VERMONT HISTORY

The Proceedings of the Vermont Historical Society

WINTER/SPRING 1997

VOL. 65, NOS. 1&2

The Evolution of the Vermont State Tax System

What makes a good tax? The Vermont Constitution teaches that a tax must have a public purpose and its impact in achieving this purpose must be proportional, taxpayer by taxpayer.

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> That every member of society hath a right to be protected in the enjoyment of life, liberty and property, and therefore, is bound to contribute his proportion towards the expense of the protection, and yield his personal service, when necessary, or an equivalent thereto but no part of any person's property can be justly taken from him, or applied to public uses, without his own consent, or that of the representative body of the freemen, . . . and previous to any law being made to raise a tax, the purpose for which it is to be raised ought to appear evident to the Legislature to be of more service to community than the money would be if not collected.
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> *Vermont Constitution,* Chapter I, Article 9th.[1]

"To contribute his proportion towards the expense of that protection" is the constitutional standard for all taxation in the State of Vermont. It is an idea that instigates controversies over equity, uniformity, and fairness. It is a weapon for those who feel they have to bear a greater burden than others in like circumstances. It is a measure the legislature uses to determine the contours of tax law—how taxes should be levied and who should pay according to what standard. The requirement that taxes must be applied to "public uses" is another benchmark, distinguishing between those uses that are legitimate expenditures of government and those that are not. That taxes ought to be judged on whether the money would be of "more service to community" if collected than if not collected is a standard that has

had virtually no real impact on taxation in Vermont. It functions as a guide to the legislature, and the judiciary has to date been reluctant to second-guess the legislature on its tax decisions.

Vermonters are characteristically fiscal conservatives. This we are taught from birth, as a part of the litany—"Use it up, wear it out; make it last, or do without." Sometimes this idea is coupled with the reminder that Vermonters are socially liberal, as if the one extreme balances off the other. Our early tax history shows a decidedly conservative bent. This is a state that accepted payment of the local highway tax in the labor of the landowner as late as 1892. This is a state that paid the same wage to the governor from 1777 to 1857 before giving him a raise. Up to the time of the Civil War, the state rarely ventured into anything but the most modest expenditure for public officials' salaries. Vermont's only big expenditures in that period were as follows: to pay off the debt to New York on land titles, a part of the settlement leading to statehood; the building of the state prison at Windsor and the State House (three times) at Montpelier; the repayment of the securities of the failed State Bank; and a misappropriation, called a "defalcation," in the State Treasurer's Office in 1860 of over $48,000.[2] Even then, there was little need for borrowing, none for bonding, and rarely a deficit.

The Civil War cost Vermonters at the state and local levels a good deal of money—it almost bankrupted some communities.[3] But the state paid off that debt before any other state in the union. Then, as the nineteenth century ended, there were reports that state spending was out of control. This became an issue in the 1906 campaign for governor, when Percival Clement charged that total state expenses had gone up 112 percent in the thirty years ending on June 30, 1901, while the population had grown less than four percent over that time. In this he saw "gross negligence and misconduct in the management of the moneys of the State."[4]

The state became more careful with its public money, and state spending seemed to level off in the first decades of the twentieth century, until it started to rain in November 1927. That flood was the worst fiscal disaster in Vermont's history. Since that time, the reputation for conservative fiscal thinking has sometimes slipped. There have been big spending years, followed by big deficits, and deficits created by federal tax cuts since Vermont coupled its income tax to the federal standard in 1967. Today taxes are high in the Green Mountain State. So are public budgets, and there are signs of tax revolt all around us, from the difficulties in adopting a school budget to the perennial demands for property tax reform.

Why do we tax? Who and what do we tax? How do we tax? These basic questions have been asked and answered continuously in Vermont since at least 1778. Each new deficit or surplus, recession or economic

improvement, each major change in the federal tax code, each newly-identified social problem, prompts a new inquiry into the "system," which some would not dignify with such a name. Certainly, if it can be characterized as a "system," it did not grow up that way. It was erected one stick at a time, added to, torn down and built back up with fresh ideas at least half a dozen times. Each year it continues to define itself. To understand it, we need to take a brief look at what we have and how it came to be. This requires a look at the legislation, reports of commissions that studied the problems of Vermont taxation, and the leading cases.

The Various Taxes

Town charters enumerated the first taxes to be paid by Vermont landowners. The charter of Berlin, for instance, required landowners to pay one ear of corn on December 25 of each decennial anniversary of the charter, "if lawfully demanded, the first Payment to be made on the Twenty-fifth day of December, 1763." Landowners were also expected to pay one shilling annually for each hundred acres they owned, settled on, and possessed.[5] There is no record of any landowner ever paying either part of this tax. Vermonters did not pay taxes to New Hampshire or New York.

Before towns organized, they were run by proprietors, who met and levied taxes on the acreage of the original divisions of the land. These paid for public improvements – surveying, highways, bridges, and clearing a town common. These were the first taxes actually paid in Vermont.

The first state tax was the confiscation and sale of Tory estates by the Court of Confiscation, created by statute in 1778.[6] This policy allowed Vermont the luxury of not taxing loyal inhabitants during the first difficult years of its existence. Ira Allen wrote in his *History of Vermont,* "In consequence of internal divisions, and to make government popular, it was thought good policy not to lay any taxes on the people, but to raise a sufficient revenue out of the property confiscated and the ungranted lands."[7] As State Treasurer Ira Allen reported, the state had collected 190,433 pounds from the sale of Tory estates during those years, amounting to 43 percent of the total amount of money spent to maintain state government from 1777 to 1791.

In 1780, the legislature taxed towns by requiring them to raise provisions for fighting the Revolutionary War, each to collect so many pounds of beef and specified amounts of other food and equipment for the troops.[8] The next year the legislature for the first time formally taxed inhabitants' property. This 1781 land tax of ten shillings on each hundred acres of land was adopted in April when the legislature met at Windsor. Its purpose was to raise money to pay the war debt of the Revolution.[9] This set the standard for taxation for the next sixty years. Land and personal

property would be assessed by statute at set values—so much per acre, so much per animal. Listers would not *appraise;* they would simply list the value of the taxpayer's property. It was a crude income tax, based on the assumption that property created wealth in proportion to its size, and that government could legitimately claim a portion of that wealth. This system ended in 1841, when full appraisal by the listers of all categories of real and personal property became the standard.[10] Beginning in 1779, each male between the ages of sixteen and sixty was also listed for poll taxes, at six pounds a head,[11] and lawyers and merchants assessed amounts proportionate to their businesses through a "faculty" tax.[12]

The property tax was the state's principal source of revenue from 1781 until 1882. It remained an important part of the total state revenues until 1931, when the income tax was first adopted. Even today the property tax remains the principal source of town and town school district revenue and the largest tax, producing more in total revenue than the state's four major taxes put together.

