

PRINCIPLES OF SOUND TAX POLICY

Tax & Fiscal Facts

Attempts to develop consensus on the attributes of sound tax policy have sparked endless debate. Tax experts continue to argue over measurements of tax equity, and what can be done to improve the economy. However, policymakers, scholars and think tanks overwhelmingly agree on a number of key overarching principles of sound tax policy. In practice, the principles below may be difficult to achieve, but nonetheless, they are worth pursuing, as sound tax policy is necessary for governments and taxpayers alike.

Certainty

Changes within a tax structure should be kept to a minimum. Frequent changes in rates or bases disrupt taxpayers' behavior and their ability to make long-range investment and business decisions. Arbitrary application of taxes also creates unpredictability, making it more difficult for taxpayers to comply with tax laws.

Neutrality

The primary purpose of a tax should be to collect revenue. Market distortions should be minimized or avoided altogether. Tax neutrality ensures that policymakers are not discriminating among certain industries, activities or products.

Stability

Governments should utilize a revenue system that is relatively stable, and not prone to unpredictable fluctuations. When governments rely too heavily on fluctuating revenue, services are negatively affected because the revenue will not be available to support expenditures. A diversified tax structure helps achieve a more stable revenue flow.

Equity and Fairness

Equity generally is measured by a taxpayer's ability to pay a particular tax. Tax fairness can be evaluated by horizontal equity (comparing tax burdens of taxpayers in similar circumstances) and vertical equity (the distribution of tax burdens for taxpayers in different circumstances).

Broad Bases and Low Rates

Governments can obtain substantial revenue from taxes that have broad bases and low rates. Lower rates minimize the impact of the tax on taxpayers' behavior, and improve economic competitiveness. A narrow base can increase volatility, and the budgeting problems that come with it. However, in some cases, narrowing a tax base through exemptions or other tax policies may improve the equity or neutrality of a tax.

Transparency

Taxpayers should understand how taxes are assessed and collected, and be able to identify the tax associated with a purchase or transaction. Open government meetings also are important, so taxpayers can be part of the legislative and regulatory processes.

Simplicity

Layer upon layer of taxes, multiple tax forms and intricate filing requirements make a tax structure complex, and compliance difficult. Simplified tax systems reduce the cost of compliance for taxpayers, and reduce the need for enforcement tools for government. Taxpayers who do business in multiple jurisdictions often face major burdens complying with complex reporting requirements.

Sufficient Revenue

A tax structure's purpose is to collect adequate revenue to support effective, efficient government. A stable tax structure should be able to generate revenue to support government in a manner that does not require policymakers to make frequent spending cuts or tax increases.

Complementary Tax Bases

A tax structure should address the relationships between state and local governments. State government can limit or expand taxing authority for local government. Local taxes should be uniform in their application and collection, with bases comparable throughout the state. Taxes levied at the state and local levels of government should share similar bases and application to the greatest extent possible.

No Retroactivity

There should be no retroactive tax increases. Taxpayers need to be aware of their potential tax liabilities. Retroactive taxes can create financial hardship for taxpayers, and hinder investment planning, savings and economic growth by introducing changes that were not accounted for in taxpayers' budgets or planning.



The California Tax Foundation is a nonprofit, nonpartisan think tank affiliated with the California Taxpayers Association. The foundation is dedicated to promoting sound tax policy and government efficiency.