Draft for discussion
For Panel Review and Discussion
April 16, 2015

Memorandum
Connecticut Tax Study Panel
April 21, 2015

TO: Members of the Connecticut Tax Study Panel

FR: Robert D. Ebel, Executive Director

RE: Guiding Principles and Criteria for Evaluating the Connecticut State & Local Revenue System

Introductory Comment

The first and arguably most important action that Connecticut Tax Study Panel will make is to reach agreement on both (i) a set of *Guiding Principles* for judging a high-quality state and local revenue system and (ii) the *Criteria for Evaluating Changes to the Connecticut Revenue Sys*tem. These are decisions the Panel must take early in its revenue review process. [1]

There are two reasons to deliberate on, and then adopt a set of *Guiding Principles* and *Evaluation Criteria*. The first is that it will provide an explicit framework for the Panel's articulation of "why" the Panel's often arcane work matters for the welfare of the citizens of Connecticut.

In order to apply and manage all the research findings that will be presented to the Panel regarding matters ranging from issues such as (i) the over-arching matters of the effects of taxes on job growth and which classes of taxpayers ultimately pay for public goods and services to (ii) the technical questions regarding the implications for alternative multistate business activity apportionment formulas or the design of property tax relief mechanisms, there must first be an agreed–upon set of normatives to allow the Panel to step back from all this information so that the members can sort through a menu of policy options that will frame Connecticut revenue policy over the next decade. Moreover, having adopted a set of *Principles* and *Criteria* will allow the Panel to complete the policy deliberation and recommendation-making process in a timely manner. Having such a framework in place will have high practical payoffs when the Panel enters its policy deliberation and recommendation phase at the end of this calendar year.

Second, by articulating/agreeing to a set of *Principles and Criteria for Evaluating the Connecticut Revenue System* the Panel will send a clear signal to the citizens of Connecticut that confirms that the Connecticut revenue system is ultimately an expression of community relationships among individuals and between the citizens and *their* state and local governments.

The Objectives for Revenue Policy Reform

[1] The discussion and adoption of a set of normative principles for evaluating the Connecticut Revenue System is on the Panel's May agenda.

1. There is no one “best” state and local revenue structure for Connecticut and no one “right” way to reform the system. Rather, any reform must be guided by the objectives to be achieved and the tradeoffs that are acceptable. Tables 1 and 2 below (appended to the end of this memorandum) summarize how different state revenue study panels have framed the objectives for carrying out their respective mandates.

There are three “take aways” from the practice of other state revenue study Panels:

- To varying degrees the tax study panels drew a distinction between a set of *Guiding Principles* that make explicit the (i) broad philosophical framework for its final policy recommendations and (ii) a separate set of *Criteria for Evaluating a Revenue System*. The *Guiding Principles* serve as starting point –a platform—for the subsequent deliberations and debates on the *Criteria* what will then be applied to sorting out the pros and cons among policy options that the Panel will be examining in both a tax-by-tax and a tax package context (Table 1).

- As evidenced by the overlapping –or lack of overlapping—cells in Table 2, the *Criteria* adopted for evaluating revenue policy options have varied from state-to-state. To generalize:

  - The Minnesota Tax Study Commission was focused on what it saw as the overly complex and, thus, non-transparent nature of its intergovernmental system, with special attention to its state-mandated classified property tax. It was also concerned on the question of whether its reputation as a relatively high tax location the state was undermining its competitiveness.

  - South Carolinians placed special importance on how the intergovernmental system was performing so that “conflicting goals should be recognized and minimized”.

  - The Ohio Commission expressed two special concerns: the relation between revenue policy and economic development and whether the state/local system had become “obsolete” in that it did not “match the realities” of the changing state economy.

  - New Hampshire was not so much concerned about the state’s economic performance (“the economic performance has ...been strong …with an outlook for continued growth”) as it was with whether the revenue system was unbalanced with the result that there was an overreliance on property taxation.

  - The District of Columba, which functions as a unitary state and local system (and thus revenue authority and expenditures responsibilities of both a state and a local government), was, like Ohio, concerned about whether its revenue system was keeping pace with its changing economic, demographic and institutional trends. That is, had the revenue system become "obsolete"?

  - The 2006 Connecticut study adopted the National Conference of State Legislatures (NCSL) criteria as its framework for judging a high quality revenue system so that policymakers could "(identify) ways to address major shortcomings the legislature could consider" to "improve the (revenue) system's performance in terms of one or more (of agreed upon) principles, and at the same time be revenue neutral".