By the time of the Civil War, wealth had changed. Liquid capital—stocks, bonds, bank deposits, and other forms of credit—was hard to tax, because assessment of its worth depended on the willingness of the owner to disclose it. When such property was listed, the value of it was often based on the owner's estimate rather than any objective standard, and the dismal state of town grand lists did not help, with property frequently appraised far lower than true value in order to ensure the town kept its state taxes low. Eventually, the law was written to require banks to disclose money on deposit, mortgages, and bank stock, but stocks, bonds, and notes continued to escape taxation. Governor John Barstow, in 1882, called this the "race of fraud."[13]

In 1882, recognizing the inadequacy of the property tax, the state adopted the corporate franchise tax. This was a direct state tax on railroad, insurance, guarantee, express, telegraph, telephone, steamboat, car, and transportation companies, and banks, savings institutions, and trust companies. The tax varied depending on the business, but was based on a percentage of gross earnings.[14] Some railroads had been taxed as early as 1874, but others enjoyed exemption by corporate charter. The 1882 tax was uniform and universal. In 1885, the state collected over $200,000 from the corporation tax, and about $171,000 in state property taxes (a ten cent on the dollar levy on the grand list).[15] The state property tax for 1880 was twenty cents, before the corporation tax was passed.[16] A tax on shares of stock in banks, steamboat and transportation companies, trust companies, "moneyed" and other corporations, except railroad corporations, was also adopted in 1882. It added the value of shares to the

town grand list,[17] and precipitated a "double taxation" controversy that consumed a good deal of legislative time during the next decades.

In 1890, the state imposed a mandatory state tax on the town grand list of five cents on the dollar for the support of public schools. This money was then reallocated to the towns on the basis of the number of legal schools maintained during the previous year. In 1892, the state abolished the system of district schools and created town school districts in their place. Towns were required to appropriate a sum not less than one-fifth nor more than one-half of the grand list for the support of schools.[18]

A town highway tax payable in labor had been a feature of Vermont law since 1778, but in 1892 the system was abolished in favor of a straight tax of twenty cents on the dollar to pay for town highways. That same year the legislature imposed a state five-cent highway tax, to be collected by the state treasurer and then reapportioned to the several towns on the basis of highway mileage. This law required selectmen to file an annual report with the state, giving the mileage of all highways in the town. The state highway money came with strings: it could not be used for bridges; it was for permanent repairs of main thoroughfares; and it could be held over until the following year if needed.[19]

A collateral inheritance tax of five percent of the value of decedent estates was adopted in 1896.[20] A direct inheritance tax based on a sliding scale was added in 1912. In 1980, the basis of the tax was changed to a formula derived from computing the amount of credit allowed to the decedent's estate under the IRS Code.[21] A gift tax was adopted in 1969 and repealed in 1980.[22]

In 1923, the legislature first authorized the taxing of gasoline. James P. Taylor of the Vermont Chamber of Commerce was its foremost proponent.[23] Governor Redfield Proctor recommended it in his inaugural address—a one-cent gasoline tax collected from the wholesaler. "The theory of this tax on gasoline is that those who use the roads most should contribute most to their maintenance. It would help to equalize the burden on road up-keep and would provide sufficient revenue to assist in abating the dust nuisance."[24] Revenues from the tax were dedicated to highway maintenance. In 1923, the tax was one cent per gallon.[25]

In its hunt for additional sources of tax revenues, the legislature in 1925 enacted a tax on intangibles.[26] Two years later the tax was amended to become a virtual tax on the income generated from intangibles. Together the reforms attempted to resolve one of the longstanding problems with the property tax—underreporting and tax evasion. The intangibles tax did not work the magic its sponsors had hoped, however, in part because of the state's needs for additional expenditures in response to the

1927 flood. In 1929, Governor John E. Weeks reported that he had asked the New England Council to appoint a committee to study the tax system of Vermont. It made its report in 1931, unanimously recommending the adoption of a state income tax.[27]

That year the state adopted the income tax as a basis for state revenues.[28] Income was easier to tax because the source of the funds was easier to find, and this new source of revenue allowed the state to abolish the state highway and education taxes, the intangibles tax, and the general statewide property tax. A flood tax, dedicated to paying the cost of repairing roads, bridges, and public buildings after the 1927 flood, was also imposed in 1931 ($1.50 on each poll in 1931, down from $2.50 in 1929, before the income tax was adopted), but even this was repealed in 1935, at the time the state tax of ten cents on each pint of spirituous liquor was imposed.[29]

After the flood tax was repealed in 1935, the property tax was no longer a source of state revenues. Problems of equity and disclosure forced the state to abandon it. The clanking machinery of appraisal was unreliable, town to town. But the problems associated with state aid never really went away. Later, when state aid to education formulas used the grand list as a measure for distribution of funds, reliable grand lists again became an issue. The latest remedy is a listing penalty against state aid to education for grand lists assessed at an equalized rate of less than 80 percent of market value.[30]

The income tax changed only slightly in its first few decades. A 1947 change graduated the tax according to the amount of income at increments of one to four percent of net income.[31] These rates were doubled by 1957, and, in 1966, the state adopted the current system, assessing state income taxes as a percentage of the federal income tax.[32]

A tax on the generation of electric energy was also adopted in 1931. Governor Stanley Wilson announced in 1933 that the tax raised almost $240,000 in 1932, that "the cost of collection has been small," and that the "tax has not been passed on to the consumers through increased rates."[33]

As noted above, taxes on alcoholic beverages arrived as Prohibition ended. In a special session in 1934, the legislature imposed a 3.25 cent tax per gallon on beer and wine, and the following year a ten cent per pint tax on liquor.[34]

In 1939, Governor George Aiken pointed out a familiar problem: "a constant shrinkage of revenue from certain erstwhile profitable sources," would cause a possible deficit that year of several hundred thousands of dollars.[35] The House and Senate appointed a Special Commission on Vermont Finances by joint resolution on January 24, 1936, and the commission made its report in 1938. It proposed a number of new tax sources,

including taxes on amusements, bottled drinks, fuel oil, games of skill, oleomargarine, motor fuel dealer's licenses, and a general retail sales tax, all of which would come in time. That year, cigarettes became the subject of taxation.

