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By Richard D. Pomp*

As part of Ohio's tax reform in 2005, then-Governor Bob Taft declared that "Ohio's economy continues to lag the nation," and the only way to enter the "Promised Land" is by reforming the State's tax law.[1] Taft and the Ohio Legislature believed that "[i]f we are to create tomorrow's jobs, we can't remain frozen in time in yesterday's tax system."[2] Ironically, given Taft's concern with "yesterday's tax system," he supported an antediluvian turnover tax, long vilified and condemned by economists, which has its roots in the middle ages and thus is more "yesterday" than the then-existing Ohio tax structure.[3]

A gross receipt or turnover tax is applied every time a good or service "turns over"—that is, transferred from one entity to another for a consideration; the resulting gross receipt is subject to tax. The tax base is "turnover"; the measure of the tax is "gross receipts."

The turnover tax is a measure of business activity. It has no connection with a firm's profits, its benefits from government spending, or the costs it imposes on society. The tax applies to business-to-business sales of supplies, inventory, machinery, materials, *etc*. The tax also applies to sales to end users, that is, to consumers. It taxes both business and personal services. A turnover tax makes no pretense of taxing profits, income, consumption, wealth, or other bases that have come to be accepted around the world.

The name of Ohio's new tax, the Commercial Activities Tax (CAT), belied its nature as an old-fashioned turnover tax and few critics drew that connection. The same can be said about the Washington B&O tax, one of the oldest turnover taxes in the country.

Origin of Turnover Taxes

The CAT has deep roots.[4] Ancient Athens laid taxes upon the sale of real property and selected goods.[5] The taxation of specific commodities, especially salt, was common in China, India, and Egypt, where the Ptolemies apparently imposed a tax of 5% on all commodities.[6] When the Romans conquered Egypt, they imposed a general turnover tax reaching 10%.[7]

During the reign of Augustus, a tax of 1% was levied on all articles, movable goods, and fixtures sold in the markets or by auction.[8] The rate was 2% upon

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slaves.[9] The turnover tax spread to France[10] and Spain, where it persevered after the end of Roman rule.[11]

The *Alcabala* of Spain and Its Progeny

The most notorious of the medieval taxes was the infamous *alcabala* of Spain,[12] a cascading turnover tax[13] of the type used today by Washington, Ohio, Texas, Nevada, Oregon, and Maryland.[14] The *alcabala* was a national tax, introduced in 1342, and covered nearly all goods.[15] Initially meant to be temporary, it became permanent in 1377.[16] Over time, its rate ranged from 1% or 2% to at least 10%.[17] Rates differed by geography and type of goods, which encouraged tax planning that hindered its collection,[18] a problem that infects any similar approach.

The Spanish Crown often contracted with cities, provincial governments, or merchant guilds (tax farmers) to collect the tax, a problem complicated by the Crown's failure to ensure widespread compliance.[19] The applicable rate was based on the destination of the good and not where it was manufactured. Fines were imposed if goods were delivered at a low-tax location and used elsewhere, reminiscent of tax-minimization strategies used today. Sellers were allowed to pay a fixed, periodic amount instead of paying on each transaction.[20]

The Spanish economists of the time,[21] joined later by the iconic Scottish economist, Adam Smith,[22] and contemporary historians,[23] blamed the tax for that country's economic decline. While Spain's continuing expensive, unsuccessful military expenditures also undermined the empire, creditors continued providing loans believing their collateral was sound. After all, there was the continuing gold and silver from the New World, and Spain would certainly win future wars. But it didn't. Smith suggests that Great Britain's economic superiority to Spain was in part because of the damage done by the *alcabala*.[24]

Spanish statesman Don Gaspar Melchor de Jovellanos described the *alcabala* tax as having "surprised local produce from the moment it was born, chasing and biting it throughout its circulation, without ever losing sight of or releasing its prey until the last moment of consumption."[25]

The negative implications of the *alcabala* were not limited to Spain. The Duke of Alba imposed a 5% *alcabala* in the Netherlands, where it played a significant part in causing a revolt.[26]

The *alcabala* was finally eliminated in 1845.[27] But before its demise, Spain exported the tax to Mexico in 1574 and Peru in 1591.[28] The Philippines adopted something similar much later in 1904.[29]

