislature and the Governor estimates of probable receipts for the current fiscal year and for the next biennium at the beginning of each regular session of the Legislature.<sup>3</sup> The Constitution further provides that appropriations from a fund in excess of revenues anticipated from the fund are invalid. This, in effect, requires that the Comptroller inspect all bills which include appropriations and, on the basis of his revenue estimates, approve or disapprove the measure. If the Comptroller disapproves, the bill is returned to the Legislature for reconsideration. However, "in the case of emergency and imperative public necessity," and with the support of four-fifths of the total membership of each house, the Legislature may appropriate in excess of the estimated revenues.

<sup>3</sup> Tex. Const., Art. III, sec. 49a.

The Constituion only provides that estimates shall be made and does not offer any guides upon which to base the estimates. Although estimating anticipated tax receipts is an extremely complex subject which has gained wide interest, there are indications that only a limited amount of material has been published in the field.<sup>4</sup> However, the National Association of Tax Administrators has studied the problem and has reported the success of several types of specific estimating techniques, particularly for general sales, motor fuel, and alcoholic beverages taxes. Often a correlation is found in the fluctuations of these taxes and projected state income. In some instances, Dow-Jones industrial averages have been found a valuable basis in estimating death taxes. These examples are mention to indicate techniques developed by some states for estimating revenue trends. However, there are no indications that any extensive and systemativ approach has been followed in Texas, in either the use of or search for economic factors by which trends in tax receipts could be charted.

With two exceptions, the practice in Texas, as evidenced by the Comptroller's 1951-1953 "Biennial Revenue Estimate," has been to estimate anticipated tax receipts by a constant projection of current collections, with adjustments in the presence of either of two conditions: (1) in case of an amendment to the tax statutes affects collections and (2) in the presence of an immediate or obvious economic or political change. Otherwise, current collections are simply projected on a straight-line basis.

### The Board of Insurance Commissioners

The Board of Insurance Commissioners is responsible for collecting the tax on insurance gross premiums. This is one of three instances in which a state tax-collecting function has been assigned to an agency concerned primarily with regulation. The Liquor Control Board, which regulates the sale of liquor in the state, collects the alcoholic beverages taxes, and the Secretary of State, who regulates issuance of corporation franchises and corporation stock, collects the corporation franchise tax.

Since the Board of Insurance Commissioners is engaged in a close regulation of insurance companies, it is familiar with the operational procedure of the business. As a result, collection of this tax is not considered the primary function of the board, even though collections were more than \$13 million in 1951. Organization of the Board of Insurance Commissioners, with special emphasis on its tax administration activities, is shown in Chart III-3. Under this arrangement, each of the three commissioners has primary responsibility for fire, life or casualty regulation. The Life Insurance Commissioner is chairman of the board and has general administrative responsibility for matters which do not fall entirely within any of the three categories. He is charged with tax-collection activities and has under him a tax and deposit supervisor with one assistant. The supervisor and his assistant are the only board employees engaged primarily in

<sup>4</sup> National Association of Tax Administrators, "1950 Conference on Revenue Estimating," Chicago, 1950,

tax collection. However, several other persons particularly field examiners, have occasional tax administration duties. These examiners, in connection with their other audits, audit insurance companies to determine whether they have paid the full taxes for which they are liable.

### Liquor Control Board

The Liquor Control Board is charged with collecting taxes on alcoholic beverages. Here again is a situation in which a primarily regulatory agency performs a tax-collecting function. In this instance, however, the administrative arrangements required for tax administration are substantially larger than for the Board of Insurance Commissioners.

Organization of the Liquor Control Board, pointing up tax administration features, is shown in Chart III-4.

Alcoholic beverage taxes brought in more than \$16 million in the fiscal year 1951. Actually, considerable variations in the levies on alcoholic beverages account in part for the administrative diversity. There are stamp taxes on liquor, wine and ale; a gallonage tax on beer; and charges for permits and licenses issued to various persons in alcoholic beverages businesses. Charges for permits and licenses are collected by the Accounting Divisions. The Tax Auditing Divisions collects the gallonage tax on beer and audits taxpayers' reports and records to ascertain accuracy of payments on all alcoholic beverage taxes. The taxes on liquor, wine and ale are paid to the State Treasurer, who sells the stamps. Thus these taxes are not actually collected by the Liquor Control Board.

The Enforcement Division is charged with field enforcement of all laws relating to alcoholic beverages. The chief supervisor and chief deputy supervisor and responsible for the division, which has 18 district field offices. The field force is engaged not only in tax enforcements but also in enforcement of other liquor control laws.

In view of the mingling of general liquor regulation and tax administration, it is impossible to ascertain with any degree of accuracy what portion of the board's work is tax administration. Although a relatively small number of employees are solely concerned with tax administration, many others are engaged part of the time in work related to the alcoholic beverages taxes.

### Secretary of State

The Secretary of State is charged with collection of franchise taxes and permit and charter fees for foreign and domestic corporations. Organization of the Secretary of State's Office, with emphasis on tax administration duties

Chart III-3: Organization Chart, Board of Insurance Commissioners

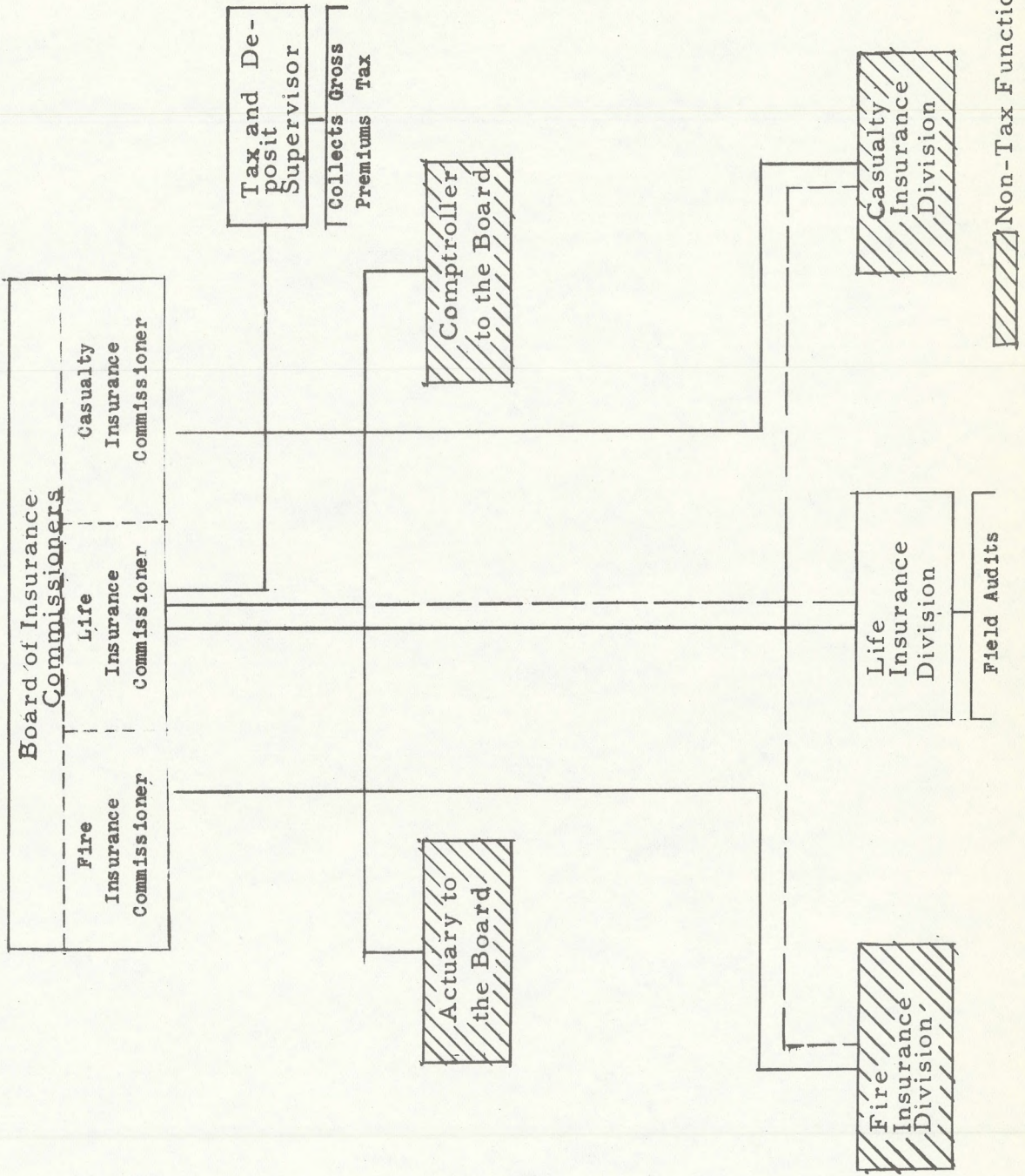
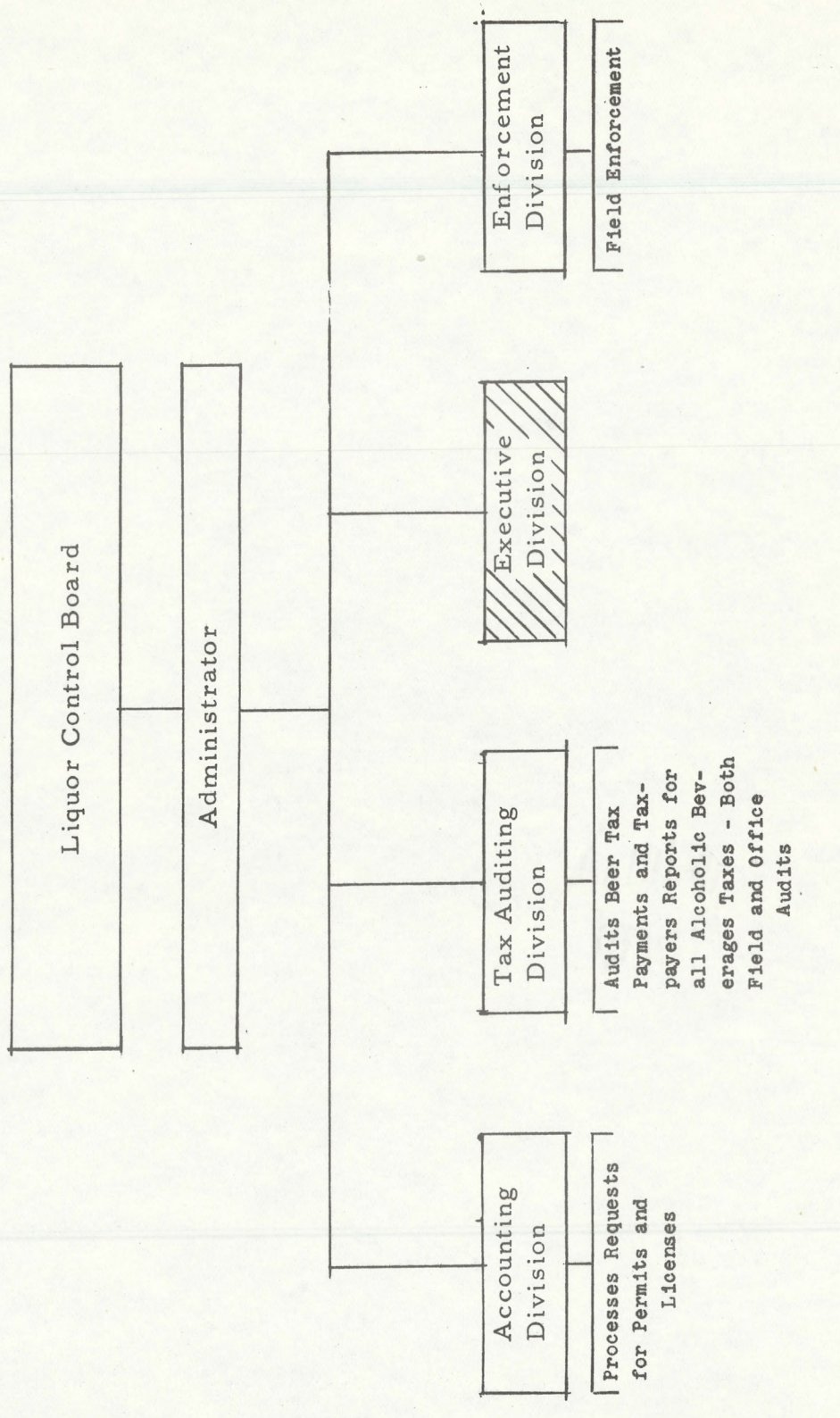



Chart III-4: Organization Chart, Liquor Control Board



 Non-Tax Functions

is shown in Chart III-5.

The Secretary of State is responsible for administration of laws relating to chartering domestic corporations and issuing permits to foreign corporations to do business in Texas. He also administers the Texas Securities Act, which regulates issuance and sale of corporation securities in the state. He is therefore more closely connected with the subjects of taxation than any other official. The Charter Division issues charters for incorporations in Texas and permits to do business to foreign corporations. It also collects charges made at the time of incorporation or of receiving a permit.

The Franchise Tax Division collects the tax on foreign and domestic corporations. Although the number of office personnel directly engaged in collecting the franchise tax varies during the year, the office force usually includes a division chief and six office assistants. The Tax Division has no field force to audit franchise tax returns, and this responsibility has been given the State Auditor.

#### State Highway Department

The tax on motor vehicle registrations is administered by the Motor Vehicle Division of the State Highway Department. Organization of the State Highway Department, with special attention to the Motor Vehicle Division and its tax administration activities, is shown in Chart III-6.

The Motor Vehicle Division is responsible for state-level administration of the certificate of Title Act as well as sections within the division handle only certificates of title or only motor vehicle registration. Some sections within the division handle only certificates of title or only motor vehicle registration, but several of them have activities relating to both. It should be kept in mind that the registration of motor vehicles has important regulatory as well as revenue-raising aspects, and not all employees connected with registration are engaged solely in tax administration. In this respect, the Department of Public Safety, particularly the License and Weight Division, is also engaged in helping enforce the motor vehicle registration tax. The registration tax, like the ad valorem, poll, motor vehicle sales taxes, is actually collected locally by county tax collectors. General supervision and rule-making powers are in the Motor Vehicle Division, and the county officials act as agents of the state. Six field investigators work directly under the Motor Vehicle Divisions. These field men instruct county officials in correct methods of registering motor vehicles and investigate illegal registrations. In addition, the 25 district offices of the Highway Department inventory the license plates and supplies on hand in tax collectors' offices at the close of each registration year.

#### Treasury Department

Organization of the Treasury Department, with special attention to tax administration duties is shown by Chart III-7. Practically all state taxes are, by law, payable to the Treasurer. In any event, it is the responsibility of the Treasury Department to deposit and safeguard state receipts. All tax money

goes to the Treasury, and that Department is directed to account for these receipts. However, the Treasury Department has other duties connected with tax administration which have been assigned by various tax acts.

The primary tax administration duty of the department, in addition to those inherent in the nature of the agency, is the selling of tax stamps. Stamps which are evidence of payment of the liquor, wine, ale, and cigarette taxes, are purchased from the Treasury Department. The department is, therefore, engaged in the collection of those taxes. This duty is handled by the Stamp Division, which has about ten employees.

### Attorney General's Department

Organization of the Attorney General's Department is shown by Chart III-8.

The Tax Division is concerned with all legal matters brought to the attention of the Attorney General, regarding tax problems. This division renders legal advice on tax matters and prosecutes when cases arise under the tax laws. In addition, the Attorney General has been assigned some special duties by various tax laws. These have been primarily in the nature of prescribing forms.

Several problems have arisen regarding the Attorney General's responsibility to prosecute delinquent taxpayers. In several instances, tax statutes provide no penalties for either delinquency or tax evasion. For example, the admissions tax has no penalty provisions. In addition, questions have been raised as to whether there are any penalty provisions which apply to the gross receipts tax on textbook publishers.<sup>5</sup> No penalties were provided for the motor carriers tax until 1951.<sup>6</sup> These matters seriously influence effectiveness of this aspect of the Attorney General's function in tax administration.

Attorney General's opinions which relate to taxation are written in the Tax Division, although they are reviewed by persons outside of the division. While tax litigation in the Attorney General's Department is important, the opinion-rendering function is also of primary significance to tax law and tax administration. It is the practice in Texas to ask the opinion of the Attorney General on many interpretive and policy decisions in tax matters. Accordingly, that department plays an important part in actual administration of the tax laws. Although the Attorney General renders numerous opinions concerning

<sup>5</sup> Texas Legislative Council, Staff Research Report No. 52-2, A Survey of Taxation in Texas, Part IIB-Analysis of Individual Taxes Concluded, p. 48.

<sup>6</sup> Tex. Civ. Stat. (Vernon, 1952 Supp.) art. 7066b.