The cigarette tax, lobbyist Hubert Dowling pointed out in a brochure entitled, "Reasons Why There Should Be No Cigarette Tax," was regressive, since smoking and income were unrelated. He wrote it would be destructive of business, because of the increase in bootlegging and purchases of cigarettes outside the state, and harmful to the maple industry, since maple syrup was used in the production of cigarettes and Virginia might consider taxing our syrup. The tax passed nonetheless, amounting to one mill per cigarette.[36]

Meals and rooms taxes were first authorized in 1959.[37] Governor Robert Stafford proposed them, reluctantly.

> No new tax is popular. All are resisted. A tax on rooms and meals is certain to arouse the understandable opposition of those engaged in the tourist trade, but I think such taxes are justified at this time on the grounds that Vermont is doing a great deal to attract the tourist who presently contributes only indirectly to the economy of the state; and since the taxes would apply equally to all motels, restaurants, and hotels in the state, no one would suffer in loss of business.[38]

In 1960, there were $568,000 in new revenues from the three percent tax on meals and rooms.[39]

The property transfer tax was started in 1967.[40] That year the tax amounted to one-tenth of one percent of the selling price. In 1969, this was quintupled to one-half of one percent, and in 1988 to one and one-quarter percent for property other than residential use, to pay for the planning process pursuant to Act 200.[41]

"If we support taxation based on ability to pay we cannot condone a system which makes the poorest Vermonter pay more of his income in property taxes than those more fortunate," explained Governor Philip Hoff in his 1968 message to the legislature.[42] To respond to the inequity, the legislature enacted the property tax relief program the following year.[43] It authorized relief from property taxes for taxpayers over the age of sixty-five whose property tax or rent exceeded seven percent of the total household income, based on a sliding scale of relief.[44]

State government faced a financial crisis in 1969. Governor Deane Davis reported that the cost of state programs had increased 780 percent in three years, and a deficit was imminent without a new source of revenue. He proposed a general sales tax of four percent, which his advisers calculated would raise $25 million a year. That year a sales tax of three percent became the law.[45]

In 1973, Governor Thomas Salmon promised that "Vermont is not for sale!" At his encouragement, that year the land gains tax became law.[46] Land held less than six years is taxed on the basis of the difference between the cost at purchase and at sale. The objective was to restrain land speculation in Vermont.

The current use program was established in 1977,[47] and the working farm tax abatement program in 1988.[48] Both were designed to relieve the pressures on agricultural and forest land caused by high property taxes.

The legislature imposed a tax on certified solid waste facilities in 1987, at a rate of $2.40 per cubic yard of waste delivered to the facility or $6.00 per ton.[49] While not a direct tax on the public, the tax was passed along to consumers in the form of user fees. The purpose of the tax was to raise revenue to pay for solid waste planning and regulation, discourage the use of landfills, and encourage the use of recycling.

In some respects, the history of taxation in Vermont is the history of a state trying to deal with alternatives to the property tax and looking for a better way to tax income. The various taxes (and funding mechanisms, such as pari-mutuel pools, state lottery, and fees) are all designed to raise revenue and achieve policy objectives, but a completely acceptable mix of sources seems to evade Vermont continually. No session passes without more legislation on taxes. In 1869, the Council of Censors declared that "we have had too much legislation; that the continual tinkering of the laws, by making amendments one year and repealing them the next, and the numerous minor modifications of our statute which our legislation has produced, have not been profitable to the State."[50] There is a need for more stability in tax laws, but that goal will continue to evade the state as long as there is no stability in expenditure, as long as economic downturns and federal income tax changes continue to surprise us.

The Reports

The State Library devotes a shelf to tax studies. Most of them contributed little more than additional library dust. Still, they represent the best thinking of their era on how to repair what seemed so obviously wrong about the tax system of the year in which the report was issued. What has survived is haphazard and not comprehensive. For many important tax reforms, no documentation exists, at least on this shelf. Nevertheless, the studies that continue to occupy that space have their stories to tell.

There is the 1865 report of a special committee of the legislature to investigate a proposal to tax the income of U.S. bonds, stocks, and other securities. The idea was not favored by the committee. A minority report

explained that only productive property should be taxed, and argued that stocks were inherently unproductive. The majority of the committee rejected the idea for a different reason, concluding that the idea of taxing federal securities was unconstitutional and void.[51] Though nothing came of the proposal, the seed was planted that something had to be done to reach intangible property.

Jumping ahead thirty-five years, we find the 1900 report of a committee appointed to study "Double Taxation in Vermont."[52] Double taxation was wrong, most agreed, but finding a solution to the problem took many years. The system levied taxes on real property through the property tax and on the mortgage that secured debt on that same property, through personal property taxes assessed against the banks and then passed on to taxpayers through the cost of borrowing money. In this committee's view, the heart of the problem was inequality of tax burden due to tax evasion. In some towns real estate mortgages were simply not listed on the grand list; in others they were listed at less than the value of the mortgage. The lack of reliable grand lists also created inequities. To answer these problems, the committee recommended reform of the assessment process, including a proposal to eliminate all exemptions on real property and a method for ensuring that only the value of the real property actually owned by the landowner was taxed to him or her.

Nothing came of this recommendation, and in 1908 another commission was appointed to study the question of double taxation. What a difference a few years (or a different committee) made! In this report, double taxation is seen as a chimera, a problem only in the minds of those who fear the worst from taxes.[53] To illustrate the problem, the committee used the example of a farmer who pays tax on his land. At the same time, the value of his debt is assessed on the lender, the interest rate paid by the debtor presumably reflecting the tax paid by the lender. To the committee this was not a problem, since the tax was on the debt, not on the mortgage. The real problem, according to the committee, was a lack of full disclosure. Under the laws at this time, the taxpayer could offset the amount of debt against value of taxable personal estate. This was simply too great an opportunity for fraud. The taxpayer (or the listers) would overstate the value of debt, leave out taxable personal property altogether from the list (especially shares of stock), and underassess the value of real and personal estate in order to avoid state taxes.

