

P4 ___ Painting a Picture of the Public Purse

Introduction to Taxation in Idaho: Overview¹

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¹ Adapted from Circular 1304 Montana State University by V. W. House and M. E. Wolfe.

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What do you think when you hear the word "taxes?" Do you feel angry, helpless or merely confused? The purpose of this series of publications is to stimulate your thinking about taxation and provide you with some "basics" of public policy making regarding taxation and revenue. To this end, we begin by challenging you, the reader, to consider the question for yourself.

My Favorite Tax Is. . .

If you find no humor whatsoever in the subject of taxes, just skip the *tongue-in-cheek quiz on the next page and proceed to the "serious" quiz that follows.

Thank you

Tax Quiz

(The Tongue-in-Cheek Variety)

1. My favorite tax is: (check only one)

- The one someone else pays.
- The one that collects the most revenue.
- Taxes that finance schools so someone else's kids can attend.
- Taxes that finance roads when you don't drive.
- Taxes that penalize sinners.
- The one that's cheapest to administer.
- The cigarette tax (I do _____, don't _____ smoke)
- The alcoholic beverage tax (I do _____, don't _____ drink).
- Auto property tax.
- The one that everyone pays.

2. My worst tax is: (check only one)

- Property
- Income
- Sales
- Excise
- Severance
- Inheritance

3. Most of the taxes I pay are: (check only one)

_____ Property

_____ Income

_____ Sales

_____ Excise

_____ Severance

_____ Inheritance

Before you proceed with the serious quiz on the following page, do you see any relationship between your answers to questions 2 and 3? Go on to the next page.

Tax Quiz
(The Serious Variety)

1. My favorite tax is:

_____ State	_____ Federal
_____ Property	_____ Excise
_____ Income	_____ Income
_____ Sales	_____ Other (?)
_____ Excise	
_____ Severance	
_____ Inheritance	
_____ Don't know	

2. My least favorite tax is:

_____ State	_____ Federal
_____ Property	_____ Excise
_____ Income	_____ Income
_____ Sales	_____ Other (?)
_____ Excise	
_____ Severance	
_____ Inheritance	
_____ Don't know	

3. Most of the taxes I pay are: _____ State _____ Federal
_____ Property _____ Income
_____ Sales _____ Excise
_____ Severance _____ Inheritance

4. I feel that I get the most for my tax dollar from the
_____ Federal government _____ Local government
_____ State government _____ Don't know

Compare Your Tax Survey

Now that you have had a chance to clarify your own position regarding some fundamental taxation issues, are you curious about how other citizens in the United States feel about taxation and revenue? Look below and see how your responses compare to similar questions asked of the public between 1972 and 1984.¹

Question 1

Which do you think is the worst tax-that is, the least fair?

(Percent of U.S. Public)

	May 1984	May 1982	May 1980	May 1978	May 1975	April 1974	Mar 1972
Federal Income Tax	36%	36%	36%	30%	28%	30%	19%
Local Property Tax	29	30	25	32	29	28	45
State Sales Tax	15	14	19	18	23	20	13
State Income Tax	10	11	*10	11	11	10	13
Don't Know	10	9	10	10	10	14	11

Question 2

**From which level of government do you feel you get the most
for your money-federal, state or local?**

(Percent Cf U.S. Public)

	May 1984	May 1982	May 1980	May 1978	May 1975	April 1974	Mar 1972
Federal	24%	35%	33%	35%	36%	29%	39%
Local	35	28	26	26	25	28	26
State	27	20	22	20	20	24	18
Don't Know	14	17	19	19	17	19	17

¹Source: Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, M-141, U.S. Government Printing Office, Washington, D.C., March 1985, p. 139.

Overview of P⁴... Series

Of all the money we spend, we seem to give it most grudgingly to pay taxes. Most of us have favorite public services, but no one seems to have a favorite tax. Disgruntled taxpayers often threaten to revolt, but they do not refuse to accept public services. Perhaps it is our distaste for paying taxes that has led to the construction of an extremely complex system that determines who will pay how much and for what. The P⁴... series of publications was written to help citizens gain a basic understanding of taxation so they can evaluate various tax alternatives. This series of four publications includes:

- I. An Introduction to Taxation
- II. A Guide to Commonly Used State and Local Taxes
- III. Criteria for Evaluating Taxes
- IV. A Tax Glossary

Part I of this series provides a general introduction to taxation and revenue and focuses specifically on three basic finance decisions all levels of government must address in their process of fiscal decision making. The person seeking a more complete understanding of taxation and revenue should obtain the supplementary pamphlets of this series.

