Principles of a Good Tax System

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Adam Smith’s Cannons, *Wealth of Nations* 1776

- 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 tax payer
- 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 fluxuations 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