The French Turnover Tax

France also used a turnover tax, starting in 1292.[30] The tax was doubled in 1355 to finance its war with England but faced massive resistance by the middle class.[31] When Louis XI levied a 5% tax in 1465 on wholesale sales, it met with such opposition that it nearly caused a full-scale rebellion, and he soon abandoned it.[32] Charles VIII unsuccessfully tried it again in 1485.[33] A broader tax was introduced by Henry IV in 1597 but eliminated it just five years later because of substantial resistance.[34] Other efforts to impose turnover taxes also failed. When the French Revolution started, one of the first actions was to abolish the remaining turnover taxes.[35]

During the seventeenth and eighteenth centuries, proposals for turnover taxes were common in England and Western Europe.[36] In the nineteenth century, England taxed most commodities to finance its war with France.[37] After the war, the tax was limited to just a few items.[38]

At the end of the Franco-Prussian war in 1871, France again considered adopting a turnover tax to deal with post-martial needs.[39] Economists railed against the turnover tax. In criticism that foreshadowed current critiques,[40] they believed the tax would have a disparate impact on different producers and would favor vertical integration and integrated enterprises.[41] Other complaints were the lack of proper accounting records and evasion. Nonetheless, ignoring these objections France adopted a new turnover tax in 1920, known as the Commodity Transfer Tax, eliminated it in 1936, reinstated it in 1939, and finally abandoned it in 1955.[42] Especially noteworthy were early criticisms of taxpayer manipulations to avoid taxable turnovers. For example, dealers became commission brokers, and economic integration was common.[43]

Post-World War One

Italy (1919),[44] Belgium (1921),[45] Luxembourg (1922),[46] the Netherlands (1940),[47] and Austria (1938)[48] all introduced turnover taxes presumably to deal with their fiscal needs after World War I and the Great Depression.[49]

Germany adopted a turnover tax in 1918, and although heavily criticized, it continued until 1968.[50] In 1968, Germany adopted a value-added tax (VAT) as part of the movement to harmonize taxes by the European Economic Community, the predecessor of the European Union.[51]

After World War I, turnover taxes were a major source of revenue for most European countries.[52] If they did not already have them, these countries adopted turnover taxes to aid fiscal systems suffering from the drain of World War I, post-martial expenditures, recessions, and uncontrolled inflation. In this context, taxes that were hidden in prices, collected through convenient business channels, and paid in small installments were viewed as advantageous. The need to finance the government during a time of rapid inflation enhanced the attractiveness of a tax that was responsive to price increases.[53] In the two decades following World War I, the turnover tax became an important fiscal element throughout most of Europe, South America, Australia, and Canada, later to be supplanted by VATs.[54]

Non-European countries using some form of a turnover tax post-World War I included Ceylon (today Sri Lanka), Taiwan, Indonesia, Korea, Chile, certain states in Brazil, Argentina, India, and west and equatorial Africa which consists of current or former French colonies.[55] Almost all of these countries subsequently replaced these taxes as part of the worldwide movement (with the exception of the United States) with VATs.[56] By the 1970s, European countries had replaced their sales taxes and turnover taxes with VATs, under pressure from the European Union to harmonize member countries' tax systems.[57] This harmonization was "considered a key element to develop a common market among EU nations and enhance international competitiveness."[58]

Summary

One commentator described the former turnover taxes as "iniquitous in their collection, unjust in their burdens, and unpopular with taxpayers."[59] "Unpopular" seems to be an understatement. Turnover taxes are not a characteristic of mature economies but instead are hallmarks of developing countries. They were often adopted to deal with dire economic conditions, typically in response to wars or recessions, when other tax bases were unavailable. As noted, the most infamous of all turnover taxes, the Spanish *alcabala*, is blamed for that country's decline. Other countries' turnover taxes were met with strong resistance by taxpayers, sometimes triggering outright rebellions.[60] Economists railed against the tax and its disparate impact on different producers and its encouragement of economic integration.[61] At the first opportunity, turnover taxes were replaced with VATs.

As one famous international economist, Edwin Seligman concluded, "taxes on … [turnover] … constitute a rough and ready system, suitable only for the more primitive stages of economic life."[62] "In a business community which is striving more and more to adjust its taxation to the ability of the individual such a reversion to bygone practices would seem to be unwise in the extreme."[63] "In modern times … the tax on gross receipts is everywhere giving way to the tax on profits or net receipts," and that gross receipts are "exceedingly inequitable as between various classes of business, or as between different individuals in the same class."[64] John Due, another iconic economist, writing a few decades after Seligman, and thus having more years of perspective, also concluded that while European and Latin American countries adopted turnover taxes to deal with wartime fiscal problems, they were abandoned once their defects became obvious.[65]

As the preceding historical summary indicates, Ohio demonstrates the adage that "those who don't know history are doomed to repeat it." That may also explain Ohio's siren call for other states, inspiring Texas, Nevada, and Oregon.

