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IN THE

Supreme Court of Virginia

AT RICHMOND

RECORD NO. 730657

COUNTY BOARD OF ARLINGTON COUNTY,
Appellant,

V.

DOMINICK FOGLIO, etc., et al,
Appellees,

APPENDIX

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IN THE

SUPREME COURT OF VIRGINIA

AT RICHMOND

RECORD NO. 730657

COUNTY BOARD OF ARLINGTON COUNTY

v.

DOMINICK FOGLIO, etc., et al,

From the Circuit Court of Arlington County
Charles S. Russell, Judge

APPENDIX

* * * * *

PETITION
(Filed August 25, 1972)

TO THE HONORABLE JUDGES OF SAID COURT:

COMES NOW the Petitioners, by Counsel, and pursuant to the provisions of Section 58-1145 of the Code of Virginia, 1950, as amended, respectfully represents unto the Court as follows:

I

The Petitioners are all engaged in the operation of businesses defined under Section 11-72 of the Arlington County Business Privilege License Ordinance.

II

In January of 1972 a Business Privilege License Tax computed at the rate of two dollars per one hundred dollars of gross revenue was assessed and collected from each of the Petitioners.

III

The two dollar rate above referred to was established by the Defendant County Board by amending Section 11-72 of the said Business Privilege License Ordinance in 1971 to provide said rate in lieu of the previously enacted rate of fifty cents per one hundred dollars of gross revenue.

IV

The Business Privilege License Tax was enacted to become effective January 1, 1949 and has been amended from time to time to add categories, establish rates and divide categories.

V

The Business Privilege License Ordinance is a general revenue measure and provides in its terms that the burden of the tax shall be equalized as far as practicable among those liable thereto.

VI

In enacting the ordinance, the Board utilized as a standard for setting the various rates, adjustments up or down from the rate established for retail merchants (Section 11-61 of the ordinance), according to relative operating margins, as a vehicle for equalizing the burden of the tax among those liable thereto.

VII

The rate set in 1971 for the computations of the 1972 tax upon the Petitioners' businesses exceed this standard by more than three hundred per cent and was arbitrary, capricious and discriminatory.

VIII

The arbitrary, capricious and discriminatory action of the Defendant has resulted in establishing Petitioners' rates so high as to be virtually confiscatory and prohibitive in some cases.

IX

The Commissioner of Revenue and Attorney for the Commonwealth have been given notice of this petition pursuant to statute.

WHEREFORE the Petitioners pray as follows:

A. That an order of exoneration issue providing relief as prescribed by statute.

B. That process issue requiring the attendance of the Commissioner of Revenue for Arlington County as a witness in the proceedings.

* * * * *

ANSWER AND GROUNDS OF DEFENSE

(Filed September 15, 1972)

The defendants, the County Board of Arlington County, Virginia, a body corporate, by counsel, answers the petition of the plaintiffs as follows:

1. The defendant is without sufficient information to answer paragraph I of the petition, and demands strict proof of the facts pleaded there.

2. The defendant admits paragraphs II, III, IV and IX of the petition.

3. Paragraphs V, VII and VIII of the petition state conclusions of law which requires no answer by the defendant.

4. The defendant denies paragraph VI of the petition.

5. All allegations not specifically admitted, avoided or denied, are denied.

6. The defendant further alleges that the tax referred to in the petition is a reasonable tax levied in accordance with law and that the rate of the tax is a proper exercise of the discretion of the levying body.

WHEREFORE, having answered fully, the defendant prays that the petition be dismissed, that final judgment be entered against each and all of the plaintiffs, and that the defendant be awarded its cost expended in this action.

* * * * *

PROCEEDINGS

* * * * *

OPENING STATEMENT OF MR. BATCHELOR

[Begin Transcript, page 5, line 20]

I would like to state at the outset that we are not attacking the ordinance itself as to its constitutionality, or as to the effectiveness of the ordinance; what we are directly attacking in this action is the application of this [Tr. 6] ordinance to these particular taxpayers who are affected under its taxing provisions.

[End Transcript, page 6, line 2]

* * * * *

[Begin Transcript, page 18, line 12]

We suggest to the Court that the appropriate method for the Board in order to properly change the categories of taxes under the gross receipts tax is to make a study of the gross receipts tax, and to determine if there are appropriate changes within the economics of any of the businesses, or professions, or trades, which would suggest that the rate of return is higher, or lower, as the case might be, which would justify a change in rates, or a change in the groupings they are placed in.

[End Transcript, page 18, line 20]

* * * * *

OPENING STATEMENT OF MR. FLINN

[Begin Transcript, page 20, line 2]

THE COURT: Excuse me, Mr. Flinn, doesn't this section allow the Court, or require the Court to intervene upon a showing of nonuniformity in the application of taxes? The taxpayer doesn't have to show it is confiscatory, or prohibitive. This thing says, and I read it --

MR. FLINN: That's the --

THE COURT: 58-1135, "In each such proceeding the burden shall be on the taxpayer to show that the property is assessed at more than the fair market value", that's in the case of real estate tax, or, "That the assessment is not uniform in its application", or, "If the Court in its discretion finds the injustice would be met by making an adjustment that it shall not be necessary for the taxpayer to show that intentional, systematic and willful discrimination has been made."

MR. FLINN: I think -- I don't think that the kind of uniformity that has to be shown with respect to real property tax has to be shown with respect to license tax.

I think my argument on the law would be that there could not be any invidious discrimination, and the same standard of uniformity that applies in the case of real property

doesn't have to be applied. The standards of uniformity are
[Tr. 21] best described by the proposition that it's only a tax that's prohibitive, or confiscatory that violates the standards here.

At this time I would only suggest what my argument would be, outlining, and on the question of this requirement to equalize, since that's a self-imposed requirement, and vague, I think, that any later measure was in the discretion of the legislative body,of the County Board in this case, wouldn't have to be consistent with some interpretation of what the appropriate method of equalization was.

So there would be no substantial argument on the fact here, but argument on what the law was that should apply to these facts.

[End Transcript, page 21, line 12]

* * * * *

[Begin Transcript, page 21, line 13]

TESTIMONY OF PAUL H. BEESON

MR. BATCHELOR: Your Honor, I would like to call Mr. Beeson.

Whereupon,

PAUL H. BEESON

was called as a witness on behalf of the Plaintiffs, and having been duly sworn, was examined and testified as follows:

BY MR. BATCHELOR:

Q For the record, would you state your name, and your occupation, sir?

A Paul H. Beeson, Commissioner of Revenue, Arlington [Tr. 22] County, Virginia.

Q Mr. Beeson, how long have you been associated with the Commissioner of Revenue's Office in Arlington County?

A 28 years.

Q And how long have you been Commissioner of Revenue of Arlington County?

A Since 1969.

Q Mr. Beeson, prior to that, to assuming the duties of Commissioner of Revenue for Arlington County, were you the head of the Business Privilege License, or Business License Section of the Commissioner of Revenue's Office?

A Well, immediately prior to 1969 I was Chief Deputy Commissioner with overall charge of the office; and then from 1958 back to 1945 I was Deputy Commissioner in charge of the Licensing Section.

Q Now, Mr. Beeson, directing your attention specifically to the Business Privilege License Ordinance in Arlington County, are you familiar with the circumstances giving rise to its enactment in the county by the County Board?

A Yes, I am.

Q At the time this ordinance was being discussed, being studied, did you participate in the formulation of a report to the Arlington County Board relating to various
[Tr. 23] recommendations relating to license taxation?

A Yes, I did, in conjunction with the study that was being made by the University of Virginia.

Q And you, I take it, you and Mr. Fisher were employed for the purposes of assisting in that study by the University of Virginia?

A We were paid on an hourly basis when we worked after 5 o'clock, or Saturdays and Sundays; during work hours, no.

Q Now, this study was ultimately forwarded to the Arlington County Board, I take it?

A Well, it was at the request of the County Board.

Q And at the time the Arlington County Board received this report there were discussions with you and Mr. Fisher with regard to licensing, and to the various aspects of the licensing presented under this recommendation?

A Let me answer it this way: Over a period of several months there were discussions with the County Board and the University of Virginia, leading up to the point of the adoption of the final ordinance.

Q Now, in the adoption of the ordinance, was a rationale established for taxation of the various occupations, businesses, and trades affected by the ordinance?

A Well, as to gross-receipt type licensing there were
[Tr. 24] various rates among the broad classifications such as personal services occupations, retail merchants, special occupations, and so on, and were assigned a tax rate.

Q Now, what was the rationale behind these various categories these taxpayers were placed in?

A Well, operating margins were established for various kinds of businesses and professions, and the retail merchant was considered to be the base point in all other types of businesses and occupations, an extension upward, or down from that point; the tax rate at 12 cents for each hundred dollars gross receipt was assigned to a retail merchant, so from determining the rate to be applicable for a professional occupation, then personal services occupation, the rate then would be two hundred times the retail rate, a contractor --

Q Did you say two hundred times, or two times?

A Two times, excuse me.

THE COURT: 12 cents was originally adopted for the retail merchant, so personal services was 24 cents, something on that order?

THE WITNESS: Something on that order, yes, sir.

THE COURT: What kinds of broad categories did you have for these initial rates?

THE WITNESS: Retail merchants 12 cents; wholesale

[Tr. 25] merchants 11 cents; manufacturers 11 cents; builders and developers, there was a bracket system, renting of houses, apartments, commercial establishments, 15 cents.

There were deviations in four cases, beginning with the special occupations, contractors, builders and developers, amusements, which was corrected two years later.

As to those four, they were on a bracket system. For example, from zero to five thousand tax receipts, $10; from five thousand to ten thousand, $15.

BY MR. BATCHELOR:

Q They were not encompassed under the gross receipt aspect, they were bracket type.

A There was a little oppostion for several years against it, and then it was changed as a result of the study that was made in 1951.

Q Now, with regard to the categories that were under the gross receipts tax, did I understand your testimony to be that this was predicated upon the rate of return?

A Operating margin.

Q Operating margin. And what was the purpose of that, Mr. Beeson?

A Well, ability to pay, really. An illustration would be the retail merchant, let's say a grocery store, the operating

[Tr. 26] margin would be the difference between the gross receipts, the cost of the goods purchased for retail, and the contractual obligations upon the person in the establishment. If a merchant has gross receipts of $100,000, and these purchases are $10,000 his operating margin is only $20,000.

Now, to take it to the extreme, a professional person, such as an attorney at law, or a medical doctor, the operating margin is quite high because he has various things that he has to buy, and so that establishes a rationale for having the different tax rate.

Q Then the rationale behind this was to establish a rate which each of the particular classifications could pay?

A Yes.

Q And were they similar, or were they equal in nature as close as practicable?

A The original study established this, that if the retail merchant has a base of one hundred, then the wholesale merchant would be 72, 70 percent; the contractor would be 180; professional occupations 360; personal services occupations 200; business services 100; repair services 100; amusement businesses 250; manufacturers and processers 72.

So whatever tax rate the merchant has is multiplied by these percentage points to bring out your rate applicable

[Tr. 27] to the persons in the other categories.

