Principles of a Good Tax System

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A good tax system is designed on the basis of an appropriate set of rules.

The system should strike a balance between the interests of the tax payer and the tax authorities.
Cannon of Equity

• Every person should pay depending on the individuals ability to pay

• Higher income individuals should pay more because without protection of government they could not have earned and enjoyed their income

• Taxes should be proportionate to income
Cannon of Certainty

• The tax a person should pay should not be arbitrary
• Taxpayer should know in advance
  • How much is to be paid
  • What time the tax is to be paid
  • The form the tax is to be paid
• The government should also be certain of the amount it will collect from the tax
Cannon of Convenience

• The method and timing of tax payment should be convenient for the taxpayer
• If based on income should be paid at the time the income is earned
• If based on sales at the time the transaction takes place
• If based on wealth (gift, inheritance, property) at the time of transfer
Cannon of Economy

• The cost of collection should be low compared to the tax collected

• Tax collection should be efficient taking no more from the taxpayer than is necessary to defray the cost of providing services

• The amount collected should cover the full cost of providing governmental services. (balanced budget)
Additional Principles of Taxation

• Elaborations upon Smith’s Cannons reflecting changes in economic structure
• National Center for State Legislatures
• American Institute of Certified Public Accountants
• National tax Association
• International Association of Assessing Officers
• Governor Underwood’s Fair Tax Commission
• Governor Manchin’s Tax Modernization Project
Efficiency

• An efficient tax system encourages economic growth and job creation

• The tax system should be competitive with other states so that it does not encourage resources to flow to other jurisdictions

• Taxes should be as “neutral” as possible not favoring one business or individual at the expense of another
Equality or Fairness

• Similarly situated taxpayers should be taxed similarly
• Equitable tax system has minimal impact on low-income taxpayers
• The impact on various income groups should be considered for the entire system as a whole (state and local) not on any certain group in isolation
• A fair tax system uses a balance of tax sources related to different concepts of ability to pay:
  • Current income basis for an income tax
  • Wealth basis for property taxes and estate/gift taxes
  • Consumption basis for sales and value added taxes
Revenue Adequacy

• Tax System should produce a stable yield in excess of collection costs
• Tax system’s yield should be sufficient to balance the state budget and meet the needs of the states highest priorities
• Should grow at the same rate as government spending and the growth rate in the state’s economy
• Administrative costs should be as low as possible with those taxes with the greatest difference between revenue and collection costs to be preferred.
• The tax base should be diversified with taxes collected from a variety of sources to prevent fluctuations in total revenue
Simplicity and Accountability

• The easier the tax structure is to understand the higher voluntary compliance and lower enforcement costs
• Transparency is the key factor in public acceptance
• Simple taxes are to be advocated over more complex ones
• Changes in taxes should be infrequent as stability is essential for planning both by taxpayers and the governments