Chart III-5: Organization Chart of Secretary of State

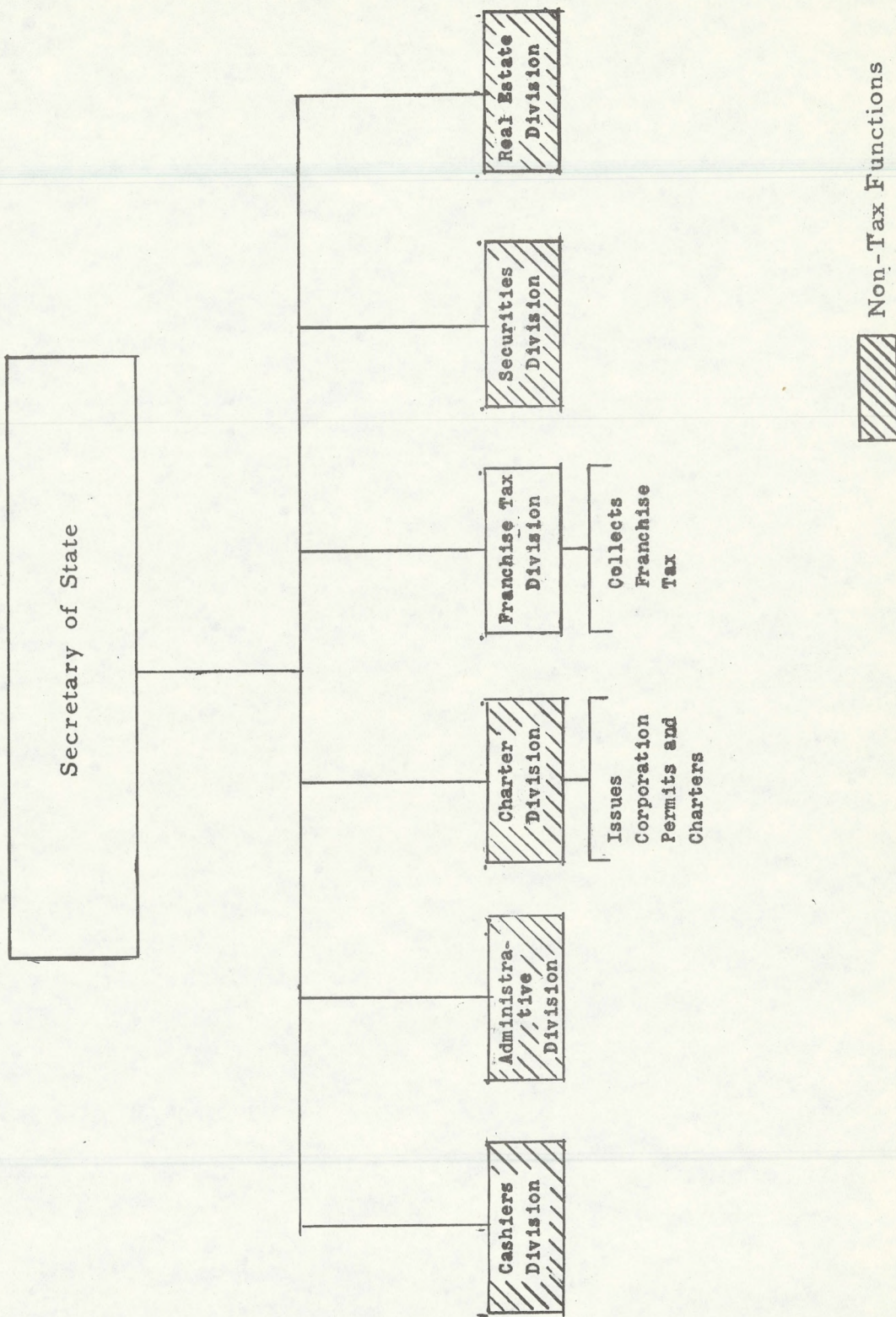




Chart III-6: Organization Chart, Texas Highway Department

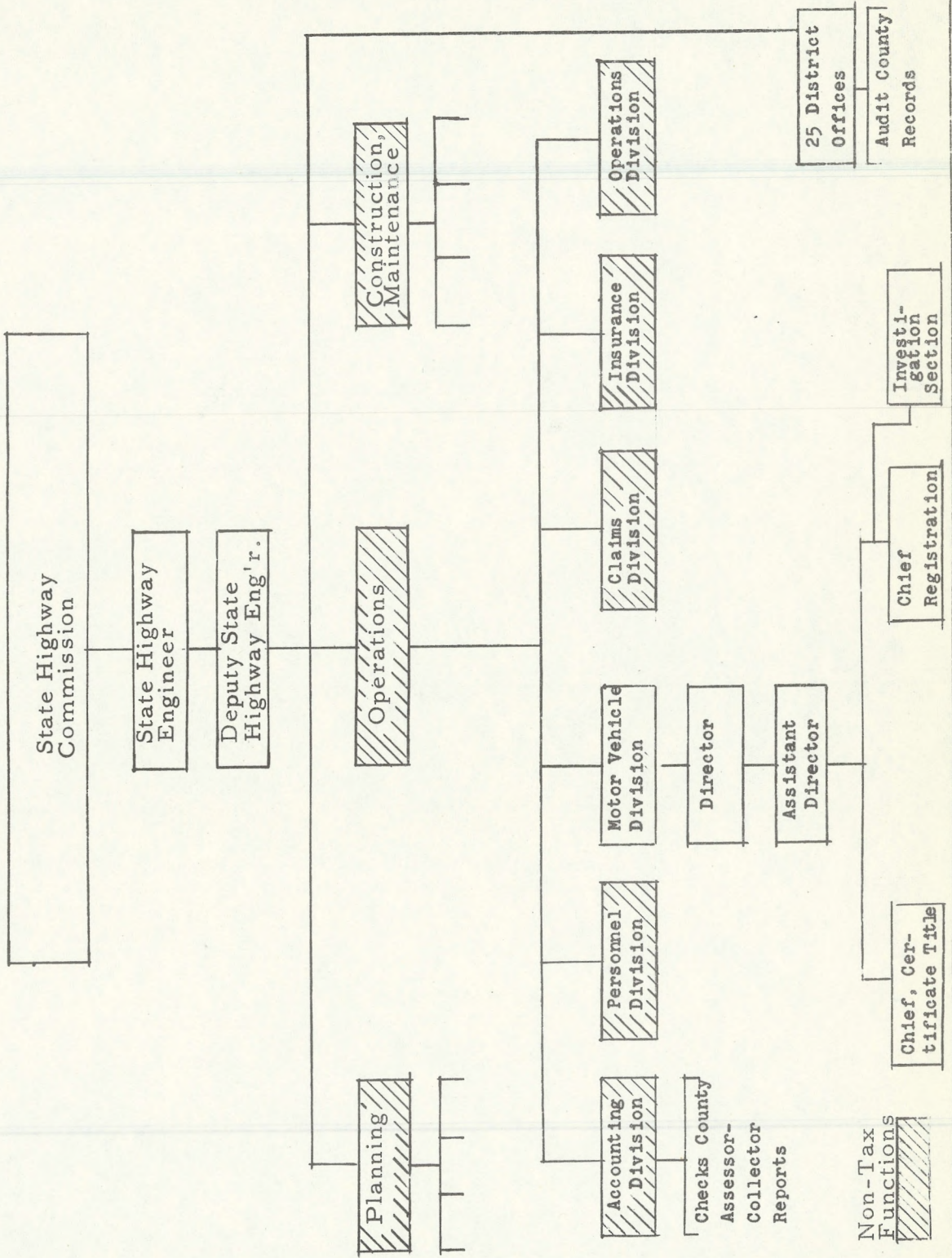
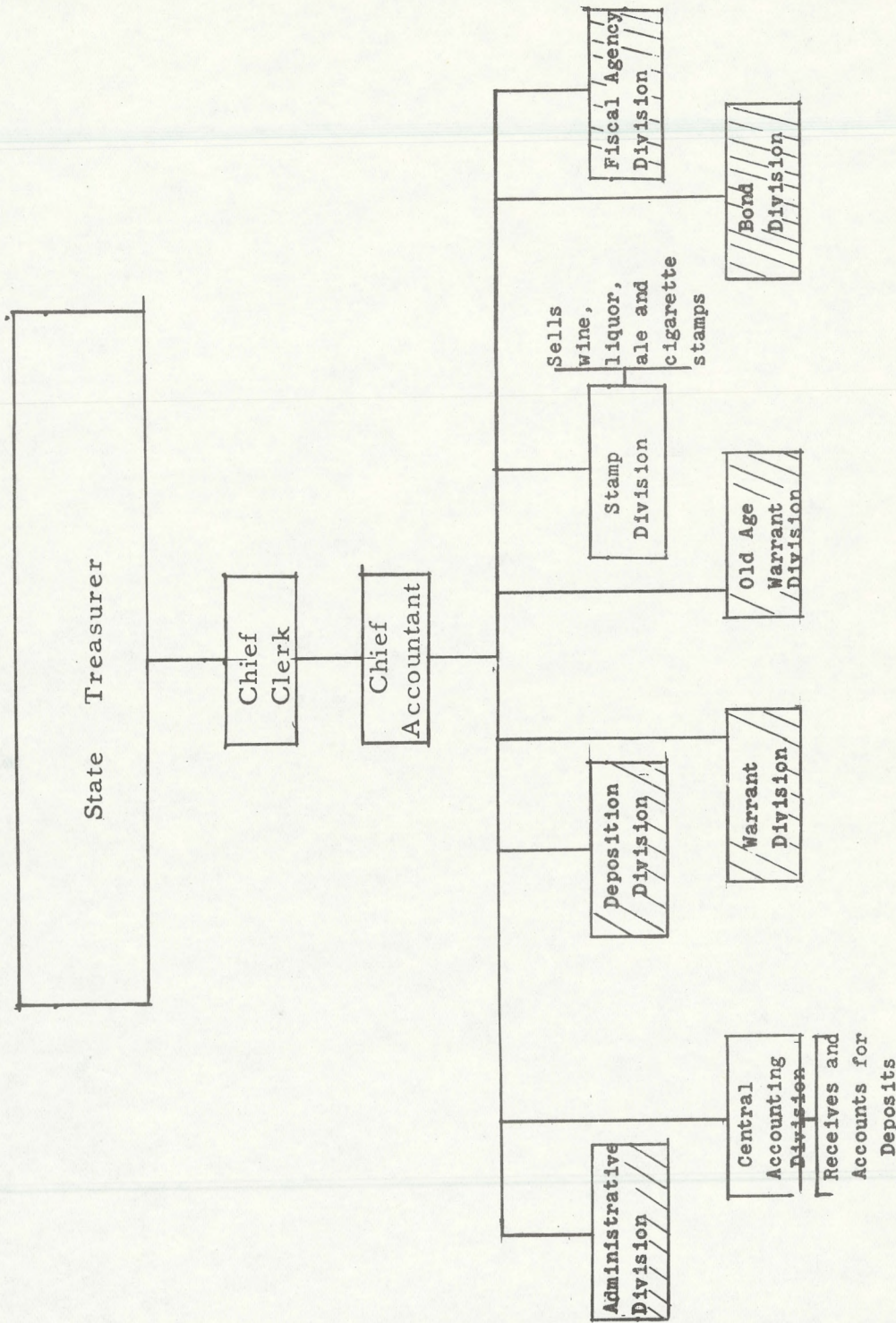
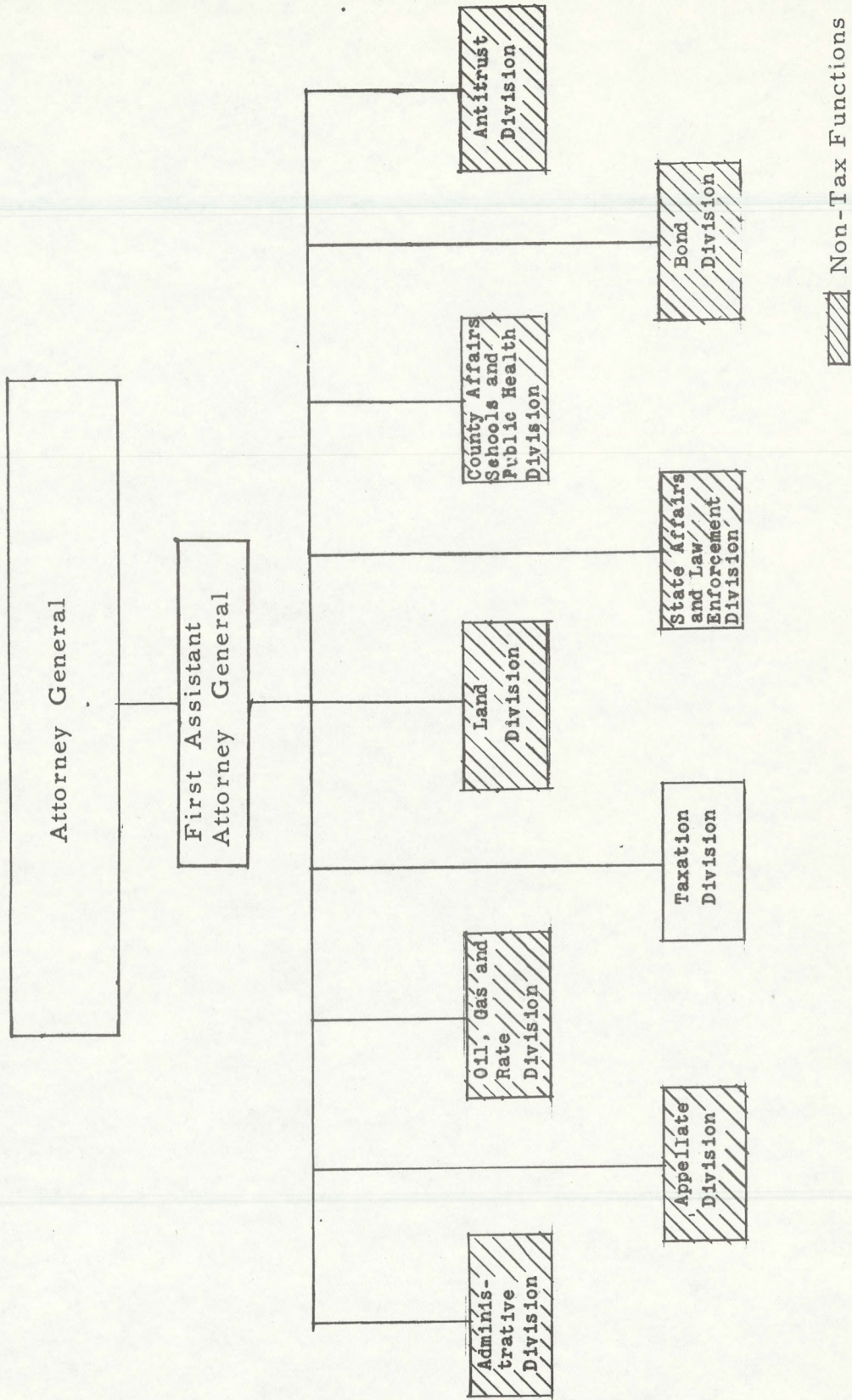



Chart III-7: Organization Chart, State Treasury Department



▨ Non-Tax Functions

Chart III-8: Organization Chart, Attorney General's Department



 Non-Tax Functions

problems in tax administration, the effect of these opinions is difficult to measure under certain conditions. In several instances, the tax administrators to whom the opinions have been directed have not adopted the practice or policy established in the opinion. For example, the State Auditor reports that, "The records of the Division (Motor Vehicle Division of the State Highway Department) reveal that every year a number of counties choose to disregard the provisions of the registration statutes, the Attorney General's interpretations of same, and specific instructions of the Division--and participate in illegal registration procedures of one form or another."<sup>7</sup> There are indications of other instances when opinions of the Attorney General have been ignored. In September, 1942, the Attorney General advised the Comptroller that balances in the oil tax enforcement fee account should be allocated at the end of each fiscal year to certain funds in the Treasury.<sup>8</sup> In 1950, the State Auditor reported that no allocation of the balance of the oil tax enforcement account had been made since the opinion was received. On the other hand numerous citations could be given to instances in which tax administrators have followed the opinions of the attorney General in answering questions concerning administration of taxes.

#### State Auditor's Office

Organization of the Office of the State Auditor, with special attention to tax administration functions; is shown in Chart III-9. The Auditor is responsible for making audits of state agencies and for insuring that they handle their affairs efficiently, accurately, and in accordance with the law. Therefore, in its general capacity, the Auditor's Office comes into contact with each of the agencies charged with tax administrative duties and to an extent reviews these administrative practices. An example of the effect of the State Auditor on tax administration was seen in 1947 when the Auditor was appropriated funds to audit revenues for the franchise tax. Prior to that time, the Auditor had stated that, in his opinion a number of corporations had not been reporting correctly. There are other instances which indicate that the Auditor gives careful attention to state tax administration. In 1940, the Auditor reported that in several instances the Insurance Commission had not attempted to collect any tax or verify that taxes were due from insurance companies which had been wholly reinsured or had withdrawn from the state. Corporations were contacted, and some taxes were collected as a result.<sup>9</sup>

Although the State Auditor has influenced tax administration substantially in some instances, there are isolated cases in which his suggestions were not given as serious attention. For example, the Auditor has suggested that the oil and gas tax enforcement allocations be placed in a special fund rather than in a so-called "fee-account" in the General Revenue Fund,<sup>10</sup> but no action has been

<sup>7</sup> Audit Report on the Motor Vehicle Division of the State Highway Department of Texas, August 31, 1950, p. 12.

<sup>8</sup> Op. Tex. Atty. Gen. No. 0-4788 (September 3, 1942).

<sup>9</sup> Audit Report of the Board in Insurance Commissioners, August, 1950, p. 16.

<sup>10</sup> Audit Report of the State Comptroller of Public Accounts, August, 1950, p. 34.

initiated in this regard.

In addition, the State Auditor's Office audits the franchise tax, which is collected by the Secretary of State. In this capacity the Auditor's Office reviews returns submitted by corporations subject to that tax. Approximately ten persons in the Auditor's Office are engaged in auditing the franchise tax. Five auditors are stationed in field offices located in Houston, Dallas, Fort Worth, and San Antonio.

#### Automatic Tax Board

The Automatic Tax Board, which was created in 1907, is an ex-officio board composed of the Governor, Comptroller, and Treasurer. It is designated by the statute as the "board to calculate the ad valorem tax to be levied and collected each year for State and public free school purposes."<sup>11</sup> However, the board, in calculating rates at which the state ad valorem taxes will be collected, is bound by a long and fairly complicated statutory formula. It is because of the lack of discretion that the board has come to be called the Automatic Tax Board.

The basic principle of the formula, which need not be detailed here, is that the ad valorem tax will operate as a balanced wheel in the state tax system and will be kept flexible so it can be used to fill in the difference between the tax revenue expected and the tax revenue that will be needed. However, the formula is fairly restrictive in terms of the method used to determine the rate.

#### Cigarette Tax Stamp Board (Board of Control)

The Cigarette Tax Stamp Board, composed of members of the Board of Control, is responsible for designing and supplying the stamps required by the cigarette tax law. This duty is apparently assigned to the Board of Control because it is generally in line with the board's central purchasing functions.

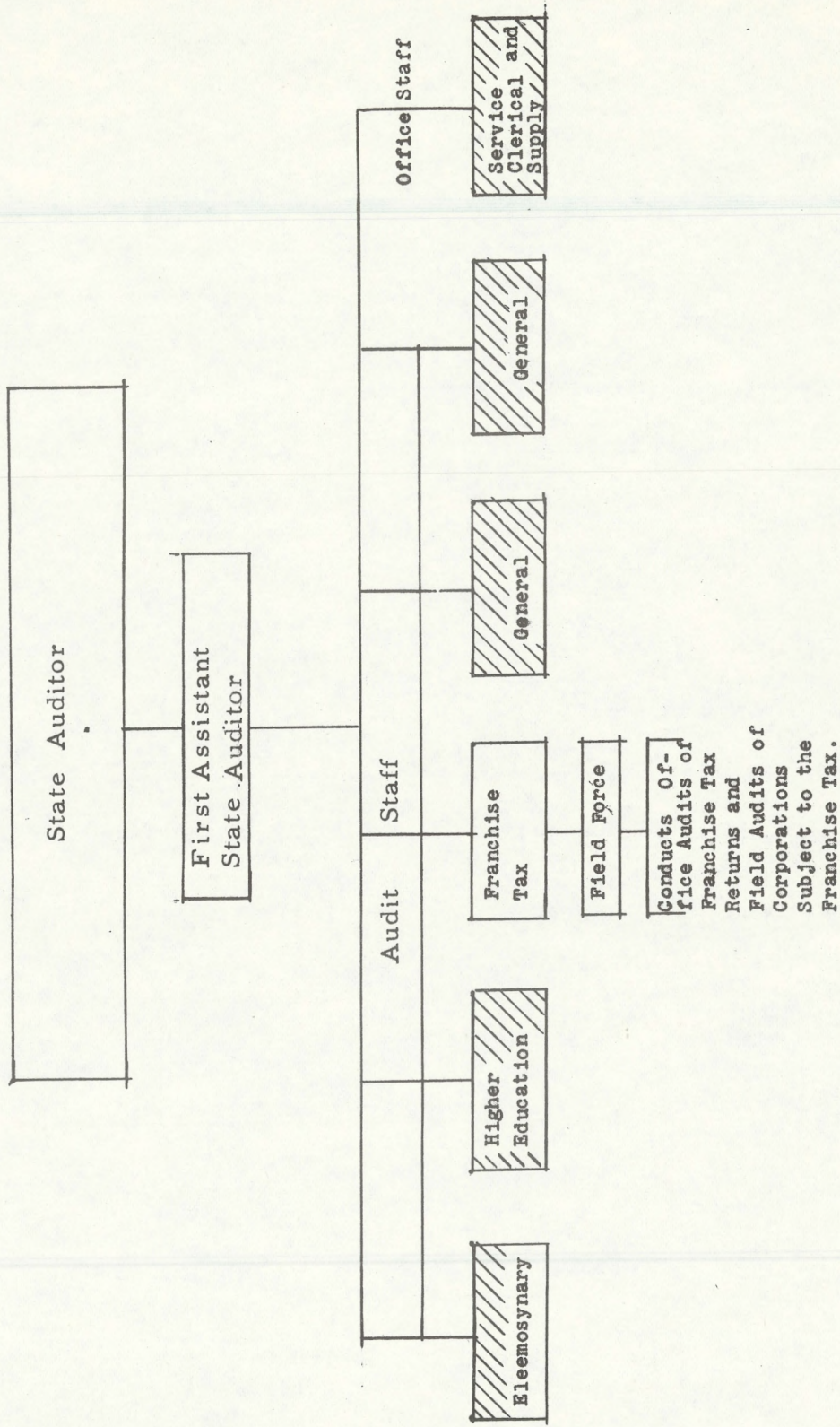
#### State Tax Board (Intangible Tax Board)


The State Tax Board, also called the Intangible Tax Board, is an agency which has great potential. In practice, it is of minor importance.<sup>12</sup> In recent years, the board has confined itself largely to assessing the intangible assets

<sup>11</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7041.

<sup>12</sup> The statutory provisions relating to the State Tax Board can be found in Tex. Civ. Stat. (Vernon, 1948) arts. 7098-7115. The following discussion on the State Tax Board is based on material supplied by the Intangible Tax Division of the Comptroller's Office, Reports of the State Tax Commissioner, and E. L. Caldwell, "The Texas Tax Board: An Historical and Comparative Study" (unpublished master's thesis, The University of Texas, 1948).

Chart III-9: Organization Chart, State Auditor's Office



 Non-Tax Functions

tax, a function performed by its administrative staff in the Intangible Tax Division of the Comptroller's Office.

The State Tax Board was created in 1905 by the intangible assets tax act. At that time, it was composed of the Comptroller, the Secretary of State, and a State Tax Commissioner appointed by the Governor. Accordingly, two of the members were state officials and the third was filled by a newly-created official whose full time was devoted to administering the intangible tax act. A number of changes in the law have been made through the years, but the only organizational change came in 1939 when the office of State Tax Commissioner was abolished, and his duties were transferred to the Comptroller. Also, the Attorney General was added to the Board. When the Comptroller took over the functions and the title of Tax Commissioner, he created in the Comptroller's Office the Intangible Tax Division, which is the staff for the board. The present arrangement is shown in Chart III-10. The Intangible Tax Division is very small, usually having about three employees, two of whom are accountants engaged in computing intangible assets of companies to which the tax law applies.

The powers and duties of the State Tax Board fall into three major categories:

- (1) To assess the intangible value of certain types of companies enumerated in the law and to certify to county-assessor-collectors the portion of that intangible value which they are to carry on their rolls and to tax.
- (2) To assist in the enforcement of state tax laws in general.
- (3) To investigate the laws and practice of this and other states with regard to taxation and to make recommendations to the Legislature for methods of improving the Texas tax system.

The function of assessing the intangible value of the specified types of companies and of certifying to county tax collectors their portions of this value is accomplished, in practice, by the Intangible Tax Division of the Comptroller's Office. The board establishes rules to be followed in assessing and reviews the results.

The tax law enforcement activities placed on the board are primarily investigatory. The board may investigate records of concerns paying taxes in Texas and has the power to require that witnesses appear and company records be presented. The board can issue a subpoena, and refusal to obey it constitutes contempt. The law also provides that each member of the board shall have these investigatory powers. Therefore the Comptroller, the Secretary of State, and the Attorney General are given these investigatory powers individually. The Secretary of State may forfeit a corporation's charter or permit to conduct business within the state if the concern does not permit its books to be inspected by the board.

The duty of recommending to the Legislature, on the basis of investigations of taxation in this and other states, improvements in Texas tax laws gives the State Tax Board a continuing responsibility for research in tax matters and for making proposals beneficial to the Texas tax system. During the period before 1939 when there was a separate Tax Commissioner, this function was taken seriously, and numerous recommendations were submitted to the Legislature. Since 1939 the recommendation function of the board has largely fallen into disuse.

### Local Officials

Several local officials are assigned duties connected with administration of state taxes. Most important are the county tax collectors. Also involved are county judges and commissioners' courts, district and county attorneys, and county clerks.

County Tax Collectors. Primary duties of collecting the ad-valorem, motor vehicle sales, poll, and motor vehicle registration taxes are placed on county tax collectors. The ad-valorem tax is primarily a local source of revenue, and the state tax amounts to no more than an additional rate. However, the poll, motor vehicle sales, and motor vehicle registration taxes are primarily state taxes. They represent a sizable addition of duties to those which county collectors ordinarily have.

In every state other than Vermont, local officials share in the administration of state taxes. In a number of states, the part played by local officials is substantially greater than that of local officials in Texas. The taxes collected locally vary, but the general property tax is the most common. Poll, motor vehicle registration, death, and various business and agriculture taxes are also much in evidence.

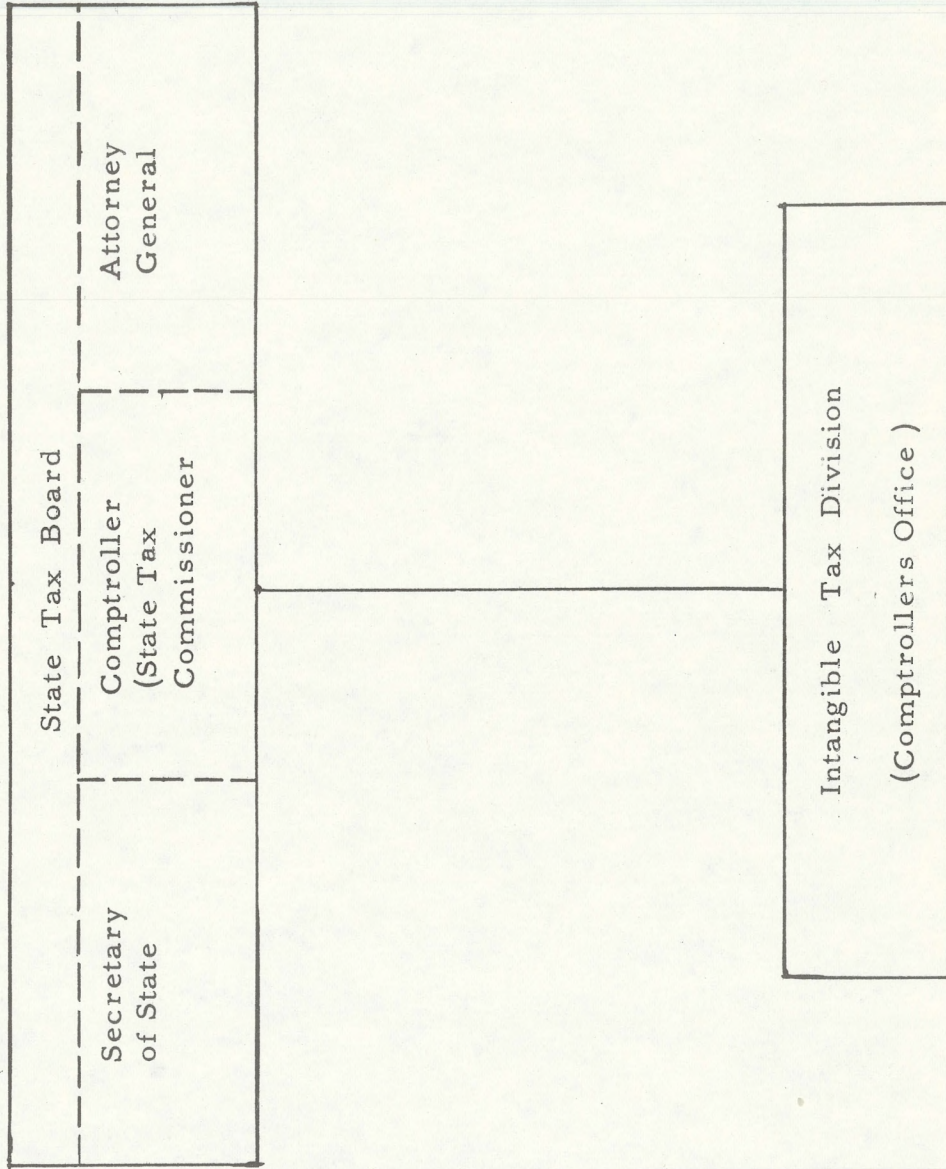
Other Local Officials. Although other county officials are assigned functions connected with state tax laws, they are usually concerned with only one or a few laws. Brief mention will be made of some of the more important duties of other local officials.

The county judge, as probate judge, certifies appraisals of estates and signs orders fixing amounts of state inheritance taxes. He also receives liquor permit applications for which he holds hearings. As the chairman of the county commissioners' court, he sits with that body in performing its functions as a county board of equalization for the ad valorem tax.

District and county attorneys are responsible for bringing suit under several state tax laws. County attorneys file suits to enforce inheritance tax liens, and district and county attorneys file suits against delinquent taxpayers or those making false reports under several other tax acts.



Chart III-10: Organization Chart, State Tax Board



County clerks sell stock transfer stamps, inform the Comptroller and county judges of estates in probate, and audit certain tax records. In counties with an auditor, this official performs audit duties. Sheriffs sell delinquent ad valorem tax property, and local peace officers make investigations to confiscate illicit alcoholic beverages and check motor vehicle registration. Effective and efficient state tax administration is dependent on the energetic co-operation of local officials.