- Despite the differences in emphasis placed on the rationale for "why" a comprehensive review of the its revenue system was merited, all of the studies nevertheless converge on some a core set of six generally accepted norms: (1) revenue productivity; (2) reliability (certainty/ predictability); (3) equity; (4) neutrality (efficiency); (5) competitiveness, and (6) simplicity (Table 2)

The Legislative Language Creating the Mandate to the Connecticut Tax Panel

In creating the Connecticut Tax Study Panel "to review the state's overall state and local tax structure …and to consider and evaluate options to modernize tax policy, structure and administration", the legislature listed twelve criteria for evaluating the state/local revenue system: (1) *efficiency, (*2) *cost of administration*, (3) *equity*, (4) *reliability*,(5) *stability and volatility* (6) *sufficiency*; (7) *simplicity*; (8) *incidence*; (9) *economic development and competitiveness*; (10) *employment*; (11) *affordability*, and (12) *overall public policy.*

An examination of each of these criteria suggest that all twelve nicely fit into the six core norms identified in Table 2:

Table 3: Reconciling the Categorization of Generally Accepted Norms With

The Core Norms	Connecticut Legislation
Revenue Productivity	*Sufficiency**
Reliability	*Reliability* (reliability will encompass the examination the degree of, and tradeoff between/ right mix of *stability & volatility*)
Equity	*Equity* (*incidence* is a measure of the degree of vertical equity; this also gets to the question of *affordability* or ability-to-pay—concepts that pertain to the impact of taxation on persons/households)
Neutrality (Efficiency)	*Efficiency*, *Economic Development*
Competitiveness	*Employment* (employment will be a dependent variable in the study of competitiveness); *economic development and competitiveness*
Simplicity	*Simplicity* refers to cost *of tax administration* and taxpayer compliance alike.
Overall Tax Policy	This will be well addressed in the Panel's adoption of its Guiding Principles

The asterisk (*) on Sufficiency will require further discussion. "Sufficiency" or "adequacy" refers to whether or not a tax system will grow at a pace so as to pay for a medium term expenditure projection. This criterion is at odds with the principle (as, for example , adopted in the 2006 Connecticut Tax study) that to be able to understand how well tax reform meets the other Criteria laid out in Tables 1 and 3 above**[MB1]**, one must adopt an presumption of revenue neutrality. In short, the Panel must decide on whether the its task is to (i) recommend reforms in the structure of the Connecticut state and local revenue *system* by taking an "equal yield"/ "revenue neutral" approach in its policy recommendations as well as (ii) make recommendations on which taxes should be increased (or decreased) if the State's medium term budget projections reveal a future deficit (surplus) in the state/local operating budgets. [2]

ACTION REQUESTED FROM THE PANEL

> Review the discussion above and be prepared to discuss both the set of *Guiding Principles* for *Overall Tax Policy* and the *Criteria for Evaluating the Connecticut Revenue System* that this Panel shall adopt to frame its policy deliberations in December and/or January.

[2] In its examination of policy changes to a specific tax, the commission must adopt strict rule of revenue neutrality ("equal yield") in order to sort out the policy tradeoffs for evaluating the Connecticut revenue system

