01.02 PRINCIPLES OF GOOD TAX POLICY

Overview

Before we can discuss what some of the generally accepted principles of good tax policy are, it is important to establish a framework or context in which to apply them. Because of this, the first part of this section will examine the revenue in the public sector, while the second part offers a brief examination of the function of taxes. The final part will then study some principles of good tax policy.

Revenue in the Public Sector

The public sector has its share of responsibilities and obligations to fulfill. With new demands for benefits and services constantly on the rise, funding flat lining or on the decline, the system is always facing the challenge of prioritizing and managing its resources. In order to understand the challenges better, we must examine how the public sector acquires resources.

Non-Taxation Sources

There are a variety of non-tax sources by which governments can obtain resources necessary to operate. Three of these are common in today’s society.

First, governments can gain resources through voluntary contributions of either money or time. Examples of such would be parents volunteering in schools, individuals serving for little or no compensation on boards and commissions, and monetary gifts to artistic endeavors. Non-profit organizations can also fulfill this function, often given tax incentives to do so.

Second, the public sector may own resources. Typically, these services will be provided without any permanent consumption, and charges may or may not apply. Examples of services that would not require a charge would be public parks and national defense. However, public utilities and education from state universities are examples of services that can be sold for revenue. Governments may also charge user fees, impose fines, or earn money by investing their cash balances in the financial markets.

Third, governments may take the resources they need. Because of the perception of arbitrary behavior, this type of acquisition can be controversial. This could be as simple as jury duty or as extreme as the use of eminent domain power to acquire property. Nonetheless, while compensation is often required, it is rarely considered to be equivalent to the value of what has been taken, be it something as esoteric as time or as real as property.

Taxation

In 1904, Justice Oliver Wendell Holmes said, “Taxes are the price of civilization.” Over one hundred years later, taxes are still the most predominant way for governments to raise revenues. Taxation, generally speaking, knows few boundaries. Taxes are levied on property, income, consumption, and legacy. Some taxes are flat while others increase as the amount being taxed increases. Regardless of what is being taxed or how it is calculated, the tax is being levied to finance the activities that the population deems necessary for government to provide.
Functions of Taxes

Taxation refers to the power of a government to levy a specific tax upon its citizens. If you go to the store, you will pay tax on the goods you purchase, or if you own property, you will pay taxes based upon its value. These are specific taxes paid under specific circumstances. That concept on its own is simple enough.

A tax system, however, is a multi-layered, multi-dimensional accumulation of several types of taxes, as well as the consideration of non-tax revenue, that combines to raise enough revenue to cover government’s necessary expenses. Assembling a tax system that raises enough revenue and maintains efficiency while also remaining politically acceptable can be a challenge.

Guiding Principles of Tax Policy

At all levels of government, the complexity of the various tax systems in place makes them extremely difficult to administer, let alone provide any meaningful analysis or proposal for improvement. Some might argue that a broad simplification of our tax laws would solve many problems. However, many complexities, such as a mortgage interest deduction on our income tax return or even reduced property taxes for homesteading, are perceived as the most real and tangible benefits for taxpayers. Because of this, a simplifying overhaul would likely be unpopular.

How is it then that we, as tax administrators and tax policy developers, formulate proposals to change existing tax rules? The best answer is to rely on a framework of principles that can serve as a guide towards current and future policymaking. The following principles have been generally accepted and commonly cited as indicators of good tax policy. The weight and importance given to any one factor may vary from issue to issue, but all maintain their relevance regardless.

Equity and Fairness
The principle of taxing similar taxpayers similarly is typically defined as equity. While a tax system cannot be all things to all people and therefore cannot meet an all-encompassing definition of fair, in the context of good tax policy, it is important to develop a tax system perceived as fair.

Certainty
A person’s tax liability should be certain rather than ambiguous. The tax rules should specify when the tax is to be paid, how it is to be paid, and the amount to be paid. A tax system’s rules must enable taxpayers to determine what is subject to tax and at what tax rate.

Taxpayers should be able to determine their tax liabilities with reasonable certainty. This certainty is important to a tax system because it helps to improve compliance with the rules and to increase respect for the system. Certainty generally comes from clear statutes as well as timely and understandable administrative guidance readily available to taxpayers.

Convenience of Payment
A tax should be due at a time and in a manner that is most likely to be convenient for the taxpayer. For example, purchased goods should be taxed at the time of purchase. Convenience is important in ensuring compliance. The more difficult a tax is to pay, the more likely that it will not be paid.
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Economy of Collection
The costs to collect a tax should be kept to a minimum. These costs include the administrative cost to the government as well as the compliance costs incurred by the taxpayer. Typically, more simple taxes have lower costs, and more complex taxes have higher costs.

Simplicity
The tax system should be as simple as possible and should minimize gratuitous complexity. Simplicity in the tax system is important both to taxpayers and to those who administer the various taxes. Complex rules lead to errors and disrespect for the system that can reduce compliance.

Neutrality
The effect of any tax law on business and personal decisions should be kept to a minimum. The effect of tax law on a taxpayer’s decisions regarding how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum. The tax system’s central aim should be to minimize distortions in the economy and to interfere as little as possible with the decisions of free people in the marketplace.

Transparency and Visibility
Taxpayers should know that a tax exists and how and when it is imposed upon them and others. A good tax system requires informed taxpayers who understand how taxes are assessed, collected, and complied with. Visibility enables individuals and businesses to know the true cost of transactions and to understand how tax burdens affect them and the economy.

Appropriate Government Revenues
Tax systems should have some level of predictability and reliability to enable the government to determine how much tax revenue is likely collected and when. This is extremely important to levels of government that operate with a balanced budget requirement.

Maintain a Broad Base
Taxes should be broadly based, allowing tax rates to be as low as possible. A mix of taxes provides a more stable tax base because different types of taxes are affected differently by changes in the economy. This responsiveness to economic conditions is often referred to as elasticity.

Ensure an Open Process
Tax legislation should be based on careful economic analysis and transparent legal procedures. Tax legislation should be subject to open hearings with full opportunity to comment on legislation and regulatory proposals.

Improving Tax Policy

Property Tax Working Group
In 2010, the Minnesota Legislature established a property tax working group under Minn. Stat. § 270C.991, subd. 4, to examine ways to simplify and improve the state's property tax system. The group was required to make its recommendations to the Legislature by February 1, 2013.
The specific goals of the working group were:

- To investigate ways to simplify the property tax system and make advisory recommendations on ways to make the system more understandable.
- To reexamine the property tax calendar to determine what changes could be made to shorten the two-year cycle from assessment to collection.
- To determine the cost versus benefits of the various property tax components, including classification, credits, aids, exclusions, exemptions, and abatements, and to suggest ways to achieve goals in simpler and more cost-efficient ways.

The group’s final report can be found on the Department of Revenue’s website.