Trade Groups. Several trade groups also have parts in the administration of the state tax program. Motor fuel distributors are required to submit monthly reports and payments. Cigarette tax distributors are required to submit reports and maintain records concerning cigarette stamp purchases and sales. Liquor wholesalers also maintain records of stamp purchases. Although the tax is initially levied on these trade groups, the statutes anticipate that the tax will eventually be paid by the consumer. In this context, these trade groups are considered a segment of the tax administrative structure, and each receives compensation for administrative assistance.

## SECTION 2 -- COST OF TAX ADMINISTRATION

Several state agencies, a number of county officials, and various trade groups, along with the tax-payers themselves, form the structure for tax administration in Texas. The function of each of these classes of administrative agents has been described. Although the cost of administering each tax was estimated in the individual tax studies, it is important to examine the administrative cost involved in the total tax structure.

It is hazardous in the extreme to try to estimate costs of administering particular taxes without allowing a considerable margin of error because most of the tax administrative agencies of Texas do not employ accounting procedures which show accurately the cost of administration for an individual tax.<sup>13</sup> Therefore any estimates necessarily represent no more than approximations of administrative expenditures. In Texas, one division of an agency may have the responsibility for several taxes. In these instances, it is sometimes not possible to prorate costs among the taxes on the basis of available data. Whenever possible, taxes have been considered individually, although occasionally a few small groupings have been made.

### Types of Expenditures and Bases for Estimates

After determining which taxes to consider singly and which to group together, questions arise as to which types of expenditures to include.<sup>14</sup> The types of expenditures included in the study are shown in Table III-2. The first two columns list the individual taxes and groups of taxes and the agency and division responsible for their administration.

The third column of Table III-2 lists salaries and the fourth column maintenance and supplies (rental of office space and machines, purchase of equipment, utilities, travel expense, printing, etc.). The cost of tax stamps is estimated in column five;

<sup>13</sup> One student of taxation, having sent questionnaires to all state tax-collecting agencies and having personally investigated the federal government's situation in the early 1940's, concluded that nearly all of the states, as well as the Bureau of Internal Revenue, lack a system of allocating costs. See James W. Martin, "Costs of Tax Administration," Bulletin of the National Tax Association, vol. XXIX, January, February, March, and April, 1944.

<sup>14</sup> Consideration was given to the problem of determining types of expenditures to include in computing tax administrative cost by Kenneth C. Black, "The Indiana Gross Income Tax" (Bulletin of the Bureau of Business Research, No. 23, University of Kentucky, 1950), pp. 47-53.

discounts to trade groups which aid in collecting taxes are listed in column six; and commissions paid to county tax collectors are in column seven. In some instances, a tax is administered by two or more state agencies or by two or three divisions within an agency. For example, the state's alcoholic beverage taxes are the responsibility of five divisions, four of them in the Liquor Control Board and the other the stamp division of the State Treasurer's office. The item of salaries for administering these taxes must therefore be allocated among these five divisions.

The choice of types of expenditures to be included in Table III-2 has been shaped largely by the availability of a basis from which to derive an estimate. The appropriation bill authorizing expenditures for the fiscal year 1951 was used, when applicable, as the most expedient source of statistical data.<sup>15</sup> If the appropriation bill was not applicable, estimates were based on audit reports, annual reports of state agencies, or special investigations.

Using an appropriation bill as the basis for cost estimates has several disadvantages, even though it is drafted in line-item form. First, the entire appropriation may not be spent. On other occasions, an agency or division will be appropriated a sum in addition to the line-item amount. Though the general effect is to produce over-estimates of expenditures, the difference is not sufficiently large to nullify the value of estimates. An additional problem arises where administrative divisions are responsible for certain taxes and at the same time for regulation of a type of business. Information for arriving at a basis on which to apportion costs between tax administration and regulatory duties has been drawn largely from the individual tax studies conducted by the Legislative Council staff.<sup>16</sup>

Because of lack of adequate information on the point, no attempt is made to include the depreciation of publicly-owned building space occupied by administrative offices. On the other hand, out-of-pocket payments of rent are included. The cost of administering refunds are deemed an appropriate charge because the activity is considered a method of administering a tax exemption. The use of the appropriation bill precludes the possibility of distributing the cost of supplies in inventory over a period of years.

Costs incurred by the State Auditor for time devoted to franchise tax administration are included in the cost estimate. Routine audits of each state agency made by

<sup>15</sup> Acts 51st Leg., R.S. 1949, ch. 615, p. 1208.

<sup>16</sup> See Texas Legislative Council, Staff Research Report Nos. 51-8, 52-1, and 52-2, A Survey of Taxation in Texas, Part II, IIA, IIB--Analysis of Individual Taxes (Austin, 1951-52).

the Auditor's Office, however, have been excluded. Certain expenses of the Attorney General's office, as well as those of the main division in the Comptroller's Office, are a part of the cost but are not shown on the table because of limited data on which to divide costs among the taxes. Figures were not available on the amount of compensation given county officers for their aid in administering the inheritance tax.

In addition to governmental costs, there are compliance costs paid by the taxpayer. The cost of compliance usually consists of expenditures necessary to execute what tax legislation requires on the part of taxpayers. This includes payments to attorneys for tax counsel or for services in tax litigation and salaries paid to employees who compute the tax, submit reports, and maintain tax records. However, the cost of campaigns for or against a proposed change in tax laws, for example, could not properly be regarded as legitimate tax compliance expenditure.<sup>17</sup> Compliance costs are not shown in Table III-2.

#### Factors Influencing Cost of Administration

It is important to recognize several factors which strongly affect the cost of tax administration in Texas. Statutory provisions which prescribe tax administration procedures are among the most influential factors determining administrative costs. Numerous examples of this factor could be given. Texas statutes require as one method of payment of the cigarette tax the purchase of cigarette stamps. The Cigarette and Occupation Tax Division estimated that approximately \$80,338 was spent in 1951 to provide these stamps. In addition, more than \$1 million was allocated for expense of selling stamps and placing them on cigarette packages as provided by law. At least two other states which levy cigarette taxes have greatly reduced this type of expenditure by adopting an inventory method of enforcement rather than using stamps.<sup>18</sup> At the same time, states employing the inventory technique depend much more heavily on field auditors for successful enforcement.

Another illustration of a Texas tax statute's affecting cost of administration occurs in the requirement that reports from gross receipts taxpayers be notarized, thereby increasing the cost to the taxpayer.<sup>19</sup>

17 James W. Martin, "Costs of Tax Administration," Bulletin of the National Tax Administration, vol. XXIX, January, February, March, and April, 1944.

18 Texas Legislative Council, Staff Research Report No. 51-8, A Survey of Taxation in Texas, Part II--Analysis of Individual Taxes (Austin, 1951), p. 29.

19 Texas Legislative Council, Staff Research Report No. 52-2, A Survey of Taxation in Texas, Part IIB--Analysis of Individual Taxes--Concluded (Austin, 1952), p. 7.

Table III-2

Cost Analysis of Tax Administration in Texas - 1951

Taxes	(1) State Agency	(2) State Administrative Division or Divisions	(3) Estimated State Administrative Expense		(5) Stamps or Licenses	(6) Discts. to Trade Groups	(7) Commissions to County Tax Collectors	(8) Total Administrative Costs
			Salaries	Maintenance, Travel, Supplies, Misc.				
Alcoholic Beverages	Liq. Cont. Bd.	Accounting	\$ 42,000					\$42,000
		Audit	83,260					83,260
		Executive Enforcement	7,356 301,456					7,356 301,456
Cigarette	State Treasurer	Stamp	13,524	\$ 153,750	\$ 15,000			13,524
		Cig. & Occupational Tax	135,520	4,150		\$ 201,352		4,150
				137,700				201,352
Motor Fuel	Comptroller State Treas.	Motor Fuel	336,300					336,300
		Motor Fuel	86,924	35,000				86,924
		Refund				1,029,659		4,150
							1,029,659	
								<u>1,400,891</u>
								336,300
								154,000
								86,924
								35,000
								956,838
								<u>1,569,062</u>

Cont'd.

Table III-2 Continued

## Cost Analysis of Tax Administration in Texas - 1951

Taxes	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Chain Store & Radio, Cosmetics and Playing Cards	Comptroller	Store tax Cig. & Occ. Tax	\$ 43,260 100,480	\$ 22,500				\$ 43,260 22,500 100,480
Inheritance	Comptroller	Inheritance Tax	54,360	17,520				<u>166,240</u> 54,360 17,520 <u>71,880</u>
Insurance	Bd. of Ins. Com.	Life Examining	5,580 9,137	1,275				5,580 1,275 9,137
Franchise	Sec. of State	Tax	26,940	11,000				<u>15,992</u> 26,940 11,000
Oil & Natural Gas	State Auditor	IBM Section Franchise Tax	7,111 47,091	3,443				7,111 47,091 3,443 <u>95,585</u>
	Comptroller	Gross Receipts	124,899	39,950				124,899 39,950 <u>164,849</u>
Sulphur, Carbon Black & Cement	Comptroller	Gross Receipts	7,347	2,350				<u>7,347</u> 2,350 <u>9,697</u>

Cont'd.

Table III-2, Concluded  
 Cost Analysis of Tax Administration in Texas - 1951

Taxes	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Gross Receipts & Stock Transfer	Comptroller	Gross Receipts	\$ 14,694	\$ 4,700				\$ 14,694 4,700
Occupation Vending Machine & Admissions	Comptroller	Cig. & Occupation Tax	16,000	15,300				<u>19,394</u> 16,000 15,300
Motor Vehicle Registration	State Highway Department	Motor Vehicle	274,022	118,987	\$360,369			<u>31,300</u> <u>274,022</u> 118,987 360,369
Poll	Dept. of Pub. Saf.	License & Weights	79,046				\$1,479,058	79,046 1,479,058
Motor Vehicle Sales	Comptroller	Ad valorem	20,667	6,351			267,927	20,667 6,351 267,927
Ad Valorem	Comptroller	Ad valorem	45,960	16,089			321,258	45,960 16,089 321,258
	Comptroller	Ad Valorem	60,003	19,899			2,267,405	<u>383,307</u> 60,003 19,899 2,267,405
			\$1,956,461	\$768,114	\$455,707	\$2,187,849	\$4,335,648	<u>2,347,307</u> \$9,703,779



Policies and techniques chosen by tax administrators can also have a bearing on administrative costs. Efficient accounting procedures and the introduction of machines have contributed to sizable reductions in cost. A close co-ordination and supervision of field auditors from various tax divisions also offers an opportunity for reducing expenditures.

There are other factors whose relative importance is difficult to measure. The geographical size of Texas works to the disadvantage of the state, particularly in regard to travel expense and to the wide dispersion of field offices. The effect of the State Auditor on tax administrative costs should be recognized. The Auditor, through this medium, has contributed valuable suggestions toward bringing about more efficient tax administration. One element which is occasionally overlooked in understanding administrative cost is that distinctly unpopular tax legislation is particularly expensive to administer.

In listing influential factors, it should be re-emphasized that inflation affects the cost of government in the same manner as other costs. Unless some more efficient or effective administrative measures are adopted, the cost of administration may be expected to increase as the effect of inflation continues, provided, of course, that at least the current amount of tax administration activity is maintained. Inflation is equally important to the cost of federal and state tax administration. However, at least one danger should be pointed out in comparing the relationship between state and federal costs in this regard. In some instances, the cost of administering a particular tax is higher because the federal government can often administer excise taxes through manufacturers, while the state must register, maintain contact with, and audit the more numerous dealers and distributors. Thus the level of administration of the tax affects the cost. The excise tax on cigarettes is a case in point. To understand the cost of tax administration, it is important to recognize the factors which exert such a strong influence. Although other factors could be listed, these are mentioned to suggest the various pressures playing on and influencing the total cost of tax administration. Excessive cost of administration therefore, may be influenced by one or a combination of several factors, including obsolete requirements found in tax statutes, ill-advised decisions of tax administrators, or public acceptance of the tax. In summary, it should be remembered that only qualified estimates have been made and that it is difficult to determine and evaluate all the factors influencing costs.

#### Analysis of Tax Administration Costs

Since tax administration costs have been grouped by type of expenditure, total costs are given for salaries; maintenance, supplies, travel, and miscellaneous; stamps and licenses; discounts to trade groups; and commissions to county tax collectors. Therefore, Table III-2 permits a comparison of expenditures by type. Since costs have also been computed for individual taxes or groups of taxes, Table III-2 also offers a basis for analyzing and comparing expenditure by taxes.

Comparison of Expenditures by Type

Of the total state administrative expense, which includes columns 3, 4, and 5, salaries far exceed the combined costs of maintenance, supplies, travel and miscellaneous and of stamps and licenses. However, the total of these three types of state administrative expenditures exceeds discounts to trade groups but is less than commissions paid to county collectors. This comparison is illustrated in Table III-3. Using figures given in Table III-2, this table distinguishes state administrative expenses by division rather than by salaries, maintenance, stamps, etc.

Table III-3

Estimated Administrative Cost and Allowance  
Permitted in 1951 for Administering  
Taxes in Texas

Administrative Group	Cost	Per Cent
<b>State Agencies</b>		
Comptroller	\$1,598,111	50.3
Liquor Control Board	602,822	18.9
Treasurer	35,348	1.1
Insurance Commission	15,992	.5
Secretary of State	45,051	1.4
State Auditor	50,534	1.6
Highway Department	753,378	23.7
Department of Public Safety	79,046	2.5
<u>Total</u>	<u>\$3,180,282</u>	<u>100.0</u> 32.8
<b>Trade Groups</b>		
Alcoholic Beverage		
Importers	\$ 201,352	9.2
Cigarette Distributors	1,029,659	47.1
Motor Fuel Distributors	956,838	43.7
<u>Total</u>	<u>\$2,187,849</u>	<u>100.0</u> 22.5
<b>Counties</b>		
County Clerk from Motor		
Vehicle Registration	\$1,479,058	34.1
From Motor Vehicle Sale	321,258	7.4
From Poll	267,927	6.2
From Ad Valorem	2,267,405	52.3 44.7
<u>Total</u>	<u>\$4,335,648</u>	<u>100.0</u> 100.0

An analysis of the separate administrative groups indicates that more than \$3 million was spent by state agencies in 1951 to administer the Texas tax program. The Comptroller's Office received approximately one-half of the total amount allocated to state agencies, and the Highway Department received slightly less than one-fourth. The balance consisted largely of administrative expenditures by the Liquor Control Board, with five other agencies accounting for from 5 to 2.5 per cent of the total. As a group, state agencies received 32.8 per cent of total state expenditures for tax administration in the fiscal year 1951.

Trade groups, including liquor stamp purchasers and cigarette and motor fuel distributors, received more than \$2 million from the state during fiscal 1951 for helping the state collect taxes. Of this amount, cigarette and motor fuel distributors received more than 90 per cent. These payments to trade groups amounted to approximately 22.5 per cent of the state's total expenditures for tax administration.

Table III-3 indicates that county assessor-collectors received more money for their activities in connection with state tax administration in 1951 than either trade groups or state agencies. For helping collect four taxes, county collectors received more than \$4 million, or approximately 45 per cent of the total state expenditures for tax administration. More than one-half of the money received by counties for tax administration was for help in assessing and collecting the state ad valorem tax and more than one-third was allowed counties in connection with the motor vehicle registration tax. The balance was distributed for either poll or motor vehicle sales taxes. The totals given in Table III-3 are reproduced in Chart III-11, which indicates the distribution of tax administration revenue among county officials, trade groups, and state agencies.

The importance of counties in administering state taxes is also indicated by Table III-4 which contains comparison of amounts paid to selected counties by the state for assessing and collecting four state taxes and shows the counties' cost of collecting the four state taxes and all county taxes.

The figures in Table III-4 must be qualified in certain respects. First, counties have been grouped according to population -- counties of more than 100,000, counties of from 25,000 to 50,000, and counties ranging from 2,000 to 7,000. The selection of counties was restricted to those on which information was available. Although figures on the total county cost for assessing and collecting both county and state taxes were specifically requested in the Texas Legislative Council's questionnaire to county governments, not all 105 counties which returned the questionnaire answered the specific question concerning tax collection costs. No information is available for estimating costs in counties which did not report or answer this question. These two factors have considerably reduced the number of counties included in the table, and of course it is not known whether the counties selected are a representative sample. Comments apply only to counties listed in Table III-4.

In estimating the significance of this table, it should be remembered that state payments to counties for assessing and collecting ad-valorem and poll taxes are given for the fiscal year 1950 rather than 1951.<sup>20</sup> However, no significant difference is expected between payments to counties for collecting the two taxes in 1950 and in 1951. Because of the date on which counties report to the Comptroller, payments to counties for collecting motor vehicles sales taxes are for the fiscal year October 1, 1950 to September 31, 1951. As would be expected, a marked increase in counties' receipts for collecting this tax was shown during the 12-month period because counties were authorized to retain five per cent of collections during the latter part of the period rather than the previous two per cent.<sup>21</sup> The Texas Legislative Council questionnaire specifically asked for (1) total expenditures from officers' salary fund for county assessors-collectors, or if the sheriff was collector, payments for his activities, and (2) expenditures from the general fund for the county assessor-collector. Answers to these questions are the basis for figures given as tax collection costs.

The final column in Table III-4 indicates total receipts by counties from the state for administering the four taxes as a per cent of total cost.<sup>22</sup> In selected counties of more than 100,000 population, payments to counties for state tax assessment and collection ranged from 35 to 102 per cent of the counties' total cost for assessing and collecting both county and state taxes. However, the two extremes were exceptions, and the percentage figures for the remaining nine counties ranged from 50 to 85 per cent. This indicates that, at least in certain larger counties, from one-half to three-fourths of tax collection cost is borne by the state.

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<sup>20</sup> The Comptroller's report carries these figures for the fiscal year preceding the year upon which the Comptroller's Annual Report is based. Figures for the fiscal year 1951 will be included in the 1952 report.

<sup>21</sup> The county tax assessor-collector also retains one-half of the affidavit error fees collected. Tex. Civ. Stat. (Vernon, 1952 Supp.) art. 7047k, sec. 6.

<sup>22</sup> As described in Section 2 of this chapter, county clerks, judges, and other county officials are also involved in helping administer and collect several other state taxes for which no compensation is given.

Table III-4

Selected Comparison of County Tax Collection Costs  
and Commissions Paid to Counties  
by the State

County	Population*	Commissions Paid to Counties by State					Estimated	
		Ad Valorem**	Poll**	Vehicle Registration#	Vehicle Sales†	Total	Total Cost††	Commissions as percentage of cost
Over 100,000 population								
1	500,460	\$ 53,476	\$ 16,732	\$ 72,281	\$ 18,953	\$161,442	\$314,610	51.31
2	124,834	13,809	3,469	16,096	3,818	37,192	105,469	35.26
3	614,799	136,881	16,590	97,790	33,362	284,623	455,967	62.42
4	194,968	26,663	6,221	28,570	8,330	69,784	82,248	84.84
5	113,066	34,443	5,464	15,831	3,925	59,663	110,689	53.90
6	806,701	173,023	33,325	135,666	38,731	380,745	531,003	71.70
7	160,446	25,879	3,712	19,170	4,454	53,215	101,528	52.41
8	100,549	24,514	2,496	24,042	7,218	58,270	56,690	102.78
9	130,194	29,459	5,296	20,875	5,190	60,820	77,226	78.76
10	359,246	45,903	10,944	66,657	19,419	142,923	242,984	58.82
11	160,980	27,458	5,872	26,307	6,196	65,833	125,953	52.27
25-50,000 population								
1	38,390	5,335	1,123	6,512	1,168	14,138	17,782	79.51
2	26,732	4,068	594	4,218	947	9,827	12,118	81.09
3	42,102	17,829	2,125	15,293	3,663	38,910	38,226	101.79
4	45,646	10,155	974	8,763	1,731	21,623	33,068	65.39
5	26,724	5,932	757	4,663	813	12,165	20,088	60.56
6	42,731	7,646	971	7,740	1,578	17,935	21,423	83.72
7	31,467	12,325	1,688	9,784	2,154	25,051	27,488	94.41
8	27,991	16,965	1,400	5,681	1,096	25,142	40,795	61.63
9	42,998	801	562	7,042	1,177	9,582	22,166	43.23

(continued next page)

Table III-4 Conclusion  
 Selected Comparison of County Tax Collection Costs  
 and Commissions Paid to Counties  
 by the State

County	Population*	Commissions Paid to Counties by State			Estimated Total Cost /	Commissions as percentage of cost
		Ad Valorem	** Poll** Vehicle Reg. #	Vehicle Sales /		
2-7,000 population						
1	2,215	\$2,326	\$142	\$115	\$ 1,715	205.89
2	3,876	1,978	265	92	3,300	105.70
3	4,045	4,758	183	180	4,745	133.88
4	4,533	2,718	119	71	6,530	52.66
5	3,658	2,946	248	232	1,631	297.12
6	3,667	161	87	166	2,207	82.92
7	6,257	59	90	148	9,611	16.07
8	7,640	3,277	347	429	16,498	38.47
9	3,965	7,772	237	166	5,400	176.62

\* 1950 Census or as reported on County Government Questionnaire.

\*\* Figures given are for 1950 fiscal year. Comptroller's Report Part II, 1951.

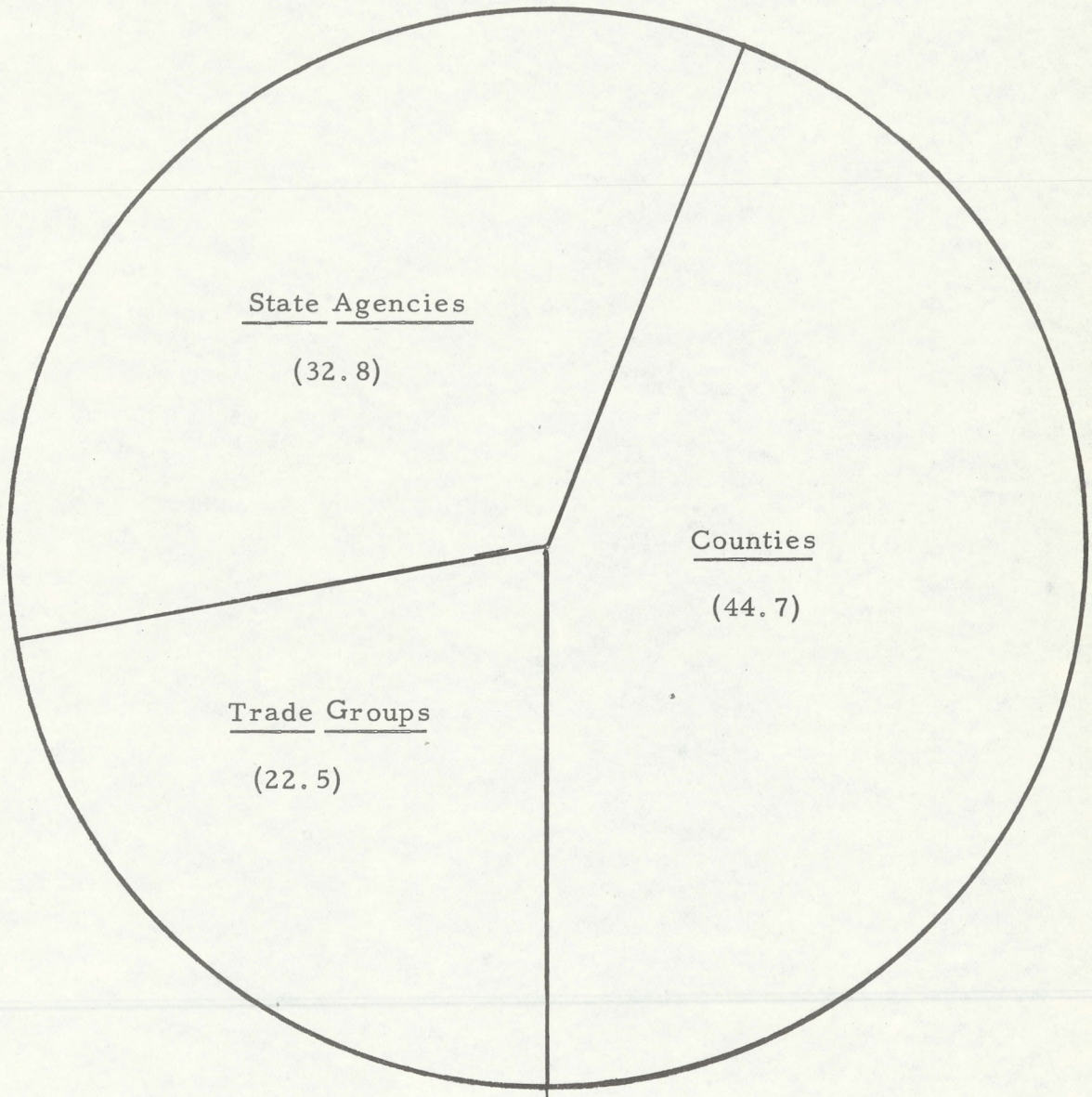
# Figures include postage costs deducted for administrative expense by counties. Audit Report of Motor Vehicle Division of State Highway Department, August 31, 1951, pp.42-56.