According to the committee, the problem of any tax system is avoidance of duty. The practice of always seeking a loophole is demoralizing. "[O]ur main purpose is to bring home the thought that if every taxpayer, before finding fault with the law as it exists, would carefully examine his own conduct and motives relative to this subject and be sure that he

has contributed his honest proportion of taxes, there would be much less dissatisfaction, and certainly much less cause for dissatisfaction, with existing laws and less necessity for the appointment of commissions of this character." The committee proposed longer terms for listers, and election by ballot. It called for the adoption of a direct inheritance tax and a tax on foreign business corporations. It also proposed a delinquent tax penalty for late payments, since discounts alone were clearly not enough to compel payment. While stepping back from the idea of eliminating all exemptions,[54] the committee stressed the need for full appraisal of all exempt property, to ensure that voters and taxpayers understood how much tax capacity was being lost to exemptions.

The commission also proposed a uniform low rate for taxation of intangible property. "The underlying reason why intangibles can never be uniformly and successfully taxed at anything but a rate lower than that which on the average now prevails in this state is, that at such average rate the burden of taxation on this class of property becomes so heavy as to operate as a partial confiscation thereform; in fact this system has been aptly characterized as 'confiscation tempered by favoritism.'"

Vermont hillsides were bare in 1908, and the commission believed that high land taxes were one reason. Landowners were being forced to cut timber to pay the taxes, sometimes before the timber was mature, often as only a temporary buffer against a tax sale. As an early effort at current use value appraisal, the commission suggested taxing forest land as if it were already cut, and then taxing lumber by the cord or board foot.

The legislature respected the work of the commission and adopted some of its proposals. That year it instituted the first delinquent tax penalty of eight percent,[55] and three-year terms for listers.[56] It adopted the direct inheritance tax.[57] It did not repair the intangibles problem or offer any solution to the double taxation issue.

In 1930, as noted earlier, Governor John E. Weeks arranged for a total study of Vermont's tax system by experts appointed by the New England Council. This report is the source of the early thinking on the income tax, which was adopted in 1931. In that act the state property tax was also repealed, along with the intangibles tax, and direct highway and education taxes. The legislature favored the income tax over its predecessors for its uniformity and efficiency of administration, its promise to remove from towns the temptation to undervalue their grand lists, and the additional revenue it would bring to the state.[58]

The 1930 commission report recommended further study of the idea of taxing electric utilities.[59] The commission reminded the legislature of the consequences of bad tax laws, that "[w]ise taxation can promote

prosperity and unwise taxation can hamper it. Unwise taxation may have two bad results: the destruction or depletion of wealth and the unwise redistribution of it by excessive taxation of certain industries. Looked at as a state problem, unwise taxation necessarily results in the ultimate reduction of the wealth of its citizens on which the revenue of the state depends." The commission's report made recommendations, none of which were adopted by the legislature.

In 1937, the legislature appointed a commission to study Vermont's financial problems.[60] The commission concluded that the problem was a lack of uniformity in collections. It proposed eight new taxes as sources of revenue, especially for money to fund Vermont's Old Age Assistance Program, that seemed in particular need in 1937.

> It is time that we reconsider the whole problem of the interrelationship of state and local finances, estimate the proportion of public expenditures which each may be honestly expected to carry, and arrive at a just and feasible allocation of costs. With the whole trend of the times in the direction of more varied and inclusive governmental services, with the tendency in Vermont more and more towards centralizing the burden of financing these services, and with the state already under heavy obligations, the only sensible course is to take stock of the entire situation and lay plans intelligently from the long-range point of view. Otherwise, even with reviving business prosperity, we shall find ourselves involved for years to come in a biennial muddle of unsatisfactory makeshift attempts to resolve our problems.

The cigarette and tobacco tax was adopted in 1939 in reaction to this report. The report is important for showing Vermont the way to new revenue sources.

A commission was appointed in the early 1950s to study all phases of taxation. Its report continues the explorations of the 1937 commission in locating and recommending new sources of revenue, including pari-mutuel betting, an amusement tax (24%), tax on soft drinks, and retail sales tax, both of these latter taxes to be considered as long range options.[61]

The most important modern study of taxation in Vermont was written in 1966.[62] It was a study of Vermont's needs and tax resources and the question of how to estimate taxes. The commission sought to help relieve the burden of the income tax on individuals by making the income tax rate structure more progressive, raising exemptions, and adopting an income tax system that "piggy-backs" the federal tax. This last was adopted that year.[63] With the help of consultant William Miller, the commission recommended recasting the state aid to education formula to give it the flexibility to respond to changes in the amount of money appropriated by the state for education. After it was law, everybody called it the Miller Formula. The ideas proposed by the commission that were not adopted

are at least as interesting. It wanted to address the problem of farm and forest land and its tax liability by zoning and not by a differential tax schedule. It favored a sales tax at a time when talk of that reform was as suspect as talk of a statewide property tax is in some quarters today.[64]

Two studies from the 1980s round out the bibliography of taxation in Vermont. The first is a 1983 study of the general fund by a group of executive branch officials.[65] It argued for decoupling the Vermont income tax from the federal, to avoid unforeseen future deficits. It recommended an increase in the meals and rooms tax to offset federal tax cuts. The second is a 1986 report from a Windham Foundation Conference on tax policy.[66] This study recommended a uniform statewide property tax on all non-residential property to generate revenues that would be redistributed to towns on a per-student basis. The study recognized the need for wealthy communities to pay for equalizing education throughout the state.

These will not be the last reports on taxes in Vermont. We are a state of inventors, and we will never give up trying to find a better way. A better appreciation for proposals made in the past that have not found a home in Vermont law, however, might help future commissions in their search for the truth and the way.

The Leading Cases

Another way of investigating the idea of taxation in Vermont is to see how the judicial branch has handled the questions that come up as each new tax is imposed. It is almost a tradition that as a new tax takes effect a taxpayer will challenge its constitutionality.

