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## Summary

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## Guiding Principles for Taxation in Oregon

By Steve Buckstein

With Oregon facing a \$1-billion-and-counting budget deficit in the next biennium, the temptation exists for legislators to close the gap with tax increases. Before any conversation about raising taxes occurs, however, state officials should first agree to a set of guiding principles of taxation.

The paramount function of taxation is to raise money for core government functions, not to direct the behavior of citizens or to close budget gaps created by overspending. Taxation always imposes some damage on an economy’s performance, but the harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A simple and fair tax system is least likely to impede Oregonians’ economic interests, allowing more prosperity for more people.

### Principles of Taxation\*

The fundamental principles presented here provide guidance for a fair and effective tax system; one that raises revenue for core government functions, while minimizing the burden on citizens:

- **Simplicity** – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws.
- **Accountability** – Tax systems should be accountable to citizens. Changes in tax policy should be highly publicized and open to public debate, not pushed through a legislative session without broad public input.
- **Economic Neutrality** – The tax system should exert minimal impact on the spending and business decisions of individuals and businesses.
- **Equity and Fairness** – Fairness means all taxpayers should be treated the same. The government should not use the tax system to pick winners and losers in society, or unfairly to shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to “soak the rich.”
- **Competitiveness** – A low tax burden can help Oregon’s economic development by retaining and attracting productive business activity. Our revenue system should be responsive to competition from other states.
- **Balance** – An effective tax system should be broad-based, avoid special exemptions and utilize a low overall tax rate with few loopholes.
- **Reliability** – A stable tax system is better than an unstable one. Revenue sources that grow faster than the economy in good times, or sink faster in bad times, should be avoided.

While these guiding principles are important, there are inherent problems with any tax system. Basically, taxation reduces spending on private sector goods and services traded in the marketplace. The benefits of free exchange – to both the purchaser and the seller – are reduced when trade is restrained by taxation. The ways that taxes restrain private economic

activity vary. Income and property taxes reduce taxpayer incomes, lowering their demand for goods and services. Sales and excise taxes increase costs to suppliers, reducing their willingness to provide goods at any given prices. In any case, taxes reduce private trade and curtail job creation.

### **Benefits of a Low Tax Burden**

Since taxes lower the economic welfare of citizens, policymakers should try to minimize the economic and social problems that taxation imposes. The benefits of a low tax burden include:

- **Faster economic growth** – A tax system that allows citizens to keep more of what they earn spurs increased work, saving and investment. A low tax burden would mean a competitive advantage for Oregon over states with high-rate, overly progressive tax systems.
- **Greater wealth creation** – Low taxes significantly boost the value of all income-producing assets and help citizens maximize their fullest economic potential.
- **End micromanagement and political favoritism** – A complex, high-rate tax system favors interests that are able to exert influence in the state capitol, and who can negotiate narrow exemptions and tax benefits. “A fair field and no favors” is a good motto lawmakers might adopt for Oregon’s tax system.

### **Tax Transparency**

Oregon’s tax system should be transparent to individuals and businesses. Since businesses don’t really pay taxes, but simply pass taxes on to individuals such as customers, employees and shareholders\*\*, a transparent tax system will avoid taxing business above documented provision of government services. If lawmakers want to raise or change any tax, they should be clear about which individuals they ask to bear the burden.

### **Conclusion**

Before the 2009 legislature makes any decisions on tough tax and budget issues, it should adopt guiding principles of taxation based on simplicity, accountability, equity and economic neutrality. It should seek to lower the overall tax burden to promote prosperity and opportunity in the economy, and it should embrace tax transparency, making it clear whom it is asking to pay for any tax changes. With these policies in place, Oregonians will be more likely to believe that their government is treating them as fairly as possible.

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This commentary is adapted with permission from “Principles of Taxation for Elected Officials,” by Paul Guppy and Jason Mercier, Washington Policy Institute, October 2008.

\*The text in this section is adapted from: “Principles of Sound Tax Policy,” by Dan Mitchell, Heritage Foundation, Washington, D.C., November 2001; “Guiding Principles of Taxation,” Tax Policy and Research, Montana Department of Revenue, October 2001; and “Some Underlying Principles of Tax Policy” by Richard K. Vedder and Lowell E. Galloway, Joint Economic Committee, United States Congress, Washington, D.C., September 1998.

\*\*“Business Taxation: A Loose Cannon on a Dark Night,” by William B. Conerly, Ph.D., Cascade Policy Institute, January 2008.

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