/ Unpublished figures computed from records of the Ad Valorem Division of the Comptroller's office. Because of method of reporting figures are from October 1, 1950 to September 31, 1951.

/- Cost estimate based on returns from Legislative Council's county government questionnaire.

Chart III-11

Tax Collection Expenditures by Administrative Group



A smaller variation is found in selected counties within the population bracket of 25,000 - 50,000. Of the total county cost of collecting state and county taxes, counties, with two exceptions, receive from 60 to 95 per cent from the state. This grouping also indicates that several of the counties receive a slightly higher percentage of their tax costs from the state than the larger counties.

The most pronounced variation in percentage figures is found in the small counties, with a minimum of 16 per cent and a maximum of 297 per cent. No clear pattern is indicated within this range. However, it is perhaps significant that figures for more than half of the counties indicate that the state paid the county more for its part in assessing and collecting state taxes than it cost the county to collect both state and county taxes. Reports from one county indicate that it received almost three times as much from the state as it cost the county to collect state and county taxes. Although the practice has been for the state to compensate county government officials for helping collect state taxes, there are no indications that the amount paid was intended to exceed greatly total county costs for assessing and collecting state and county taxes.

In summary, figures in Table III-4 indicate that from 50 to 85 per cent of the total county and state tax cost burden in several of the larger counties is paid by the state. In several counties of from 25,000 to 50,000, the state has paid from 60 to 95 per cent of total tax cost. In smaller counties, the percentage figure has been even higher, with more than one-half of the listed counties reporting a total tax collection cost less than the amount paid them by the state for help in collecting four state taxes. In all three county groups, serious questions could be raised as to the lack of correlation between the costs incurred by the county for helping collect state taxes and the amount paid for this aid. It is expected that this lack of correlation is reflected to some extent in the high cost of administering taxes collected through counties. However, it should also be recalled that the poll, ad valorem, motor vehicle sales, and registration taxes involve more taxpayers than many other state taxes.

#### Analysis and Comparison of Expenditures by Taxes

Cost estimates in Table III-2 offer a base from which an analysis and comparison of individual taxes and groups of taxes can be made. However, several precautions should be mentioned. The fact that one tax is more cheaply administered than a second does not necessarily indicate either efficiency or effectiveness. A low cost can just as reasonably result from a small appropriation as from administrative efficiency. Moreover, some taxes require lower expenditures to maintain economy and efficiency.

Table III-2 indicates that four taxes collected in Texas cost more than a million dollars each to administer, and two of the four cost more than \$2 million in 1951. The ad valorem tax is the most expensive to collect, costing the state approximately \$2,347,307 in 1951. The major



expenditure, amounting to more than 95 per cent, was commissions paid to county tax collectors responsible for assessing, collecting, and enforcing the tax. The administrative responsibility of the Ad Valorem Tax Division of the Comptroller's Office is restricted primarily to accounting and verifying receipts and reports from the counties. The cost of administering the motor vehicle registration tax is also more than \$2,300,000. As in the ad-valorem tax, commissions paid to county clerks constitute the largest expense item. Expenditures for administering the cigarette and motor fuel sales taxes amounted to from \$1.4 and \$1.6 million in 1951. Discounts to wholesalers and distributors were the largest type of expenditure for both taxes. More than a million dollars, or approximately 75 per cent of the total cost of administering the cigarette tax, and slightly less than a million dollars, or approximately 60 per cent of the total cost of the motor fuel tax, are attributed to discounts.

In addition to discounts paid to distributors of motor fuels, administration of the Motor Fuel Refund Division of the Comptroller's Office constitutes a sizable cost. More than \$100,000 was spent in 1951 by the state to meet the administrative expense of refunding motor fuel taxes. However, this administrative expense is met primarily by charging a refund filing fee which would not be collected if no refunds were allowed.

Table III-2 also indicates which tax or group of taxes are the least expensive to collect. Administrative costs for the severance taxes on sulphur, carbon black, and cement, the insurance tax, and business gross receipts taxes appear relatively low. The largest expenditure item in administering these taxes is salaries.

The cost of administering other taxes ranges from \$31,300 for occupation taxes to more than \$800,000 for alcoholic beverage taxes. It is also important to recognize some of the major costs involved in administering these taxes. As in sales taxes considered previously, the cost of enforcement and discounts to trade groups are sizable expenditures in administering the alcoholic beverage taxes. The cost of purchasing and selling stamps amounted to more than \$32,000 in 1951. The enforcement division of the Liquor Control Board spent approximately \$300,000, and discounts to producers and importers totaled \$201,000. These items comprised almost 65 per cent of the total cost of collecting the alcoholic beverage taxes.

It is interesting to note that although the statutes make the Secretary of State to be responsible for administering the franchise tax, the State Auditor spent more money collecting the tax than the Secretary of State in 1951. The fact that both agencies are involved in collecting the tax suggests a certain amount of duplication, but audit reports indicate that increased revenues have resulted.<sup>23</sup> Both poll and motor vehicle sales taxes are col-

lected on the county government level. Commissions paid to counties amount to more than 90 per cent of total cost of administering the poll tax and 84 per cent of the cost of the motor vehicle sales tax.<sup>24</sup> It is also important to note that the Cigarette and Occupation Tax Division spends more enforcing chain store and radio, cosmetics, and playing cards taxes than does the Store Tax Division, which is primarily responsible for their administration.

Although Table III-2 indicates the wide dispersion of costs of administering taxes in Texas, the difference appears even more pronounced in Chart III-12, which shows total cost figures in a bar graph.

This chart indicates clearly the variation in total costs. Based on estimates that have been made, the total cost of administering two taxes -- the motor vehicle registration and state ad valorem -- was slightly less than the total cost of administering all other taxes combined in 1951. The state spent more collecting the ad-valorem tax in 1951 than was spent during the same period collecting the alcoholic beverage; inheritance; insurance; franchise; poll; motor vehicle sales; chain store; radio, cosmetics, and playing cards; oil; natural gas; sulphur; carbon black; cement; gross receipts; stock transfer; vending machine; admissions; and all occupation taxes combined. The chart also indicates that the poll tax was three times as costly to administer as the franchise tax and that more money was spent administering the chain store and the radio, cosmetics, and playing cards tax than was spent on the oil and natural gas taxes.

A different view of the cost of tax administration is provided by showing expenditures for collecting and enforcing a tax in relation to receipts. Table III-5 lists the individual taxes and groups of taxes included in Table III-2 and gives expenditures as a percentage of collections for the fiscal year 1951.

Percentage figures given in the third column of Table III-5 indicate a wide variation in the percentage of tax revenue spent for administration. For comparative purposes, this variation is pictured in Chart III-13.

Figures range from .1 per cent, the approximate percentage of tax collections -- spent administering the insurance; oil and natural gas; sulphur; carbon black; and cement taxes -- to the 19.4 per cent spent administering the poll tax. These figures represent an exceedingly wide variation. However, there are several reasons why a constant ratio between expenditures for administering taxes and amounts collected is not to be expected. Some types of

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<sup>24</sup> The cost of administering the motor vehicle sales tax is expected to rise sharply during 1952, since county clerks will receive five per cent of the collections on their commissions rather than two per cent as was computed during 1951 and for this study. See Tex. Civ. Stat. (Vernon, Supp. 1952) art. 7047(k).

taxes are simply more expensive to collect than others. Expenditures vary with many factors including the number of taxpayers, statutory requirements, administrative organization, and general economic conditions. On the other hand, collections vary through changes in rates, in exemptions, by judicial interpretations, and in enforcement activity. Therefore administrative costs are not expected to reflect in a constant relationship to collections. The fact that a particular tax requires a higher percentage of its collections to be spent for administration is only "suggestive rather than conclusive evidence of either the operating efficiency or the inherent level of costs."<sup>25</sup>

Several comparisons can be made indicating the significance of the percentage figures in Chart III-13. It would be helpful to consider Chart III-13 in relation to statements of tax authorities concerning what percentage of tax collections should usually be spent on administering a tax. Another comparison could be made between administrative costs in terms of dollar amounts as pictured in Chart III-12 and costs shown as a percentage of receipts in Chart III-13. On the basis of other studies, a comparison might be made between similar taxes in Texas and other states.

Although it would be unrealistic to set an absolute percentage figure for all taxes, some relationship has been recognized between administrative costs and collections. According to a prominent writer in the field of taxation, tax collection costs should not exceed two or three per cent of revenue collected after the initial administrative expenses have been met.<sup>26</sup> Although Table III-5 indicates that total state cost of tax administration represents approximately 2.4 per cent of total tax receipts, particular taxes far exceed the suggested maximum. In fact, 7 of the 15 individual taxes and groups of taxes listed in Chart III-13 exceed the maximum. Of the seven taxes exceeding three per cent, alcoholic beverages; cigarette; and store; and radio, cosmetics, and playing cards taxes are in the nature of individual sales or consumer taxes. There are several indications that this type of tax might be expected to have a relatively high cost/revenue ratio. First, a study by James Martin published in the Bulletin of the National Tax Association in February, 1944, showed that administrative costs for several individual sales or consumer taxes, including alcoholic beverages and tobacco, are among the highest. Second, administrative costs for two of the three taxes included payments in the form of discounts to trade groups, who receive more than 22 per cent of the state's total tax administrative expenditures, as was estimated in Table III-2.

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<sup>25</sup> Kenneth Black, Ibid., p. 51.

<sup>26</sup> Harley L. Lutz, Public Finance (4th ed: New York and London: D. Appleton-Century Company, 1947), p. 321.

Chart III-12

1951 Administrative Costs by Individual and Groups of Taxes in Texas

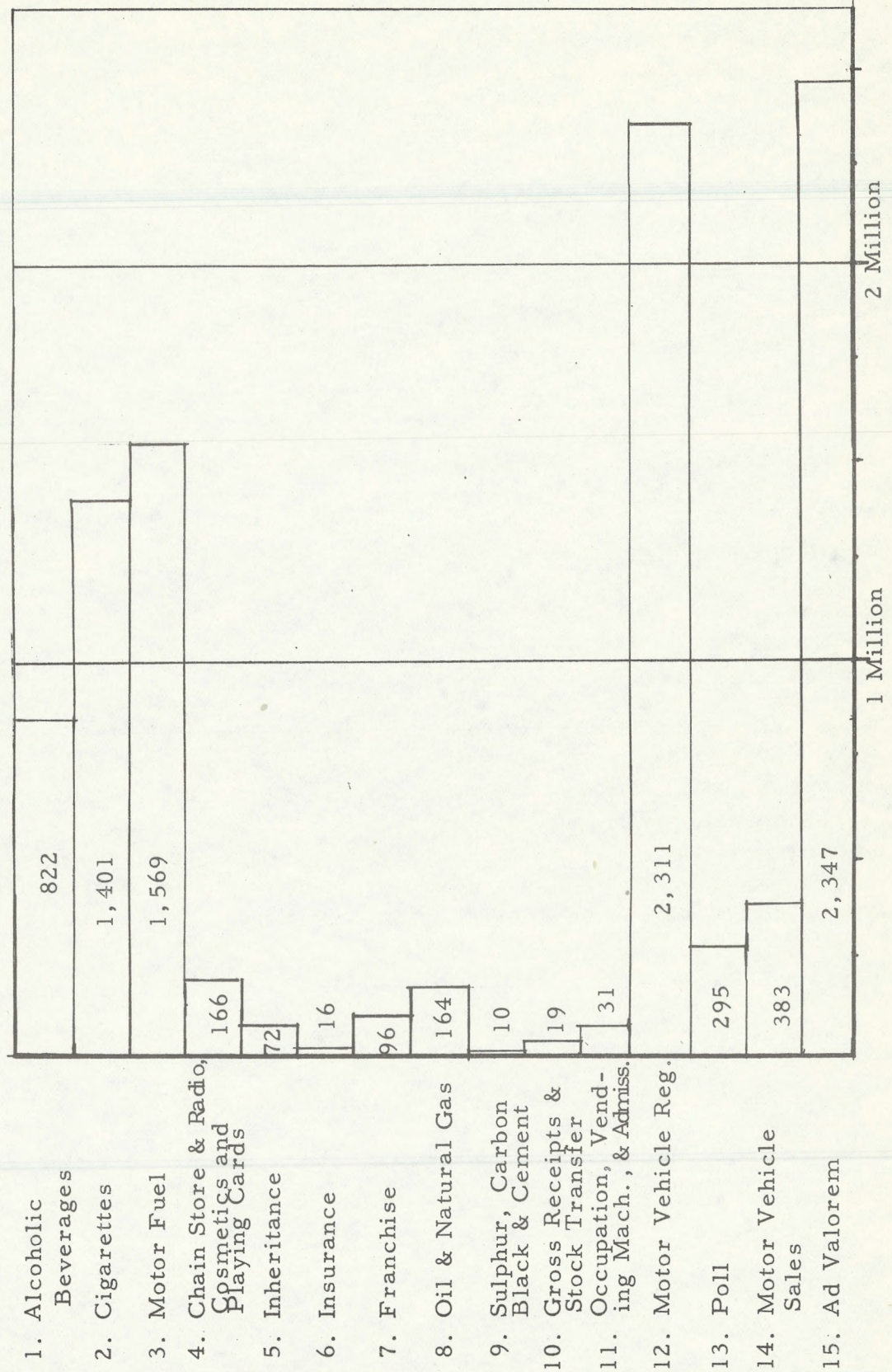


Chart III-13

1951 Cost/Revenue Ratio of Tax Administration by Taxes in Texas

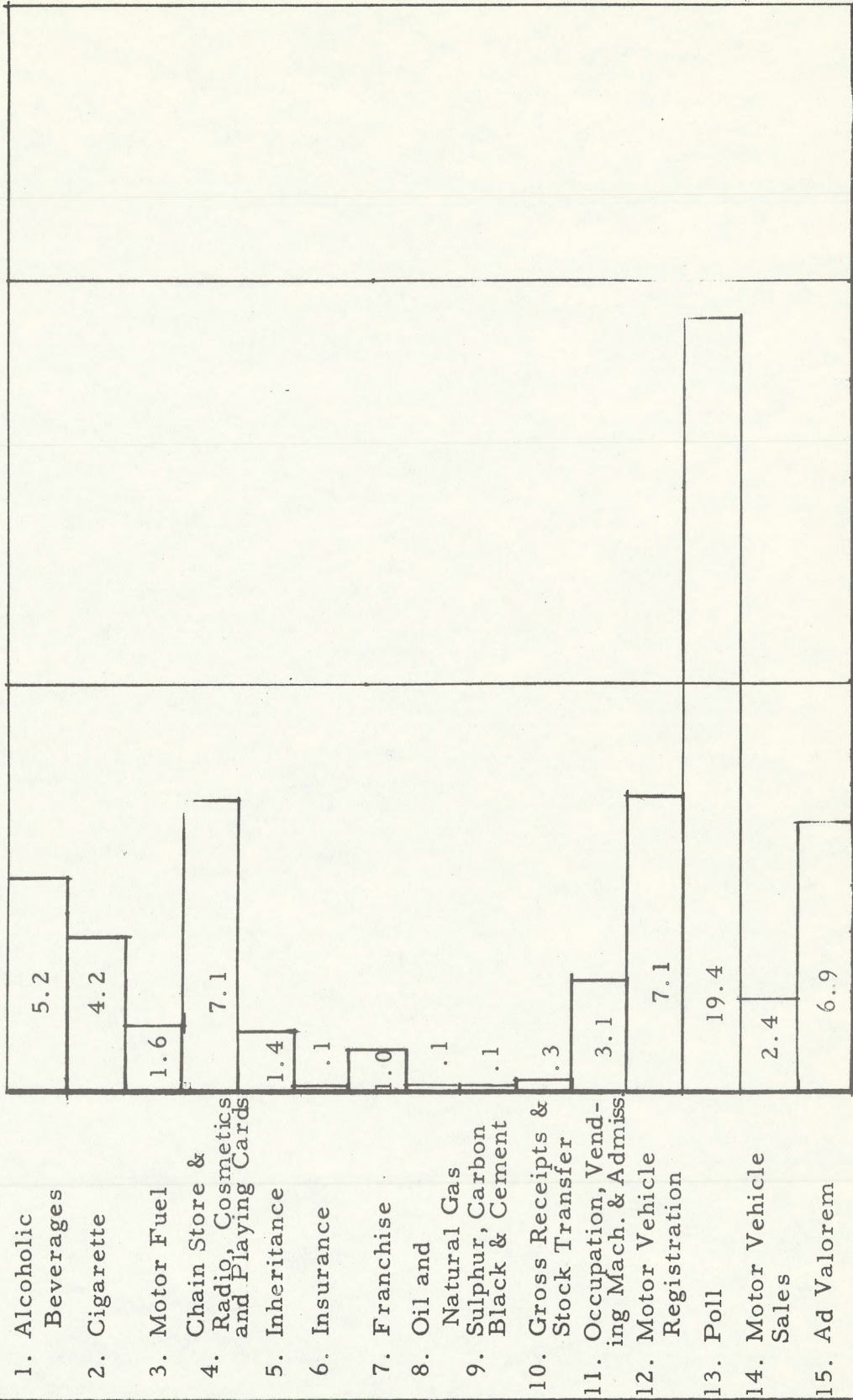


Table III-5

Cost-Revenue Ratio of Tax Administration By Taxes

in Texas

<u>Tax</u>	<u>Administrative Cost</u>	<u>Collections</u>	<u>Cost/ Revenue Ratio</u>
1. Alcoholic Beverages	\$ 821,848	\$ 15,799,763	5.2
2. Cigarette	1,400,891	33,292,320	4.2
3. Motor Fuel	1,569,062	95,683,795	1.6
4. Chain Store and Radio, Cosmetics and Playing Cards	166,240	2,348,054	7.1
5. Inheritance	71,880	5,074,443	1.4
6. Insurance	15,992	14,196,912	.1
7. Franchise	95,585	9,703,771	1.0
8. Oil and Natural Gas	164,849	125,805,591	.1
9. Sulphur, Carbon Black and Cement	9,697	9,844,141	.1
10. Gross Receipts and Stock Transfer	19,394	7,750,101	.3
11. Occupation	31,300	1,022,055	3.1
12. Motor Vehicle Registration	2,311,482	32,576,399	7.1
13. Poll	294,945	1,520,871	19.4
14. Motor Vehicle Sales	383,307	15,741,670	2.4
15. Ad Valorem	2,347,307	33,843,359	6.9
 Totals	 \$ 9,703,779	 \$ 404,203,245	 2.4

The remaining taxes may be segregated by the fact that three of them -- the motor vehicle registration, poll, and ad valorem taxes -- are primarily administered by local units of government. The most expensive in terms of the cost/revenue ratio is the poll tax, administrative expenditures for which totaled more than 19 cents for each dollar collected. Actually, high administrative costs for these taxes are not surprising, since county collectors received in 1951 more than 44 per cent of the state's total expenditures for tax administration for helping administer these four taxes. Table III-5 indicates that occupation, vending machine, and admissions taxes are probably included because of relatively low revenues rather than relatively high costs of administration.

A comparison with Chart III-12 might be helpful in determining the significance of Chart III-13. In the comparison, taxes may be divided into several classes. The first includes taxes which are relatively expensive both in terms of dollar amounts and in terms of percentage of collections. This class is composed of alcoholic beverages, cigarettes, motor vehicle registration, and ad valorem taxes. The charts indicate not only that these taxes are relatively expensive to collect but also that the cost represents a prominent percentage of total collections. The motor fuel tax is in contrast to the first class of taxes. Although it is a relatively expensive tax to administer, collections from the tax are sufficiently large to show administrative expenditures as only a small proportion of total receipts. The inheritance, franchise, and motor vehicle sales taxes may be classified together, since their administrative cost is not particularly high in either dollar amounts or as a percentage of collections.

The poll tax; chain store and radio, cosmetics, and playing cards taxes; and occupation; vending machine; and admissions taxes compose another class. This class is characterized by the fact that although administration is relatively inexpensive in dollar amounts, the taxes are expensive when administrative costs are shown as a percentage of receipts. Inclusion of the poll tax may be partially explained by the fact that the tax not only raises revenue but also has a close relationship with the state electoral process. The fact that the tax is not aggressively enforced undoubtedly affects both administrative costs and receipts. The chain store and radio, cosmetics, and playing cards and vending machine administrative taxes are similar in that a large number of taxpayers are involved. However, the fact that a relatively large percentage of receipts spent collecting the taxes might indicate that additional administrative expenditures might more profitably be spent elsewhere.

The final group of taxes includes those on insurance companies; oil and natural gas; sulphur, carbon black, and cement; and gross receipts and stock transfers. In Charts III-12 and III-13, these taxes have been described as relatively inexpensive to administer. In fact, administrative expenditures have amounted to from one to three-tenths of one per cent of their receipts. There are several possible explanations for these low percentages. Some taxes are paid by a very limited number of taxpayers and therefore involve a minimum of administrative expense. The small costs involved in collecting the tax on sulphur, carbon black, and cement might be partially explained in this way. Moreover, minimum administrative costs may be affected because the state is also engaged in regulating the taxed industry. To some extent, this explanation might be applicable to the tax on insurance companies and on the production of oil and natural gas. The business taxes based on gross receipts and the stock transfer tax do not clearly fall within either of these possible explanations, since both are paid by numerous taxpayers who are not regulated as a group by the state. Although the reason for the small administrative expenditure is not apparent, the facts do suggest that tax enforcement is not as aggressive for these taxes as for others.

Although a relatively low administrative cost has often been deemed indicative of an efficient or economical tax department, some tax authorities have interpreted low collection costs in a different light. Joseph Hutson and Thomas Smith have stated that ". . . low collection costs, measured in this manner (collection costs shown as a per cent of revenue collected), may only be evidence of lackadaisical enforcement. Far from indicating economy, low collection costs may actually mean millions of dollars in unrealized revenues rightfully due."<sup>27</sup>

Several recent studies have been published comparing tax administrative costs within and among various states.<sup>28</sup> However, in several instances, it is impossible to determine from the publication the type of costs included and upon what basis the cost was estimated. Similar studies conducted by various research groups have produced wide differences in estimates. These two facts discourage any immediate attempt to make meaningful comparisons of costs of collecting taxes in Texas and in other states on the basis of a cost/revenue ratio. To give some of the implications of these problems, the alcoholic beverage tax will be used as an example.

In a study conducted by the Distilled Spirits Institute, the alcoholic beverages tax in California was shown as costing 11.1 per cent of collections during 1947.<sup>29</sup> However, a recent study in California estimated the percentage in 1947 at 6.0385.<sup>30</sup> These figures represent an example of the differences in estimates of tax administration costs. A recent Florida study offers an example of the problem of determining the base from which cost estimates have been made. In estimating the cost of alcoholic beverages taxes, the entire expenditure of the State Beverage Department was included as tax costs. The report states that "Part of the expenditures are chargeable to enforcement activities. But no division is possible from existing records."<sup>31</sup> No mention is made of the cost of paying distributors for handling tax stamps,<sup>32</sup> and there are no indications that this cost is included in the computation. Such problems have discouraged any further comparisons of tax administrative costs as a percentage of tax receipts.

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<sup>27</sup> Hutson and Smith, op. cit., p. 12.