Most attacks failed. One of the few successes arose from a local tax question from the City of Vergennes in the 1880s. A charter provision authorized city authorities to build sidewalks and levy assessments against property owners served by them, but challengers argued it was unconstitutional. It contained no fixed, certain, and legal standard for assessment. The village trustees were left to determine how the taxes were to be assessed, in the words of the act, "as they shall deem just and equitable." The law itself did not require uniformity—proportional contribution, that is. Even though no citizen had yet been taxed and the trustees had not shown themselves to be unfair or unwilling to recognize uniformity as the leading principle, the court struck down the charter section. Without standards, there is no right to tax.[67]

The longest-running litigation in the history of Vermont involved a fight between the Vermont Central Railroad and the Vermont and Canada Railroad over the line between Rouses Point and Essex Junction and the rights and liabilities of the parties.[68] The immediate questions relating to the role of receivers and who would control the road were settled

by the supreme court by 1882, but that same year the corporate franchise tax was enacted. Running a railroad became much harder, especially for the Vermont Central and its successor, the Central Vermont, since that railroad had enjoyed complete exemption from all taxes by charter from the 1840s. The tax was a harsh blow to all railroads, but especially the C.V.R.R. The gross receipts tax provided that the tax should be paid by the lessor and deducted from the rent agreed on in the lease. The Rutland Railroad claimed that this was an impairment of its contract with the Vermont Central, from whom it had leased miles of road, and a violation of the U.S. Constitution. The Vermont Supreme Court remained unpersuaded:

> The object of the legislation was to make each railroad in the State, *as a railroad,* contribute to the public treasury its proper share of the burdens of taxation. Under the act of 1874 the plan of treating railroads as real estate was adopted as the basis of a scheme of taxation. This act not proving acceptable, in 1882 the plan was adopted of graduating the taxation upon the basis of earnings. In both cases the tangible thing upon which the State laid its hand was the railroad itself, and unless we substitute the shadow for the substance, the thing taxed under the act of 1882 was "the property of the Rutland R.R. Co."[69]

The court found that the payment requirements of the law were no impairment of contract, but an acceptable method of collecting the tax. The court did cut back on the tax in one way, however. It held that the Rutland Railroad was correct in arguing that a portion of its operations involving interstate commerce was out of bounds for the state to tax. But the court rejected the main challenge to the law, that it was an impairment of contracts.

Within ten years of its enactment, the 1896 inheritance tax was challenged on the way it treated some property. While taxing the value of estates passing as inheritance, the law exempted bequests to charitable, educational, or religious societies or institutions. The tax commissioner refused to allow an exemption for nonresident corporations, and one sued him to learn whether this constituted a violation of Article 9. The court found the tax constitutional. It is not a tax on property at all, announced the court, but on the transmission of property. The exemption for payments to Vermont charitable, educational, or religions societies or institutions, and not to similar foreign corporations, was also approved. Proportional contribution, according to the court, is to be measured by the impact on the taxpayer. "It seems clear that privileges of this character, as well as property, are to be considered in determining the just proportion of the individual."[70] As long as exemptions are based on reasonable distinctions, they would not be upset on grounds of uniformity or equality.

The Burlington city charter authorized the city to build public wharves, borrow and bond to pay for them, and condemn land to accomplish that purpose. The Central Vermont Railroad resisted the condemnation of its property in 1909, arguing that the wharves were for private use, and that this was not a public purpose. The court disagreed. "[W]hat is a public purpose within the meaning [of the charter], is a question for the Legislature to decide, and concerning which it has a large discretion, which the courts can control only, if at all, in very exceptional cases, and this is not such a case."[71] The court served notice that it would not second-guess the legislature's decision that "the purpose for which it is to be raised [is] of more service to community than the money would be if not collected."

The intangibles tax came under attack in 1911. This was a tax of seven-tenths of one percent on the average deposits of savings banks and trust companies. A national bank challenged the tax and the court agreed that the state could not tax a national bank as a condition of the privilege of doing business there without the consent of Congress. But the court agreed that the state could tax the depositors and their interests. The court decided that taxing nonresidents would be wrong since those assets would not be sited in Vermont. For resident depositors, the court sustained the tax.[72]

The court has shown such deference to the legislature over the years on matters of taxation. In 1921, it upheld the taxability of land owned by a trust fund. The court would not invade the legislative function of judging the constitutional mandate. "That [the legislature has] appeared to fail at times must be admitted; but, considering the magnitude of the task, the results attained compare favorably with those in other jurisdictions." The trust fund was taxable.[73]

Two years later a taxpayer challenged the tax on premiums paid for insurance, which applied to all persons, companies, associations or corporations residing or doing business in Vermont who were paying premiums to insurance companies not authorized to do business in this State. This tax the court found to be unconstitutional and void, since it deprived parties of the liberty to contract guaranteed by the Fourteenth Amendment of the U. S. Constitution.[74]

The first big challenge to the Vermont income tax came in 1934. The court sustained the tax, finding no conflict with the Fourteenth Amendment unless the tax clearly results in "flagrant and palpable inequality between the burden imposed and the benefit received as to amount to an arbitrary taking of property without compensation." The test is uniformity and equality, and the question for the court was whether the classification was rational and whether all those within the same class are treated similarly.[75] The court validated the Vermont income tax.

In 1974, the year the land gains tax took effect, the tax was immediately challenged by an unhappy taxpayer. The challenge to the tax was based on its stated purpose—"to limit a person's property tax on his basic housing to five percent of his household income; and to provide partial funding for such property tax relief by imposing a tax on the gains from certain sales in exchanges of real property." The taxpayer felt that this stated purpose was a mask hiding its real purpose, which was to deter land speculation in Vermont, but the court disagreed, and upheld the tax. "Legislation may frequently serve multiple objectives. There is no requirement that the objectives served by the manner in which a tax is collected and those served by the manner in which it is spent be related to each other for constitutional purposes."[76]

In 1989, a taxpayer challenged a provision of the Burlington city charter that authorized the city to appraise nonresidential property at 120 percent of fair market value. Business interests in the city questioned this standard as violating Article 7 (Common Benefit clause) and Article 9 of the Vermont Constitution. The court found no problem with the method of assessment. The court held that the test is reasonableness (a reasonable relation to the purpose for which the tax is established) and that the classification scheme must be fairly and equitably applied among like classes of taxpayers. If the purpose is to raise overall city revenues, then there is no offense to the idea of proportional contribution, since there is a public purpose to the object of the tax.[77]

Taxes bring out the litigiousness in people. To the extent that the Vermont Constitution is used to challenge a tax, however, it will be an uphill battle for taxpayers. The government has the high ground, benefiting from the traditional deference shown the legislative branch by the courts and the willingness of the courts to respect tax classifications that are at least minimally reasonable.