Q Then the practical effect of these figures was to see that based on profit each person pay essentially the same tax?

A You are attempting to get the point perfect, perfection is not to be had.

Q Just as far as practical?

A Yes, sir.

Q Now, when the ordinance was enacted it provided for, in Section 11.2 of the ordinance, it provided for this type of equalization; did it not?

A Yes, it was under what was known then as Section 64, and was listed under a "hotel" every person engaging in any of the following personal services established the tax rate was 25 cents for each $100, which here is twice the retail; and then listing by type of business, barber shop, beauty parlor, a hotel, and going on to --

THE COURT: Well, what you are speaking of now is the original rate applicable to all personal services businesses, 25 cents?

THE WITNESS: Yes, the retail would be 12 cents; and two times the retail rate would be the personal services rate.

[Tr. 28]THE COURT: And that initially applied to hotels, which is a sub-division under personal services?

THE WITNESS: Yes, sir.

THE COURT: It falls in the personal services category?

THE WITNESS: Yes, sir.

BY MR. BATCHELOR:

Q You didn't have anything on motels?

A We didn't have any motels, we only had 167 bedrooms in all in the hotel industry in Arlington.

Q Now, subsequent to that time there were motels that came into being, and the ordinance was amended to include them in the same category as the hotels; is that true?

A Not for the purpose of including motels. However, as time went on it came out hotel-motel, rather than hotel.

Q Well, for purposes of taxation under the ordinance hotel meant motel?

A It did indeed.

Q All right, sir. Now, getting back to the section that related to the "equalize as far as practicable", the tax, this related to these various categories, and to the view that there would be updated studies from time to time to determine if there had been any marked change in the cost of doing

[Tr.29] business in any of these categories; isn't that correct?

A Yes, the first one was in 1951 by the University of Virginia; I participated in this study.

Q What was the result of that study?

A The recommendation was that there had been no material changes in operating margins, and a strong recommendation which was followed by the Board to abolish the bracket system on gross receipts, and go directly to the tax rate on gross receipts.

Q And that was done?

A That was done.

Q Now, with regard to the hotel-motel industry, was there a time when a gentlemen's agreement was entered into with the County Board and the industry whereby a rate, a substantial rate was established for that industry, and it was passed on as a sur-charge without objection, or anybody discussing it, let's put it that way?

A I knew this, but I was not in on any of the discussions, so I have no direct knowledge.

Q You were aware of it. How did you become aware of it?

A The discussions with the then Commissioner, Mr. Fisher.

Q I see. Now, did there come a time when you appeared before the Board as a result, or you were present at a Board

[Tr.30] meeting when a further study had been made by Laurin Thompson of George Mason University; and a discussion was had with regard to this particular category under the Gross Receipts Act, that is hotels and motels.

A There again I was not consulted on that study, although I was aware of what was going on; and did participate in the report.

Q Now, as a result of that study -- let me show you some notes, Mr. Beeson, I know it's hard to ask you to remember the many things that happened in the county government.

I have some Clerk's notes here that might help you to refresh your recollection, if the Court will indulge me.

A I misunderstood your question. I thought you were speaking of the study made by Dr. Laurin Thompson.

Q No. It was about the time that this occurred.

A I see. This was a separate, distinct matter from this study, it is an outgrowth of the occupancy tax which began --

MR. FLINN: Excuse me. May I ask that the witness identify the event that he is talking about?

THE WITNESS: Yes, it is a minutes of the meeting of the Arlington County Board on the date of August 5, 1970.

MR. FLINN: And what is the precise subject under

[Tr. 31] discussion?

THE WITNESS: The matter is, "Hearing on Amendment to the Business Privilege License Ordinance."

BY MR. BATCHELOR:

Q And at that time --

A I was there.

Q Yes, and were you called upon to give them information and advice with with regard to the category of motels and hotels?

A Yes, sir.

Q And at that time what did you indicate to the Board?

A Very briefly I recommended to the Board that day going back to the original formula; and subsequent they did adopt a rate of 50 cents on each $100 of gross receipts.

Q Mr. Beeson, was that because the rate of return for the motel and hotel industry had never changed appreciably from when it was first adopted?

A I had no knowledge of the industry itself because of the lack of ability to get into the corporate records of most of the corporations.

However, in discussions with members of the motel industry on several occasions prior to the Board meeting in conjunction with the transient occupancy tax which went into

[Tr.32] effect July 1, 1970, it was my feeling that they were doing quite well; that they were not prospering as much as we assumed they would, and in view of having nothing better than that we simply had to go back to the original philosophy that their rate would be an extension of the rate applicable to a retail merchant, or two times.

THE COURT: Well, I'm a little confused. I thought the retail merchants' rate was originally set at 12 cents, and the personal services rate at 25 cents, which would be double; and the motels were sub-divisions under the category of personal services.

How do you maintain that when you take the motels at 50 cents, how do you maintain the relationship?

THE WITNESS: Well, the retail changed to 24 cents over the years, so two times that.

THE COURT: I see. This has been a series of grad changes?

THE WITNESS: That has been a change over the years, every two, or three years.

THE COURT: Every time was there a study when the rates went up?

THE WITNESS: No, sir; as the rates go up it is correspondingly the same.

[Tr. 33] THE COURT: All the rates, across the board, by the same proportion, more or less?

THE WITNESS: More or less.

THE COURT: Would you say the history of the thing has been for the relationship between the categories to remain relatively fixed, even while all the rates go on up together?

THE WITNESS: The relationship has been fixed, we will say, with the exception of the motel-hotel. For example, the current rate for retail merchants which is your base, is 24 cents; professional occupations is 65; personal services occupation is 52.

Here is a deviation here, business services occupations is 26, it should only be 24 because that would be equal to the retail merchants. Repair services occupations is 26 where it should be 24. These deviations are very, very minor.

BY MR. BATCHELOR:

Q But in the case of the motel industry they have been rather dramatic, have they not?

A I would have to accept that word.

Q The differential in the rates.

A Yes.

Q Under the rationale of equalizing this, based on the

[Tr. 34] cost of doing business that was originally established, two times the retail merchants' rate, would make in this particular case the tax 48 cents, or 50 cents, as opposed to the rate of $2 which is two percent, or three hundred percent more than that rate?

THE COURT: I have a feeling, Mr. Batchelor, that I jumped you ahead by my questions, which is the end of the story, and you wanted to go through a chronology; as a matter of fact, I sort of left off the chronology.

If you would go back and bring me up to date I would appreciate it.

BY MR. BATCHELOR:

Q The Laurin Thompson report, Mr. Beeson, was that an updated study of the Gross Receipts Tax Ordinance with certain recommendations?

A I don't know how deeply he went into the matter, I just saw the final report.

Q You did see the report?

A Yes, sir.

Q And it did relate to gross receipts and recommended specific changes in it; did it not?

A I don't know whether I have a copy of the report.

Q Let me show you a copy of it.

(Handing document to witness.)

[Tr.35] A In some cases he suggested that the rates be lowered; and in other cases he recommended that they be increased; in other cases he recommended no changes at all. That is the report dated April 18, 1967.

Q Now, during this period of time there were certain changes in the tax picture in the county as a result of the enactment of the sales tax, and the authority for the county to impose a transient occupancy tax.

The transient occupancy tax was a tax designed to be added on to, I assume, any transient that took a room for hire in Arlington County. It was added on much as a previous business license tax had been added on as a sur-charge; is that correct?

A My understanding the motel-hotel business was adding on the bill an item called "sur-charge". For example, if the room rate was $10, the sur-charge would be 20, or 30 cents, depending on whether it was $2, or $3.

Q That was when they were operating under the gentlemen's agreement?

A Yes, and then when the transient occupancy tax came along which specifically stated that there shall be a tax on the transient of two percent, that is when I had to come into the picture and tell them they could no longer show that as a

[Tr.36] sur-charge, or as tax because we in fact now had a tax, and the only recommendation I had for them was simply a matter for them to change their work structure.

Q Actually they never really had a right to put that on, did they?

A They had no legal right at all.

Q And this was sort of a mutual agreement that occurred, however illegally, between the county and the industry for a period of years prior to the enactment of the sales tax.

THE COURT: Was the transient occupancy tax a part of the sales tax package?

MR. BATCHELOR: It's in addition to.

THE COURT: Was it enacted at the same time?

THE WITNESS: It was enacted in 1970, effective July 1, 1970. It's a bill unique for Arlington and Fairfax only, granting them the authority to have a transient tax.

MR. BATCHELOR: Which they exercised, and imposed.

THE COURT: Then the gentlemen's agreement that Mr. Batchelor referred to was in fact over what period of years, do you know?

THE WITNESS: It was effective January 1, 1959 through 1970.

[Tr.37] BY MR. BATCHELOR:

Q And at that time the tax was imposed, the two percent occupancy tax was imposed.

A That's correct.

Q And at that time the Board reduced the rate of the industry to 50 cents per hundred.

A Effective for the license year 1971.

Q Effective January 1st, 1971.

A It went down to 50 cents.

Q Which was close to the original rationale established for this industry in the enactment of the ordinance.

A Yes, it was.

THE COURT: At that time the retail merchants' rate was what?

THE WITNESS: 24 cents. It came out 48 cents, but it was rounded off to 50 cents.

THE COURT: All right, sir.

BY MR. BATCHELOR:

Q So that meant at that time, or effective in 1971, that all these other taxes were imposed, the gentlemen's agreement was canceled. The tax rate was then close to what it was originally set at when the ordinance was enacted; and then in 1971, the summer of 1971 there was a departure in the

[Tr.38] enactment of the new rate of $2 per hundred, or two percent under the business privilege license tax, to be effective in 1972.

A Yes, sir. In fact, it was license year 1972 that it was increased to $2.

Q Which was two percent gross.

A Two percent.

Q And that was an increase of three hundred percent, is that correct?

A Well --

Q Over the 50-cent rate.

A Yes. The rate for 1973 is now $3.

Q That's an additional two hundred percent, or five hundred percent over the rate established in 1971.

A If your mathematics are correct, yes.

Q Well, it was 50 cents in 1971, and --

THE COURT: I can do it better this way, has anything happened to the retail merchants' rate in those years?

THE WITNESS: Well, for 1970 the retail rate was 20 cents, in 1971 it was increased to 24 cents; and it is holding at 24.

THE COURT: All right.

BY MR. BATCHELOR:

[Tr.39] Q When you say holding at 24, that's the rate for 1973, is it not?

A Yes.

THE COURT: So if we are constructing a parallel table, for 1970 the retail merchants' rate was 20 cents; and the motel rate had not yet dropped to 50, had it?

MR. BATCHELOR: $2.

THE COURT: $2 in 1970, is that correct?

THE WITNESS: That is correct.

THE COURT: Then in 1971 the retail merchants' rate changed to 24, and the motel rate dropped to 50 cents?

THE WITNESS: Yes, sir.

THE COURT: In 1972 the retail merchants' rate is 24, and the motel rate is --

THE WITNESS: $2.

THE COURT: -- back up to $2. In 1973 the retail merchants' rate is 24, and the motel rate is $3.