A systematic treatment of the defects in turnover taxes merits a more detailed and rigorous treatment.[66]

ENDNOTES

* The author thanks Karl Frieden, Doug Lindholm, and Bruce Nelson for perceptive comments on a draft of this article, which will be expanded upon and published as part of a monograph prepared for the State Tax Research Institute (STRI).

1 Bob Taft, *Editorial, Tax Reform Will Boost Job Growth*, CINCINNATI POST, Mar. 1, 2005.

2 *Id*.

3 For an overview of the Ohio tax structure existing at that time, *see* April L. Butler, *A Look at What the Cat Dragged In: The Problems Inherent in Ohio's Commercial Activity Tax*, 32 U. DAYTON L. REV. 99 (2006), at 103–107.

4 Historians seem to use the terms turnover taxes and gross receipts taxes interchangeably. They sometimes refer to turnover taxes as sales taxes but the turnover tax has none of the features of a sales tax. It is sometimes difficult based on skimpy descriptions and imprecise language to distinguish single-stage excise taxes from turnover taxes, especially in the early tax history of the world.

5 Alfred D. Buehler, GENERAL SALES TAXATION: ITS HISTORY AND DEVELOPMENT, at 3 (1932); Augustus Boeckh, PUBLIC ECONOMY OF THE ATHENIANS, trans. Anthony Lamb, at 433 (1857).

6 Buehler, *supra* note 5, at 3; J.P. Mahaffy, A HISTORY OF EGYPT UNDER THE PTOLEMAIC DYNASTY, at 164 (1899).

7 Buehler, *supra* note 5, at 3; J. Grafton Milne, A HISTORY OF EGYPT UNDER ROMAN RULE, at 124 (1898). In a later edition, Milne describes the tax as applying only to real property. J. Grafton Milne, A HISTORY OF EGYPT UNDER ROMAN RULE, at 164 (1924).

8 Buehler, *supra* note 5, at 3; Victor Duruy, HISTORY OF ROME AND THE ROMAN PEOPLE, vol. III pt. II, ed. J.P. Mahaffy, at 721 (1884). Economist Clinton V. Oster, however, offers a more nuanced account. "In 6 A.D. Roman Emperor Augustus introduced the *centisima rerum venalium* which was a one per cent general sales or turnover tax. Even though the tax applied only to goods sold at auction, its application was fairly broad because this was the customary Roman method of marketing all commodities except articles of domestic consumption." Clinton V. Oster, STATE RETAIL SALES TAXATION, at 8 (1957).

9 Buehler, *supra* note 5, at 3; Duruy, *supra* note 8, at 721.

10 Known as the *sur le chiffre d'affaires*.

11 Buehler, *supra* note 5, at 3.

12 The *alcabala* is also spelled *alcavala* in many sources. *Alcabala* is the Spanish spelling.

13 Neil H. Jacoby, RETAIL SALES TAXATION: RELATION TO BUSINESS AND CONSUMERS, AND ADMINISTRATIVE PROBLEMS, at 23 (1938); Buehler, *supra* note 5, at 3; Edwin R.A. Seligman, STUDIES IN PUBLIC FINANCE, at 126–127 (1925). Most of the literature refers to this cascading problem as "pyramiding." But pyramids decrease in width and become narrower as you move further to

their tops. In contrast, the cascading problem gets broader as you move through the chain of production and distribution.

[14] Janelle Cammenga, *Does Your State Have a Gross Receipts Tax?* Tax Foundation, Mar. 10, 2021, available online at *taxfoundation.org/state-gross-receipts-tax-2021/*.

[15] Buehler, *supra* note 5, at 3–4; Seligman, *supra* note 13, at 126–127; J.K. Ingram, *Alcavala*, Dictionary of Political Economy, vol. I, ed. R.H. Inglis Palgrave, at 30 (1901).

[16] Ingram, *supra* note 15, at 30.

[17] John F. Due, Sales Taxation, at 256–257 (1957); Buehler, *supra* note 5, at 3.