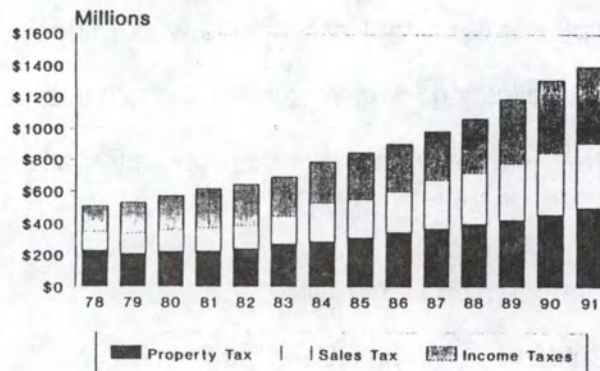
Introduction

In 1989-1990, Idaho's state and local government revenues totaled \$3,372,524,000. Of that, the tax system raised more than \$1.65 billion--47 percent of all revenue². This income, derived from state and local tax sources, has grown

²U.S. Department of Commerce, Bureau of the Census, "Government Finances in 1983-1984," GF84 No. 5. Complete breakdown is: Taxes--42% (\$1,050,300,000), Federal government transfers--18% (\$446,700,000), Charges and miscellaneous revenues--40% (\$984,200,000).

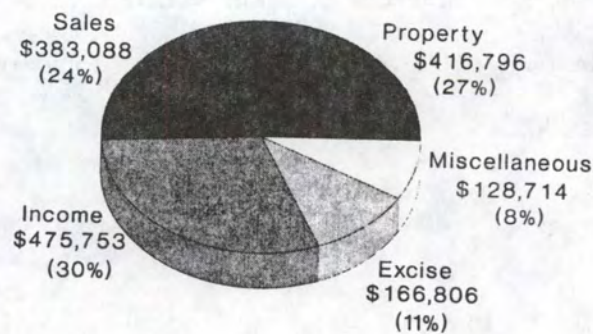
considerably over the years. Figure 1 shows how state tax revenues have changed over time.

Figure 1. Total Tax Revenues
(State and Local Sources)



Idaho Tax Equity Summit, Dec. 12, 1991

Figure 2 shows the principal sources and proportions of tax revenue collected from Idaho state and local sources during fiscal 1989-90.



How did we decide which taxes to use and how much to use them? We negotiated the tax structure through our political system.

Principles for Decision Making

The process of negotiating a tax system requires that each level of government make three basic finance decisions:

1. What services are desired?
2. What funds are needed to obtain the desired services?
3. How should government obtain these funds?

Why are these issues fundamental? Because the tax system distributes the costs of government among various individuals and groups in society. Personal income is allocated between public and private spending. And, in the end, the impacts of the level of spending adopted become evident in the quantity and quality of public services government provides.

Determining What Services Will Be Offered

Government budgetary decisions, to a considerable extent, determine whether quality of life improves or deteriorates. Some choices shake nations—such as a choice regarding the defense budget. Although not as dramatic, other choices, such as a change in education policies, may affect everyday lifestyles. Ideally, public and private spending is divided in a way that provides the greatest satisfaction to the most people in benefits received. However, since goals among individuals and between individuals and society often conflict, determining how government revenues should be acquired and should be spent is a subject of considerable debate.

In general, a tax system serves three purposes: 1) to allocate funds between essential services; 2) to distribute and redistribute income; and 3) to achieve social goals.

How government allocates funds is complicated because the benefits of public services may not be received by those who pay taxes; or benefits may be less than, or greater than, the individual's cost of government. In addition, some public services,

such as education, conservation and resource development, may be paid for by today's taxpayers but offer benefits that will be enjoyed in distant time, by future citizens.

In other words, taxation is often used to *redistribute* benefits. Such redistribution can occur geographically (rural to urban, Appalachia to western irrigation projects); among classes of citizens (industry to agriculture, poor to rich); and over time (build now, pay later). As efforts are made to redistribute the benefits of taxation, conflicts between "winners" and "losers" can occur. Eventually, compromises are achieved through the political process that resolves these conflicts.

How are such compromises on spending reached? Abraham Lincoln once said, "What I want is to get done what the people desire to have done, and the question for me is how to find that out exactly." But how to find out exactly what people want is no easier today than it was for Honest Abe.

In general, citizens "purchase" public services through government financial decision making. "The people" and the groups they join to represent their interests continually inform elected officials of their needs and goals and press for their accomplishment through government action³. Citizens and their representatives groups attempt to achieve their goals by working through elected and non-elected officials: school board and city council members, county commissioners, state legislators and various administrative and appointed agents who implement public laws.

