Commissioner Brighton's Draft on Volatility and Progressivity

Volatility

There are so many ways to think about volatility in the tax structure that it's amazing we only have one word for it.

First, from the government's point of view, volatility in the revenue stream is a problem for responsible planning, budgeting, and providing services. This volatility can result from changes in the tax base from year to year, or from the difficulty of accurately predicting, at the time the budget is prepared, what the tax base will be by the time the year is over. This volatility is seen in the income tax and the sales tax. This type of volatility is dealt with by maintaining a stabilization reserve and/or adjusting the budget mid-year to account for changes.

This revenue volatility is avoided by the property tax for two reasons. First, rather than keeping the same rate from year to year, the property tax rate is set each year to raise the revenue needed. The rate is calculated by dividing the amount needed by the tax base—so the right amount is collected. Second, rather than applying the tax rate to the coming year's tax base, which is unknown at the time the budget is being developed, the property tax rate is applied to a tax base that is determined and fixed before the rate is set.

Volatility is also an issue for the taxpayer. The education property tax results in an especially volatile tax bill because the rate is set by totaling the amount needed to fund education and subtracting all the non-property tax revenue before dividing by the tax base. All components of cost and revenue are variable, and the combined variation determines the property tax rate. The income tax, in contrast, varies depending only on the taxpayer's income, making is less of a problem for the taxpayer. While this means the tax revenue is variable, it also serves as an automatic stabilizer to the economy; in recessionary times, the tax is reduced, enabling consumer spending.

Progressivity

A tax is considered to be progressive if the tax burden rises with income.

The Tax Structure Commission recognizes that an individual tax may be regressive, but it is the progressivity of the overall structure that is most important. For reasons of simplicity, or to tax "bads" rather than "goods", imposing a flat tax which ends up burdening lower income households more than higher ones may be an effective part of a progressive tax structure, assuming it is counterbalanced by a progressive income tax.

For example, a tax on gasoline may be regressive because gasoline purchases are a higher percentage of the income of lower income households than of higher income households. Yet it may play a valuable role in discouraging the use of fossil fuels--as well as raising revenue. If the amount of money lower-income households pay in the gas tax results in an equivalent income tax reduction or credit, the regressivity is offset, the state receives more gas tax revenue from the higher-income taxpayers than it did without the tax, and gasoline consumption is discouraged.

For that reason, the Commission considered changes that would make one tax more regressive, by increasing the burden of that one tax on households with lower incomes. However, the guiding assumption is that there would be an equal or greater offset to those families though the income tax.