THE WITNESS: 24 cents, and $3.

THE COURT: But in 1970 when the motel had the $2 rate before, as against the retail merchants' rate of 20 cents, that entire $2 was, according to your information, being passed on to the consumer, the customers, as a sur-charge on the bill?

[Tr.40] THE WITNESS: Not after 1970.

THE COURT: I'm really thinking of during 1970.

THE WITNESS: Well, during the first six months of 1970 they may have passed it on. Effective with the transient occupancy tax on July 1, 1970, they could no longer put it on the bill.

THE COURT: Now, how closely after that change, that is the adoption of the transient -- the effective date of the transient occupancy tax did the County Board reduce them from the $2 to 50 cents?

THE WITNESS: The hearing was in August, 1970; and the new rate was adopted effective for licensing for 1971.

THE COURT: So presumably there was a period of six months when the hotel operators had to absorb the $2 rate, the last half of 1970?

THE WITNESS: I might say they had had a windfall the first six months of charging the sur-charge. That might have been put into escrow, and in 1971 they had to come up with less money to pay the license because the current year license was based -- they might have had a slight economic advantage.

BY MR. BATCHELOR:

Q The Board took the action immediately after the implementation of the transient occupancy tax, and that became

[Tr.41] effective on July 1, 1970?

A Yes, sir.

Q And then in August at the public hearing on the adjustment of this rate they adopted the 50-cent rate; and that became effective the following January 1st?

A That is correct.

Q These rates are payable on gross business for the previous year?

A Yes, they are.

Q And that was the death of the gentlemen's agreement between the Board and this particular industry in the county?

A I guess so.

Q Now, when the rate for this particular industry in the county was increased in 1971, to be effective in 1972, to $2 by the Board, was there any information furnished as to any change of rate of return in the industry?

A Not to my knowledge.

[End Transcript, page 41, line 17]

* * * * *

[Begin Transcript, page 42, line 2]

Q Mr. Besson, just one last thing, all of the people, the companies affected under the business privilege license tax, gross receipts, were one class and divided into various

[Tr.42] categories for the purpose of equalizing the tax; is that correct?

A Yes, equalizing it by --

Q Tax rate. But they were all of the same class, the taxpayers?

A That is true.

[End Transcript, page 42, line 10]

* * * * *

[Begin Transcript, page 42, line 15]

BY MR. FLINN:

Q Mr. Beeson, do you recall what years motels were first introduced as a separate category?

A Yes, the change was adopted May 5, 1958, effective January 1, 1959, to change the rate from 36 cents for each $100 to $2 for each $100.

Q Now, had motels been mentioned in whichever section was in effect, either 11-58, or its predecessor section, personal services section; were they mentioned as a category

[Tr.43] in either section?

A Prior to the change they were under personal service occupations; and when the change occurred they were deleted from the personal service occupations and set up in a separate category.

Q Well, the issue that I was trying to get to, I believe you testified that in 1949 only hotels were mentioned, not motels.

The question I was trying to get an answer to was whether or not between 1949 and 1959 there was any addition in the 11-58, a category for motels.

A In the ordinance just prior to January 1, 1959, hotels were listed in personal service occupations.

THE COURT: At what rate, sir?

THE WITNESS: At a rate of 36 cents for each hundred of gross receipts; and then when the ordinance was adopted, or rather amended effective January 1, 1959, it shows that hotels were deleted from the personal service occupations, and a separate classification set up known as Section 11-72, defining every person operating a hotel, or motel shall pay a tax of $2 for each $100 gross receipt.

BY MR. FLINN:

Q Was this the first time that motels had been mentioned

[Tr. 44] at all?

A That was the first time that the word "motel" appeared in the ordinance.

Q Were you familiar with any other proposals that were considered as a basis for establishing a rate for the business privilege license tax at the various times that the tax rate was considered?

You testified here about the standard that was recommended in 1949, were you aware of other standards that were under consideration at that time?

A You mean as to licenses measured by other than gross receipts?

Q No, other than by this formula of differentiation between categories.

A I don't think I really understand the question.

Q You testified that, for example, using retail merchants as the base of one hundred, that professional occupations would be taxed at a rate of 360; personal services at a rate of 200, and I believe repairs at 72 percent of that of retail merchants as a base of one hundred.

Are you aware of whether or not there were any other formulae for distinguishing rates between classes that were considered at that time?

[Tr. 45] A Well, there were other ways of levying a license tax considered, such as value added, but it was not adopted because it was too costly to administer, and costly for the business man to maintain the records.

Q Now, as I understand your testimony, I think that the essential consideration that was used in adopting the formula that was adopted by the University of Virginia study, was the profit margin; is that correct, sir?

A The operating margin.

Q The operating margin. Now, were there other factors that were considered and rejected in preparing that study, other than the operating margins?

A The one that was given consideration, other than the gross receipts method was the value added tax.

Q Are there other formulae? I believe the report by the University of Virginia speaks about considering the nature of the market in the community as a question that might be considered in establishing the rate for business privilege licenses.

A Not the rate itself, the philosophy was that people dealing in the market, it was only rational that they should pay for the use of the market.

Certainly Arlington County has established, what we

[Tr.46] have here, the business man has every right to pay for the use of the market that has been created by the economy of Arlington.

Q And wasn't it considered in that study that in establishing a rate of the tax it was at least arguable, some people argued, that the person considering what the rate would be would look at the nature of the market in that community, and establish a rate for that particular category of business.

A No, there was nothing of that nature considered.

Q Wasn't there language to the effect that the market in an urban community for doctors and lawyers was better than it would be in a rural community?

I believe I recall language to that effect in the 1949 University of Virginia study.

A Yes, perhaps I can find it, it's in here. Let me use my own words on it. Certainly a medical doctor would want to -- if he were going into practice he would want to establish himself in the most desirable location for him, and it would certainly be in the urban, as opposed to the rural community; the gravity is towards the greatest possible potential.

Q Yes, and I was trying to get to the question of whether or not that was a factor that those that made the study said could be considered.

[Tr.47] A This is more or less stated in the explanation, or the justification for a business privilege license tax.

Q Tax as a whole?

A Yes.

Q Now, were you asked in 1970 to consider the proposal for an amendment of the business privilege license tax?

A I discussed it with the Board; it wasn't the sole item. I made a projection of possible revenues to be received at various tax rates, and I think one of the projections was 40 cents, and another 45 cents, and another one 48 cents; and as a result of the meeting the Board established a rate of 50 cents.

Q Now, are you familiar with what the considerations were that went into considering whether it would be 40, or 48, or 42 cents?

A You mean --

Q They were attempting to apply the standard recommended by the 1949 study in all of these rates, or were there other standards that were offered as a basis for the various rates that you had to consider?

A The only standard that was used was the original standard that the hotel rate would be twice the base rate assigned to retail merchants.

[Tr.48] Q Do you know what the reason was for these small deviations, but nevertheless these various alternatives that were offered; why was it that they didn't equal exactly twice the rate?

A Well, I just made the projections on various tax rates, it was up to them to make the selection of the tax rate they wished to adopt.

Q But, let's say -- was one of the proposals 42 cents, and one of them 50 cents?

A I think I took in a two cents increment, from 40 cents up.

Q Could you give reasons why they might adopt a 42-cent rate as opposed to a 50-cent rate

A It is purely up to the County Board to make that judgment.

Q Well, what were the facts that you considered in deciding whether to pick 42 as one alternative, and 50 as another alternative?

A For the purpose of giving the Board an opportunity to know how much revenue would be attained if they used Rate A, B, C, D.

Q So what you were doing was projecting a revenue producing a tax of the rate?

[Tr.49] A That is correct.

Q I would like to go back again to 1949, and look at the rate in various categories, perhaps select a couple as examples, perhaps the retail merchants, rate 49; and the professional occupations rate.

Was the proposal of the study that the professional occupations should be taxed 360 percent of the retail merchants?

A Yes, that was the original recommendation.

Q And what was the actual?

A As adopted by the Board? They did not follow that principle, the fact that the professional people are in the bracket system. For example, $10 if his gross does not exceed $5,000; if it does not exceed $12,000, then it's $35; if it exceeded $12,000, $75; if it exceeded $25,000, the maximum then was $100.

The same thing happened as to contractors, builders and developers, and amusements; the others did have the 12 cents, 20 cents of the one hundred gross receipts.

Q So at $5,000 it's not an accurate reflection of the rate all across the board, at $5,000 would have been 20 cents a hundred on professional occupations at that time.

A That was the gross inequity of the thing. If a person had an income of $4,999, he would pay $10; if the gross

[Tr.50] was $5,001, it would then go up to $35.

Q $35, so his rate could jump with an increase of the $1 on income, his rate would go from 20 cents a hundred to 35 cents a hundred?

A If you would put it on a graph it would go up very sharply.

Q And how long did this bracket system stay in effect?

A Effective from '49, '50, '51, '52, and then it was corrected and went to a tax rate on gross receipt.

Q And was this across the board in all the business privilege license tax?

A Oh, no, all those on a bracket system went to a tax rate on gross receipt.

Q And in 1959, then, could you compare the rate between retail merchants and professional occupations?

A The professional rate then was 65 cents, and the retail was 18 cents.

Q Was there any recommendation to change the rate that had been proposed in 1949, the 360 percent rate that was made?

A Well, it was an outgrowth of the study, the 1951 study made by the University of Virginia, showing that it was inequitable to use the bracket system.

Q But was it their recommendation to keep the 360 per-

[Tr.51] cent differantiation between retail merchants and professional occupations?

A Yes, it was; they said that the difference between the various categories remained unchanged.

Q And as I compute it, 65 cents is pretty close to 360 percent of 18 cents.

A Right close.

Q Now, using 1959 as another year of example, what were the rates in 1959 on retail merchants and professional occupations?

A In 1969?

Q 1959.

A '59, professional occupations 65 cents; retail merchants 22 cents.

Q And what are the rates for those two categories now?

A As of this year?

Q Perhaps you can give us the rate on '72, and if there is any change from '72 to '73.

A Well, the retail rate for last year ended this year, 24 cents; and the professional occupations is 65 cents.

Q Now, has there been any study that recommended a change of that 360 percent factor?

A Well, subsequent to the original study, only the

[Tr.52] one that was made in 1959 by the University of Virginia, and another one that was made in 1967 by Dr. Laurin Thompson.

Q Did those recommend any change in the 360-percent factor?

A The one in 1959 recommended no changes, and Dr. Thompson as to those two categories recommended that professional occupations be reduced from 65 cents to 50 cents; and retail merchants be reduced from 26 cents to 25 cents.

THE COURT: That was in the 1967 Thompson report?

THE WITNESS: Yes, sir.

THE COURT: And that is the one where he recommended the reduction in motels from $2 to 50 cents?

THE WITNESS: That is correct, sir.

BY MR. FLINN:

Q Do you know whether or not that was ever followed in the period from 1967 to 1972?

THE COURT: Which?

MR. FLINN: The recommendation with respect to the ratio between professional occupations and the retail merchants

MR. BATCHELOR: In 1970.

