

**State Tax Reform:**

**General Principles and Lessons from Prior Efforts**

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- A) Suggestion for a Working Definition of Tax Reform
- B) Review Tax Policy Analysts' Principles of State Tax Reform
- C) Compare Comprehensive and Partial Reform
- D) Brief Review of a Federal Comprehensive Reform: *TRA86*
- E) List Steuerle's 'Lessons' from his *TRA86* Experience
- F) Brief Review of Hellerstein/Francis Account of Florida's 1987 'Sales Tax Reform'
- G) Lessons from Florida and Elsewhere

Too much to do, too little time – Please see unabbreviated version of presentation

## A) A Working Definition of Tax Reform

- 1) Senator Huey Long: Don't tax you, don't tax me...
- 2) Wikipedia: Process of changing tax collection and management (includes Texas 1991 "business tax reform")
- 3) Americans for Tax Reform: Political philosophy as tax reform
- 4) Kennedy Administration: Tax cuts for growth (Heller)
- 5) 1<sup>st</sup> Reagan Administration: Tax cuts for revenue (Wanniski), smaller government (Stockman), growth, etc.
- 6) 2<sup>nd</sup> Reagan Administration: Steuerle says TRA86 goals were equity, economic efficiency, and simplicity

*'Tax Reform' denotes change in the tax system designed to improve*

*a) Equity*

*b) Economic Efficiency*

*c) Simplicity*

*Continued...*

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7) TR denotes change in the tax system designed to improve Equity, Economic Efficiency, Simplicity

a) Equity

i) tax according to benefits received from government services

ii) tax according to “ability-to-pay”

*horizontal equity* – equal tax treatment of equals

*vertical equity* – higher taxes on higher abilities (controversial)

b) Economic Efficiency: “Inefficiency” occurs when taxes alter taxpayer choices, creating economic costs

i) deadweight loss – worse than robbing Peter to pay Paul

ii) economic value flushed down drain

***Efficient taxation would reduce deadweight tax losses to the “minimum”***

c) Simplicity

i) in administration

ii) in compliance

B) Tax Policy Analysts' Principles of ***State*** Tax Reform (from *Final Report* of 2002 Governor's Commission)

- 1) Sufficiency: Revenue system that grows with economy in the long run
- 2) Appropriate Federalism: state/local sharing of revenue/taxing responsibility and authority
- 3) Competitiveness: Promote long-run economic development, job creation, growth
- 4) Equity
- 5) Economic Efficiency
- 6) Simplicity

C) Comprehensive versus Partial Reform (from Bruce, *Public Finance and the American Economy*)

- 1) Comprehensive reform would improve the tax system by changing the “structure” of the tax system or replacing it entirely (tax base, deductions, exemptions, exclusions, etc.)
- 2) Partial reform would improve the tax system by targeted changes in details of the existing structure
- 3) Steuerle argues comprehensive federal tax reform rarely is achieved
- 4) Fox et al. argue comprehensive state tax reform rarely is achieved
- 5) Above analysts tend to focus on post-WWII era, and exclude
  - a) 1913 federal Income Tax Act
  - b) North Carolina revenue reform
    - i) 1849
    - ii) 1921
    - iii) 1931-33

## D) Federal Comprehensive Reform: *TRA86*

### 1) Principles

- a) Improve equity, efficiency, simplicity
- b) *NOT* to cut tax rates, increase growth, change level of revenue

### 2) General approach

- a) Remove low income families from tax roles
- b) Revenue neutral
- c) Broaden tax base
- d) Cut tax rates (a contradiction?)

### 3) Select details

#### a) Equity

- i) horizontal – broaden tax base by reducing itemized deductions, exclusions, tax shelters
- ii) vertical – increase personal exemption/standard deduction, excluding millions from tax roles

#### b) Efficiency

- i) reduced highest personal marginal income tax rate 50% to 28%, highest corp. rate 46% to 34%
- ii) broaden tax base by reducing itemized deductions, exclusions, tax shelters

#### c) Simplicity: reduce itemized deductions, exclusions, tax shelters. But removing shelters requires rules

#### E) Steuerle's Lessons from *TRA86* Experience

- 1) Listen!
- 2) Know the forces at play (understand root causes)
- 3) Have an overall vision
- 4) Start with principles (work top down)
- 5) Balance principles
- 6) Seek bipartisan consensus
- 7) Plan snapshots (presentation to public)
- 8) Acknowledge reform involves losers
- 9) Work bottom up as well as top down (deal with tedious details)
- 10) When stuck between camps, work on common concerns

Please see unabbreviated version, and/or Steuerle's article

Possible # 11) Create mechanisms to periodically monitor tax law conformity to principles & economy (Hawaii)

## F) Hellerstein/Francis Account of Florida's Sales Tax Reform

- 1) Principle (my interpretation) – expand tax base to correct insufficiency
- 2) General approach: extend Florida's general sales and use tax to most services
- 3) Some specifics
  - a) Taxed services
    - i) Accounting, advertising, contracting, legal services (et al.)
    - ii) Services were taxable if sold in Florida
    - iii) Use of services in Florida taxable even if services purchased outside Florida
  - b) Exempt services
    - i) Agric., educ., govt., health, sanitary, social, and religious services, et al.
    - ii) Services purchased in Florida but used elsewhere
- 4) Chronology

6/1986: Legislature passes law extending sales/use tax beginning in 1987 (“surprising little resistance”)  
1986: Bob Martinez campaigns on an anti-tax platform  
Early 1987: Governor Martinez reverses position, supports sales/use tax on services  
4/1987: Governor signs legislation extending sales/use tax to services  
7/1987: Tax takes effect. Vigorous media criticism begins in earnest  
9/1987: Governor reverses position, opposes sales/use tax on services  
12/1987: Sales/use tax on services repealed



## G) Lessons from Florida and Elsewhere

### 1) Francis:

- a) Extend sales/use tax comprehensively to all services (enumerate exempted services)
- b) Find a way to make the media's self-serving anti-tax message be seen for what it is
- c) Pro-reform coalition must proceed on a consensus basis before and after enactment

### 2) Many tax analysts agree principles should apply to the tax *system*, not individual parts

### 3) Feldstein & Stiglitz: whatever shortcomings of current tax system, taxpayers have adjusted. Ease transition to new system by gradually introducing reforms

### 4) Steuerle's Guideline 3 – 'Have an Overall Vision'

## ***Revenue neutral tax reform that broadens tax base & lower tax rates***

Possible # 5) Horizontal equity first, then tax structure, then vertical equity

Thank you and good luck