<sup>28</sup> See Joseph W. Hutson and Thomas Lee Smith, "Toward Effective Tax Collection" (Federation of Tax Administration Research Report No. 15, 1942). Although the study is directed primarily toward measuring the completeness of tax collection, reference is made to relations between revenue and cost of collection.

<sup>29</sup> Report of the Revenue Laws Commission of the State of Illinois, Part I (Springfield, Illinois, 1949), p. 568.

<sup>30</sup> See Report of the Senate Interim Committee on State and Local Taxation, Part III, State and Local Taxes in California: A Comparative Analysis (April, 1951), Table 17, p. A-448.

<sup>31</sup> An analysis by the Legislative Reference Bureau presented by The Legislative Council, Florida's Tax Structure (April, 1951), p. 153.

<sup>32</sup> Tax stamps are sold at 98 per cent of face value, giving distributors a two-per-cent discount. Florida Statutes, 1951, ch. 651.47.



## Significance of Cost Analysis

The total estimated cost of administering the state tax program in 1951 is approximately \$10 million. Therefore the magnitude of the program is expressed not only in terms of the numerous administrative units involved in the tax structure but also in regard to the cost of administering the program. Moreover, the size and disposition of the administrative structure directly affects the cost of operating the program. Although accurate reporting and periodic study of tax administrative costs afford the possibility of detecting unbalanced aspects and costs trends within the tax structure, there is apparently insufficient accurate data at present to support such judgments. However, on the basis of data gathered, several general observations can be made.

Approximately two-thirds of the total expenditures for administering the state tax program is paid in terms of discounts and commissions to counties and trade groups. This cost is primarily dependent on tax statutes which govern the amounts paid these groups. Therefore increases in administrative efficiency on the part of counties and trade groups would not necessarily be reflected in lower administrative costs for the state. This leaves approximately one-third of the cost of administration which could be reduced by improved programs and techniques.

A study of tax administration indicates wide variations in the cost of assessing, collecting, and enforcing individual taxes. This variation is found both among large and small revenue-raisers. For example, it was estimated in Table III-2 that the poll tax was more expensive to collect than both the oil production and natural and casinghead gas taxes. Table III-5 indicates that the oil and gas tax receipts for 1951 were more than \$125 million and that poll tax collections amounted to less than \$2 million. However, several factors should be taken into consideration in understanding this lack of correlation. One approach to determining the conditions behind extremely high or low administrative expenditures is separate investigation of each tax and consideration of it within an economic and political framework. Another possibility for examining administrative costs is through a type of office procedure and work simplification program, but this approach is beyond the scope of the immediate study.

## SECTION III: FINANCING TAX ADMINISTRATION

The State of Texas has not adopted a consistent policy for paying the expenses incurred in administering its tax program. The cost of tax administration in the state is apportioned among counties, trade groups, and state administrative agencies. Administrative costs of a single tax, however, often involve costs incurred by both trade groups and several state agencies, or by counties and state agencies. Attention in this section is directed toward sources of revenue and techniques of financing tax administrative costs paid to counties, trade groups, and state agencies. The purpose is to analyze the several current revenue sources and financing techniques used in the administration of state taxes, to consider some of the problem areas which have developed in the employment of these techniques, and to examine the relative merits of the approach currently in use.

### COUNTIES

County governments help to collect or enforce the franchise, ad valorem, poll, motor vehicle sales, inheritance, stock transfer, alcoholic beverages, and motor vehicle registration taxes. The statutes provide that counties are to be compensated directly for assistance in administering four of these taxes--poll, ad valorem, motor vehicle sales, and motor vehicle registration--but make no provision for paying counties for aid in administering other taxes. For example, county clerks are agents of the Comptroller in making local sales of stock transfer stamps, but county clerks are not paid for this service. On the other hand, the motor vehicle sales tax law provides that "the Tax Assessor and Collector . . . shall retain five per cent (5%) of the taxes and one half of the affidavit error fees of office, or to be paid into the office salary fund . . . ."33

Although the commission which county collectors are paid varies from one tax to another, the source of revenue from which county administrative costs are paid is identical. All commissions are deducted from tax receipts before collections are transferred to the state treasury. This method obviates the need for the Legislature to appropriate each biennium a payment to the counties. At the same time, the method precludes the possibility of a biennial budgetary review to determine whether the allocation is below, even with, or more than administrative expenses. It is estimated that counties received over four million dollars in 1951 in commissions for helping collect state taxes. This means that a large proportion of state tax administrative expenditures was paid out with no immediate attention to whether the allocations matched anticipated expenses.

### TRADE GROUPS

The alcoholic beverages, cigarette, and motor fuel taxes are administered with the assistance of trade groups, which receive discounts as compensation. The statutes provide that the tax on these products is intended to fall upon the consumer, 33 Tex. Civ. Stat. (1952 Supp) art. 7047 (k), sec. 6.

even though it is originally paid by the distributor. For the distributor's effort in putting stamps on the taxed product and to cover his losses and his expense in collecting the tax, purchasers of liquor stamps receive a two per cent discount on stamp purchases in excess of \$500. Similarly, motor fuel distributors receive a one per cent discount and cigarette stamp purchasers a discount of four per cent of three-fourths of the stamps' face value.<sup>34</sup> Although the collection of several other state taxes also involves the co-operation of trade groups and business interests, compensation is specifically allowed to cigarette, liquor, and motor fuel distributors.

As was true of county officials, all compensation paid to trade groups is derived from the particular tax being collected. The deductions are made before the tax receipts are deposited by the state. Consequently, no appropriation is necessary; these state expenditures receive no budgetary review. The \$2.2 million which is the estimated amount that trade groups received in 1951 represented a sizeable portion of the state's expenditures for tax administration, a portion which receives no regular attention to determine whether expenditures fall short of or exceed actual costs.

#### STATE TAX ADMINISTRATIVE AGENCIES

In contrast to the practice of paying counties and trade groups from one source, a portion of tax receipts, a combination of sources has often been used to pay state agencies for administering taxes. The table entitled "Special Sources of Revenue for State Tax Administrative Agencies, 1951" lists the major sources of revenue from which those agencies received appropriations during the fiscal year 1950-1951. The appropriation bill was drafted in line-item form, which permitted particular sources of revenue to be appropriated to certain designated administrative divisions and for specific types of expenditures. Only state agencies which have primary responsibility for administering a particular tax or group of taxes are included in the table. Though agencies such as the Attorney General's office and the State Treasury have important duties in relation to tax administration, they are omitted. So are some divisions within the Comptroller's office.

Frequently the practice has been to meet the tax administrative expense of state agencies by using enforcement funds or fee accounts in the General Revenue Fund, supported by a portion of the tax collected. In some respects this approach is similar to that used for paying commissions to county collectors and discounts to trade groups. In addition, expenses of state agencies incurred in enforcing several taxes are partially paid from filing fees or audit charges. The sale of confiscated goods is also used as a source of revenue. Administrative costs incurred by agencies without a special source of revenue for tax administration are paid largely from general revenue.

<sup>34</sup> Tex. Penal Code (Vernon, 1948) art. 666-21d, sec. 2; (1950 Supp), art. 7047c-1, sec. 3.

Table III-6

Special Sources of Revenue for State Tax Administrative Agencies

1951

State Agency	Adminis- trative Division	Sources of Revenue for State Tax Adminis- tration			
		Special En- forcement Funds	Fee Ac- counts in Gen- eral Revenue	Audit Funds	Filing Fees
Comptroller	Cigarette & Occupa- tion Tax Division	Cigarette Tax En- forcement Funds; Vend- ing Machines & Occupation Tax Enforce- ment Fund		Cigar- ette Tax Audit Fund	
			Gross Re- ceipts Division*	Oil Tax Fee Acct.; Gas Tax Fee Acct.	Nat- ural & Cas- inghead Gas Au- dit Fund
	Store Tax Division		Radio, Cos- metics, & Playing Cards Fee Acct.	Store Filing Fee	
	Inheritance Tax Division				
	Motor Fuel Tax Refund Division			Refund Filing Fee	
	Motor Fuel Tax Division	Motor Fuel En- forcement Fund		Motor Fuel Audit Fund	

Table III-6 (Concluded)  
 "Special Revenue Sources . . ."

State Agency	Adminis- trative Division	Sources of Revenue for State Tax Adminis- tration			
		Special Enforce- ment Funds	Fee Accts. in Gen. Rev.	Audit Funds	Filing Fees
Board of Insurance Commissioners	Life Division				
Liquor Control Board	Executive Division	Liquor Tax Enforcement Fund; Confis- cated Liquor Fund			
Secretary of State	Franchise Division				
State Highway Department	Motor Vehicle Division				

\*Gas-gathering Tax, involved in litigation in 1951, has an enforcement fund and an audit fund.

In many instances the source for funds to go to state agencies for collecting and enforcing taxes is named in the statute enacting the tax. The cigarette tax, for example, provides that a percentage of the tax is to be "set aside in a special fund subject to the use of the Comptroller and so much of said fund as may be necessary shall be expended in the administration and enforcement of the provisions of this Act."<sup>35</sup> Again, the natural gas tax provides that "all funds collected for audits and examinations shall be placed in a revolving fund which may be used from time to time by the Comptroller in making such audits."<sup>36</sup> There are a number of other examples of specific provisions in the statutes listing the source from which expenditures for tax administration by state agencies are to be met. In all instances, revenue is deposited either in special funds or in fee accounts.

In some instances the statutes do not mention the means of meeting costs of collecting and enforcing a new tax. Neither the stock transfer tax nor the gross receipts tax on well servicing, car and motor carriers, enacted in 1941, specified

<sup>35</sup> Tex. Civ. Stat. (Vernon, 1950 Supp) art. 7047c-1, sec. 30c.

<sup>36</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7047b, sec. 5.

any source from which costs involved in their collection and enforcement were to be paid. However, the primary administrative responsibility was given to the Comptroller, who in turn selected the Gross Receipts Division within his agency to administer the tax. The practice has been to meet the costs of the three new taxes primarily from enforcement fund receipts from the oil and natural gas taxes which supported the Gross Receipts Division. In these instances some discretion was left to the tax administrator in choosing the source of revenue for paying the administrative expenses.

Most tax statutes provide that the Attorney General is responsible for bringing suit to collect delinquent taxes or to enjoin taxpayers from continuing business until delinquent taxes have been paid. Expenses of this sort are paid chiefly by appropriations from general revenue receipts, but the Attorney General has also been appropriated a percentage of delinquent franchise taxes collected.<sup>37</sup>

These examples have been cited to illustrate several distinct features in comparing the general approach used in financing tax expenditures by counties, trade groups, and state agencies. Commissions to county collectors and discounts to trade groups have been paid consistently from the receipts of the tax which they assist in administering. This money is deducted from the tax receipts without being transferred to the State Treasury. There has been no legislative policy established concerning the most desirable source from which to finance tax expenditures by state agencies. Although the selection of revenue source has usually been made in the statute, occasionally state agencies or officials have been left some discretion in the matter.

Sources of revenue for state agencies are all first deposited in the State Treasury. Expenditures from the Treasury must be authorized by appropriations. Hence allotments for tax collection and enforcement by state agencies generally receive budget review biennially. This review gives an opportunity for examining anticipated expenditures and adjusting them according to legislative decisions each two years. These examples illustrate some of the differences in the general approach taken in the statutes for financing tax administrative costs of state agencies and compensation given to counties and trade groups.

Differences may also be found among the sources of revenue from which state tax agencies are financed. Tax administrative agencies draw on one or a combination of earmarked special funds, earmarked fee accounts, funds holding filing fees, audit funds, and the General Revenue Fund. An analysis and comparison of these sources may be useful.

#### Tax Earmarked Funds and Fee Accounts

One of the most common methods of providing sources of revenue for the state's tax administrative agencies and divisions has been earmarking a portion of

<sup>37</sup> Laws 1949, R.S. 51st Leg., ch. 615, p. 1208.

tax receipts for administration.<sup>38</sup> Earmarking a portion of a tax has been prevalent in Texas,<sup>39</sup> and this means has been widely adopted in granting revenue to tax agencies. The practice has been for the earmarked amount to be allocated to either a special fund or an account and used to defray the expenses of the division which administers the tax. Regardless of whether the earmarked moneys are placed in funds or fee accounts, expenditures are dependent upon the biennial appropriations. Therefore the portion of the tax earmarked does not necessarily indicate the amount that may actually be spent for enforcement purposes but merely designates the source from which the money may be drawn.

There appear to be several possible reasons for the widespread use of tax enforcement funds and accounts. Often a proposed tax bill will include a supplemental appropriation to the state agency to be made responsible for administering the new tax. Since it is improbable that the biennial appropriation bill provided funds for the designated agency to take care of its added expenditures, the tax bill names the source from which the supplemental appropriation is to be drawn. To carry out this provision, another tax enforcement fund or fee account is established to receive and hold the earmarked money. Whereas the supplemental appropriation is effective for only two years, the earmarking provision is a part of general law and remains in effect until amended or repealed. However, authorizations for expenditures from the fund or account must be obtained every two years. The gas gathering tax enacted in 1951 followed this procedure by setting up a special tax enforcement fund and a supplemental appropriation to the Comptroller.<sup>40</sup>

The statutes provide for earmarking a portion of the following taxes for enforcement: (1) oil production tax, (2) natural gas production tax, (3) cigarette tax, (4) vending machine tax, (5) motor fuel tax, (6) radio, cosmetics, and playing cards tax, and (7) liquor and beer tax. Except for the liquor and beer tax, which is enforced by the Liquor Control Board, all of these taxes are administered under the supervision of the Comptroller. The Comptroller has organized several tax divisions in his office and has placed one or more taxes with enforcement funds in these divisions. In certain divisions there are included other taxes which do not have a provision for an enforcement fund.<sup>41</sup> During 1951

<sup>38</sup> There are also several regulatory agencies or divisions which also receive money earmarked for tax enforcement funds. For example, the administrative expense of the oil and gas division of the Railroad Commission, the Bureau of Labor Statistics, and the Interstate Oil Compact Commission are all paid from the Oil and Gas Enforcement Fund.

<sup>39</sup> See Chapter II for a discussion of this point.

<sup>40</sup> Tex. Civ. Stat. (Vernon, 1952 Supp) art. 7057f, sec. 6.

<sup>41</sup> For example, the Gross Receipts Division of the Comptroller's office administers 18 taxes. The division is financed mainly from the oil and gas tax enforcement accounts. The cigarette and vending machine tax enforcement funds largely finance the Cigarette and Occupation Tax Division. The motor fuel tax enforcement fund is employed chiefly in financing the Motor Fuel Tax Division. The (Footnote is completed on next page.)

the Comptroller's cost of administering these other taxes was paid partly from the receipts of taxes with enforcement funds.

Tax receipts earmarked for enforcement are deposited either in special funds or in fee accounts in the General Revenue Fund. The enforcement allocations for cigarette, alcoholic beverages, vending machine and motor fuel taxes are handled in special funds. Money set aside for the collection and enforcement of the oil, natural gas, and radio, cosmetics, and playing cards taxes are carried as fee accounts in the General Revenue Fund. Whether earmarked tax revenues are deposited in special enforcement funds or in the General Revenue Fund depends principally on provisions of the tax statutes. If general law directs that the allocation for tax enforcement be "set aside in the Treasury" and no mention is made of a special fund, the practice has been to employ fee accounts, as is done with the oil and natural gas taxes.<sup>42</sup> If the enactment provides that the money is to be placed in a "special fund," or if a new fund is explicitly named in the law, the usual policy has been to create a new fund.<sup>43</sup> Yet there are exceptions to this policy. For example, the radio, cosmetics, and playing cards tax law provides that "the Comptroller is authorized to set aside in a special fund . . ." but a separate enforcement fund has not been established.<sup>44</sup> During 1951 the enforcement allocation for the radio, cosmetics, and playing cards tax was held as a fee account in the General Revenue Fund. If no provision is made for the enforcement allocation to be set aside either in a "special fund" or in a specifically-named fund, the money has ordinarily been placed in a fee account in the general revenue.<sup>45</sup>

41 cont'd. The radio, cosmetics, and playing cards enforcement account, together with the store application fees, finances the Store Tax Division. The liquor act enforcement fund supports the tax enforcement activities of the Liquor Control Board. Several of the divisions mentioned also receive revenue from audit funds.

42 Tex. Civ. Stat. (Vernon, 1948) art. 7057a, sec. 9(1); art. 7047b, sec. 3.

43 The Cigarette Tax Enforcement Fund, Cigarette Tax Audit Fund, and Motor Fuel Tax Enforcement Fund were created as a result of the "special fund" provision. See Tex. Civ. Stat. (Vernon, 1948) art. 7047c-1, sec. 30, 30a; art. 7047c-1, sec. 8; art. 7065b-25. The Natural and Casinghead Gas Audit Fund and Confiscated Liquor Fund received their identity from specific reference to them in the general law. See Tex. Penal Code (Vernon, 1948) art. 666-30, sec. (b); Tex. Civ. Stat. (Vernon, 1948) art. 7047b, sec. 5.

44 The 1950 Audit Report of the Comptroller stated, "We feel that the enforcement fund derived from the Radio, Cosmetics, and Playing Cards Tax should be carried as a special fund and not as a fee account. . ." See Audit Report, State Comptroller of Public Accounts, August 31st, 1950, p. 57.

45 Examples of this practice are illustrated by the disposition of the store tax filing fees and by the newly-created fee account for the gas-gathering tax enforcement allocation. See Tex. Penal Code (Vernon, 1948) art. 1111d, sec. 2, and Tex. Civ. Stat. (Vernon, 1952 supp) art. 7057f, sec. 6.



The tax statutes generally determine whether enforcement revenue from newly-enacted taxes is deposited in fee accounts or in a special enforcement fund. There is no obvious reason for the lack of consistency in placing the cigarette tax enforcement allocation in a Cigarette Tax Enforcement Fund and the oil tax allocation in a General Revenue fee account. Enforcement allocations from both taxes are at the disposal of the Comptroller and are dependent upon appropriation. They amounted to approximately one-half million dollars during 1951. A similar question arises regarding the fact that one-half of one percent of the natural gas tax is placed in an enforcement fee account in General Revenue, while a new fund, the Natural and Casinghead Gas Audit Fund, has been created to hold collections for expenses in auditing the same taxpayers. During 1951 over \$62,000 was deposited in the natural gas tax fee account and less than \$4,000 in the Natural and Casinghead Gas Audit Fund, which at the close of the fiscal year reported a balance of approximately \$22,000.<sup>46</sup>

Although fee accounts and special funds are both accounting entities and are similar in some respects, it does make a difference whether tax enforcement allocations are placed in one or the other. Tax allocations held in earmarked fee accounts represent a surety against warrants drawn on the General Revenue Fund. Therefore, money held in a fee account may be spent for general revenue purposes if the General Revenue Fund is being seriously depleted. Deficit accounts are not issued on the fund until moneys in all fee accounts have been spent. Therefore, agencies which are authorized to spend fee-account money are merely given credit in their earmarked account; the money is not segregated to the extent it would be in a special fund. In essence this first distinction between special funds and fee accounts means that there is a possibility that state activities financed from fee accounts may receive deficit warrants before that activity has actually spent the amount of money earmarked and appropriated to it. If the deficit warrant must be discounted to be cashed, the tax agency is at a financial disadvantage to other state activities financed from special funds.

A second distinction is found in the fact that if the provision establishing a fee account does not provide for its disposition at the close of each fiscal year, the practice has been to allow the account to dissolve into the General Revenue Fund.<sup>47</sup> Under this arrangement fee accounts may increase as a part of, and be exhausted into, the General Revenue Fund each year. - One treatment of special funds under similar circumstances is to hold the unexpended portion of the allocation at the end of the year in the fund unless directed otherwise. For example, in the absence of a provision for the handling of the unexpended balance in the Natural and Casinghead Gas Audit Fund, the balance in the fund at the close of 1951 was held over into the following year.<sup>48</sup> These examples indicate that in several respects, tax earmarked money held in fee accounts is treated differently from money held in special enforcement funds.

<sup>46</sup> Comptroller of Public Accounts, Annual Report, 1951, Part I.

<sup>47</sup> An example of this practice is found in the natural gas tax, which makes no provision for the disposition of the unexpended portion of the account. Tex. Civ. Stat. (Vernon, 1948) art. 7047b, sec. 3.

<sup>48</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7047b, sec. 5.

To reveal some of the problems which have arisen from the use of both special enforcement funds and fee accounts, a description will be given of the various bases which determine amounts allocated for enforcement. For the fiscal year 1951, general law provided that a flat amount of \$10,000 should be allocated to the enforcement of the vending machine tax.<sup>49</sup> The appropriation bill for the same fiscal year provided that an additional \$6,000 be appropriated for the enforcement of occupation taxes collected "under the provisions of Article 7047 R.C.S."<sup>50</sup> The \$16,000 was placed in the Occupation and Vending Machine Tax Fund.

Allocations from taxes contributing to the Liquor Act Enforcement Fund are not based on a flat amount each fiscal year but rather on the amount provided in the biennial appropriation bill. Since the appropriation bill also determines expenditures from the fund, this basis largely avoids the problem of expenditures not matching allocations and of disposing of unappropriated surpluses within the enforcement fund.

The most common base from which to set allocations for enforcement funds has been to dedicate a percentage of total revenue from a tax. However, there is no uniformity in the tax statutes on the percentage to be allocated for enforcement. For instance, the oil tax enforcement account receives one-half of one per cent of the total collections from the oil tax, whereas the radio, cosmetics, and playing cards tax enforcement account receives two per cent of that tax's proceeds. In selecting the percentage for each tax, consideration is probably given to the approximate amount of revenue that the tax will raise and to the estimated cost of collection. If the percentage figure is not amended, allocations to the fund are determined each year by the amount collected from the tax. During recent years tax collections have risen rapidly. As a result, enforcement funds have often received more money than the appropriation authorized to be spent. The disposition of this surplus has presented a problem.

Apparently some statutes anticipated the problem of surpluses by directing that any balance in the fund was to be re-allocated. The Occupation and Vending Machine Tax Fund, which is given a flat amount, has a provision for re-allocation. The oil tax statute provides that the excess in the Oil Tax Enforcement Fund at the end of the fiscal year is to be allocated in the same proportions as the tax on oil is apportioned. Other statutes provide that the balance in the Motor Fuel Tax Enforcement Fund and the Cigarette Tax Enforcement Fund likewise revert in the same proportion as the balance of those taxes, but the re-allocation is postponed until the close of the biennium. However, no mention is made in the tax statutes of the procedure for distributing any surplus in the natural gas or the radio, cosmetics, and playing cards tax.<sup>51</sup> A different kind of problem might occur if the tax revenue of the state were drastically reduced and the allocation for enforcement would not meet the amount appropriated from the fund. No attention is given in the statutes to this possibility.

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<sup>49</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7047a-9.

<sup>50</sup> Acts. 51st Leg., R.S. 1949, ch. 615, sec. 1, p. 1208.

<sup>51</sup> See Audit Report, State Comptroller of Public Accounts, August 31, 1950,

As a specific example, the proportions by which the oil tax is prorated after the enforcement allocation is made are one-fourth to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund. Therefore, any surplus in the oil tax fee account should, by general law, be allocated in the same manner each August 31st. However, confusion has been caused in the handling of both fee accounts and special enforcement funds by conflicts between general law and appropriation acts. To use the oil tax fee account as an example again, the appropriation bill for the fiscal year 1951 provided that the Comptroller was to receive one-half of one per cent of oil tax collections, plus balances on hand August 31, 1949, and August 31, 1950.<sup>52</sup> A clear conflict exists with the general law, which stipulates that the surplus in the oil tax enforcement fund is to be distributed in the same way as net receipts from the tax. There are indications of many other conflicts between appropriation acts and general law concerning the handling of these enforcement funds. Although general law is held to be superior to appropriation bills,<sup>53</sup> there has still been some uncertainty, apparently, since in several instances provisions in the general law or the appropriation act have not been followed.<sup>54</sup>

The preceding discussion has brought out the widespread acceptance and use of tax enforcement and fee accounts, the revenues of which are derived from portions of the tax being collected. A review of the treatment given these funds and fee accounts and their operations during the fiscal year 1951 has uncovered a number of questions. Although the moneys deposited in special funds are not handled in the same manner as those placed in fee accounts, there appears to have been no clear decision as to which procedure is more desirable. There has also been no consistent administrative interpretation of the legislative intent in establishing funds or accounts. During the past eight or ten years tax collections have increased markedly. The result is that the allotment earmarked for enforcement accounts and funds has often exceeded appropriations, and surpluses of revenue have accumulated, particularly in the funds. In several instances no provision has been made in the statutes for the disposition of these surpluses. In other cases balances have not been re-apportioned as called for in the tax statute.