Final Thoughts

What makes a good tax? That depends on your perspective. The Vermont Constitution teaches that a tax must have a public purpose and its impact in achieving this purpose must be proportional, taxpayer by taxpayer. The legislature has the power to develop classifications and grant exemptions that give advantage or disadvantage to categories of taxpayers without risking constitutional repeal. Only the legislature can say whether a tax is of more benefit to the community than if there were no tax. Analysts add other standards, such as whether the tax will not be so burdensome as to destroy or discourage the taxpayer, how convenient and costly the tax is to administer, how clear its provisions are to the taxpayer, and how much of a return it is capable of producing.

The state's experience with the property tax shows that a good tax is one that does not encourage disobedience to its strictures, whether that means the inclination to underreport assets for the property tax or to shop in New Hampshire to avoid the sales tax.

In 1920, the Hon. Fred B. Thomas delivered a paper to the Vermont Bar Association Annual Meeting on "The Property Tax." There he tried to define why we tax. He began by offering the old explanation, that taxes are a payment for protection or security, a necessary cost of the liberty to make a living and live peacefully. He admitted such ideas had passed from favor, and that today most people, if they try, will justify taxes as a duty to contribute to the needs of the state. This second generation theory is still quite current. It follows from the recognition of duty, not compensation. How much is enough is the next question. Some Vermonters think we've passed that point already.

Tax policy is not an exact science. Politics color every debate and no change comes without full consideration of the fiscal impact on each town, with corresponding support or opposition for the change depending on the result of that test. Fear of a statewide property tax remains fervent in many corners of Vermont. Others argue the property tax is exhausted and has outlived its useful life. Cities and towns urge the state to grant them the option of adopting other local taxes. In each legislative session there are debates on tax reform, and every five years or so another commission is appointed to study the system and propose improvements that will repair the problems of fairness, progressivity, and a sufficient tax base to justify necessary expenses, including the exploration for new sources of taxation. The hunt for a balance will continue, but, if the history of state taxation in Vermont is any pattern, no answer will hold good for long.

Notes

[1] In the 1777 Constitution, Article 9 provided, "That every member of society hath a right to be protected in the enjoyment of life, liberty and property, and therefore is bound to contribute his proportion towards the expense of the protection, and yield his personal service, when necessary, or an equivalent thereto; but no part of a man's property can be justly taken from him, or applied to public uses, without his own consent, or that of his legal representatives; nor can any man, who is conscientiously scrupulous of bearing arms, be justly compelled thereto, if he will pay such equivalent; nor are the people bound by any law, but such as they have, in like manner, assented to, for their common good." Section XXXVII of the 1777 Constitution provided, "No public tax, custom or contribution shall be imposed upon, or paid by, the people of this State, except by a law for that purpose; and before any law be made for raising it, the purpose for which any tax is to be raised ought to appear clear to the legislature to be of more service to the community than the money would be, if not collected; which being well observed, taxes can never be burthens." The 1786 Council of Censors proposed, and the Constitutional Convention of the following year adopted, an amalgamation of these two parts. This change included the substitution of "that" for "the" before the word "protection," the substitution of "or that of the Representative body of the Freemen" for "or that of his legal representatives," and the deletion of words, "No public tax, custom or contribution shall be

imposed upon, or paid by, the people of this State, except by a law for that purpose" and "which being well observed, taxes can never be burthens." In the 1793 Constitution, the phrase "no part of a man's property" became "no part of any person's property."

[2] See Frederick Augustus Wood, *The Finances of Vermont* (New York: Columbia University, 1913). Also by Wood, *The History of Taxation in Vermont* (New York: Columbia College, 1894).

[3] Frederick Wood calculated the total town debt arising from the Civil War at almost ten million dollars. Compare this to the total grand list in 1865 for state tax purposes at $1,037,660.05. *Vermont House Journal* (1865), 399.

[4] *Clement v. Graham,* 78 Vt. 290 (1906). See also Otto T. Johnson, *Nineteen-Six in Vermont* (privately printed, undated).

[5] Albert Stillman Batchellor, ed., *The New Hampshire Grants, Being Transcripts of the Charters of Townships* (Concord: Edward N. Pearson, 1895), 29–34.

[6] Mary Greene Nye, ed., *Sequestration, Confiscation and Sale of Estates,* State Papers of Vermont VI (Montpelier: Secretary of State, 1941).

[7] Ira Allen, *The Natural and Political History of the State of Vermont* (London: J.W. Myers, 1798; reprint Rutland: Charles E. Tuttle Company, Inc, 1969), 64–65.

[8] "An Act for the Purpose of Procuring Provision for the Troops, to be Employed in the Service of This State for the Year Ensuing," November 3, 1780, Allen Soule, ed., *Laws of Vermont 1777–1780,* State Papers of Vermont XII (Montpelier: Secretary of State, 1964), 212–17.

[9] "And whereas the Land is the great Object of the present War, and receives the most solid Protection of any Estate, a very large part of which has hitherto paid no part of the great Cost arisen in defending it, while the Blood and Treasure of the Inhabitants of the State has been spent to protect it, who many of them owned but a very small part thereof," was the justification for this first land tax. John A. Williams, ed., *Laws of Vermont 1781–1784,* State Papers of Vermont XIII (Montpelier: Secretary of State, 1965), 23–28.

[10] Fred B. Thomas, "The Property Tax," *Vermont Bar Association Proceedings* 16 (1920), 151–64.

[11] The poll tax, a feature of Vermont local government from the beginning, was abolished in 1978, with a four-year transition to lessen the pain of withdrawal, effective 1982. Once disconnected from voting status, as it was in 1974, the poll tax simply lost its vitality as a part of the system of local revenues.