BY MR. FLINN:

Q Was it?

A They must have gone beyond the recommendation because

[Tr.53] the rate here shows 20 cents for each $100 gross receipts for a retail merchant; and on the professional, the 50 cents followed that recommendation.

Q But they didn't have exactly the same ratios.

A No.

Q As the ratios applied.

A It doesn't have to be precisely on that ratio, it can deviate slightly.

Q Are you familiar with standards for differentiating between different classes of licenses that are followed elsewhere, whether in Virginia, or in the United States as a whole?

A Well, making your study and trying to characterize tax business, in the retail merchant area you don't have much trouble determining who are retail merchants because they simply sell at retail.

However, in retail merchants you have varying profits, or operating margins.

Then, as to personal service occupations, why, you try to group people who do things that are similar, and have the necessity to bring into the market thing. The personal services usually do not bring too much to the market. A retailer, of course, has to buy and bring things in.

[Tr.54] What I'm trying to say, the value that a person adds to the market has a great deal to do with the category you put him in, and also the things they are taking from the market. Is that what you are saying?

Q As I understand what you said in this respect, you are testifying as to the reasons for establishing various categories?

A That is correct.

Q And perhaps I should have asked this question, but the question that I was asking was, are you familiar with what standards are applied in other localities which have similar taxes are applied in determining what the differentiation between the rate on various categories is?

A Well, only one case that I know of, the City of Alexandria went to do this same thing by the University of Virginia; I understand they retain their services from time to time.

Q And do you know whether or not they have applied this operating margin standard?

A I would have to study that.

THE COURT: Mr. Besson, setting of rates within the same broad categories, has any distinction been made between different types of retail merchants, such as a comparison between

[Tr.55] a gift shop that sells articles of a very high mark-up, high value; and a Five and Ten Cents item with a small mark-up?

THE WITNESS: It is recognized that there are great profit margins among retail stores, jewelers stores have a tremendous mark-up, furniture stores; but the idea to set them in separate categories as far as rate purpose is concerned was abandoned simply because of the bookkeeping involved.

For example, Hecht Company is a retail store. Within Hecht Company you have a jewelry department and furniture department, so they would have to set up for each kind of merchandise they sold, set up records to control that because we would want to know how much did you sell, what were the gross receipts for the sale of furniture, and apply a tax rate to that.

It was abandoned simply because it was too much of a burden upon the business man, and too much for the government administrative office.

THE COURT: Have any of the studies that have ever been made to your knowledge recommended any break-down among the different types of retail merchants in order to equalize the burden?

THE WITNESS: The study recommended against breaking up.

[Tr.56] THE COURT: For the reasons you mentioned?

THE WITNESS: Yes, sir.

THE COURT: I suppose the study recognizes that produces an inequity between the smaller mark-up and the large mark-up?

THE WITNESS: The recommendation acknowledged that.

THE COURT: All right.

BY MR. FLINN:

Q A related question to that, do you know whether or not there have been any recommendations there be graduation of the rates within the various categories; I use graduation as distinguished from just bracket categories.

A I see what you mean, having a gross receipt up to $100,000 being taxed, say a tenth of a hundred; $100,000 to $200,000, at 15 cents a hundred. It could be done. There are one, or two localities in the State that do it.

Q Now, I take it, to the effect of Mr. Thompson's report as to recommend a certain change in the ratios between the various categories --

A The Thompson report?

Q Yes.

A He didn't touch upon that subject, however, I think he did take it into consideration when he came up with the

[Tr.57] proposed tax rate.

Q Now, do you know whether or not there was ever any consideration within the county government whether or not this change in the ratios, that this was the effect of his recommendation, was a proper and just change in what the ratios should be?

A I think it might answer itself, if he would establish a rate of 25 cents on retail merchants, and went to professional occupations and recommended a rate of 50 cents; then he was getting a rate of 360 and was going to 200.

Q That's how I understand it. My question is whether or not his report was considered from this point of view, or was it considered that any part of the discussion, or consideration include the issue of changing that ratio, or was it just looked at from the point of view of the particular rate that he recommended without considering the question of the ratios between the categories?

A I don't think I can properly answer that, I wasn't in on the study. I really only draw a conclusion from reading this report.

Q I understand that, but can you say that you are not aware of any consideration that was given to it from that point of view?

[Tr.58] A I know of no consideration being given to it. I might conclude that it would not have been possible because it takes months and months to do something like this.

Q Now, you said that in 1950 -- I'm sorry, in 1970 one of the factors that was considered was the amount of revenue that would be produced by a rate of a particular level.

A That was taken in conjunction with the new occupancy tax.

Q Right. Now, was that question of the amount of revenue that was produced a factor that was considered at other times when the rates were changed?

A No, I think this is the only time that a trading off was considered as far as the overall budget was concerned.

Q Now, during the period that the amount of the gross receipt tax was being passed along to the occupants of the motels and hotels, were the hotel and motel owners and operators required to report that amount in their gross income?

A I took the position that their taxable base was the entire amount received.

THE COURT: Did this pass the entire tax along to the customers in the form of the sur-charge?

THE WITNESS: Well, on the motels --

[Tr.59] THE COURT: I think you said they did. If there was a motel bill of $10, it was 20 cents.

THE WITNESS: The first time it would be $10, and then the next time it would be sur-charge, and then the four-percent sales tax; and then the total.

MR. FLINN: I don't have any more questions.

[End Transcript, page 59, line 6]

* * * * *

[Begin Transcript, page 59, line 8]

BY MR. BATCHELOR:

Q When they paid tax, however, they paid their tax on the gross amount, which included the sur-charge, actually?

A The transaction, one night $10, I considered the taxable gross receipt as $10.20.

Q Right. Now, when the change was made that Mr. Flinn referred to in 1951, when they created the hotel-motel, the first time motels were actually mentioned in the ordinance, this was the onset of the gentlemen's agreement; was it not?

A No, the onset of it was in 1959. Let me clear up this point, the mere fact that the word "motel" was not in the ordinance was not controlling because it was controlled by State law as to the definition of motel.

Q I see. So it was encompassed in the term "hotel"?

A That is correct. The gentlemen's agreement was effective 1959.

[Tr.60] THE COURT: When the rate went to $2?

THE WITNESS: Yes, sir.

MR. BATCHELOR: Thank you, Mr. Beeson.

[End Transcript, page 60, line 3]

* * * * *

[Begin Transcript, page 88, line 12]

CONCLUDING REMARKS OF MR. BATCHELOR

Now, perhaps Mr. Flinn has misunderstood me, I do not attack the business license ordinance as such, or the right for such an ordinance to exist; I'd be wasting your time, and my time, and Mr. Flinn's time because the Courts of Virginia have said that this is a proper ordinance, and constitutional.

What I do attack here is the application under a part of this ordinance of the rate, or inappropriate rate to this particular class of taxpayers, or this particular group of taxpayers.

[End Transcript, page 88, line 20]

* * * * *

[Begin Transcript, page 90, line 3]

I am going to address myself momentarily to this question of confiscatory tax. I'm not suggesting to the Court that there is any evidence before the Court that this is a confiscatory tax. I would suggest to the Court that the tax tends to become confiscatory when it is $2, and the next year $3, when you are charging this on gross receipts because three percent, two percent gross receipts, when you apply that against what is the profit in that business, could well amount to 50 percent of profit; and I think that tends to become a little confiscatory when it's a privilege tax, not an income tax, but a privilege tax.

[End Transcript, page 90, line 13]

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[Begin Transcript, page 90, line 22]

ORAL OPINION OF JUDGE RUSSELL

THE COURT: It appears to me that the attack ~~a tax~~ made on the business privilege license tax today does not reach its general [Tr.91] constitutionality, nor does it reach the regularity of the proceedings whereby it was amended to raise the rate for 1972. Rather, the attack is confined to the question of equalization in the distribution of the burden of this tax among those liable therefore.

In my opinion the burden of the taxpayer has been carried. The testimony of the official of Arlington County responsible for the application of this tax, and who has a great deal of personal background in it, demonstrates by far more than a preponderance of the evidence that the County Board had before it no standard whatever which would have shown a change in the circumstances of this industry, justifying a quadrupling of the tax rate between 1971 and 1972.

It appears that in all prior years the county had acted by adjusting the tax rate to maintain what in its best judgment was an equal burden upon different kinds of businesses. The most recent study to which the county had access was that of Dr. Loren Thompson in 1967.

Dr. Thompson either didn't know about the so-called gentlemen's agreement, or he ignored it because he looked simply at the $2 rate then in effect without reference to who was paying it, and commented in his report that it was very high; and he recommended that it be reduced to 50 cents, which
[Tr.92] would put it right back at the same ratio to the retail merchants' as had obtained at the inception of the ordinance. His recommendation was followed.

As soon as the County Board and the members of this industry found it impossible to pass this tax along to the customers, the industry was put back to the 50 cent level, which

made its effective tax rate double that of the retail merchants which it had been from the beginning, roughly.

Thus the county, in making that reduction was motivated, apparently, by substantial evidence of uniformity in the distribution of the burden of this tax; that is the reduction from $2 to 50 cents.

Conversely when the increase was made in the next year from 50 cents to $2, it was apparent that the county had nothing before it whatsoever to justify that change. I suppose it's unnecessary to comment on the $3 rate for 1973, since that is outside the ~~plea.~~ pleadings.

It would appear, then, that Section 58-1135 reaches the situation because in the opinion of the Court the assessment is not uniform in its application, and the Court finds that the ends of justice would be met by making an adjustment.

Accordingly an order of exoneration will be entered in favor of the petitioners in this case from all gross receipts [Tr. 93] taxes imposed upon them for the year 1972 in excess of 50 cents per $100. Prepare such an order.

[End Transcript, page 93, line 2]

PLAINTIFF'S EXHIBIT 1

ARLINGTON COUNTY

BUSINESS PRIVILEGE LICENSE ORDINANCE

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* * * * *

Sec. 11-2. Statement of General Policy.

It is the purpose and policy of the county board, in enacting this chapter imposing license taxes for the privilege of conducting business and engaging in certain professions, trades and occupations in the county to equalize as far as practicable the burden of such license taxation among those hereby liable thereto, by adopting, for general application, but subject to the exceptions hereinafter specifically set forth, a system of license taxes measured by the gross receipts of the business, profession, trade or occupation in respect of which the tax is levied. (Min. Bk. XII, p. 37, 1-1-49. §1.)

* * * * *

Sec. 11-72. Hotels and Motels.

Every person operating a hotel or motel, renting in excess of seven (7) bedrooms to transients or sojourners, shall pay for the privilege an annual license tax of 50¢ for each $100.00 of gross receipts, as hereinabove defined, from the business during the preceding fiscal or calendar year. The minimum annual license tax shall be $25.00. (Amended 7-30-62, effective 8-30-62; amended 6-3-67, effective 1-1-68.) (Amended 8-5-70, effective 1-1-71.)

* * * * *

Sec. 11-4. Levying of License Taxes.