Citizen Involvement Opportunities in Idaho

Idaho law provides some specific opportunities for any citizen to become involved in determining public spending and taxation levels. In particular, budget making at all levels of government is an open process. And at the county and local

³For more information on communicating your views, ask for "Making Your Views Known," Extension Circular, MSU, Bozeman, MT 59717.

levels, citizens have been given specific legal means to present their ideas to public officials.

The County Budget Process

On or before the third Monday in August county commissioners must advertise their proposed budget for the coming year. Hearings begin on Tuesday after the first Monday of September. Any taxpayer or resident of the county may appear and be heard for or against any part of the budget. Idaho laws also provide for public hearings on county budget amendments, bond election challenges, emergency expenditures and transfer of cash balances at the close of a fiscal year.

The Local Budget Process

On these same dates (the Wednesday before the second Monday in August), cities hold hearings on their preliminary budgets (MCA 7-6-4228). Citizens are welcome to attend. Idaho law also provides for hearings on cities' emergency expenditures, and protests to creating districts to maintain fire hydrants or establish lighting.

Special Districts

Before counties form special districts or cities form special districts, the respective officials must give notice of their intentions. Such notice provides opportunity for public input regarding the creation of such special districts.

Public School Budgets

By law, taxpayers are included in the local school district budget process. Specifically, citizens are granted a role in the consideration, adoption and review steps

of school budget deliberations. Taxpayers may attend meetings at which school trustees consider preliminary budgets.

County and State Tax Appeals

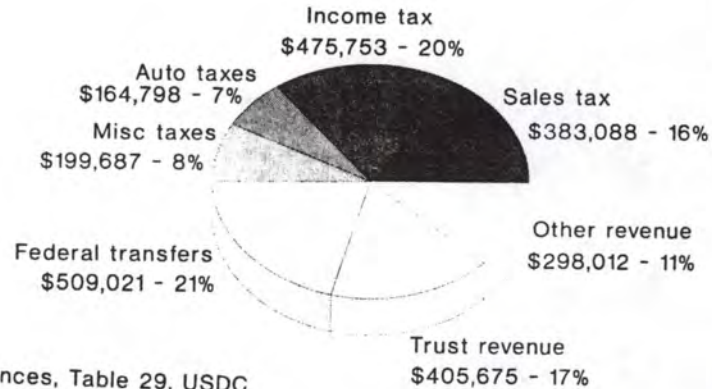
A system of tax appeals was included in Idaho's constitution and subsequently in law. Assessments must be mailed before the first Monday in June. The County Equalization Board must meet between 4th Monday of June and 2nd Monday of July. Appeals must be filed by 4th Monday in June. The County Equalization Board may change protested assessments. Any person or the Assessors' Office may then appeal disputed tax assessments to the State Tax Appeal Board or District Court.

Sources of Revenue

Once government officials determine what services are necessary and desirable, they must consider what sources of income are available to provide the desired services. It is useful, as one examines alternative sources of government revenue, to keep in mind three often-overlooked facts: 1) There are other ways of generating revenue besides taxation. 2) Revenue is sometimes gathered for other purposes than to merely generate government income. 3) Different types of revenue-generating activities (taxes, borrowing, intergovernmental transfers) can have different effects on different segments of the population.

Government income comes from both non-tax and tax sources (Figure 3).

Figure 3 Idaho State Government Sources of Revenue 1989-90 (in Thousands)



Source: State and Local Finances, Table 29, USDC

Non-tax sources of revenue include licenses, permits, fees and fines. Licenses and permits are used both for revenue generation and for regulation and control. For example, when an individual pays a hunting license fee, he contributes to the governmental coffer (revenue), and simultaneously he is regulated through the governmental grant of the privilege to hunt. Other examples of licenses and permits used to provide income to government include business and occupation licenses and permits, fishing licenses, motor vehicle registrations, drivers' licenses and liquor licenses.

Other non-tax sources of revenue are fees and fines. Fees are charges for services performed by public agencies. Some examples are student fees at universities and colleges, and fees for bonding, title transfers and recording deeds. Fines, unlike fees, are penalties imposed for not conforming to law.

The remaining common means for generating government revenue are intergovernmental transfers, borrowing, reserve spending and taxation. Borrowing and intergovernmental transfers can be important governmental revenue-generating devices, so some familiarity with these types of revenue is important.

Intergovernmental transfers are subsidies from one level of government to another. These generally flow from the higher levels to the lower levels of government:

federal to state, and state to local. These come in the form of categorical grants, made for specific programs; block grants, for broad categories of spending; and revenue sharing, which can be spent as states and localities see fit. Intergovernmental transfers can be a significant revenue source for state and local governments. For example, in 1990, the federal government made grants of \$553 million to Idaho state government and local governments, and Idaho state government made grants of \$572 million to local governments, with the bulk earmarked for education. In Idaho, in fiscal 1989-1990, 20 percent of state revenue was from federal government transfers.

