Why should the tax structure matter?

- The revenue burden is not the only aspect of taxation that matters
- Different tax structures have different “hidden” burdens
Tax structures can differ in four important ways:

- different economic incentives and disincentives
- different distributions of the tax burden
- different responses to growth and fluctuations in economic activity
- different “running” costs of administration and compliance
Non-economic considerations may also be important

- timing of tax payments (lumped or spread out)
- visibility (transparency) of the tax burden
- legal issues such as *nexus*
- predictability by the taxpayer
- privacy and intrusiveness
Tax structures can differ in four important ways

- different economic incentives and disincentives
- different distributions of the tax burden
- different responses to growth and fluctuations in economic activity
- different costs of administration and compliance
Tax rates may vary from one economic activity to another

- Higher than average effective tax rates (due to statutory rates or pyramiding) discourage activities
- Lower than average effective rates (reflecting statutory rates, exemptions, deferrals or credits) encourage activities
- Uniform tax rates neither favor nor disfavor one activity over another--such a tax structure is said to be neutral
A tax structure that imposes a low excess burden is desirable.

- Excess burden is caused when economic decisions reflect tax differences rather than economic values.
- Excess burden is a hidden burden due to lost economic efficiency.
- High and differential tax rates create the largest excess burdens.
- A broad-based uniform tax structure imposes a lower excess burden.
Examples of tax differentials in WA structure

- exemptions of groceries and many services under the RST
- tax pyramiding under RST and B&O
- different property tax rates by use
- different local sales and use tax rates (may be offset by benefits)
- “tax-free” internet, catalogue and out-of-state shopping
Tax rate differences and user fees can increase economic efficiency

- high rates on goods and services that exhibit low price responsiveness
- high taxes on external-cost (e.g., pollution-causing) activities
- User fees for government goods and services that have high “privateness”
- congestion and impact fees
Tax structures may differ in four important ways

- different economic incentives and disincentives
- different distributions of the tax burden
- different responses to growth and fluctuations in economic activity
- different costs of administration and compliance
Distributions may differ in *fairness*, *tax-exporting* and *competitiveness*

- distributions over WA households determine *fairness*
- distributions over residents and non-residents determine *tax-exporting*
- distributions over households and enterprises determine *competitiveness*
Several (sometimes conflicting) concepts of fairness exist

- **ability-to-pay principle**--taxpayers’ burdens should reflect ability to pay tax.
- **benefit principle**--taxpayers’ burdens should reflect benefits received
- **horizontal fairness**--”equal” taxpayers should bear equal tax burdens
- **vertical fairness**--”unequal” taxpayers should bear appropriately unequal tax burdens
A tax structure that is less regressive is desirable

- one study finds taxes are 17% of income for lowest quintile vs 7% for highest
- all sales taxes are regressive because spending/income ratio falls with income
- regressivity of RST reduced by exempting more “necessities”
- Such exemptions make tax less uniform, hence less “efficient”
Benefit principle explains some features of the tax structure

- Benefit principle may limit resistance to some regressive taxes
- Earmarking used to connect tax revenues to benefits
- Decline in share of MV fuel tax linked to decline in state spending on roads
- User fees considered fair if benefits focused narrowly on payer
Non-residents lack “standing”, so *tax-exporting* is desirable

- states are legally restricted in ability to directly tax non-residents
- most obvious form of direct tax-exporting is tourism taxes
- some taxes levied on residents may be “shifted” to non-residents
- main means of tax exporting is federal deduction offset
S&L taxes deductible from federal taxable income can be exported

- a fraction of property tax and business-paid RST and B&O is exported in WA
- additional exporting possible by switching from sales to income tax
- BP figure is $5.8 b. x .6 x .75 x .25 x .98 = $640 m.
- initiatives abolishing MVET and limiting property tax reduce tax-exporting
Business-household tax “balance” affects competitiveness

- ultimately, all business taxes are shifted to households
- businesses limited in ability to shift taxes by interstate commerce
- tax burdens higher than in other states discourage firms from locating in WA
Tax structures may differ in four important ways

- different economic incentives and disincentives
- different distributions of the tax burden
- different responses to fluctuations in economic activity
- different costs of administration and compliance
A tax structure that provides more stable revenue is desirable

- WA is obligated to balance state budget
- Stabilization (rainy day) funds prove difficult to conserve
- An unstable revenue stream can cause state fiscal crisis
- Budget balance by means of expenditure changes aggravates state business cycle
Tax structures differ in their cyclical revenue variability

- Corporate income tax among the most variable
- Property tax among the least variable
- No clear advantage of income tax over sales tax on cyclical variability
- Variability of sales tax increased by exempting necessities and services
Studies show that WA has one of the more variable tax structures

- measured by short-run elasticity of revenue to state personal income
- average elasticity for WA is 2.15 over 1972-93 period
- comparable figure for Oregon was 1.04
- same study does not find WA RST as source of variability
A tax structure that provides sufficient revenue growth is desirable

- government spending grows with population, income and inflation
- revenue growth insufficient if long-run revenue elasticity less than 1
- LR elasticity in WA estimated at 1.25
- growth in tax-exempt services and internet shopping poses problem for sales tax systems
Tax structures may differ in four important ways

- different economic incentives and disincentives
- different distributions of the tax burden
- different responses to fluctuations in economic activity
- different costs of administration and compliance
A tax structure that has low “running cost” is desirable

- running cost = administration, monitoring, enforcement and private compliance costs
- running cost of income tax minimized if federal system imitated
- running cost increases exponentially with tax rate and complexity
- simple, broad-base, low-rate tax structures have lower running cost