

# Principles of a High-Quality Tax System

Education Income Tax Study Committee

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October 12, 2022



# Six Key Principles to a High-Quality Tax System



# Six Principles

1. Sustainability/Reliability
2. Fairness
3. Simplicity
4. Economic Competitiveness
5. Tax Neutrality
6. Accountability



# Sustainability and Reliability

**Principle:** Maintain a reliable, sustainable, and diverse revenue stream

- Reliable – not one time, predictable, doesn't vary much from year to year
- Sustainable – not one time, is enough to cover expenses over time
- Diverse – the tax base is broad enough to mitigate volatility and increase reliability

## **Considerations:**

- How does the tax base change over the long term?
- How does this impact planning for people and business?
- What is the volatility of the tax base from one year to the next?
- Are that state sources of revenue mixed and balanced?



# Fairness

**Principle:** Ensuring equality in taxes paid across similar ability to pay and circumstances

- Horizontal Equity – taxpayers with similar economic circumstances have similar tax burdens
- Vertical equity or progressivity – how the distribution of tax burdens varies among taxpayers with different economic circumstances

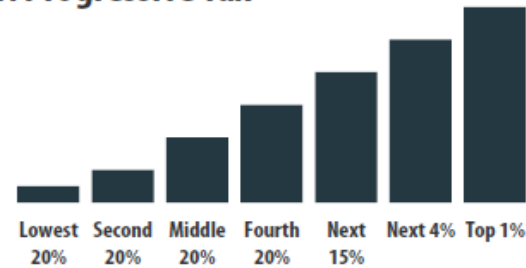
## **Considerations:**

- What is more important - Vertical or Horizontal Equity?
- Does this principle apply to the entire tax system, or just to individual tax types?
- If vertical equity is the goal, what is the desired amount of progressivity?



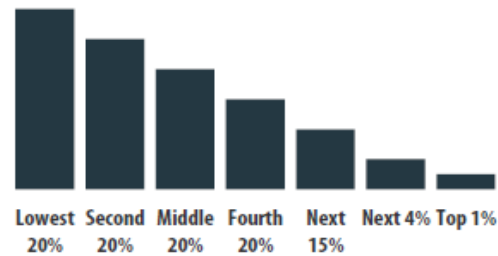
# Progressive vs Regressive vs Proportional Tax

## A Progressive Tax



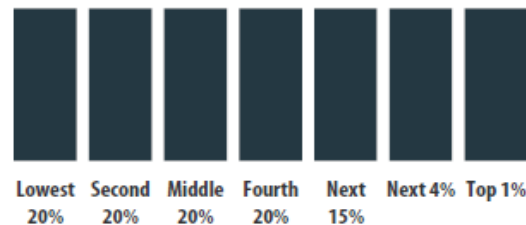
A **progressive tax** is one in which upper-income families pay a larger share of their incomes in tax than do those with lower incomes.

## A Regressive Tax



A **regressive tax** requires the poor and middle-income to pay a larger share of their incomes in taxes than the rich.

## A Proportional Tax



A **proportional tax** takes the same percentage of income from everyone, regardless of how much or how little they earn.



# Simplicity

**Principle:** The tax system is easy for a taxpayer to understand and comply with, and is it easy to administer

## **Considerations:**

- How well do taxpayers understand what they need to pay each year?
- Are taxpayers informed? Do they understand how assessment, collection and compliance work?
- Is it equally easy for all taxpayers to comply with the law?
- Does the system minimize compliance costs?
- How simple and efficient is it to administer and raise revenue?
- Is there existing infrastructure in place that can handle changes in the tax system?



# Simplicity vs Fairness: A tradeoff

- Decisions about simplicity are made in the tax code to achieve specific policy goals often at the expense of fairness
  - Consumption taxes are often flat (and inherently regressive) because it would be complicated to integrate ability to pay into the sales tax
- Decisions about fairness are made in the tax code in achieve specific policy goals often as the expense of simplicity
  - Renter Rebate ensures that a renter's contribution to property taxes is aligned with their ability to pay





# Economic Competitiveness

**Principle:** A tax system is responsive to interstate and international economic competition

- Provides a level playing field devoid of unnecessarily high rates and compliance burdens
- Discourage tax liability-shopping and interstate migration

**Considerations:**

- Does the tax incentivize tax shopping and avoidance?
- Does the tax unnecessarily harm Vermont taxpayers and economy?
- Does the system put the state significantly out-of-line with other states?



# Tax Neutrality

**Principle:** The tax system tries to minimize the unintended consequences

- Encourage or discourage consumption/production of good and services
- Change the allocation of resources
  - Influence decision to invest in land and a house or other types of wealth
- Impact business decisions

## **Considerations:**

- How can policy makers reduce the unintentional effect of taxation on economic decisions?
- Is the tax policy trying to change behavior? And is the tax policy explicit about the type of behavior it is trying to influence (or not)?
- Are policy makers comfortable with the indirect consequences or behavioral shifts that result from the tax change?



# Accountability

**Principle:** The tax system should include taxes that are explicit, minimize credits and exemptions, and limit the amount of tax flow through

- Tax systems and individual taxes should be evaluated regularly to ensure consistency with intended policy goals

## **Considerations:**

- Are exemptions, credits, and other tax expenditures openly available to taxpayers who are eligible?
- Will the intended payer ultimately be the one paying the tax?



# Parting Thoughts



# Parting thoughts – Goals

- Committee needs to think through:
  1. What makes a good tax system, including all tax types
  2. Which principles are priorities, and which are ancillary
  3. How would moving from a state-wide property tax to fund education to an income tax to fund education address these principles individually and as a whole?
    - What goals does the current system achieve? What is sacrificed?
    - What goals do you want the new system to achieve? What will be sacrificed?
    - The property tax as it stands now is complicated, but is that because of the work to make it fair?
- **NOTE:** There are tradeoffs, it is difficult to get perfect a tax system within these 6 principles