Table 1: Guiding Principles for a High Quality State and Local Tax System

Principle	Guiding Principles for Overall Tax Policy
Avoid obsolescence	A state/local revenue system should be designed to "fiscal sense" over the long term, that is to avoid reliance on tax sources that will become obsolete by a failure to capture the fiscal benefits (and minimize the fiscal downside) of changes in medium and long term trends in the Connecticut's economic structure, demographics , and institutional arrangements.
Revenue System Balance	A high quality revenue system should be composed of elements that function together as a system, including the finances of both state and local systems (including finances of local and state governments). The elements of a tax system should match expenditure responsibilities and revenue capacities. However, as there is *a priori* relationship between assigned responsibilities and a capacity to generate revenues, there is a role for intergovernmental aid. (CT, OH, SC)
Intergovernmental Complementarity	Measures put in place to provide tax relief and control local public budgets can have unintended consequences and especially difficult to achieve when government adopt constitutional and statutory tax and expenditure limitations (CT)
S/L Tax Diversification & Tax Mix	All taxes have inherent structural inefficiencies and inequities. Accordingly, a state tax system should rely on a mix revenue bases as to not lead to an overreliance on one or a few tax sources. If transparent and coordinated for simplicity, the overlapping local with state revenues sources need not be competing or contradictory (CT. SC, NCSL)
Broad Bases, Low Rates	As a corollary to the principle of tax-mix: giving tax relief to classes of taxpayers is not inherently wrong if such treatment can be shown to satisfy an agreed –upon and explicit set of policy goals. However, the standard full disclosure in the granting of tax preferences should be high. Moreover, if preferences are kept to a minimum, substantial revenues can be generated with low tax rates. Such a broad-based low rate policy also enhances the goal of neutrality (economic efficiency)
Fiscal Accountability	Tax policy should be enacted visibility and explicitly rather than through expedient responses to respond to system obsolescence (MN)
Political Accountability, Transparency	The tax system is an expression of community relationships among citizens and between the people and their governments. Policy should not be designed in a manner that obscures which class of individuals or institutions bears the final burden of a tax (Incidence) when another class receives relief. (CT, MN. NCSL, TxFnd)
No Retroactivity	Taxpayers should be able to rely with confidence on the law as it exists when contracts are signed and transactions are completed (TxFnd).
Uniformity	A revenue systems should be administered professionally and uniformly throughout the State.
Tradeoffs recognized	All studies recognize that when designing a high quality state/local revenue system, than when making recommendations on any single tax there will inevitably be tradeoffs. No tax source will meet all the criteria. It is a matter of tax mix and balance.

Source: Selected Tax Panel (Commission) and Tax Association Reports, 1986-present.

Table 2. How Different States Have Adopted Variants of the Criteria for Judging Evaluating the State/local Revenue System

Criterion/State	Revenue Productivity	Reliability.: (Stable vs. Responsive)	Equity	Neutrality (Efficiency)	Competiveness (economic development, employment effects)	Simplicity	Other
MN (1986)		Fiscal certainty and avoid need for frequent ad hoc changes	Horizontal equity requires equal treatment of taxpayers in equal circumstances ("equal treatment of equals") Thus if the criterion for deterring tax liability is on income, expenditure or wealth, equity then requires that taxpayers having = amounts of these measures be taxed equally. __________ Vertical Equity addresses the *systems* "fairness' of the distribution of effective tax liability among *persons* not in equal circumstances ("unequal treatment un equals"). Here the most common index of equity is income and the degree of –whether the tax system is regressive, progressive or proportional. __________ NCSL goes a bit further in language: "minimizes regressivity and taxes on low income households"	Neutrality: Avoid unintended interference (consumer, worker, producer)	Competitiveness: Revenues evaluated for their effect on economic growth and residential mobility	For Tax administration and taxpayer compliance alike	
SC (1991)	The State/Local should produce revenues that are adequate to finance an agreed-upon flow of public services overtime and to balance the tradeoffs between revenue responsive to economic growth (elasticity) and stability during economic downturn.			Neutrality: Taxes should minimize interference with private economic decisions. If intended to discourage/provide incentives or disincentives to some activity, the intent should be explicit	Competitiveness: A high quality revenue system should enhance SC business community to compete in national and world markets.		Specifically stressed importance that state to local transfers be equalizing
OH (1995)	Balance of elastic and stable revenues				A concern in Ohio was the then-decline of the "Rust Belt		
NH (1992)	Recognized responsiveness v. Stability tradeoff; explicit that though revenue "adequacy" matters, that the study was not about the "right" level of spending			Neutrality	"Competitiveness"		Exportability: Taxes that are "exported" to non -residents have merit
NCSL (1985, 2015)	"Reliability"						
DC (1998)	Revenue productivity to pay for public good & services				Fair in apportioning tax impacts and consistent in application		
CT (2006)*	Reliability: stable, certain adequate	Reliable			Competitiveness		
TxFnd (2015)	Stability				Provide for economic growth in least disruptive manner		Transparency

***The 2006 Connecticut General Assembly Legislative Program Review and Investigations Committee largely adopted the Principles of a High-Quality State Revenue System of the National Conference of State Legislatures (NCSL). The NCSL set of principles was first released in 1992 and then modified in in the 1990s to reflect new policy concerns—concerns such as those the Panel will examine as part of its research on trends in Connecticut's "fiscal architecture" " The criteria included in this table are posted on today's NCSL website, 2015 (www.ncsl.org)