#### Tax Filing Fee Accounts

Filing fees are collected from store tax applicants and are deducted from motor fuel tax refunds. During 1951 each store tax application was accompanied

<sup>51</sup> (Concluded) pp. 35-37. The report recommends that appropriate action be taken for the disposition of the balance in these funds.

<sup>52</sup> Acts 51st Leg., R.S. 1949, ch. 615, sec. 1, p. 1208.

<sup>53</sup> Op. Tex. Atty. Gen. No. 0-4788 (Sept. 3, 1942).

<sup>54</sup> A description of the Comptroller's treatment of the oil tax fee account is given in the Audit Report, State Comptroller of Public Accounts, August 31st, 1950, p. 34.

by a 50-cent filing fee. The receipts from this fee were appropriated "for the purposes of defraying the cost of administration of this Act."<sup>55</sup> The motor fuel tax act provides that "the Comptroller shall deduct fifty cents from all such refunds as a filing fee . . . for the use and benefit of the Comptroller in the administration and enforcement of this Article."<sup>56</sup> During 1951 the store tax filing fees were applied to support the Store Tax Division of the Comptroller's office, while the motor fuel tax refund filing fees were appropriated to the Comptroller's motor fuel tax refund division. For that year the filing fees represented important sources of revenue for the two tax divisions.

The practice has been to hold these filing fees in fee accounts in the General Revenue Fund rather than in special funds of their own. The statutes make no provision for the distribution of unexpended balances remaining in these accounts at the close of the fiscal year.

### Tax Audit Funds

Several tax administrative divisions are partly financed from audit funds which receive revenue from audit charges made by field investigators and paid by delinquent taxpayers. General law provides that state tax enforcement officials engaged in collecting the cigarette, natural gas, and motor fuel taxes are permitted to make audit charges. For example, the motor fuel tax provides that if the tax has "not been properly remitted and paid to the State of Texas, the distributor shall pay as additional penalty any reasonable expenses incurred by the Comptroller in such audits."<sup>57</sup> The practice has been to deposit audit charges in special funds and to use these receipts for conducting other audits. No provision is made in general law for allocating the unexpended balances. Here the customary procedure has been to retain balances in the fund each year as directed by the appropriation act.

The Cigarette Tax Audit Fund helps support the cigarette and occupation tax division of the Comptroller's office. However, no receipts are shown for this fund during fiscal 1951; the fund showed a constant balance of \$52.45. The audit report of the Comptroller's office in 1950 reported that for the five-year period that the audit covered, there were no revenues from this source--the balance in the fund as of September, 1945, was \$52.45.<sup>58</sup> The motor fuel tax division of the Comptroller's office is partly supported by the Motor Fuel Tax Audit Fund, but like the Cigarette Tax Audit Fund, this fund has remained dormant over the past several years.<sup>59</sup> The Natural and Casinghead Gas Audit Fund actively supports the Gross Receipts Division of the Comptroller's office.

<sup>55</sup> Tex. Penal Code (Vernon, 1948) art. 1111d, sec. 2. The filing fee was increased to one dollar by the 52d Legislature. See Tex. Penal Code (Vernon, 1952 supp), art. 1111d, sec. 2 (c).

<sup>56</sup> Tex. Civ. Stat. (Vernon, 1948) art. 7065b-13, sec. (h).

<sup>57</sup> Tex. Civ. Stat. (Vernon, 1948), art. 7065b-3, sec. (c).

<sup>58</sup> Audit Report, State Comptroller of Public Accounts, August 31, 1950, p. 44.

<sup>59</sup> Ibid., p. 49.

During 1951 approximately \$4,000 was collected from audit charges paid by delinquent natural gas taxpayers. The fund contained a balance of \$22,486 at the end of the fiscal year. A substantial sum has been building up in this fund during recent years, for in 1945 its balance stood at \$3,122.

At the present time, natural gas producers are the only taxpayers assessed an audit charge when found delinquent. Other delinquent taxpayers are not charged this penalty. Several inequalities have apparently developed in the application of these charges. The general law provides that the cost of the audit is to be borne by the taxpayer, regardless of the amount of his delinquency. He may be \$1 or \$10,000 delinquent and be charged the same amount. On several occasions the cost of the audit has exceeded the amount of the delinquency.

### General Revenue Funds

Although most of the tax divisions within the Comptroller's office have enforcement accounts or special funds as sources of revenue for administrative expenses, the inheritance and ad valorem tax divisions do not. During 1951 these divisions were financed in the main from the General Revenue Fund. In addition, tax enforcement activities of the Board of Insurance Commissioners and the Secretary of State were financed from general revenue. Presumably other tax enforcement agencies or divisions would be financed in the same way if there were no special enforcement or audit funds and no special filing and tax fee accounts. Agencies and divisions financed from general revenue avoid the problems which have been described in regard to "these special funds and accounts." Although this approach to tax financing is the simplest, it has not been adopted in Texas nearly as frequently as the setting up of a special fund.

Several problem areas and a number of questions have appeared in this review of the methods currently used by the state in financing state tax administration. Since no uniform procedure is employed, it may be desirable to weigh the various approaches taken.

One of the most direct approaches now used to finance a tax administrative unit is exemplified by the inheritance tax division of the Comptroller's office. Expenditures of the division are provided in the biennial appropriation bill and are paid directly from the General Revenue Fund. No money is allocated from the tax to any particular enforcement fund. This method avoids the need of establishing a separate fund, estimating the percentage of the tax that will be sufficient to cover administrative expenses, determining what adjustment should be made in years when the allocation by per cent is more than sufficient to meet the allocation, and deciding the proper distribution of the surplus if accumulated.

However, if it were deemed advantageous to pay the expenses of enforcing a tax directly from the revenue produced by the tax, consideration might be given to a second approach, that used in meeting the cost of enforcing the liquor and

beer taxes. These taxes are administered primarily by the Liquor Control Board, which receives money to meet most administrative taxes it enforces. The amount of money allocated from the taxes is determined by biennial appropriation rather than from a percentage of the total taxes collected. Therefore, the amount of money allocated to the fund matches the amount which may be spent, thus avoiding the possibility of any serious surplus or deficit in the fund. This approach might involve establishing a central tax enforcement fund. The amount allocated from the taxes and the amount to be spent for enforcement would be determined by legislative action, with each tax contributing to that one fund. This approach would eliminate many of the present legal, administrative, and accounting difficulties and free from certain enforcement funds a considerable sum of money.

### Comparison of Approaches

Various approaches are presently in use in Texas for financing the cost of administering the state tax program. Payments made to counties and trade groups for their assistance have followed the same broad pattern. However, numerous financial techniques and sources of revenue contribute in meeting tax administrative costs incurred by state agencies.

Tax statutes provide the basis for determining commissions paid to county tax collectors and deductions paid to trade groups. These two groups receive their compensation from the tax before it is deposited in the State Treasury. This approach implies that no appropriation is necessary and therefore these payments are made without periodic attention being given to the question of whether the compensation exceeds or is less than actual costs. Since it has been estimated that approximately two-thirds of the cost of administering the state tax program is included in payments to counties and trade groups, this practice is widely accepted as an approach to financing tax administrative units and agents.

Several other methods of financing state tax administrative costs are presently in use in Texas. Tax administrative activities are supported through the use of tax enforcement funds, tax enforcement fee accounts, audit funds, and filing fees. Activities which are not financed through the use of one of these techniques are generally paid from general revenue. This latter approach avoids many of the problems involved in establishing and adjusting balances in these special funds and fee accounts.

## SECTION 4 -- TAX ADMINISTRATIVE STRUCTURE -- REORGANIZATION IN OTHER STATES AND TEXAS -- SOME PROBLEMS

In directing the study of taxation in Texas, H. C. R. 69 speaks in terms of "proposals for the overhauling of the Texas tax structure . . ." During recent years, numerous committees, commissions, and citizen groups throughout the country have outlined programs for studying reorganization of various units of government for establishing definite administrative responsibility and clearing lines of communication. This interest was demonstrated in the report made by the Hoover Commission on the federal government. Since then, numerous Little Hoover Commissions were named in several states to study reorganization plans on the state government level. This same type of interest in fiscal management, economy and efficiency, personnel, methods, and procedures was reflected on the state level in recent studies conducted by the Texas Economy Commission.

Although administrative reorganization has received considerable public attention in recent years, it is generally recognized that a reorganization plan alone will serve as no panacea. In fact, it is no guarantee of greater efficiency or economy unless it harnesses the natural forces that exist in the situation and puts them to work properly. There is a tendency on the part of some persons to want to solve any problem by reorganization. Others would belittle the necessity for any change and criticize reorganization proposals as theoretical, academic, and for practical purposes, unworkable. Both views are probably narrow.

Any reorganization should be approached in terms of (1) how the present arrangement was arrived at and some appreciation of its values, (2) the problems that exist and are attempted to be solved, and (3) the experience of others in like situations.

In the preceding sections and volumes, attention has been directed toward some of the administrative problems in Texas. For comparison, it might be helpful to look at how similar tax administrative problems have been approached in terms of reorganization in other states.

### Reorganization in Other States

Since 1900 the states of the union have moved further and further away from a heavy dependence on the general property tax. The property tax in Georgia, for example, yielded only six per cent of the state's revenue in 1948, compared to 62 per cent in 1900.<sup>60</sup> The Council of State Governments estimates that property taxes of the states accounted for less than four per cent of their tax collection in 1951.<sup>61</sup> Taxes on property have remained a basic type of tax in many states, of course. For the property tax, states have substituted such levied as those on sales or gross receipts, on motor fuel, and on personal and corporate income. The role of collector of these special taxes has often been retained by the state

<sup>60</sup> William M. Lester, Comparison of State Revenue Systems (Atlanta: Georgia Tax Revision Committee, 1948), p. 40.

<sup>61</sup> Council of State Governments, The Book of the States, 1952-1953 (Chicago, 1952), p. 211.

instead of being delegated to the counties or other local units, apparently on the grounds that the newer taxes were a kind that could be more effectively administered on the state level.

As a rule, states began by assigning these newer taxes on the basis of subject-matter. A tax was put in the hands of the agency that seemed most closely related to the thing taxes--liquor taxes became the responsibility of the liquor control board, motor vehicle taxes the province of the highway commission, and so on. As a consequence, the administration of state taxes came to be split among a number of agencies, sometimes as many as six or eight or more in one state.

Over the last three decades, the trend in tax administration among the states has been toward unification of the tax-collecting function -- toward bringing together into one department as far as practicable the work of tax collection. This movement in about half the states has taken the form of the creation of a department of revenue, headed either by a single official or by a small board.<sup>62</sup> Instead of being elected or serving ex-officio, the official and the board members have been made appointive in many cases, the appointing power being vested in the governor. The officer or board in charge of the department therefore is responsible to the governor.

Relatively few states have actually achieved complete or almost-complete consolidation of their tax administration. Rather, they have typically reduced the number of agencies concerned from five or six to two or three. By mid-1951, 12 states had succeeded in committing to one agency the collection of their major taxes, as compared to nine such states in 1947.<sup>63</sup> More than half the states in 1951 used either one or two agencies. Recent studies in five states -- Nebraska, Oregon, Maryland, Minnesota, and California -- recommended that those states move in the direction of greater unification by establishing departments of revenue.<sup>64</sup>

Kentucky is one of the states to reorganize its tax administration into a department of revenue in charge of a single commissioner named by the governor.<sup>65</sup> It had replaced its State Boards of Equalization and of Valuation and Assessment in 1917 with a state tax commission. Then, in 1936, it took the further step of substituting for its tax commission a department with one administrative head. The Department of Revenue, which collects about 95% of the state's taxes, is composed of seven divisions. Four of them -- income taxation, property taxation, excises, and local relations -- are operating divisions, and three -- field, service, and research -- are staff divisions. The field division maintains nine field offices around the state. The organizational pattern of the department is pictured in Chart III-14. Some taxes, notably those on motor transportation, insurance premiums, and alcoholic beverages, still lie outside the revenue department.

<sup>62</sup> W. Brooke Graves, Public Administration in a Democratic Society (Boston: D. C. Heath, 1950), p. 283.

<sup>63</sup> Council of State Governments, Book of the States, 1952-1953 (Chicago, 1952), p. 162.

<sup>64</sup> Ibid., pp. 161-162.

<sup>65</sup> Legislative Research Commission, Taxation: The Over-all Picture (Frankfort, Kentucky: 1951), p. 11.



The experience of New York parallels that of Kentucky in several respects. New York's loosely-knit State Board of Tax Commissioners developed into a State Tax Department in 1915. A further administrative reform was adopted in 1921 when the collection of four more major taxes (inheritance, personal income, stock transfer, and motor vehicle) was transferred to the tax department. It was at this time that New York accepted the principle of a single-executive head in place of a commission form of management.<sup>66</sup> The three-member tax commission was retained but without administrative authority. Since 1926, tax revenues have been handled by the Division of Taxation in the combined Department of Taxation and Finance. The division receives 12 of the state's taxes. Within it are four bureaus -- the Corporation Tax Bureau, Income Tax Bureau, Truck Mileage Tax Bureau, and Miscellaneous Tax Bureau -- each in charge of a deputy tax commissioner. Service bureaus for the whole department include those concerned with administration, law, research and statistics, and special investigations.

Other states have taken steps toward unification. Missouri organized its department of revenue in 1946. The next year Indiana instituted a thorough reorganization of its tax collecting, consolidating into a department of revenue the previous agencies charged with tax administration. An ex-officio board selects the administrative head of the department.<sup>67</sup> Ohio in 1947 overhauled its division of sales and excises, grouping into three sections -- audit and assessment, compliance, and excise -- work that had formerly been carried on in 18 sections.<sup>68</sup>

#### Recent Proposals for Reorganization in Texas

In 1933, the report of the Joint Legislative Committee on Organization and Economy on the government of Texas, sometimes known as the Griffenhagen Report, set forth a suggested plan of reorganization for the state's fiscal agencies. The report recommended that a department of revenue and taxation be set up, in which there would be a division of collections and a division of receipts, among others. The division of receipts would take care of non-tax income of the state, taking over the function of the existing central cashier division in the Comptroller's Office. The report advocated further that the State Tax Board be abolished and a new one formed that would be made up of three members appointed by the governor for six-year overlapping terms. The governor would also appoint the

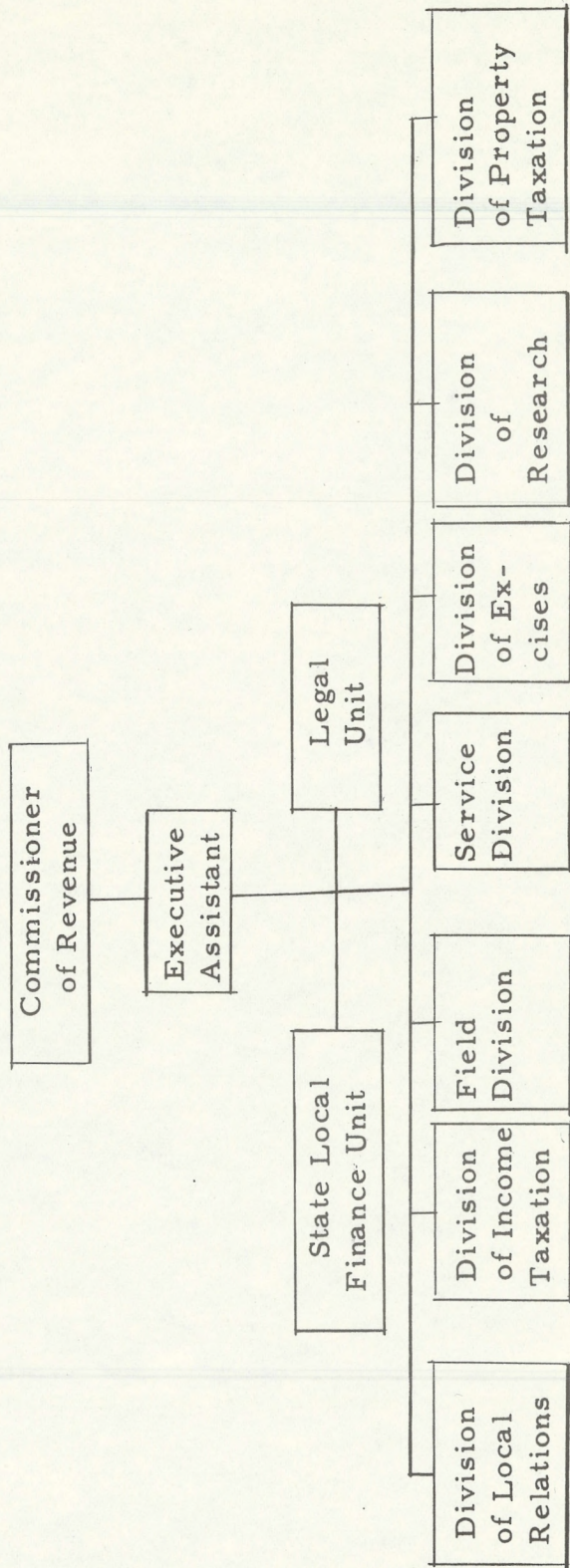
<sup>66</sup> State Tax Commission, The New York State and Local Tax System (Albany, 1951), p. 25.

<sup>67</sup> Federation of Tax Administrators, "Recent Trends in State Finance" (Chicago, 1948), p. 15.

<sup>68</sup> Ibid.

Chart III-14

Kentucky Department of Revenue



Commissioner of Taxation from a list of nominees submitted to him by the new State Tax Board. The tax board itself would help in formulating policy and would act in a quasi-judicial capacity by hearing appeals on tax assessments. The Department of Taxation and Revenue would be divided into a Bureau of the Treasury and a Bureau of Taxation. The taxation bureau, in turn, would be organized into divisions of administration, taxation, motor vehicle registration, inheritance taxes, franchise taxes, gross receipts taxes, tobacco sales and occupation taxes, and local government.<sup>69</sup>

The State Auditor, in a report of 1945, observed that a reorganization of the tax divisions within the Comptroller's Office might well secure more efficient operation. The 1945 audit report put forward a tentative plan designed to place the existing tax divisions more directly under one head in the interests of gaining greater uniformity in tax enforcement and administration policies. Another suggested step was to pull together all licensing and accounting functions, instead of having them performed in each division as was then done.<sup>70</sup> The Auditor's Report on the State Comptroller of August 31, 1950, repeated this observation. It also expressed the opinion "that the tax collection and enforcement duties now performed by the Comptroller and several smaller departments and agencies of the state should be placed under a separate State Department of Taxation with a head or director appointed either by the Governor or in some manner by the Legislature."<sup>71</sup> This same idea of reorganization was recently expressed by the Auditor concerning administration of the franchise tax, which is now administered by the Franchise Tax Division of the Secretary of State's office.<sup>72</sup>

### Reasons for and Objections to an Integrated Tax Agency

Previous studies in other states and comments made by the State Auditor indicated that most of the reorganization discussion is in terms of an integrated tax agency. The purpose of integration is to establish central responsibility for tax administration in one administrative unit. As shown in Chart III-1, several state agencies are responsible for administering the tax program in Texas. Arguments can be presented for both centralized and decentralized approaches.

Arguments in favor of separate tax administrations may include: On a short-term basis, immediate expenses may be less when the agency regulating

69 Joint Legislative Committee on Organization and Economy, The Government of the State of Texas, Part II--Financial Administration; the Fiscal Agencies (Austin: Von Boeckmann-Jones Co., 1933), pp. 90-91, 127.

70 State Auditor, Audit Report, State Comptroller of Public Accounts, August 31, 1950, pp. 3-4.

71 Ibid., p. 4.

72 Audit Report of the Secretary of State, August 31, 1950, p. 35.

the tax industry is also given tax responsibility. Another advantage could result from the specialized approach of regulatory agencies. This permits several tax administrators to work directly with the people concerned and without restraints imposed by the broader scopes of control. This also permits each tax administrative program to stand alone, and deficiencies in one may not affect the smooth operation of another.

The advantages listed for an integrated tax administrative function are the following: Responsibility for administration of entire tax program is clearly fixed and defined. Under these conditions, authority commensurate with responsibility could be assigned so that accountability for decisions could be definitely established. This approach also provides the opportunity for close co-ordination of field personnel by placing this activity under direction of a single organization plan. This would make possible mobility of field personnel. An integrated program would also promote consistent policies and interpretations of tax administrators.

### Problem Areas

Regardless of whether reorganization is considered important or necessary, some administrative problem areas are evident in surveying the tax program in Texas. These problems areas should be considered in any extensive reorganization program, but they could also receive attention, even within the present tax administrative arrangement. Since this study has not involved a study of financial management nor an investigation of administrative methods, procedures, and personnel, these problems have not received concentrated attention. Additional study would be required to crystallize the problem areas and offer suggested approaches to their solution.

Apparently a number of these problems result from statutory inadequacy. No attempt has been made to weigh the importance of these problems, and they are only listed to point out possible areas of organizational concern.

### Tax Interpretation

In practice, tax interpretations are given by the courts, the Attorney General, the State Auditor, and tax administrators. Court records, opinions of the Attorney General, and audit reports contain holdings, opinions, recommendations, and comments concerning tax interpretation. In addition, there are instances when this responsibility has been placed upon or left to tax field collectors or auditors and even to taxpayers. No clear responsibility is fixed in the area of tax interpretation, and a certain amount of uncertainty and confusion is not surprising.

## Rules and Regulations

There has been no established practice of issuing and recording rules and regulations concerning tax policy questions. Although a practice of issuing rules for each tax from each tax division or administrative agency might be developed, there is no uniform practice. These rules and regulations could furnish the basis for consistent policy in areas where the statutes apparently leave decisions to tax administrators. The practices concerning record keeping and exemptions could be published; but this information is not now issued nor is it gathered in one place for convenient dissemination.

## Communication for Compliance

There is no state-wide approach to maintaining communication with taxpayers and helping them comply with tax statutes. No consistent method is used for disseminating interpretations of tax statutes by the courts, the Attorney General, and tax administrators. The seriousness of enforcement problems in some areas could possibly be alleviated by an effective program for communicating such interpretive material.

## Interchange of Information and Consistency of Policy Among Tax Administrators

There is lack of information exchange and consistent policy not only among the various engaged in tax administration but among tax divisions within the Comptroller's Office, which often act independently in tax administration. There is no consistent policy concerning opinions of the Attorney General. One administrator may ask questions as they arise in his work, while another may not question the meaning of the statutes or interpretations by the Attorney General. Policies concerning public relations also vary distinctly among agencies. Some agencies inform taxpayers of their exemptions on report forms and others do not. Some taxpayers receive refunds for overpayments and others do not. Enforcement policies also differ in that some taxes are enforced stringently.

## Tax Research and Modern Methods and Procedures

Although the State Tax Board has authority to study the state tax system and conduct research on problems, there is no apparent activity in this field. This type of program requires a specialized staff, and considerable time might be required. Such a program need not be restricted to tax research but might also include studies in connection with simplified work methods and procedures.

## Field Supervision

Some tax administrative agencies and divisions apparently have different concepts of the purposes of field personnel. Field representatives could function either as collectors, compliance officers, or investigators. Field personnel are used in different capacities among the state agencies and divisions. Differences also arise concerning deployment of field personnel and field offices. The approaches to instructing new field personnel in methods of communication also vary.