[18] Multiple rates plague some of the "modern" day turnover taxes.

[19] I am grateful to Bruce Nelson for pointing this out. *See* Jon Cowans, Early Modern Spain (2003), and William Maltby, The Rise and Fall of the Spanish Empire (2009).

[20] Kendall Brown, *Alcabala*, Iberia and the Americas: Culture, Politics, History, vol. I, ed. J. Michael Francis, at 57–58 (2006).

[21] *See* Geronymo De Uztariz, The Theory and Practice of Commerce and Maritime Affairs, vol. II, trans. John. Kippax, at 236–254 (1753).

[22] Adam Smith, Wealth of Nations, at 850–851 (1937): "[The alcabala is levied] upon the sale of every sort of property whether movable or immovable, and it is repeated every time the property is sold. The levying of this tax requires a multitude of revenue officers sufficient to guard the transportation of goods, not only from one province to another, but from one shop to another. It subjects not only the dealers in some sorts of goods, but those in all sorts, every farmer, every manufacturer, every merchant and shopkeeper, to the continual visits and examination of the tax-gatherers."

[23] Eugene Rice Jr. and Anthony Grafton, The Foundations of Early Modern Europe, 1460-1559, at 119 (1994), considered the *alcabala*, "a cornerstone of Spanish royal finance," which created a "heavy burden on merchants and probably a contributing cause of the declining vigor of Spanish economic life in the later sixteenth century." Jon Cowans, Early Modern Spain, at 3 (2003), described the *alcabala* as taking "place alongside [Spain's] borrowing but was unable to save Spain from 'the Crown's chronically ill finances,' and because of the burden it caused, Castile remained a relatively poor country through even the best years post-Columbus." William Maltby, The Rise and Fall of the Spanish Empire, at 4 (2009), blamed high taxes, and a weakening agricultural economy as causing an economic crisis.

[24] Smith, *supra* note 22, at 850–851.

[25] *Gaspar de Jovellanos, Obras publicadas é inéditas de D. Gaspar Melchor de Jovellanos*, vol. 50, ed. M. Rivadeneyra, at 118 (1859).

[26] H. Michael Tarver and Emily Snape, *Alcabala*, The Spanish Empire: A Historical Encyclopedia, vol. I, ed. H. Michael Tarver, at 67 (2016).

[27] Historians have used various dates for the final death of the *alcabala*. Economist Clinton V. Oster cited 1819. Oster *supra* note 8, at 9 (citing National Industrial Conference Board, General Sales or Turnover Taxation, at 165 (1929)). Professor John Due said that "gradually, in the early 19th century, the scope of the [alcabala] was narrowed and the exemptions increased. A few vestiges of the tax carried over into the present century, the last being eliminated in 1911." Due, *supra* note 17, at 257. As Due suggests, there were various changes to Spain's taxes in the early nineteenth century, and Comín claims a new progressive government finally abolished Spain's turnover tax in an 1845 reform. Francisco Comín, *Public Finance and the Rise of the Liberal State in Spain, 1808–1914*, Paying for the Liberal State: The Rise of Public Finance in Nineteenth-Century Europe, eds. José Louís Cardoso and Pedro Lains, at 220–223 (2010). *See also* Tarver and Snape, *supra* note 26, at 66–67.

[28] *Id.*, at 165.

[29] Due, *supra* note 17, at 340; National Industrial Conference Board, *supra* note 27, at 203.

[30] National Industrial Conference Board, *supra* note 27, at 164.

[31] Buehler, *supra* note 5, at 4; Eyre E. Crowe, The History of France, vol. I, at 418–456 (1858).

[32] Seligman, *supra* note 13, at 125.

[33] *Id.*

[34] Buehler, *supra* note 5, at 4; Seligman, *supra* note 13, at 125–126.

[35] Seligman, *supra* note 13, at 126.

[36] Buehler, *supra* note 5, at 4–5; *See also* Edwin R.A. Seligman, The Shifting and Incidence of Taxation, at 19–78 (1910) (giving a general survey of the arguments for general sales tax over time).

[37] Buehler, *supra* note 5, at 5.

[38] *Id.*, at 5.

[39] Buehler, *supra* note 5, at 5; Seligman, *supra* note 13, at 128–129.

[40] *See, e.g.*, Andrew Chamberlain and Patrick Fleenor, *Special Report, Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes*, Tax Foundation, Dec. 2006, at 6–10, available online at *files.taxfoundation.org/legacy/docs/sr147.pdf*.