For each and every year beginning with January first of each year and ending December thirty-first following, until otherwise changed, there are hereby levied and there shall be collected the annual license taxes hereinafter set forth in this chapter, except as otherwise specifi cally provided in this chapter, on persons conducting or engaged in any business, trade or occupation in the county hereinafter set forth in this chapter, which license taxes shall be for the support of the county government, the payment of the county debt, and for other county purposes. (Min. Bk. XII, p. 37, 1-1-49, §4.)

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PLAINTIFF'S EXHIBIT 2

MEMORANDUM 1

ARLINGTON COUNTY

BUSINESS AND PROFESSIONAL LICENSE TAX SURVEY

ARLINGTON COUNTY BUSINESS AND PROFESSIONAL LICENSE TAX SURVEY

MEMORANDUM NO. 1

The immediate problem of the County Board of Supervisors of Arlington County in connection with business and professional license taxation is that of implementing the authority granted by Chapter 150 of the Acts of Assembly 1948, which reads as follows:

> "Be it enacted by the General Assembly of Virginia:
> 1. That the governing body of any county in this State having a population of more than two thousand per square mile, according to the last preceding United States census, and in any county having an area of less than sixty square miles, is hereby authorized to levy and to provide for the assessment and collection of county license taxes on businesses, trades, professions, occupations and callings and upon the persons, firms and corporations engaged therein within the county, whether any license tax be imposed thereon by the State or not; provided, however, that no county license tax shall be levied in any case in which the levying of a local license tax is prohibited by any general law of this state."

It must be pointed out, however, that the imposition of business and professional licenses cannot be considered in a vacuum. So many, and so varied, are the ends to be achieved by taxation that no single segment of a tax system can effectively be viewed except in terms of the entire county revenue structure. A highly regressive tax of a certain variety may well serve to tap some hitherto untouchable source, and at the same time be balanced by sharply progressive taxes in other revenue areas, or it may be designed for regulatory purposes, in which event its very regressivity may be an important virtue. Moreover, overall considerations of balance and stability must be recognized, and care taken not to depend too heavily for the financing of stabilized service costs from instable revenue sources. Again, it must be recognized that taxpayers pay many different kinds of taxes, and caution must be exercised to avoid the undue accumulation of tax

burdens upon the same basic wealth-producing activity ( ) s the wealth makes its appearance in various forms at various stages of development.

It is important, therefore, to understand the problem of business and professional license taxation in Arlington County in its proper perspective, and in proceeding to the adoption of this new and unquestionably appropriate revenue source to relate it to existing county taxes on real and tangible personal property, and to other charges imposed by the local government. It is also important to realize that this most recent expansion of the taxing jurisdiction is an important step, but is only a single step, toward building the type of revenue system necessary to support the financial requirements of an essentially urban metropolitan government. The business and professional license tax cannot solve all of Arlington County's revenue problems. The business and professional license tax plus the motor vehicle license tax cannot solve all of Arlington County's revenue problems. While there is no apparent way in which the community value of a given tax may be predetermined without considering its relation to the entire revenue structure, it is possible to describe its characteristics so that a given tax may be intelligently woven into the larger fabric of the local revenue system. It is fundamental that this be done, for ad hoc and piecemeal adoption of taxes to accomplish ad hoc and momentary ends inevitably builds up a pattern of taxation that is incoherent and illogical, as well as inequitable and politically dangerous.

It is also true, however, that the internal equities of any particular tax can be analyzed and determined. The establishment of a proper and equitable relationship between the license tax system and the other revenue sources of the county is largely a

matter of rate adjustment, provided the licenses themselves have been soundly based and proper internal relationships established as among the various classes of licensees. In other words, it is much easier to build a tax system the overall effect of which is equitable and fair if each of the component elements operates equitably among those upon whom it falls. Moreover, if it is then desired to accomplish regulatory purposes in addition to raising a certain amount of revenue, the special ancillary provisions may be embodied to achieve the non-fiscal purpose without distorting the entire system. Thus, for example, if Arlington County believes that it would be better off without fortune-tellers, phrenologists or palmists, it can readily achieve this social objective if, on the basis of a soundly constructed licensing system, it simply adds punitive charges handicapping such enterprises, rather than attempting to equate the relative desirability of a large number of undertakings of dubious value to the community.

Terminology

Taxation is unavoidably a fairly complicated and technical subject, and in order to facilitate consideration of the various elements entering into the licensing system, and to reach agreement on objective as well as ways and means, it is important that the words used have a constant reference. As used generally in discussions of taxation, and specifically in this and subsequent memoranda, the principal terms involved are defined as follows:

A License: A License is a payment exacted by government or its agents for the privilege of performing an activity otherwise considered illegal.

A Permit: Where such activity involves a physical change in property, or where such activity is usually considered potentially prejudicial to public health, safety, morals or welfare, the authorization is usually referred to as a permit.

A Franchise: Where the carrying on of the activity involves a contract appropriating public property for private

use, the authorization is called a franchise.

A Fee and a Tax: Where the payment exacted is related primarily to the cost of regulation and supervision, it is usually called a fee; where the cost of regulation is not a primary factor and the payment is exacted for general revenue purposes, it is usually designated as a tax.

Base or Measure: The base or measure of a tax is the variable to which the rate is applied. The base of property taxes in the United States is usually ad valorem, or on the capitalized value of the property, although other countries frequently use the rental, rather than ad valorem, base. In the field of business and occupational licenses, the bases are many and varied. A recent study by the Municipal Finance Officers' Association lists twenty different bases in common use in American local governments:

1. Type of occupation alone.
2. Value of goods, stocks or inventories on hand as of a certain date, or average value of inventories within a given period.
3. Rental value of premises occupied.
4. Amount of street or highway frontage.
5. Amount of floor space or ground space utilized.
6. Seating capacity, for certain types of enterprises.
7. Number of rooms or units.
8. Number of units of some essential equipment.
9. Number of vehicles used in certain types of business activity.
10. Number of employees engaged in the business.
11. Number of salesmen employed.
12. Number of customers.
13. Number of companies represented.
14. Amount of fee or admission price charged.
15. Volume of sales.
16. Volume of purchases.
17. Volume of gross receipts.
18. Amount of invested capital.
19. Kind or size of equipment used in production process.
20. Volume of actual production, productive capacity of the plant, or kind and size of product manufactured.

Obviously, these bases may be used separately or in combination. The Commonwealth of Virginia uses approximately fifteen of the above bases in the administration of the State licensing system.

Rate: The rate of a license tax is the amount charged per unit of the base, for example, "32¢ per $100 of retail sales." Rate structures may be of many types:

1. Flat amount.
2. Flat amount plus another type of schedule.
3. Flat rate applied to variable base.
4. Bracketed structure (progressive)
5. Bracketed structure (regressive)

Business or occupation: In general, the term business refers to activity which is primarily mercantile in character, or in more technical terms, economic entrepreneural enterprise.

Occupation is used to cover this and other activities. It is not necessary at this time to introduce further distinctions which are frequently useful for rate-making purposes, such as profession, personal service occupations, business service occupations, etc. This topic is reserved for a later memorandum.

Legal Basis of Licensing

Business and occupational licenses have been issued under color of two distinct grants of authority.[1] The first is the police power - the authority to regulate in behalf of the public health, safety, welfare and morals. The second is the taxing power. In general, licensing has been utilized in the northern and middle-western parts of the United States primarily for purposes of police regulation. In the southern and far-western sections it has long been a recognized and important part of the revenue systems of State and local governments, in addition to its regulatory influence. However, throughout the country there appears to be a marked shift in licensing operations from regulation to revenue, and with this shift in interest has naturally come an increased concern with considerations of equity, fairness, and responsiveness to changes in economic conditions. In 1946, for example, the City of Richmond, pressed by the need for additional funds, attempted virtually to double its license taxes "across the board", and although many compromises occurred in the process, the net result was a drastic accentuation of the inequities prevalent in the prior arrangments. While crude indices and measurements are tolerable as long as the aggregate burden of the tax is inconsequential, recent increases in the revenue realized from licenses have pushed the rates so high in many quarters that the awkward and inequitable bases generally in use have come in some cases to constitute severe burdens on the cost of doing business. The thorough restudy of business and occupational licensing has therefore been a matter of prime necessity in many

1. Williams v. Richmond, 177 Va. 477, 14 S. E. (2d) 287.

political subdivisions in Virginia and throughout the country, not only from the standpoint of equity, but of reasonableness, and consequently of legality.

Chapter 150 of the Acts of Assembly of 1948, while conferring upon Arlington County the maximum licensing power granted by the State to political subdivisions, contains at the same time prohibitions against the levying of a license tax in any case where the levying of such a tax is prohibited by general law. The Tax Code of Virginia contains fifteen provisions affecting the power of the local authorities with respect to licensing:

Section 8. Makes insurance taxes, licenses on insurance companies, taxable intangible personal property, and rolling stock of railroad companies subject to State taxation only.

Section 73-a. Makes dairies taxable on capital, rather than as merchants, under State law and local ordinance.

Section 73-c. Makes suppliers of wood pulp, veneer logs, mine props, and railroad crossties under certain circumstances taxable on capital, and not subject to license taxation as merchants or brokers.

Section 172. Provides that no city or town (and by implication no county to which licensing power is extended) shall levy a greater license tax on the paid-in capital of building and loan associations or companies than that imposed for State purposes, and further that such city or town (county) license tax shall be levied only where the principal office of the association or company is located in this State.

Section 176. Limits municipal (county) license taxation of contractors or plumbing and steamfitting contractors to those cities and towns (counties) in which the principal office and branch offices are located, regardless of the fact that business may be carried on in many other political subdivisions.

Section 188. Permits manufacturers to sell at their place of manufacture without a license and, under certain circumstances, to sell and deliver at the same time to licensed dealers or retailers anywhere in the State without the payment of any license tax to the State, or to any city, town or county. Also prohibits local license tax on persons or firms licensed as merchants in this State for selling goods or merchandise by sample, where delivery is not made at the time of sale.

Section 192. Exempts from the definition of peddlers those selling ice, wood, meat, milk, butter, and other supplies of a perishable nature, grown or produced by them and not purchased by

them for sale, and al dairymen using wagons on the city streets.

Section 192-a. Exempts vendors and distributors of motor vehicle fuel and petroleum products, farmers, dealers in forest products, producers or manufacturers selling and delivering at the same time, other than at a definite place of business to licensed dealers and retailers, from license taxes imposed by cities and towns (counties).

Section 192-b. Exempts distributors and vendors of motor fuel and petroleum products, tobacco, or seafood, a farmer, farmers' cooperative association, producers of agricultural products, or manufacturer taxable on capital by this State, or distributors of goods paying a State license tax on their purchases, who or which peddles goods, wares or merchandise by selling and delivering at the same time to licensed dealers or retailers, other than at a definite place of business operated by the seller.

Section 199. Makes persons, firms and corporations engaged in the business of mixing, compounding or manufacturing carbonated beverages, bottling and selling the same, manufacturers and not merchants.

Section 219. Limits local taxation of express companies to taxes on real estate and tangible personal property.

Section 224. Prohibits local taxes on sleeping car, parlor car, and dining car companies.