## Administrative Audits and Legal Assistance

The State Auditor reviews activities of all tax administrators, and the Attorney General is responsible for offering legal assistance. These services and aids have, in some instances, offered different interpretations on the same administrative activity. For example, the Attorney General has given a letter opinion approving an administrative policy questioned by the State Auditor. This poses an administrative problem. In some instances, the Auditor checks taxpayers' records extensively, as in the franchise tax. In reviewing other agencies, only an audit of office records is made. In contrast to both of these practices, types of spot checks are occasionally made of individual taxpayers. The policy of the Auditor has been to make revenue audits only when something unusual or questionable has arisen. Example can be given, as in the franchise tax, where the fact of an audit, or even the threat of one, has increased taxpayer compliance. This revenue audit is to be contrasted with the general collection audit. The former would also serve as a check on the effectiveness of the collection and enforcement operation.

## Legislative Possibilities

Regardless of whether any over-all reorganization program is adopted, these problem areas need legislative attention. There is a wide range within which these problems can be approached, to give such legislative attention. At least three approaches are as follows:

1. The creation of a single tax administrative agency would require substantial additional study to establish it initially upon a sound basis. This approach would require shifting several taxes from present administrative agencies to the new tax agency. In addition, organizational and personnel problems involved in such a move would be sizable. Some state officials have expressed views that such a transfer would possibly necessitate a constitutional amendment. It is generally thought that this approach would require considerable time and study. However, many reorganizational surveys such as the Hoover Commission and the Connecticut Reorganization Commission have pointed most favorably to the consolidation of all tax administrative responsibilities in one agency.

2. A second possible approach might require no reorganization. This could involve legislative attention primarily on encouraging more effective and efficient work within the present administrative structure. An examination of these problems in terms of each agency and interagency relationship would be necessary.

3. A third approach, which might be classified as falling between the first and second, would involve primarily a revitalization of the State Tax Board, which is delegated considerable authority in the statutes. The board is given the authority: (1) to make rules and regulations to execute purposes of the board effectively, (2) to examine books and to interrogate persons under oath for securing compliance of the tax laws, (3) to study revenue laws of other states and countries and recommend to the Legislature changes or modification of the laws, and (4) to report to the Legislature each regular session.

These powers also include investigating and aiding counties in enforcement revenue laws. Apparently, particular interest was given the property tax.<sup>73</sup>

The board is composed of the Comptroller of Public Accounts, the Secretary of State, and the Attorney General. The Comptroller is Tax Commissioner of the ex-officio board. Although this authority has been used in some instances, it is generally recognized that the board has not exercised its full potential. It appears that the Comptroller generally has authority to fulfill his responsibilities without the additional support of being Tax Commissioner, and it has proved unlikely that his interest will extend to the responsibilities of other tax administrators.

Some changes in the board and its program might solve many of the problems listed above, or at least set in motion the machinery which would bring about solutions.

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73 Tex. Civ. Stat. (Vernon, 1948) arts. 7098, 7098a, 7099, 7100, 7101, 7102, 7103, 7104, 7106, and 7106b.

## CHAPTER IV

### TAX STRUCTURE IN TERMS OF ECONOMIC BASE

This chapter has as its orientation the economic base of Texas taxes, as distinguished from legal, revenue, earmarking, and administrative surveys which precede it. The economic base necessarily rests upon taxpayers, and various techniques have been devised as approaches for measuring this base. There is wide interest in this general area among taxpayers, legislators, and various groups. Research bodies in a number of other states have recently attempted various approaches to analysis of taxation in terms of actual and possible revenue sources and the problems of weighing and selecting sources in formulating a tax system. Concern for this area appears also to be implicit in H. C. R. 69, 52d Legislature. The resolution refers to inequalities within the present tax structure and directs the Legislative Council to search for a "sound system of taxation designed . . . to eliminate any inequalities found under existing laws."

This study has as its purpose investigation of the problems involved in approaches which might be useful in understanding of the economic tax base in terms of inequalities and a sound tax system. One of the problems involved in this search -- and perhaps one of the most important -- is the fact that at present, sufficient information is not available to conduct a thorough study of the economic base of the tax structure. Although a sample of this type of information has been gathered and published in A Survey of Taxation in Texas: Part I--Comparative Tax Revenue Analysis--Texas and Selected States, the bulk of such material is either not available or is not presently being gathered by the state. Many problems are involved in developing reliable information for making a realistic appraisal of this broad field. The problems range from the divergence of economic theories of the purposes and effects of taxation to difficulties in procuring accurate data in a dynamic economy. One indication of the magnitude of these difficulties is the absence, despite considerable research activity in the field, of discussions which purport to be comprehensive.

One approach to the study of the economic base of the Texas tax structure would seem to divide the study into two areas:

- I. One area might involve primarily the question of inequities in the tax base in terms of an examination of who pays the tax initially and finally and an attempt to determine the amount of taxes paid by various segments of the economy. The question further implies an examination of the relative burden of taxation on taxpayers or groups of taxpayers who are similarly situated. This would provide data from which analysis could be made of the equity of the tax structure.



II. A second study area might be concerned with the broader question of the soundness of the economic base from other viewpoints, such as its stability or flexibility. This chapter attempts to explore in some detail what would be involved in this approach. Each of the two general areas is discussed in terms of (1) the information now available, (2) some further information which might be developed and the problems and methods of developing it, and (3) the value of the information and limitations on its use in an over-all study. No suggestion is intended that this approach would exhaust the subject matter.

It is hoped that this will convey a concept of the extreme complexity of this aspect of taxation. The magnitude of the project of collecting economic data and the scarcity of current information is emphasized. Furthermore, no assurance is given that, even gathering a substantial amount of data, specific answers to these questions will follow directly. In discussing both approaches to understanding the economic base of the tax structure, an oversimplification has been used for clarity and ease of understanding.

## SECTION I--EQUITIES OF THE TAX BURDEN

The suggested approach for considering inequities in the economic tax base first involves studying techniques for determining who pays the tax. After some attention to the problems involved and the approaches to this question, a means of examining the relative burden of different types of tax-payers can be considered. This general approach implies that the question cannot be answered now for several reasons. At present, there is insufficient data available to conduct a thorough study of the questions of who pays the tax and the relative tax burden. A comprehensive study of this type involves surveying economic data over a period of years. Moreover, other difficulties are involved. The relative weight given the criteria selected would be a value-judgment. Since different weights could reasonably be assigned by different persons, it is apparent that absolute results are not possible.

The question of tax burden has been of continuous interest to economists. For this study, tax burden is considered from two viewpoints. First, initial burden or the impact of a tax falls on persons initially paying money to the state. Second, ultimate burden is concerned with what might be considered the final resting place of a tax. Tax burden will first be considered in terms of initial burden.

### Initial Burden

It would seem that determining the initial burden of the Texas tax system would involve listing taxes found in the statutes and classifying the persons and groups on which they are levied.

As has been pointed out, the most complete picture now available of the

sources of tax revenue of the state of Texas is to be found in Part I of this survey.<sup>1</sup> This material provides a starting point from which further study may be made. That survey contains some breakdown of the economy. It also contains an analysis of revenues by source and class of tax. It does not, however, attempt presentation of either of these two types of information in a correlated form. Such a correlation would seem essential if the approach is to provide data from which analysis of the equity of the tax system may be made. Since equity of economic burden means essentially equality of burden on taxpayers in similar circumstances, the methodology should be to show the tax burden on the classes of taxpayers comprising the basis of the Texas tax structure. There are several possible ways in which taxpayers may be classified. The main guide in devising a system should be the rule of reasonable classification. The following method of classification is but one of several which might be based on a system of reasonable classification. It is used only to illustrate the possibility of acquiring more meaningful information on the tax structure by a definite breakdown of the various classes of taxpayers. A logical beginning would be to start with general classifications and by constant refining break down the general classifications into specific ones. This method produces a simple arrangement of the various groups comprising the bases of the tax structure.

Taking the tax structure as a whole, taxpayers may be divided into two broad classifications -- businesses and individuals. By business is meant (1) the business entities rather than the natural persons concerned in them and (2) economic activities or occupations of different types, constituting the callings of men. Applying these two rules of thumb, various tax bases may be separated into these main classifications. Business may be further broken down by classes of business activity as follows:<sup>2</sup>

- Agriculture
- Mining
- Manufacturing
- Transportation
- Communications
- Contract Construction
- Public Utilities
- Wholesale Trade
- Retail Trade
- Finance, Insurance, and Real Estate
- Services

<sup>1</sup> Staff Research Report No. 51-3 (1950).

<sup>2</sup> The method of classification is based on that used by the Office of Business Economics, U.S. Department of Commerce, with modifications to make certain classifications more applicable for Texas.

Each of these classes is subject to further refinement. (Since the purpose at this point is only to outline a proposed method, no attempt is made to break down all the classes further. A sample breakdown is given to illustrate the method.) Manufacturing, for example, could be subdivided into the following classifications.

- Food and kindred products
- Tobacco manufacturers
- Textile-mill products
- Apparel and other finished fabric products
- Lumber and timber basic products
- Furniture and finished lumber products
- Paper and allied products
- Printing, publishing, and allied industries
- Chemicals and allied products
- Products of petroleum
- Rubber products
- Leather and leather products
- Stone, clay, and glass products
- Iron and steel and their products
- Non-ferrous metals and their products
- Machinery, except electrical
- Electric machinery
- Transportation equipment except automobiles
- Automobiles and automotive equipment,
- Miscellaneous

Sub-classification in some instances may be dictated by particular types of Texas taxes. For example, in addition to classifying retail trade by types, a classification should be set up to show the burden of the chain store tax. Such a classification might proceed along the following lines.

- One-unit retail enterprises
- Two-unit retail enterprises
- Three-unit retail enterprises, etc.

A similar breakdown could be made for each of the other classes of economic activity. The refining process does not end at this point, for each division can be broken down further. For illustration, a further breakdown of "Food and kindred products" could be:

- Food and Kindred Products
  - Meat products
  - Dairy products
  - Canning, preserving, and freezing
  - Grain mill products
  - Miscellaneous food preparations

Again, each product is subject to further classification, such as:

Grain Mill Products

- Flour and meal
- Prepared animal feeds
- Rice cleaning and polishing
- Blended and prepared flour

Using the refinement process on all the classes would provide a complete classification of every phase of economic activity in Texas.

Classification of Individual Taxpayers

Here again, the over-all objective requires that the broad class of individual taxpayers be divided into more homogeneous groups. This classification will differ from that for business taxpayers. All taxes not levied on business, as defined, are considered taxes on individuals, but individuals are taxed in various capacities. He may be taxed as a consumer.<sup>3</sup> He may also be liable for a personal tax.<sup>4</sup> These factors will condition classifications of individual taxpayers.

Since personal taxes fall on specific individuals, a meaningful classification would be by income groups, separated by a standard increment.<sup>5</sup> This would be the best method of illustrating the burden of the inheritance tax. But for other personal taxes, such as the poll tax and various licenses on persons in non-business capacities, it would be difficult to allocate the burden to income groups, since taxes are not levied on income. No information is available to show to what income groups such taxpayers belong. In such cases, the most that can be concluded without an extensive survey of individual taxpayers is that persons who pay poll taxes or buy hunting and fishing licenses or drivers' licenses (in a non-business capacity) each constitute separate classes of taxpayers.

These methods could provide a classification system which would cover the phases of business activity in Texas and define, as far as practical, major classes of individual taxpayers.

<sup>3</sup> The motor fuel tax may be such a tax.

<sup>4</sup> Poll tax and inheritance tax.

<sup>5</sup> The choice of a range for the various groups could be that considered most desirable for providing the information desired; i. e., it might show the burden on incomes within ranges of \$1,000 or it might show burden on income ranges of \$2,000.

The next step would be to allocate to the appropriate classes of taxpayers the total amount of state taxes paid by each class. In the allocation of tax payments, it would be necessary to separate payments of incorporated and unincorporated enterprises because of the corporation taxes.

Several major problems which need to be faced in the allotment process. One of these is, again, the magnitude of the project. The following statistics, which do not cover the entire range of business activity in Texas completely, are indicative of the problem:

<u>Type of Enterprise</u>	<u>Number</u> <sup>6</sup>
Farms	331,567 (1950)
Manufacturing Firms	10,256 (1952)
Retail Firms	90,674 (1948)
Wholesale Firms	11,558 (1948)
Service Firms	28,724 (1948)

The ad valorem tax presents another problem in the allocation to various classes of taxpayers. This problem arises because no present method of reporting provides information necessary for valid allocation of the tax. It is not known how much of the tax assessed is paid by the different classes of business enterprise and how much is paid by individuals in a non-business capacity. Information pertaining to personal property is also such that it cannot serve as a basis of allocation. Under present circumstances, it might be possible to secure information on the ad valorem tax payments of corporations in the state from the franchise tax reports. For similar information on unincorporated business enterprises, however, it would be necessary to investigate the tax rolls of the 254 counties or use questionnaires.

The motor fuel tax presents a somewhat similar problem. It constitutes a burden on some forms of business activities, such as the various types of commercial motor transportation. On the basis of annual reports of gasoline consumption to the Texas Railroad Commission by motor bus and motor freight operators, an allocation of the tax could be made to these enterprises. For the burden on other forms of enterprise, some method of allocation has yet to be devised.

No doubt other problems of this kind would arise in undertaking a study of this area. The extent to which it is possible to solve them will, of course, affect the usefulness of the data collected.

<sup>6</sup> These are taken from Bureau of the Census, Texas Directory of Manufacturers, and Census of Business.

## Ultimate Burden

Although several problems were mentioned in connection with establishing a system of classifying taxpayers and gathering information necessary to study initial tax burden, a study of ultimate burden appears even more difficult--and conceivably impossible. Although economists generally agree that under certain conditions taxes are passed on or shifted and that the ultimate tax burden does not always fall on persons initially paying the tax, there is very little generally-accepted factual data on the shifting of taxes. There is much theoretical discussion, some of which is sharply conflicting. Since the concepts tend, on occasion, to be abstruse, it might be helpful to describe several ways in which shifting may take place.

### Shifting Forward

This form of shifting occurs when the taxpayer bearing the impact adds the amount of the tax to the price of the goods or services he is selling. This is probably the most recognized form of shifting. An illustration is the Texas motor fuel tax, which is paid to the state by the distributor but must be added to the selling price of the fuel. The tax is thereby shifted forward to the consumer.

### Shifting Backward

When a tax burden is passed back to the factors of production, the process is called backward shifting.<sup>7</sup> A manufacturer can shift the burden back on one or more of the factors of production in the form of lower prices for the goods and services he purchases. These two types of shifting are said to occur when a tax is considered to be placed on the stream of commerce--i. e., the flow of goods from raw material to ultimate consumer.<sup>8</sup>

### Problems of Determining Ultimate Burden

Consideration of the theories of shifting makes it apparent that objectivity would demand differentiation between the taxpayer who bears the initial impact of a tax and a taxpayer who bears ultimate burden. Identification of the persons who bear the incidence of the Texas taxes and measurement of the amount would be useful information in a study of tax structure. For determining the relative burden on different taxpayers and classes of taxpayers, the best information would seem to be the ultimate taxes they pay measured in definite monetary amounts.

<sup>7</sup> Rent, wages, and raw materials are often considered factors of production.

<sup>8</sup> William H. Anderson, Taxation and the American Economy (New York: Prentice-Hall, Inc., 1951), p. 77.

Although a knowledge of ultimate tax burden would be significant, the possibility of determining this information accurately might be seriously questioned.

There would apparently be less difficulty in ascertaining ultimate burden for some taxes than for others. The less difficult taxes would be those in which the initial tax impact and ultimate burden appear to be similar. Examples are the poll tax and the inheritance tax.

To attempt to ascertain the ultimate burden of taxes which could be shifted, a possible approach would be to investigate the tax, beginning at the point of its initial impact. Through detailed examination of the transactions of the impact taxpayer, an attempt could be made to determine (1) whether the tax was shifted, (2) the persons to whom it was shifted, and (3) the amount of the tax shifted. Following this pattern for each of the persons or entities affected, an attempt could be made to trace the tax to the person or persons bearing the ultimate burden. Apparently, no means short of this detailed examination could yield any information of value. There are several reasons why information gained by detailed investigation may be questioned.

The shifting process will be influenced by conditions of supply and demand in the particular market place where a shift might take place. That is, the economic conditions in one market place might be such as to allow one person to shift all the initial burden of a particular tax, while another person in a different market place might not be able to shift any of the same tax. A hypothetical example of this situation follows:

States A and B adjoin. Located partly within each is city Y. One hundred miles from the border in state B is another city, X. State B places a tax of 3 cents per gallon on the retail seller of gasoline. State A has no tax on gasoline. Following the assumption that the dealers in state B, acting to their economic self-interest, will attempt to shift the burden of the tax to the motorists who purchase gasoline, it would be logical to expect that the dealers in city X will have greater opportunity to shift the tax than dealers in city Y, who have to compete with untaxed gasoline. Thus it would not be possible to make valid assumptions as to whether a particular tax is shifted, where, and to what degree unless consideration is given to variations which might be caused by any one of a number of factors in various market places.

The time element must also be considered in attempting to investigate shifting. The process of shifting may be carried on by devious routes and over a long period of time. Here again, valid assumptions could not be drawn unless a survey covered a time sufficient to allow for completion of shifting--perhaps several years.

The extreme difficulty of tracing shifting when a variety of possibilities are present is another problem. An illustration is a hypothetical case of a corporation operating a chain of 30 grocery stores, each store handling many different products and operating in a different section of the state. Assuming that the corporation would seek to shift the burden of its state taxes, its opportunities would be numerous. It might distribute the amount of burden to the various stores to be passed off in higher prices in proportion to the degree of competition each store faced. It might distribute the burden among products sold in proportion to the demand for each product. It might shift the burden backward to employees or to the suppliers of products in the form of lower wages or prices. Since, in practice, it is probable that the corporation would add the taxes to costs of operation and attempt to fix its selling prices and lower its costs to a level which would yield a profit, all these forms of shifting might play a part. Tracing shifting under these circumstances would be a difficult and perhaps unrewarding task.

Despite the extreme difficulties, some attempts at empirical research have been made to determine the ultimate burden of particular taxes. Otto von Mering<sup>9</sup> cites the following results of some studies of narrow scope which were undertaken in Europe.

E. Laspeyres seems to have been similarly successful in verifying the shifting processes of certain taxes under particular conditions. After an extremely exact study, extending over a period of twenty years, of the effects of abolishing the Prussian milling and slaughtering taxes he found that bread prices fell only in towns where the tax had existed, that the prices of other articles did not fall, and that the price of bread fell only at the time of abolition and not at other times. It seemed therefore that he was completely justified in drawing the conclusion that the tax was borne by the consumer and that the latter was thus benefited by repeal.

Strangely enough doubt has been raised concerning this seemingly incontestable result by other statistical enquiries. Thus S. Schott, on the basis of his own statistical studies, came to the conclusion that abolition of a milling tax would be of more than temporary advantage to the consumers if, (a) the tax were sufficiently large for a change in the retail price of bread to be expressed in full pfennigs, and (b) at the same time competition among producers of the finished flour is effective in preventing monopolistic exploitation of the lifting of the tax.

G. Hellwig, whose researches were comparable to Laspeyres in thoroughness if not in methodology, arrived at

<sup>9</sup> Otto von Mering, The Shifting and Incidence of Taxation (Philadelphia: The Blakeston Company, 1942).



the conclusion that the abolition of the octroi on flour and bread collected by certain Hessian towns did not result in a permanently lower level of prices and that the producers and merchants, not the consumers, had benefited from this abolition.<sup>10</sup>

Von Mering also cites the results of a survey undertaken in this country by Robert M. Haig and Carl Shoup as to the effects of a sales tax.<sup>11</sup>

The enquiry was carefully elaborated on the basis of questionnaires filled out by the taxed dealers and manufacturers in various states. But the authors themselves are well aware of the fact that the conclusions at which they arrived are not final. They rightly point out that price levels are subject to a variety of forces and that it had not been possible in their investigation to isolate the effect of the sales tax and trace its share, if any, in the price fluctuations. The questioned individuals may inadvertently or even purposely have given incorrect statements concerning their actions in regard to their price policies; and it is likely that in many instances they believed that certain actions had resulted in shifting the tax, whereas larger net profits might have been obtained had no tax been levied. Or the price increases made "because" of the tax might in fact have been made even if no tax had been imposed. The faith in the reliability of the conclusions is further weakened by the fact that the answers given by the dealers and manufacturers show an extraordinary degree of variation.<sup>12</sup>

From a consideration of the difficulties inherent in any attempt to ascertain the ultimate tax burden, it is reasonable to assume that it would be impractical, if not impossible, to secure quantitative information within a reasonable period of time. What has been said should not be construed to mean that there is no validity to the theory of shifting. No consideration of the burden of taxation would be complete without some recognition of the shifting process. But the theory and empirical research methods based on shifting have not reached a point of substantial usefulness in measuring ultimate tax burden.

<sup>10</sup> Ibid., p. 8.

<sup>11</sup> The Sales Tax in American States (New York, 1934).

<sup>12</sup> Ibid., pp. 8-9.

## Relative Tax Burdens

This section discusses the methods by which the relative economic burden of taxes on the various classes of taxpayers may be measured objectively. It also mentions some of the problems involved in such a determination. The purpose of such a study would be to provide information from which judgments could be made as to the equity of the tax structure. An interest in whether the tax burden is equitable apparently stems from the Texas Constitution, which provides that "taxes shall be equal and uniform . . ." <sup>13</sup>

It is generally recognized that all taxpayers are not in equal circumstances and that equal taxation of unequal circumstances would not be a valid application of the principle of equal and uniform taxes. It is generally accepted that equity may be more nearly satisfied if taxpayers in similar circumstances are treated equally. The United States Supreme Court has recognized this principle in its development of the doctrine of reasonable classification. Decisions of that court have sanctioned any classification which has a reasonable relation to some permitted end of governmental action. It would be enough, for example, if the classification is reasonably founded in the purposes and policy of taxation. <sup>14</sup> An expression of this concept of reasonable classification is found in a section of the Texas Constitution which states that "all occupation taxes shall be equal and uniform upon the same class of subjects within the limits of the authority levying the tax." <sup>15</sup> (emphasis added)

From a legal viewpoint, a tax which was uniform and equal on taxpayers falling within classifications which have no relationship to the economic circumstances of those within the class might nevertheless be considered to have conformed to the principle of equity. But from an economic viewpoint, this same tax might be considered inequitable in that the economic abilities of the class of taxpayers on whom it is levied may vary considerably. The poll tax, for example, would be considered equitable from a legal point of view. However, considering the economic burdens it places on a taxpayer with \$1,000 income and one with \$100,000 income, the tax may be considered to place a relatively unequal burden on the two taxpayers from the economic viewpoint in the sense that they are not in similar circumstances in terms of wealth.

### Measurement of Relative Burden

From the discussion of shifting, the conclusion seems inevitable that it is not, under present conditions, feasible to obtain this information concerning the ultimate tax burden. It may be possible to obtain such information as it

<sup>13</sup> Tex. Const., Art. VIII, sec. 1.

<sup>14</sup> William Anderson, op. cit., p. 51. This was enunciated in Heisler v. Thomas Colliery Co., 260 US 245 (1922).

<sup>15</sup> Tex. Const., Art. VIII, sec. 2.

relates to the initial burden placed upon taxpayers. Considering what has been said about shifting, there may be some doubt as to the value of such measurement. While a quantitative measurement in terms of ultimate burden might be more informative, information developed about initial statutory burden would also provide a source of meaningful data.

This discussion assumes that the process of meaningfully identifying the classes of taxpayers and the amount of their initial tax burden has been carried out by some method comparable to that outlined in previous discussion. The next step in a possible methodology is to ascertain by some standard measurement the relative economic burden on the various classes of taxpayers. Since the relative initial economic burden, insofar as it could be ascertained for various income groups, would be self-evident, what follows will be a consideration of a possible methodology for determining the equity of the tax burden as it applies to various classes of business enterprise. In considering business burdens, one possible method to test for the equity of economic burden is known as the "alternative tax system." In brief, this system seeks to compare the taxes paid by one taxpayer or class with those which he would pay if taxed under the institutions applicable to another taxpayer, or to compare the actual tax payments of two or more taxpayers with the payments each would make under some hypothetical tax system.<sup>16</sup>

The method of comparing the actual tax payments of two or more taxpayers with the payments they would make under such a hypothetical system might be one method of measuring the economic equity of the Texas tax structure. Use of this method would necessitate the setting up of a model system of taxation,<sup>17</sup> against which the actual burden could be measured. Assuming that general agreement could be reached as to what constitutes a model tax system, the next step would be to compare the actual tax payments of the subjects of comparison with the payments they would make under the model system. Those whose tax payments were greater than what they would be under the model system could be considered relatively overburdened. Those whose tax payments were less than they would be under the model system could be considered to be relatively underburdened.