[12] *Laws of Vermont, 1777–1780,* 44–49.

[13] *Journal of the Senate,* October 5, 1882, 33.

[14] *Laws of 1882,* No. 1, 3–11.

[15] William H. DuBois, "Treasurer's Report," 1885, *Vermont State Officers' Report for 1885–6* (Rutland: The Tuttle Company, 1886), 8–9.

[16] *Laws of 1880,* No. 143, 136–37.

[17] *Laws of 1882,* No. 3, 20–1.

[18] *Vermont Statutes* (1894), 175–201.

[19] *Laws of 1892,* No. 56, 54–7.

[20] *Laws of 1896,* No. 46, 38–41.

[21] 32 V.S.A. § 7442a.

[22] See note following 32 V.S.A. § 7411.

[23] Andrew E. Nuquist and Edith W. Nuquist, *Vermont State Government and Administration: An Historical and Descriptive Study of the Living Past* (Burlington: University of Vermont, 1966), 168–69.

[24] *Journal of the Joint Assembly,* January 4, 1923 (Montpelier: Capital City Press, 1923), 595.

[25] *Laws of 1923,* No. 83, 90–92. In 1929, the tax was raised to four cents (No. 30, 38–41); in 1947, to four and a half cents (No. 25, 46–7); 1949, five cents (No. 35, 34–35); 1955, five and a half cents (No. 209, 180–81); 1957, six and a half cents (No. 251, 246); 1968, eight cents (No. 380, 632–33); 1971, nine cents (No. 35, 57); 1981, eleven cents (No. 87, 330); and reached its current thirteen cents in 1986 (No. 207, 411). 23 V.S.A. § 3106.

[26] Governor Franklin Billings vetoed the intangibles tax in 1925. His veto message explained that, "the subject matter of taxation is one concerning which there is probably more divergence of opinion than concerning any other subject, and dissatisfaction with taxation laws is bound to continue and trouble people in the future as it has through past ages." But he felt he had to veto the bill because the proposal would shift the tax burden from bank stocks to real property by taxing intangibles at a different rate (and not including them as part of the grand list for property tax purposes). The legislature voted to override the veto, and the intangibles tax became law. *Senate Journal* (1925), 439–42.

[27] *Report of the Vermont State Tax Commission,* Montpelier, 1930.

[28] *Laws of 1931,* No. 17, 17–46. At first there were two rates. Individuals and corporations each paid two percent of income.

[29] *Laws of 1935,* No. 28.

[30] 16 V.S.A. § 3475.

[31] *Vermont Statutes* (1947), § 934. See also, *Report of the Commission to Study Inconsistencies of Income Tax Laws*, 1941. *Vermont House Journal* 1941, 11–13.

[32] 32 V.S.A. § 5822.

[33] *Journal of the Joint Assembly*, January 5, 1933, 511.

[34] *Laws of 1934* (Sp. Sess.), No. 1, 422; *Laws of 1935*, No. 28, 35. The liquor tax rose to twenty-three cents a pint in 1937 (No. 35, 35); twenty-five cents in 1939 (No. 34, 48); thirty-five cents in 1945 (No. 20, 21); forty-five cents in 1947 (No. 109, 174); $5.10 a gallon in 1957 (No. 277, 290–91); $5.60 a gallon in 1969 (No. 144, 468); twenty-four percent of gross revenues in 1974 (No. 129, 3); and the present twenty-five percent in 1981 (No. 96, 397). Beer and wine rose to ten cents a gallon in 1937 (No. 38, 68); fifteen cents in 1949 (No. 142, 137–38); twenty cents in 1957 (No. 265); twenty-five cents in 1969 (No. 144, 276–77); wine alone rose to fifty cents a gallon, with beer still at twenty-five cents, in 1976 (No. 243, 345); and both climbed to their present rates of 26.5 cents for beer and 55 cents for wine in 1981 (No. 96, 397).

[35] *Laws of 1934* (Sp. Sess.), No. 1, 422; *Laws of 1935*, No. 28, 35. The liquor tax rose to twenty-three cents a pint in 1937 (No. 35, 35); twenty-five cents in 1939 (No. 34, 48); thirty-five cents in 1945 (No. 20, 21); forty-five cents in 1947 (No. 109, 174); $5.10 a gallon in 1957 (No. 277, 290–91); $5.60 a gallon in 1969 (No. 144, 468); twenty-four percent of gross revenues in 1974 (No. 129, 3); and the present twenty-five percent in 1981 (No. 96, 397). Beer and wine rose to ten cents a gallon in 1937 (No. 38, 68); fifteen cents in 1949 (No. 142, 137–38); twenty cents in 1957 (No. 265); twenty-five cents in 1969 (No. 144, 276–77); wine alone rose to fifty cents a gallon, with beer still at twenty-five cents, in 1976 (No. 243, 345); and both climbed to their present rates of 26.5 cents for beer and 55 cents for wine in 1981 (No. 96, 397).

[36] *Laws of 1939*, No. 35, 49–56. In 1949, the tax was increased to two mills (No. 30, 32); 1957, to two and a half mills (No. 163, 120–21); 1959, three and half mills (No. 243, 299–300); 1963, four mills (No. 226, 309–310); 1969, six mills (No. 144); 1983, eight and a half mills (No. 2 [Sp. Sess.], 4–5); and 1991, nine mills on July 1, 1991, to ten mills on July 1, 1992 (No. 32, 64–65); and finally to twenty mills on April 14, 1995 (No. 29, 1995).

[37] *Laws of 1959*, No. 217, 246–55.

[38] *Journal of the Joint Assembly*, 1957, 786–87.

[39] William Wheaton, ed., *Vermont Facts and Figures* (Montpelier: Department of Budget and Management, 1973), 355. The tax was raised to four percent in 1968 (No. 346, 551); in 1969, to five percent (No. 144, 472–73); 1989, six percent (No. 51, 102–3); and in 1991 to eight percent until July 1, 1993, when it went back to seven percent (No. 32, §§ 18, 20, 62–63).

[40] *Laws of 1967*, No. 146, 211–15.