Section 229. Limits city and town (county) license taxation of water, heat, light and power companies to ½ of 1 per cent of gross receipts.

Section 239. Prohibits local license taxation of insurance agents and insurance companies.

Section 296. General law limits licensing power of cities and towns not having general taxing power in their charters to subjects of State license taxation. Also exempts those selling farm or domestic products, grown or produced by them, from local taxation, and exempts newspapers from local license taxation.

In addition to these specific limitations and restrictions, taxing authorities generally are subject to general provisions of the State statutes and constitution, of the Federal Constitution, and to the general body of precedents in the law of taxation with respect to such matters as reasonableness and relevency of classification, etc.

Who Pays License Taxes?

Before considering the details of license taxation, it is worth

while to give some attention to the final resting place of these taxes. Taxes do not always come to rest at the point where they are levied. Some taxes can be more easily shifted than others, and even of the taxes that can be shifted there are certain conditions that make the shift easy and certain that make it difficult. Unless the conditions affecting the incidence of the tax are reasonably well known, it is almost impossible to relate the burden imposed by the license tax system to the other aspects of the local revenue structure, and correspondingly difficult to be an even approximately certain that the tax system is, in the aggregate, operating with reasonable equity upon the wealth-producing activities of the community.

The classical economists are accustomed to the view that taxes on real estate stay where they are levied, and are never passed on. Laterly, even this view of the one tax which presumably is never shifted has been challenged in a very fundamental way. The Wehrwein analysis points to the possibility that in some circumstances any tax may be shifted. Even the taxpayer who owns and lives in his own home may, in certain conditions of the market, pass on increases in his real estate tax. Moreover, as Wehrwein points out, taxes on commodities - which is the essential nature of the modern license tax - may undergo some shifting even after the goods have reached the hands of the ultimate consumer.

License taxes are levied upon businesses, upon sellers of goods and services. It is reasonable to suppose that such a tax will, in some instances, be passed on through higher prices and charges. Just when this will be possible, and to what degree the tax may be shifted, is by no means clear. In the present market, with most goods in short supply and prices uncontrolled either by competition or by government fiat, conditions are propitious for the shifting of a large part of the tax. On the

other hand, competition is developing in certain fields, and it may well be that license taxes falling primarily on goods or commodities in the sale of which there is competition would tend to remain where levied. Moreover, some commodities are sold at nationally published prices, and a tax on such commodities could hardly be passed on in the sale of the commodities themselves, although prices on other commodities might be raised sufficiently to maintain intact the seller's overall position.

In short, the ability of a business and occupational licensee to shift the license tax depends upon a complex of economic conditions - the specific or ad valorem nature of the tax itself, the margin or surplus condition of the seller of goods or services, the relative elasticity of demand for the goods or services, the monopolistic or oligopolistic nature of the business, and perhaps most important of all the general state of the market at any particular time. Under normally competitive conditions, the tax probably remains in large part where it is levied. Under present conditions, a very substantial amount of shifting probably takes place.

To the extent that the tax is shifted, in whole or in part, its effect is regressive, since it becomes for all practical purposes a sales tax at an extremely nominal rate. Inasmuch as a very large proportion of the income of persons in the lower income brackets goes for commodities and services affected by the license tax, it tends, if shifted to bear most heavily on those least able to pay. On the other hand, this element of regressivity in present circumstances must be considered in relation: (a) to the probably transient character of the regressive feature of the tax; and (b) to the fact that the progressive taxes - on net income, for example - are virtually inoperative as far as lower-bracket incomes are concerned, and for administrative reasons will likely

so remain. In sum, the regressive characteristics of the tax are, at relatively nominal rates, self-correcting. In the present market, expanded lower-bracket incomes largely exempt from the progressive taxes applicable to higher-bracket incomes are probably able to bear the shifted burden, while in a competitive market, when lower bracket incomes tend to contract, the tax will cease to be shifted.

Licenses and Benefits

All taxes are defended as to equity upon one of two bases - benefit or ability to pay. For example, in many states , although no longer in Virginia, the costs of streets and gutters are chargeable directly to abutting property owners, since such improvements benefit directly the property and enhance its value, although the improvements are used by the general public. The cost of maintaining fire protection is readily justified on the same theory, as are police protection and the sanitary and epidemic control aspects of the public health function, since these costs arise principally by reason of the congregation of people and the concentration of valuable personalty in fairly congested areas. Less direct is the equitable argument for the taxation of real property on the benefit principle for the financing of public schools and relief.

Taxes on business and occupations are justified on the benefit principle on somewhat different grounds, and the license charge is sometimes looked upon as a franchise tax for the use of the market created in the community by society. Clearly, there are fundamental economic values for businesses and for professional and other service occupations in locations within fairly densely populated areas, as evidenced by the fact that there are few large mercantile establishments in the open country, while doctors and lawyers likewise seem overwhelmingly to prefer the more populous centers. Since the maintenance of the basic

amenities which permit the market to operate are provided in part by local government, those who derive benefit from operating in the market, it is argued with considerable cogency, should contribute to the cost of maintaining the amenities. It has been suggested, moreover, that a fair measure of the contribution of those who operate in the market should be th extent of their use of the market, as measured by gross receipts or, for those who prefer more precise instruments of taxation, by the value added by handling.

However, whether the surgeon's scalpel or the butcher's cleaver is preferred, it is clear that those who pursue business or service activities derive clear and unmistakable benefits from the market created by the people who live in Arlington County, that the facilities financed in large part from the common-wealth of the people of the County enhance the value of that market, and those who benefit should be called upon to share in the cost of maintaining the market.

Licenses and Ability to Pay

The doctrine of ability to pay, when confined to individuals, is based primarily on psychological considerations. The assumption is that those who have more can give more for the maintenance of the public services without suffering a higher proportionate sacrifice. There are several ways in which the calculation of ability to pay may be approached, but in this country it has, not always too logically, been closely allied to the concept of net income and the theory of a descending marginal utility of an additional increment thereto-in less technical language, that beyond a certain point (and there are enormous divergencies of opinion as to where that point should be set) a person has a progressively diminishing right to keep what he is able to earn. A small exemption is allowed, the purpose of which is to guarantee that at least net income

taxation shall not e' 'oach upon the requiremen for biological survival, and as the income exceeds this minimum it is held that the burden of the sacrifice varies inversely with the amount of the excess.

In this sense, of course, businesses have no ability to pay. A business suffers no psychological deprivation. However, the persons who derive profits from the business do suffer such deprivations, and it is true that the businesses themselves vary in ability to compete with similar businesses in the earning of profits. But it is the net profit, or the amount available to the capital account, which most closely ties i to our individual concept of the ability to pay. In fact, even the net income of a business means little, since it is a wholly artificial calculation based upon a complex series of conventions with respect to accounting procedures producing a result which has little to do with the fiscal health of the enterprise, as well as because of stock distribution and the varying economic circumstances of the recipients of business incomes. The plain fact is that the transference by brute force and sheer awkwardness of our legitimate concept of net income in the hands of individuals to the field of business in one of the grosser absurdities of American taxation, and the sooner we cease attempting to commingle two completely alien principles the more logical will be our results. Ability to pay, as the concept is used in thinking of personal income taxation, has no significance for the taxation of business.

Bases and Equity

It has been suggested above that the essential justification of business and professional licensing lay in the benefit principle, that the notion of ability to pay as expressed in net income, legitimate as it may be in thinking of income in the hands of individuals, had very little to contribute to the solution of the problem of taxing business

and the occupations. Authors of business a professional license tax ordinances and statutes have devised a long list of indicators aimed at measuring the use which business and the service occupations make of the market maintained by society, and we have listed twenty of the most frequently encountered indicators. It is the purpose of this section o the memorandum to examine the operation of the more important of these indicators, and to try to suggest some benchmarks for judging the equitable characteristics of each.

Type of Occupation Alone. Taxes levied on type of occupation alon would not be manifestly unfair were it demonstrated that use of the mar varied perfectly according to type of business or occupation. Thus, if could safely say that all, or substantially all, grocery stores used th market twice as extensively as jewelry stores, or that all doctors, or substantially all, used the market twice as extensively as lawyers, the could be no objection to levying a flat amount by which doctors would b charged twice as much as lawyers, and grocery stores twice as much as jewelry stores. This is not the case. It is reasonable to say that o the whole the manufacture of steel tends to be a larger scale operatio than the shining of shoes, but this is about as far as we can go. Bus activity, the magnitude of individual operations, and even the actual of the market by businesses or occupations of approximately equal size vary to such an extent that even within types of business or occupatio the differences exceed the similarities. This extremely crude indicato in the light of present knowledge of the economics of business enterpr and in the presence of vastly better and more precise measurements, ha little place in modern taxation. But why, one might ask, is the "typ of business" indicator in such widespread use. The answer lies princ in the lag of our governmental fiscal devices behind the development

economic conditions, and on the suitability of such a simple, even if grossly inequitable, indicator to the type of personnel which local government is able to command in many sections of the country. Certainly Arlington County, which enjoys a thoroughly modern structure of government and administration, and which is able to attract and maintain personnel of a high order of competence, has no need of burdening itself with such primitive devices of taxation.

Intermediate Non-Volume Indicators. In many American localities rental value of premises occupied, street frontage, floor space, number of rooms or units, units of essential equipment, number of customers, number of salesmen, and like standards of measurement have acquired wide acceptance as bases for the local taxation of business and the occupations. They represent an effort to get at the measurement of the use which businesses and occupations make of the market, and as such must be recognized as steps, faltering though they may be, toward more accurate indicators. Generally speaking, the reasoning behind these attempts is illustrated in the assumption that a barber shop with two chairs does more business than the barber shop with one chair, or the storage warehouse with 50,000 cubic feet of space does more business than one with 25,000 cubic feet. On the whole, this may be true, but there is much variation between two barbers with two chairs each, which suggests that the day's cutting schedule is much more important in determining the amount of work done than is the number of chairs in the shop. This can be readily illustrated by an example drawn not from Arlington County, but from another revenue survey conducted recently by the Bureau of Public Administration.

	Number of Chairs	Gross Receipts	License Tax	License as Cents per $100 of Gross Receipts
Shop No. 1	3	$4,260	$30	70.42
2	5	9,577	50	52.21
3	1	2,067	10	48.38
4	4	14,364	40	27.83
5	1	2,627	10	38.09
6	2	2,650	20	75.47
7	2	8,334	20	23.99
8	5	18,288	50	27.34
9	4	4,136	40	96.70
10	4	9,926	40	40.29
11	4	13,257	40	29.41

The spread in each category should be carefully noted. Two of the four chair shops do more business than one of the five chair shops. One two chair shop does more business than one three and one four chair shop, and so it goes. The moral of this comparison is that the best indicator of volume is volume. To be sure, in certain circumstances, where records do not provide essential fiscal information, or where administrative difficulties are large in relation to the potential revenue, indirect indicators may legitimately be used. But the burden of proof is clearly upon the proponent of indirect indicators, especially when Federal taxation has made some sort of elementary book-keeping all but universal.