<sup>16</sup> Carrier Taxation, House Document 160, 79th Congress, 1st Session, pp. 352-353.

<sup>17</sup> Several theoretical "model systems" have been formulated by various groups interested in the field of taxation, especially the Committee on State and Local Taxation of the National Tax Association. See Proceedings of the National Tax Conference, vol. 12 (1919), pp. 426-470; vol. 26 (1933), pp. 353-420.

Another possible method of measuring relative economic burden would be by the tax burden-ratio method, which has been the traditional one.<sup>18</sup> In this method, the tax burden is expressed as the ratio of taxes to some criteria of taxable capacity. Judgments of equity are possible through comparison of taxpayers with a higher ratio and taxpayers with a lower ratio.<sup>19</sup> A major problem encountered in an application of this method would be the selection of criteria for measuring taxable capacity. "The essence of this problem is to select a fiscal characteristic of the subjects of comparison which, if used as the base of a perfectly administered single tax of uniform rate, would most propitiously spread any given amount of taxes among the subjects of comparison."<sup>20</sup> Several different criteria such as "net income," "net operating income," "income produced," "gross receipts," and "total assets" have been used as evidence of taxable capacity in various studies. The problem would result from the fact that different results for a taxpayer or class may be obtained from use of different criteria. James C. Dockeray, in his Public Utility Taxation in Ohio, used three criteria--gross revenues, net operating income, and net income--to measure the relative burden of his subjects of comparison in a tax burden-ratio method. The following table indicates the results he obtained.

Table IV-1

Ratios of Tax Burden Computed on Basis of Gross Revenues, Net Operating Income, and Net Income for the Various Classes of Utilities

Gross Revenues		Net Operating Income		Net Income	
Waterworks	12.11%	SS&IRR*	119.82%	SS&IRR	179.56%
Electric Lts.	11.20	Natural Gas	48.30	Waterworks	82.71
Telephone	10.17	Railroad	37.60	Railroad	76.17
SS&IRR <sup>1</sup>	9.98	Telephone	34.47	Natural Gas	57.89
Railroad	7.24	Waterworks	31.88	Electric Lights	49.91
Natural Gas	6.61	Electric Light	31.48	Telephone	38.76

\* Street, Suburban, & Interurban Railroads.

SOURCE: Dockeray, op. cit., p. 174.

<sup>18</sup> Some examples of surveys of economic burden which have used this method to some extent are:

Oklahoma State Legislative Council, Report No. 11, November, 1951, An Analysis of State Taxes Paid by Corporations in 1948.

Dockeray, James C., Public Utility Taxation in Ohio (Columbus, Ohio State University Press, 1938).

Dun and Bradstreet, Inc., A Survey of Taxes Paid by Business in 1938 (New York, 1939).

House Document 160, 79th Congress, 1st Session, Carrier Taxation (Washington, 1944).

<sup>19</sup> Carrier Taxation, op. cit., p. 353.

<sup>20</sup> Carrier Taxation, op. cit., pp. 382-383.

Dockeray's approach to the problem of obtaining different burden ratios for a subject of comparison by using different criteria of taxable capacity was to set up a burden index based on the aggregate of the three burden ratios he had obtained.<sup>22</sup> The subject with the least aggregate burden was used as the base of the index. This table shows the results he obtained.

Table IV-2

Sum of Burden Ratios and Burden Index  
for Selected Classes of Utilities

Classes of Utilities	Sum of Three Burden Ratios	Index
S.S. & I.R.R.	309.36%	3.709
Waterworks	126.70	1.519
Railroad	121.01	1.451
Natural Gas	112.80	1.353
Electric Light	92.59	1.110
Telephone	83.40	1.000

SOURCE: Dockeray, *op. cit.*, p. 176.

Dockeray felt that the index he obtained by this method was fairly representative of the relative tax burden of the subjects of comparison in his study. Some method of this kind might be used in determining the relative position of taxpayers. It should be recognized, however, that, assuming the availability of basic data, determination of the relative weight to be given the criteria selected is a value judgment. There is apparently no method by which equity of a tax structure may be determined without making subjective judgments at some point.

For either method discussed, a large amount of fiscal information relating to taxable capacity of the subjects of comparison would be needed. Examples would be information relating to total assets, equity capital, gross receipts, net operating income, and net profit. In attempting an actual survey, all these categories may not be needed, although most of them would. At present, information of this type would be available in varying amounts for different classes of business in reports made to the state. The franchise tax reports would contain much of the information needed to establish one or more criteria of taxable capacity. But these reports would only cover the 28,000--odd corporations operating in Texas which are subject to the franchise tax. For comparable information for other segments of the economy, a fiscal questionnaire would probably be the only way to obtain necessary information. Considering the enormous scale of economic activity, this would be a difficult and time-consuming project.

<sup>22</sup> See Table IV-1.

## SECTION II--THE ECONOMIC BASE

The Texas economy in its various aspects is the base from which state revenues are obtained. As such, it is of great importance to understand the Texas economy, since for what affects it will affect state revenues. The information required for understanding the economy, in contrast to that required for determining who pays the state taxes and the equity of tax burden, must of necessity be much broader in scope. The problem of water is a good illustration of the broad scope of information needed. At first glance, the problem of a water shortage, which is of great concern in some sections of Texas, would seem to have little relation to the tax structure. But the growth of population and industrial development depends to a large degree on whether there is enough water available to meet increased demands. Since expansion of population and industrial development means increased sources of revenue for the state, the water supply problem will have some effect on the tax structure.

Another factor which would require that a study of the Texas economy be very broad in scope is that fact that the Texas economy is not isolated but is an interdependent part of the national economy. Matters affecting the national economy, even those which take place thousands of miles away, may cause fluctuations in state revenue and threaten the stability of the tax structure. This is true for all states, but it is particularly true for Texas, since this state's economic role is essentially that of a primary producer supplying raw materials and products to fill the needs of the national economy. Table IV-3 illustrates in part the particular role of the Texas economy in supplying resources and products which fill, in large part, the demands of the nation's economy. The table is a partial listing of the resources, industries, and agricultural products in which Texas ranks first, second, or third in production among the states.

An examination of the petroleum industry might serve to show the relationship of the Texas segment of that industry to the industry as a national economic entity. It may also explain how fluctuations of the industry as a whole will affect the Texas economy and tax structure.

Texas levies six taxes on the petroleum industry, not including consumer taxes on petroleum products. These include severance taxes on the production of crude oil, natural gas and carbon black; a regulation and administration tax on the production of oil; a gross receipts tax on certain industries which service oil wells; and a tax on the intangible property of pipelines. In addition, the state also collects revenue from oil and gas royalties, leases, bonuses, and awards on state lands. Of these sources of revenue, the severance tax on oil is the best revenue-producer. Table IV-4 illustrates the importance of these revenue sources to the state. It shows the amount of revenue

Table IV-3  
Texas National Ranking -- Selected Resources and Products

Resource or Industry	Texas Rank	
	Quantity	Value
Asphalt, Native	1	1
Bromine	1	1
Carbon Black	1	1
Cement	3	3
Fullers earth	2	2
Helium	1	1
Magnesium	1	1
Natural Gas	1	1
Natural Gasoline and Cycle Products	1	1
Liquefied Petroleum Gases	1	1
Petroleum	1	1
Sulfur	1	1
Tin	1	1
<hr/>		
Agricultural Crops	Texas Rank	
	Quantity	Value*
Cotton and Cotton Seed	1	
Wheat	3	
Rice	2	
Peanuts	2	
Roses	1	
Grain Sorghum for grain	1	
Shipments of Fruits and Vegetables	3	
<hr/>		
Livestock and Livestock Products	Texas Rank	
	Quantity	Value*
Sheep and Wool	1	
Goats and Mohair	1	
Beef Cattle	1	

\* Figure not available

from the severance tax on crude oil and the percentage it contributes to total state income; total revenue obtained from the six taxes, including the severance tax on oil production; the revenue from royalties, leases, bonuses, and awards from state lands; the sum of these as a percentage of the total state income.

Table IV-4  
Revenues from Petroleum as Percentage of State Income

Year	State Income From Crude Oil Severance (\$000)	% of Total State Income	State Income from Petroleum Industries-- All Sources (\$000)	% of Total State Income
1945	\$40,433	14.45	\$53,932	19.28
1946	39,044	11.38	58,825	17.14
1947	54,845	13.15	77,233	18.52
1948	85,795	15.36	138,219	24.75
1949	87,436	15.65	127,880	22.88

SOURCE: Texas Legislative Council, Staff Research Report No. 51-5, The Texas Petroleum Industry and State Finances, Table XXV.

Thus the petroleum industry constitutes a major source of state tax revenues. It should be evident that economic fluctuations in the industry affecting production will have a serious effect on state revenues and operations dependent on these revenues. The major share of revenues in this field are based on production taxes. General economy will be affected as well as state revenues because the petroleum industry is a major segment of the Texas economy, ranking in importance with agriculture and manufacturing.

It might be well to consider the possibilities of economic fluctuation in the petroleum industry. The production of crude oil will be used for illustration, since it is the most important source of petroleum tax revenues. While the long-term trend in crude oil production is one of increasing production, there are several economic factors peculiar to the industry which can cause disruption of that trend. The first of these factors is that petroleum is only one of several sources of energy. Hydroelectric power and coal are other major sources. Within the petroleum industry, natural gas competes with crude oil as a source of energy. All these energy sources must compete, and an increase in hydroelectric facilities in an area may diminish the demand for petroleum as an energy source. Too, the price of coal may determine the demand for petroleum. Another competitive factor which may influence the demand for petroleum produced in this country is the amount imported from



Venezuela and the nations of the Middle East. These countries have cheap costs, large production, and little, if any, native demand. Another seemingly inconsequential but important factor in determining demand is the weather. An extremely mild winter in the Northern sections of the country will have an important effect on the use of petroleum as a source of heat in those areas. Any one or a combination of these factors may restrict the short-term demand, even though the rest of the economy is in a cycle of expansion. Such a restriction recently occurred. Production of crude oil went into a decline in 1949, and continued to decrease, with short seasonal spurts of increased production, until the middle of 1950. In 1949, Texas production was 898,313,973 barrels of crude oil, and in 1948, production was 735,742,533 barrels.<sup>21</sup> On a calendar-month basis, revenue from the crude oil severance tax dropped from \$94.4 million in 1948 to \$81 million in 1949--a decrease of \$13.4 million.<sup>22</sup> This loss in revenue at a time of prosperity when governmental expenses were very large was critical. Had it not been for the Korean military emergency in 1950 which caused increased demand for crude oil, it is probable that some governmental services would have had to be curtailed or new taxes levied.

Information of this type on the stability, instability, and possibilities or yield over a long-term period, with information as to possible alternative sources of revenue--based on a complete survey of the entire economy--would be extremely helpful in planning for the fiscal needs of the state. Also some adjustment in the present fiscal management approach to earmarking and of funds might help this situation. Some such information is available in the previously cited Council report upon which much of this discussion is based. An important problem area that should be considered is the amount of information available for making a broad survey of the Texas economy. At present, an enormous amount of information is available. The federal government publishes a number of documents and reports. These vary in usefulness for a study of Texas economy. The various census publications, including the Census of Population 1950, Census of Agriculture, Census of Business, and Census of Manufacturing are very useful. Many federal agencies and bureaus publish helpful reports. These include, for example, the Bureau of Mines: Minerals Yearbook and pamphlets on economic activities concerning specific minerals; and the Department of Agriculture: A variety of marketing and production reports and other reports relating to Agricultural economics are available.

An enormous amount of information relative to the Texas economy can also be secured from reports filed with state regulatory agencies such as the Railroad Commission and the Insurance Commission.

<sup>21</sup> The Texas Petroleum Industry and State Finances, op. cit., Table IX.

<sup>22</sup> Ibid., p. 15.

Information can also be obtained from the records of the Comptroller's Office. Charters, permits to do business, and franchise tax returns filed by corporations are available from the Secretary of State.

Other sources of information are the numerous industry and trade publications. For example, information on the petroleum industry can be secured from the weekly and monthly statistical bulletins and from Petroleum Facts and Figures, published by the American Petroleum Institute. Information may also be found in publications such as World Oil, The Oil and Gas Journal, The Petroleum Refiner, and Gas Age. The reports of educational and private economic research organizations are also sources of data. Publications of The University of Texas Bureau of Business Research, for example, report on a wide range of Texas economic activity. These reports are included in the Bureau's monthly publication, Texas Business Review, and in intensive studies of particular economic activities and segments of the economy. In citing these sources of available material, no attempt is made to encompass the field. The sources and publications mentioned are merely illustrative.

The fact that such information is available can be very misleading as to the difficulty and possibility of making a complete survey of the Texas economy. The following facts should also be considered before any such conclusion on the matter can be reached.

In its present condition, the material available would be--to use a statistical term--"raw data". That is, it is just the raw material from which a survey must be constructed. For example, a 1,000 page report of a federal agency may yield only five lines of material which would be of use in a survey of the Texas economy. Then, too, the information in a report may cover broad areas of the economy, whereas a more specific breakdown would be required. Or the information may be oriented to be helpful from a particular point of view and yet will be relatively valueless for such a survey. Another possibility is that the information available will not cover the entire range of the economy. A questionnaire, audits, or interviews or some sort would be necessary to secure the lacking information. Finally, the magnitude of the Texas economy constitutes a major problem in research. For example, research in the Secretary of State's Office concerning corporations would involve working with roughly 28,000 corporate reports. To serve as an informative aid in legislative policy determination, this information needs to be correlated, analyzed, interpreted, and presented in a co-ordinated orientation for governmental purposes. A consideration of the factors involved in making such a study seems to warrant an assertion that the task would require a good deal of time and considerable physical and financial effort.

Another point would be a consideration of what has been done in the way of a usable survey of the Texas economy.

Some information has been developed by the Council staff in this general area. The first volume in the series of tax studies, of which this is a part, presents a comparative survey of the economy of Texas with that of several other states.<sup>23</sup> The purpose of the survey was to describe some of the characteristics of the economies of Texas and the selected states to give general background and perspective to a comparative analysis of tax revenues by source. The introduction to the portion of the study which deals with this subject describes it as follows:

At the outset of the presentation, four general economic characteristics of the States are compared: their populations, employment totals and patterns, incomes, and business populations. These factors directly or indirectly influence and are influenced by all fields of economic endeavor. After discussion of those features, the four major areas of economic activity in the selected states, agriculture, mining, manufacturing, and trade are contrasted and compared. The relative importance of these sources of goods and services and of money income in Texas are compared with their significance in other states. . . .<sup>24</sup>

That report was made as comprehensive as possible at the time insofar as the over-all Texas economy is concerned. But as was pointed out in that report, the survey depicts economic activities in very broad terms and with omissions in certain areas.<sup>25</sup> It was designed to provide, so far as was possible, a broad picture of the economy in general terms and to serve as a point of departure for a more detailed survey.

<sup>23</sup> Staff Research Report No. 51-3, A Survey of Taxation in Texas, Part I - Comparative Tax Revenue Analysis, Texas and Selected States, Chapter II, pp. 9-35.

<sup>24</sup> Ibid., p. 9.

<sup>25</sup> The limitations of time, personnel and finances served as limiting factors to range of the survey. Ibid., p. 9.

## CHAPTER V

### PROBLEMS OF TAX STRUCTURE FROM THE VIEWPOINT OF REVENUE NEEDS

In this volume, an attempt is made to conclude the survey of taxation undertaken shortly after the establishment of the Legislative Council. Its particular purpose is to aid the Council and its Study Committee on Taxation in responding to House Concurrent Resolution No. 69, adopted by the 52d Legislature. The resolution is couched in broad language of a "study of the tax structure" and a "sound system of taxation designed to meet the revenue needs of the State". It also indicates particular concern for meeting increased revenue needs and for removing any loopholes and inequities in present tax laws. An approach to this broad area involves examination of the data which has been previously collected by the staff--four volumes of research in this field have been published since the Council's organization. It also involves taking a broad view of the entire area of taxation to place research already completed in perspective and gain a concept of the areas yet partially or completely unexplored. Finally, it involves examination of some particular problem areas which may now be viewed in the context of the broad field.

The preceding chapters of this report approach this task from the viewpoints of : (1) the tax statutes themselves, (2) constitutional and statutory earmarking of tax revenues, (3) tax administration, and (4) the economic base of taxes. In this chapter, the tax structure is considered from the viewpoint of revenue needs. Drawing upon work done for previous volumes and information developed in preceding portions of this report, an attempt is made to discuss problems of improving the tax structure to meet the revenue needs of the state and some of the approaches to these problems.

#### Danger Points in the Revenue Picture

There are two areas of the tax structure which are of sufficient importance to require particular attention. These are: fluctuations in the production of crude oil and their relationship to revenues; and the part played by constitutional and statutory earmarking of tax revenues by source in fiscal management. Both of these areas involve broad problems which have been incompletely explored.

#### Fluctuations in Oil Production

The severance tax on oil provided approximately 25 per cent of the state tax revenue in the 1951-52 fiscal year. In a study of the petroleum industry and state finances made by the staff,<sup>1</sup> it was found that for the

<sup>1</sup> Texas Legislative Council, Staff Research Report No. 51-5, The Texas Petroleum Industry and State Finances (1950).

calendar year 1949, crude production dropped 162 million barrels from peak production in 1948 and that tax revenues from this source dropped from \$94 million to \$81 million, a reduction of about \$13 million. A serious revenue crisis did not arise because the curtailment occurred in two fiscal years, and receipts for the remaining portion of each year were high.<sup>2</sup> Primary reason for the decline in revenue was a reduction of monthly crude production allowables by the Railroad Commission in discharge of its responsibility under conservation laws.<sup>3</sup> Many factors are involved in the commission's determination of production allowables. However, the financial need of the state is not one of them.<sup>4</sup> While the staff has collected no data on this problem since November, 1950, there are some indications that sharp downward fluctuation in crude production may again occur within the next biennium. Whether or not it does so in the near future, the problem potential of this situation is of some moment. Tying the immediate financing of state programs to a revenue source which--for reasons over which the state has little control--may fluctuate considerably in a short period of time, could lead to the temporary failure of some state programs. Other areas of the present tax system are involved in this problem. Revenue-estimating and approval of appropriation bills by the Comptroller, for example, raise serious questions in the light of present policies of revenue-estimation based on straight-line projection of present revenues except where clear indications appear to the contrary. Further, the problem of a failure of anticipated revenue from this source would be compounded by present earmarking provisions, which might cause a storage of funds to fall unequally on state programs in an unintended pattern.

### Fiscal Management

Constitutional and statutory earmarking of tax revenues by source closely relate the state tax program to fiscal management. The use of this device apparently both results from and induces a way of thinking about particular tax sources as a means of financing particular state functions or programs. Thus earmarking is both a technical or mechanical device through which revenues are channeled from source to expenditure and a tool through which the Legislature makes fiscal management decisions. A number of problems arising from the earmarking process are discussed in Chapter II of this report. Three of these are adverted to here. First, raising or lowering the rate of a particular tax becomes immensely more complicated by reason of earmarking. Review of all or of substantial portions of the state's revenue system may be necessary to insure that the revenue is added to or subtracted from the particular program intended to be affected. Second, the rigidity of the system may cause unanticipated revenue changes, as in the previously-mentioned case of the severance tax, to have unintended effects on state

<sup>2</sup> Ibid., pp. 15-16.

<sup>3</sup> Ibid., p. 17.

<sup>4</sup> Ibid., Chapter IV, pp. 19-46.

programs. These problems might be avoided by a more flexible system. Third, legislative control over expenditures is reduced, both because of technical reasons and because of the pattern of thinking induced by allocation of particular funds to particular purposes--an identification of tax with use. This is apparently a two-edged blade. If legislative control is reduced by present earmarking provisions, this device may also be used to establish patterns which tend to confine future Legislatures. Thus there is a tendency toward continued reduction of general revenue, to which the Legislature gives intensive consideration in making appropriations, and toward expansion of earmarked funds, which are less intensively reviewed.

While the study of earmarking as a part of the tax structure has been adequate to raise substantial problems, no study has been made from the viewpoint of fiscal management. Since the policy implications of earmarking are of such importance--development of a highway program through this technique is an apt example--it would seem that attempts to solve these problems insofar as they are created by present laws might await such a study. Further extension of the earmarking process should be undertaken, if at all, only with full awareness of the problems which it creates.

#### Approaches to Increasing Revenue from Present Tax Sources

There are indications that tax revenues might be increased to some extent, without new sources or increased rates, through strengthening present tax laws and through improved administration. As indicated in other portions of the study, increased revenue yields may not be the only nor even primary purpose in considering these. All such measures might reasonably be expected to affect revenue favorably.

#### Loopholes

A number of specific problems were found in completing the analysis of individual taxes. Successful solutions of these problems would result in increased yields from the taxes which they concern. The problems are of three general types: (1) inadequate or unrealistic sanctions or penalties--for example, absence of penalties for failure to file reports or for breach of administrative rules; (2) inadequate administrative powers--for example, no power to examine books and records or to require that records be kept; and (3) inadequate coverage--for example, failure of the statute, because of technological change, to clearly reach a subject which is taxed in another form. These problems and some of the possible approaches to their solution are discussed in section 6 of each chapter in the volumes on individual taxes. Some of these approaches in Volume II of the series were considered by the Council, which made recommendations concerning them to the 52d Legislature.

## Statutory Revision

Possibilities of improving the tax structure through revision of the tax statutes is discussed extensively in Chapter I. As pointed out there, the technical competence of the statutes and their organization in an easily used and understood form has a significant bearing on the smooth operation of the tax system. It might therefore be expected that revision would aid in securing greater taxpayer compliance and in improving tax administration. Both of these should affect revenues favorably.

One aspect of statutory revision which may be recalled here has direct implications for revenue. In reorganizing the tax laws, rate provisions of each tax may be segregated and placed in a single section. If this were accomplished, amendments to change rates could be effected without the necessity for rewriting all or other portions of the statute. This would facilitate use of the Omnibus Tax Bill as a means of considering adjustments in the entire tax program.

## Administration

Solution of administration problems arising in the operation of particular taxes is mentioned as a part of the problem of loopholes. Another approach to improving tax administration is from the viewpoint of the total administrative program. It seems probable that substantial gains in this area are possible through: (1) improved techniques of securing taxpayer compliance and enforcement methods; (2) co-ordination of the tax effort; and (3) improved methods and procedures. While these would not necessarily result in revenue increases, they could be important in focusing and making more effective the administrative effort. This, in turn, would affect revenues favorably.

## Approaches to Increasing Revenue From New Sources

Considerations involved in the selection of new sources of revenue are many and complex. An attempt is made to discuss some of these in Chapter IV and to indicate the difficulties in collecting data helpful in making the policy judgments of selection. The information developed there is in terms of problems and methods of measuring the total tax structure against the economic structure of the state. Here, from a different viewpoint, the concern is the specific problem of finding new sources and levying effective taxes.

## Selecting New Sources

If new sources of revenue are to be selected to help form part of an integrated tax system, it would seem that the selection would be aided by a broad research program such as is outlined in Chapter IV. Selection of sources for such an integrated system might not be feasible without such a

program. If, however, it is necessary to seek new sources without extensive study, some aid may be secured by comparing a list of persons who bear the tax impact under present laws with an index of current economic activity in Texas. Preparation of these indexes would involve some difficulties and, because of these, could not be wholly accurate. They would, however, give an indication of possible new sources and could be prepared in much less time than the broader study.

#### Levying an Effective Tax

Difficulties would not end with the selection of a tax source. Determination of the type of tax; the particular process, activity, or person on whom it is placed; and the solution of the legal problems coincident with drafting effective law would seem to require a thorough understanding of the economic situation of the source selected. Although this is the same kind of information needed for the broad study, approaching it from the viewpoint of a particular tax would reduce the task substantially.