[41] *Laws of 1969*, No. 144; *Laws of 1988*, No. 200. Codified at 32 V.S.A. § 9602. The tax on residences up to $100,000 of value is one-half of one percent. On all other transactions, the rate is one and one-half percent.

[42] *Journal of the Joint Assembly*, January 12, 1968, 385.

[43] *Laws of 1969*, No. 139. Now codified at 32 V.S.A. § 5961 and following.

[44] 32 V.S.A. § 5967.

[45] *Laws of 1969*, No. 144. The rate was increased in 1982 to four percent (No. 170, 178–79) and five percent in 1991 (No. 32, § 10, 59–60). Despite intentions to reduce the tax to four, it remains at five percent (January 1, 1997).

[46] *Laws of 1973*, No. 81, 228–38.

[47] *Laws of 1977*, No. 236.

[48] *Laws of 1988*, No. 200.

[49] 32 V.S.A. § 5952.

[50] Paul S. Gillies and D. Gregory Sanford, eds., *The Records of the Council of Censors* (Montpelier: Office of the Secretary of State, 1991), 645.

[51] *Vermont House Journal* (1865), 150–53, 192–96.

[52] "Double Taxation in Vermont," Report of the Special Committee Appointed To Report a Measure for Its Relief to the Legislature of 1900 (Burlington: Free Press Association, Printers and Binders, 1900). (October 3, 1900).

[53] Commission to Investigate Double Taxation *Report of the Commission on Taxation Appointed under No. 501 of the Acts and Resolves of the General Assembly of the State of Vermont* (Montpelier, 1908).

[54] Governor Charles Bell, in his 1906 retiring remarks to the legislature, said that, "Taxation is a simple matter when all property, both real and personal, without exemption of any class or kind, is made to pay its just proportion. The moment we begin to legislate in favor of one class, some other class is sure to suffer, and trouble begins." *Journal of the Joint Assembly* (1906), 520.

[55] *Laws of 1908*, No. 201, 175.

[56] *Ibid.*, No. 82, 73.

[57] *Ibid.*, No. 31, 27–29.

[58] *Report of the Vermont State Tax Commission* (Randolph: Roy L. Johnson Company, 1930).

[59] This led to the 1933 report of a commission duly appointed to investigate this subject. *Report of Commission to Investigate the Subject of Taxation of Public Utilities, Vermont House Journal* 1933, 79–87.

[60] *Vermont Finances, Report of a Special Commission*, Joint Resolution, January 24, 1936. The text of this report is missing, but a four-page flyer describing its conclusions is filed in the committee minutes of the 1937 House Ways and Means Committee.

[61] *Report of the Commission to Study the Question of Taxation.* August 30, 1952.

[62] *Report of the Tax Study Committee to the Legislative Council, Relating to R–23 of the Acts of 1966.* Montpelier, December 28, 1966

[63] *Laws of 1966,* No. 61 (Sp. Sess.).

[64] While not part of the story of state tax reform, in 1972, the Department of Budget and Management proposed an interesting new approach to property taxes in a document called "The Rockingham Study" (*The Rockingham Study, General Property Tax Reform Plan.* [Dept. of Admin., Budget and Management Division, 1972]). This proposal would have required classification of all real property according to its use. After this is done, each property would be subject to a possible mixture of taxes depending on its type. Everyone would pay a graduated "cost of government" tax based on land use and size of holding. There would be a graduated income-based education tax, a graduated real property transfer tax, a "cost of buying in" tax to pay for extension of town services. The study proposed eliminating the personal property tax, business inventory tax, and tax on structures (thus eliminating the need for appraising real property). It also proposed collecting property taxes by the payroll deduction method, with the state responsible for all billing and enforcement. Monthly payments would be made by the state to municipalities. These good ideas did not become law.

The record also includes an interesting monograph on equalizing grand lists from 1976, co-written by Gerow Carlson, who subsequently headed the Property Valuation and Review Division. Carlson argued that the problems of assessment could be resolved by the introduction of the computer to the appraisal system of Vermont towns. The computer would permit annual up-dating of every value on the roll. Computers are now common tools for property assessment in Vermont, at the state and local levels, but they have not fulfilled the vision of Gerow Carlson in 1976 (Gerow W. Carlson, Robert J. Finnegan, *Assessment Administration in Vermont.* [October, 1976]).

[65] *Vermont's General Fund Taxes: A Study.* The Tax Study Group, Executive Department, State of Vermont. October, 1983.

[66] *A Review of Vermont's Tax Policies, Report of the Eighth Grafton Conference, June 22–24, 1986* (Grafton: The Windham Foundation, 1986).

[67] *Barnes v. Dyer,* 56 Vt. 469 (1884).

[68] See Max L. Powell, "The Twenty-Seven Years' Litigation," *Vermont Bar Association Proceedings* (1907), VIII (Montpelier: Argus and Patriot Press, 1909), 100–44. Also, *Report of the Joint Special Committee to Investigate the Vermont Central Railroad Management* (St. Albans: Messenger Printing Establishment, 1873).

[69] *Rutland R.R. Co. v. Central Vermont R.R. Co.*, 63 Vt. 1, 26, 21 Atl. 262 (1890).

[70] *In re Hitchcock's Estate,* 78 Vt. 259, 265, 62 A. 724 (1906).

[71] *City of Burlington v. Central Vermont Railway,* 82 Vt. 5, 71 A. 826 (1909).

[72] *State v. Clement National Bank,* 84 Vt. 167, 78 A. 944 (1911).

[73] *City of St. Albans v. Avery,* 95 Vt. 249, 114 A. 31 (1921).

[74] *State v. International Paper Co.*, 96 Vt. 506, 120 A. 900 (1923).

[75] *Colgate v. Harvey,* 107 Vt. 28, 175 A. 352 (1934). See also, *Pabst v. Commissioner of Taxes,* 136 Vt. 126, 388 A.2d 1181, appeal dismissed 439 U.S. 922 (1978). Test of classification will be upheld if it "serves any of the purposes that are conceivably behind the statute in question and that are within the powers of the legislature to pursue."

[76] *Andrews v. Lathrop,* 132 Vt. 256, 315 A.2d 860 (1974).

[77] *In re One Church Street,* 152 Vt. 260, 565 A.2d 1349 (1989).