Direct Volume Indicators. Since net profit is inapplicable as an indicator for measuring the benefit derived from the use of the market, and since flat taxes and intermediate non-volume indicators are manifestly too crude for modern taxation, what then can be relied upon. There are two measures applicable to the determination of the use of the market. One is widely used, principally because of its relative ease of administration. The other is agreed by students of business taxation to be superior, but its administrative requirements are somewhat higher and it has not been used by local governments. The Commonwealth of Virginia, as well as most of the municipalities of the State, tax retail business on gross sales

and wholesale business on gross purchases. Otherwise, the municipalities have extended the use of volume indicators, principally gross receipts, to a wide variety of service occupations, whereas the State has continued in the main to levy these license taxes on a flat basis. The value added by handling indicator, somewhat incorrectly designated as gross profits, is generally agreed to constitute the most precise measure of the use of the market, but because it involves calculations additional to the simple addition of daily, weekly or monthly sales, and because it presents certain problems with respect to multiple-outlet enterprises, such as chain stores, municipalities have generally felt themselves unable effectively to administer such a tax. It is probably true that unless the income from business and occupational licenses is sufficiently great to justify at least $25,000 per annum for administration and field audit, the cruder measure of gross receipts and gross purchases, even involving as it does a low ceiling with respect to rates, constitutes a device better within the administrative possibilities of most local authorities.

Gross sales and gross receipts are, of course, self-defining, as is gross purchases in the case of wholesalers. The value added by handling base is calculated by subtracting from gross sales or gross receipts, as the case may be, the cost of goods sold and all commodities, services and supplies secured by contract outside the business. Labor costs, interest, depreciation, etc., are not deducted. If one merchant, for example, handles his deliveries under contract while another handles his by force account, the amount paid under the contract is deducted, and the operations of the contracting delivery agency taxed separately, so that as far as license taxes go, both merchants end up in the same place. As far as professional licenses and most types of service occupations are concerned, the tax liability under either system tends to become

identical. The difference is significant mainly in mercantile enterprises. The most important virtue of the "value added" base is that it permits a single rate to be applied to a uniform base completely across the board, and accomodates itself very effectively to the different mark-up practices among different types of business, thus measuring precisely the use of the market. A miller, for example, who buys $40,000 worth of wheat which he grinds and packages into $50,000 worth of flour has not traded in the market to the extent of $50,000, but only to the extent of $10,000, and $10,000 is the amount which should be taxed. A jeweler who buys a diamond for $500 and sells it for $900 has traded in the market to the extent of $400, and this is what should be taxed. The "value added" base, as may be readily observed, in comparison with the gross sales basis, favors the enterprise which handles a large volume on a low mark-up. Since many of the fields tending to operate on high volume low mark-up are dominated by chain stores, this has not endeared the "value added" base to some local governing bodies.

The accompanying tabulation seeks to summarize the principal characteristics of flat amount, gross receipts and gross sales, and value added by handling bases.

ISSUE	FLAT	GROSS RECEIPTS	VALUE ADDED
A. Equity			
1. Conformity to value added by handling.	No relation whatsoever.	Does not accomodate large differences in mark-up policies between types and sizes of businesses.	Measures accurately and taxes value added by handling.
2. Impact on businesses with low mark-up.	Very heavy. No relation to mark-up.	Very heavy. No relation to mark-up.	Corrects precisely for mark-up differentials.
3. Measurement of value of franchise.	No relation whatsoever.	Much better than flat tax, but still crude indicator.	Accurate measure of value of franchise, but must be bolstered with high minima, which are subject to same criticism as flat taxes.
4. Relation to exemptions in State law.	Requires close adherence to State law and exemptions therein.	Requires close adherence, which makes auditing difficult and creates grave inequities.	Avoids most of the inequalities produced by exemptions in State laws.
5. Discrimination.	Discriminates against small-volume businesses.	Discriminates against large volume businesses.	No discrimination.
6. General observations on equity.	Probably least equitable, and fails completely to respond to economic changes.	Responds to volume changes but not to mark-up differentials.	Almost completely equitable, except for high minimum requirements.
B. Revenue Fluctuation			
1. Stability.	Stable to point of inertia.	Varies with total dollar volume of transactions.	Varies with dollar volume and mark-up and write-off policies
2. Quantity.	Nominal rates imperative to avoid confiscation of small businesses.	Maximum rates must not impose undue burden on businesses with lowest mark-up.	Large amount of latitude with respect to quantity of tax tak
3. Estimating.	Very simple - practically no variables.	Involves estimating volume of business in light of general economic conditions.	Involves estimating volume of business and mark-up and writ off policies.

 Exhibit 2-18

COMPARISON OF CHARACTERISTICS OF FLAT AMOUNT, GROSS RECEIPTS AND VALUE ADDED BUSINESS [illegible]

ISSUE	FLAT	GROSS RECEIPTS	VALUE ADDED
C. Administration			
1. Staffing	Virtually self-administering. No technical personnel required.	Requires simplified audit of a single factor, which can be performed by clerical personnel.	Requires professionally competent administrative staff in adequate numbers.
2. Cost of administration.	Very low cost involved.	Fairly low, in view of simplicity of audit.	Probably around 3 per cent. of collections, $25,000 minimum.
3. Auditability.	Simple head-count is sufficient.	Relatively uncomplicated; nearly all merchants record sales.	Involves audit determination of at least two factors.
4. Discretion of taxpayer.	Practically none involved.	Practically none involved.	Ordinance must be drawn with care and great detail to avoid extensive discretion.
5. Compliance cost.	None.	Negligible	Inconsequential for businesses with adequate accounting records. Probably high for some small businesses.
6. Technical problem in defining cost of goods sold.	None.	None.	Requires clear and accurate definition in terms of business operating methods.
7. Precision in applying definition of tax base.	None.	Negligible.	Requires accuracy in establishing deductions, and special procedures for interlocal and interstate business.
8. Political-administrative factors.	Non-controversial.	Relatively non-controversial.	Involves understanding of business economics and business accounting, and sound administrative judgment.
D. Drafting and revision of ordinance.	No problem.	Negligible in technical problems involved.	Requires competent technical assistance in taxation and business economics fields.

Exhibit 2-19

COMPARISON OF CHARACTERISTICS OF FLAT AMOUNT, GROSS RECEIPTS AND VALUE ADDED BUSINESS TAXES(cont.)

ISSUE	FLAT	GROSS RECEIPTS	VALUE ADDED
E. Applicability to businesses of different types.	Crudity makes extension matter of individual negotiation.	No problem except that arising from differential mark-up policies.	Can be extended to any ty of business or occupatio provided economics sound analyzed.

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Exhibit 2-20

Rates and Equity

It has been demonstrated that license tax bases vary substantially in characteristic of equity. Even more obvious, in many respects, is the connection between rates and tax fairness. Of the five types of rate structures mentioned in the discussion of definitions and terminology, we may pass over consideration of the first, the flat amount, since its effects were fully explored in the section dealing with tax bases. It is sufficient to note that a flat amount tax tends to be extremely regressive since no account is taken of the business or occupational operation, or of variations from time to time in its economic characteristics.

The flat amount plus another type of schedule usually takes the form of a volume tax with a flat minimum amount, or a bracketed tax with a flat minimum. The result for the operator within the maximum gross receipts allowed under the minimum tax is precisely the same as if the tax were at a flat amount. As the minimum tax becomes a smaller and smaller percentage of the total license tax paid, the regressive character of the tax becomes decreasingly important. Obviously, the larger the initial bracket of business allowed under the flat minimum, the more emphatically regressive are the effects of the levy.

Bracketed structures may be either progressive or regressive as they operate from bracket to bracket. Within each bracket they operate precisely as do flat amount taxes. This situation is seriously aggravated where the brackets are large enough to encompass enterprises with substantial variations in volume of business and basic economic characteristics. It is, of course, possible to use the bracketed structure in conjunction with a volume rate, in which case the brackets would make the tax

progressive or regressive in proportion to the percentage rise or drop from bracket to bracket. For example, Charlottesville achieves a high degree of regressivity with a retail merchants license tax of $20 minimum covering gross receipts up to $2,000, $0.27 per $100 of gross receipts from $2,000 to $100,000, and $0.15 per $100 of gross receipts in excess of $100,000. Fredericksburg utilizes a reverse procedure in imposing a flat tax of $20 plus $0.29 per $100 of gross receipts up to $200,000, and $0.58 per $100 of gross receipts in excess of $200,000.

There is a tenuous economic justification for an ascending scale on the assumption that large scale operators are frequently able to avail themselves of the economies of quantity purchasing and certain other techniques of reducing their costs, thereby expanding their profit margins. On the whole, the proof runs in the opposite direction; most large scale operators conduct their businesses on substantially smaller profit margins than do small enterprises. Clearly, there is no justification for regressive rates which put a heavier relative burden on the small scale operator, unless the social objective is to encourage combination and freeze out small business. Since, as has been pointed out, businesses have no ability to pay in the customary sense of the term, it is probable that progressive and regressive rate structures are both inapplicable to business taxation.

As a practical matter, there are only two major alternatives involved in the decision as to the dominating principle which is to govern the rate structure. If, on administrative grounds, it is decided that a percentage of value added by handling presents a problem of management beyond the ability of the County economically to execute, recourse must then be had to a

percentage of gross receipts, applied to several classifications of enterprises which have generally similar economic characteristics, and through the process of classification to approximate as closely as possible the equitable taxation of the value added by handling, even though the gross receipts indicator is utilized in the actual calculation of the levy. In the first alternative, a uniform rate may be applied to a uniform base, with the assurance that the burden will be equitably adjusted to the temporal variations in the economic characteristics of the various types of businesses licensed. In the second alternative, a set of assumptions involving temporarily static economic conditions is involved, which is not self-adjusting and which does not respond very closely to economic differentials even within the same type of business or occupation, and which therefore demands continuous revision and adjustment of the rate structure. It must be admitted, however, that the second alternative has strong administrative arguments in its favor.

PLAINTIFF'S EXHIBIT 3

MEMORANDUM DATED APRIL 18, 1967

April 18, 1967

Memorandum

TO: Bert Johnson, County Manager, Arlington County

FROM: Lorin A. Thompson, George Mason College

Subject: Business Privilege Licenses.

In this memorandum I have suggested certain revisons in the rates. In the main, I have suggested that the rates which appear excessive be lowered, that professional licenses be reduced from 65 to 50 cents, and that retail and service industries be charged 25 cents. The result is that the rates are from 8 cents to 50 cents per $100. These are comparatively low rates.

License taxes enable local governments (1) to keep themselves informed of the different kinds of businesses and (2) to levy taxes upon businesses as a source of revenue. The first purpose is regulatory. Registration usually requires the payment of a fee which is ordinarily nominal in amount. The second purpose, i.e. to raise revenue involves questions as to an appropriate base. Gross receipts, as a measure of tax liability, is perhaps the simplest base since it is easily audited and the cost of compliance is minimal. The rate applied, however, does not affect all businesses in the same way.