[41] Buehler, *supra* note 5, at 5.

[42] Martin Norr and Pierre Kerlan, Taxation in France, at 973 (1966).

[43] William R. Green, The Theory and Practice of Modern Taxation, at 177 (1938).

[44] Oster, *supra* note 8, at 13.

[45] *Id.*, at 13–14.

[46] Due, *supra* note 17, at 81.

[47] *Id.*, at 83–84. The Dutch enacted a single-stage manufacturers sales tax in 1933. *Id.*, at 83. They were hostile to turnover taxes after Spain attempted to impose the *alcabala* during the Inquisition. *Id.*

[48] *Id.*, at 73–74. Austria's first turnover tax was to become effective in 1923. Fears of the tax's impetus for economic integration led the government to modify it in ways that would reduce that incentive. *Id.*, at 74.

[49] John L. Mikesell states with no citation that the Nazi's exported the gross receipts tax to the countries they intended to annex (Austria, Luxemburg, and the Netherlands). John L. Mikesell, *Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance*, Council on State Taxation, Jan. 2017, at 4, available online at *www.cost.org/link/69673ca9cb46480d87d58456b76baed9.aspx*. After Germany annexed Austria and the Netherlands, it forced both countries to replace their single-stage sales taxes with German-modeled turnover taxes. Due, *supra* note 17, at 76, 83–84. Luxembourg had a turnover tax prior to annexation that was primarily modeled after France's. *Id.*, at 81. But when Germany annexed Luxembourg, it forced the country to modify its tax to match the German form. *Id.*

[50] Buehler, *supra* note 5, at 97–99. Henry J. Gumpel, Taxation in the Federal Republic of Germany, at 4203–4209 (2d ed. 1969). A 1952 study showed that the effective tax rates on selected commodities ranged from 3.2% to 12.5%, a result of cascading that marks all turnover taxes. Mikesell, *supra* note 49, at 8.

[51] Gumpel, *supra* note 50, at 4203; Due, *supra* note 17, at 52; First Council Directive of 11 April 1967 on the Harmonisation of Legislation of Member States Concerning Turnover Taxes, Art. I (67/227/EEC), J. O Comm. Eur. (No. 71). In 1918, a VAT was recommended to Germany as a replacement for its turnover tax. Due, *supra* note 17, at 52.

[52] Robert M. Haig and Carl Shoup, The Sales Tax in the American States, at 5 (1934). At the conclusion of World War I, the turnover tax existed in a few underdeveloped countries, for example, in both Mexico and the Philippines because of Spain's influence. Seligman, *supra* note 13, at 130.

[53] For example, Buehler considered the automatic fluctuating nature of France's turnover tax as its "most important asset," in response to rapid inflation. Buehler, *supra* note 5, at 93–94.

[54] Haig and Shoup, *supra* note 52, at 5.

[55] John F. Due, Indirect Taxation in Developing Economies, at 118 (1970).

[56] *See generally*, Kathryn James, *Exploring the Origins and Global Rise of VAT*, The VAT Reader, 2011, at 15–22; Fabiola Annacondia, *Overview of General Turnover Taxes and Tax Rates*, International VAT Monitor, Mar./Apr. 2018.

[57] First Council Directive of 11 April 1967 on the Harmonisation of Legislation of Member States Concerning Turnover Taxes, Art. I (67/227/EEC), J. O Comm. Eur. (No. 71). Every EU member must use a VAT that conforms to the definitions of goods and services in the EU VAT directive. Council Directive 2006/112, article 401, 2006 O.J. (L347) 1 (EC).

[58] Karl A. Frieden and Douglass L. Lindholm, *U.S. State Sales Tax Systems: Inefficient, Ineffective, and Obsolete*, State Tax Notes, Dec. 14, 2020.

[59] Buehler, *supra* note 5, at 5.

[60] It is not always possible to distinguish between resistance to taxes qua taxes and resistance based on the type of tax being imposed.

[61] *See, e.g.*, Buehler, *supra* note 5, at 5; Green, *supra* note 43, at 177; Due, *supra* note 17, at 81.

[62] Seligman, *supra* note 13, at 133.

[63] *Id.*, at 134.

[64] *Id.*, at 133–134.

[65] Due, *supra* note 55, at 122–123.

[66] Forthcoming in the next volume of the Journal.