In addition to intergovernmental transfers, governments borrow money to help pay for their expenditures. A common example is through the sale of bonds, where, in effect, the government borrows money from the public to finance its spending. Borrowing tends to impose costs on people in the future to a greater degree than do taxes. However, in cases where future generations stand to gain the most from projects financed by debt, borrowing can be readily justified.

There are several non-tax, revenue-generating methods, but the main topic of this publication is taxes. Taxes are usually levied on:

- what's owned (property),
- what's spent (consumption),
- what's produced or received (income).

Government tax policies differ between states because taxes are used in different ways to provide a greater or lesser proportion of state and local revenues (Figures 4 and 5).

Though states tap different tax revenue sources, some generalizations can be made regarding fundamental aspects of commonly used types of taxation.

Property taxed may be real estate or any other possession that is a reserve of purchasing power. Wealth is an example of reserve purchasing power; and income taxes on dividends and interest are, therefore, an example of a "property" tax on wealth. The transfer of reserve purchasing power held by the wealthy *between*

individuals can also be taxed. Death, estate, inheritance and gift taxes are the "property" taxes that affect such transfers.

Taxes on consumption include the general retail sales tax; specific sales taxes on gasoline, liquor, tobacco and luxuries; use taxes; and taxes on gross receipts.

Taxes on production include the income tax, grain and seed taxes, and severance taxes on coal, oil, gas, minerals and timber.

The main purpose of taxation is to obtain sufficient revenue to fulfill the service functions of government. However, in addition, legislation often attempts to use taxes to achieve economic and social reforms.

Achieving reforms can involve *discouraging* certain activities through *big* tax rates, such as cigarette, liquor and pollution taxes. Or, reforms can also be achieved through *encouraging* or promoting certain activities through low tax rates or exemptions.

Higher taxes that attempt to discourage activities may increase tax revenues, depending on how much they discourage the activity. Lower taxes, while they may promote certain desirable activities, can lower the amount of tax revenue government has at its disposal.

However, some schools of thought argue that in many instances, lower taxes will actually increase government revenues. For example, at local and state levels, economic development depends both on private entrepreneurship and government spending for the provision of public services such as roads, bridges and education. This school of thought argues that lower taxes free private capital for increased investments that return benefits to the economy in the form of jobs, services and economic growth (i.e. additional tax base).

In contrast to this rationale for lower taxes, it is often argued that exemptions and special low rates on certain items or tax categories will narrow the tax base. The result may be that though exemptions and special low tax rates decrease taxes for one

individual or group and may increase their capacity for capital investment, they may increase the tax rate for others.

Summary

Before taxation and revenue policies are initiated, changed or reformed, decision makers at all levels of government must decide three basic finance questions:

- what services are desired,
- what funds or revenues are necessary to provide the desired services,
- what means or methods can be used to acquire the needed revenue.

Either individually or through their representative groups, citizens inform decision makers of the services they require. In Idaho, residents enjoy several specific opportunities to be directly heard by officials at the county, local and state levels. Through such public input, decision makers learn of changing public needs, concerns and problems and use this information to develop or revise the taxation and revenue system.

Once the desired services are known, officials must then determine how much income is needed to provide the services and how the income can best be generated. In general, this requires either using or adjusting existing tax and non-tax revenue sources or developing new ones.

As individuals and groups examine the total revenue picture- fees, fines, intergovernmental transfers and borrowing-it becomes clear that taxation is only one of several ways to raise revenues. Furthermore, the tax and nontax activities of government frequently serve other important purposes beyond providing income for government services. Income distribution, redistribution and the pursuit of popular social goals are well-known examples. Finally, despite socially agreed-upon goals, the impacts of different revenue-generating activities will vary for different sectors of the population. Though an awareness of these factors may appear to complicate the tax

evaluation process, knowledge of them as existing components of taxation sets one firmly on the pathway to understanding taxation.⁴ The programs of the Idaho Cooperative Extension System are available to all people regardless of race, creed, color, sex or national origin.

Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, LeRoy Luft, Acting Director, Cooperative Extension System, University, of Idaho, Moscow, Idaho.

⁴See "A Guide to Commonly Used State and Local Taxes," Part II of the My Favorite Tax Is. . . series for more information about different types of taxes and "Criteria for Evaluating A Tax System," Part III of the same series, for a discussion of major tax criteria that concern various segments of society.