Gross receipts taxes using the same rate for all types of business falls with unequal force upon different kinds of businesses and upon different firms

in the same business. The impact of such a tax depends on the gross profit margin, that is the difference between gross receipts and cost of goods, rate of turnover in merchandize and the capital structure or pro forma capital structure of the business. Each of these three factors apply to all business firms, but to each in a different way since the mix among the foregoing three factors varies along with other conditions affecting a business. The following example illustrates the way in which the severity of a gross receipts tax may be measured when gross receipts are taxed at 1 percent.

A and B represent two business concerns whose gross receipts margin and turnover rates differ.

Assume	A	B
1. Capitalization	$100,000	$100,000
2. Gross Receipts	2,500,000	400,000
3. Cost of Goods	1,875,000	200,000
4. Margin	625,000	200,000
5. Gross Receipts @ 1%	25,000	4,000
6. Net Profit after income tax	37,500	37,500
Ratios		
Net Profits/Capitalization	37.5%	37.5%
Net Profits/Gross Recipts	1.5%	9.375%
Average stock turnover/yr.	25x	4x
Tax/Margin	4%	2%
Tax/Net Profits	67%	10.7%

 Exhibit 3-2

Other examples using different factors which affect a business will produce almost infinite variation. The case used illustrates the fact that a gross receipts tax of 1 percent in a high turnover, low margin business can claim 4 percent of the margin for doing business and 2 percent in a high margin, slow turnover business. In this case capitalization, net profits and rate of tax on gross receipts were assumed to be the same. Gross receipts and cost of goods are the variables. Other costs of operation although variable have produced the same amount of net profit after income taxes.

It is clear from the foregoing that gross receipts taxes do not apply with equal force upon different businesses. What then is the justification for their use?

Gross receipts taxes, designated in the Arlington Code as business license and privilege taxes provide the local government with a simple method of raising revenue. The cost of compliance to the business is also minimal. The same rates on one business, however, may be and often is much more severe than on another. If the rates are kept low, i.e. less than 1 percent, the impact of the gross receipts tax on the costs of doing business and on profits is reduced. It is recognized that businesses often feel that taxes, such as a gross receipts tax, weaken their competitive position. This view is held by certain groups of taxpayers in Arlington. The real crux of the problem is whether the total of local taxes

levied on businesses in Arlington are heavier than in adjacent political subdivisions. Local governments of course, can and do vary their local tax rates from time to time as circumstances require such action.

There is a body of opinion that believes that Arlington would do well to eliminate all business license and privilege taxes. If this were done the savings would increase the liability of the business for federal and state income taxes. Hence businesses would gain only a part of the tax saving.

Business license and privilege taxes are used extensively in Virginia cities and towns and a number of counties, At present Arlington rates are relatively low as compared to Virginia municipalities of comparable population. It is also true that the rate structure varies widely. These taxes in Arlington now produce about $3 million. To the writer, some effort should be made toward equalizing the rates among those subject to the tax. If this is done the total amount of revenue from this source will be about 75 percent of the amount produced by the present rates. A suggested modification in the rates is given in Exhibit I.

Consideration should be given to changing the rates of the following professions to retail rates:

Auctioneer
Broker
Business chance broker
Commission merchant
Furnisher of domestic and clerical help

The nature of the business activity is a proper basis for classifying a business. In suggesting

revisions in the rates several matters were considered.

1. The existing rates on motels and hotels, telephone and telegraph companies were very high when compared to all other rates. It is recommended that they be reduced to a rate of 50 cents per $100, which is the highest rate suggested in Exhibit I.

2. It is recommended that the rates for selling and merchandizing operations be brought closer together.

3. It is recommended that a uniform rate apply to all service occupations.

4. Reduce professional rates from 65¢/$100 to 50¢.

5. The desirability of using a maximum rate of 50¢/$100 of sales on businesses where license tax liability is measured by gross receipts. A rate of 25 cents has been suggested for most retail operations.

Some differences in rates have been retained on the premise that the costs of doing business is less in professional activities than in retail and wholesale operations. Some rates have not been changed to any considerable extent, such as developers and wholesale merchants.

Licenses on vending machines, non-resident laundries and dry cleaners, peddlers, taxi operators and many other businesses covered under the license tax ordinance and which account for relatively small amounts of revenue have not been changed. Some are flat fees, others are variable. The registration of such businesses is more important than the revenue produced. Such license taxes are mainly regulatory. Others, such as non-resident laundries, can continue on flat fees since it would entail considerable cost for such businesses to comply on the basis of volume done at Arlington and/or other locations.

Using the 1965 revenue figures for the business and occupational license tax in Arlington, the loss in revenue which would result from the suggested revision in rates is shown below:

Total Receipts and Penalties	$2,655,875
Estimated Receipts (New Scale)	2,044,229
Total Reduction	$ 611,646 - 23%

The range of rates in the present ordinance is from 8¢ per $100 on wholesale business to $3.00 on hotels and motels. In the revised schedule (Exhibit I) the range is from 8 cents per $100 to 50 cents per $100. The rates suggested for retail and service businesses are the same at 25 cents per $100. It is further suggested that some activites now classified as professional be reclassified as retail.

If the wish of the Arlington County Board is to reduce the business and professional license taxes as a source of revenue, the suggestions in Exhibit I would reduce the revenue from this source by about 25 percent. If the Board wished to obtain the same amount of revenue as is presently contemplated, the suggested rates should all be increased by 25 percent. In this case, the rates would range from 10 cents per $100 on wholesale merchants to 62.5 cents on professions, telephone, telegraph companies, hotels and motels. Retail and service rates under these circumstances would be increased from a proposed 25 cent rate to 31 or 32 cents.

If the Board wishes to gradually eliminate the business privilege and license taxes as measured by

gross receipts, the rates could be lowered in successive years.

In conclusion, the rates in Arlington are comparatively low as compared to other cities in Virginia. Moreover, business locations are influenced mainly by economic advantage, costs and convenience. The complete elimination of the business license tax would substantially increase the liability of the taxpayer for federal and state income taxes. Lowering of some tax rates only shifts the burden to some other activity in the economy of the area. The suggested revision would provide a better balanced privilege and license tax structure for Arlington. It is not severe in its impact since the rates range from 8 cents per $100 to 50 cents per $100. Such rates should not hamper the growth of Arlington's economy.

FINAL ORDER

(Filed April 12, 1973)

THIS CAUSE came on to be heard this 12th day of January, 1973, upon the petition of the Plaintiffs for an order of exoneration pursuant to the provisions of Section 58-1145 of the Code of Virginia, 1950, as amended, Answer of the Defendant, opening statements of Counsel, presentation of testimony and exhibits, closing arguments of Counsel, and

THE COURT certifies that the following facts were deemed proved:

1. The Commonwealth Attorney has defended this application pursuant to statute, and

2. The Commissioner of Revenue has appeared and given testimony touching on the application as required by statute, and

3. The Arlington County Business Privilege License Tax was enacted by the Defendant Board in 1949 and, among other provisions, provided in Section 11-2 of the ordinance, "It is the purpose and policy of the County Board, in enacting this Chapter imposing license taxes for the privilege of conducting business and engaging in certain professions, trades, or occupations in the County to equalize as far as practicable the burden of such license taxation among those hereby liable thereto, by adopting, for general application, but subject to the exceptions hereinafter specifically set forth, a system of license taxes measured by the gross receipts of the business, profession, trade, or occupation in respect of which the tax is levied."; and further providing in part in Section 11-4 of the ordinance:"....which license taxes shall be for the support

of the County government, the payment of the County debt, and for other County purposes."

4. That rates for the various businesses, professions and trades were established by the Defendant Board after advice of professional consultants employed to study and recommend categories and rates which was intended to equalize as far as practicable the burden of the tax among those affected thereby.

5. That a method of equalization of the tax among those affected was developed by studies determining the average profit margins for the various businesses, professions, and trades based on evidence of past performance and adopting the category of Retail Merchant as a base point, fixing a rate for this category and adjusting rates for all other categories up or down from the base point according to their relative profit margins; the rationale being to tax according to ability to pay as determined by the studies of the average operating or profit margin of each category under the ordinance.

6. That from time to time the Defendant Board ordered studies by professional consultants to re-evaluate the categories and rates therefore in keeping with the Board's stated purpose and policy of equalizing the burden of the Business Privilege License Tax.

7. That the Defendant Board consistently followed the recommendations of the professional consultants so employed with the exception of certain categories which were bracketed prior to January 1, 1952, and the Hotel-Motel category from January 1, 1959 to December 31, 1970, during the period of a so-called "Gentlemen's Agreement" between the County Board and the Hotel-Motel Industry.

8. That in 1959 a so-called "Gentlemen's Agreement" was entered into between the Hotel-Motel Industry and the County whereby a rate far in excess of the formula rate was placed on this industry with the understanding that it was to be passed on as a local tax on customer's bills and that such "Gentlemen's Agreement" continued in full force and effect until 1970 when a transient occupancy tax of Two Percent (2%) of gross receipts was adopted for Arlington County; that the industry was directed not to charge the Business Privilege Tax as a local tax or surcharge on customer's bills any further and the Industry's Business Privilege License Tax rate was restored to its formula rate, and

9. The Defendant, without evidence of a change in the Hotel-Motel Industry's profit margin, arbitrarily enacted a rate in 1971, to be effective in 1972, which increased the rate Three Hundred Percent (300%) above the formula rate, in violation of equalizing provisions, thereby entitling the petitioners to the exoneration prayed for, and

10. The Court being of the opinion that the ends of justice would be met by making an adjustment, now therefore

IT IS ADJUDGED ORDERED AND DECREED, that:

1. The Plaintiffs be, and hereby are, exonerated from the Arlington County Business Privilege License Tax for 1972 as computed at the rate of Two Dollars ($2.00) for each One Hundred Dollars ($100.00) gross receipts and the rate be, and hereby is, established at Fifty Cents (50¢) per One Hundred Dollars ($100.00) gross receipts for 1972, and

2. The Treasurer of Arlington County, Virginia be, and hereby is, directed to refund to the Plaintiffs such funds as each

of them may have paid for their 1972 Business Privilege License Tax which is in excess of the rate hereinabove established by the Court, and

THIS ORDER IS FINAL.

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ASSIGNMENT OF ERROR

(Filed April 23, 1973)

1. The conclusion of the Court that the 1972 Business Privilege License Tax on hotels and motels was arbitrarily enacted is not supported by the evidence.

2. The County Board of Arlington County is fully empowered to enact a Business Privilege License Tax on hotels and motels and set any rate so long as that rate is not prohibitive or confiscatory and the Court erred in finding the rate excessive without any finding that it was prohibitive or confiscatory, or any evidence to support that finding if it had been made.

3. The Court erred in finding that the burden of the tax had not been equalized, and in finding that there was any requirement to equalize the burden that could restrict the power of the County Board to enact the rate for 1972.

4. The Court erred in construing Sec. 58-1145 as empowering it to correct the tax rate under the facts of this case; the only assessment which may be corrected by the Court is the valuation of the property that forms the basis for the assessment, and the tax rate is not within the power of the Court to correct.

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