TAX POLICY AND REVERSE TAXES

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ABSTRACT

Sales tax holidays in various forms have become quite popular with state legislatures and taxpaying citizens in recent years. Adding to these are other tax schemes to give something back to the taxpayer – most notably tax rebates and refundable tax credits. These "reverse taxes" have had various degrees of success in achieving the stated purposes. This paper first examines what authorities consider to be good tax policy. Next, several of these reverse taxes, both enacted and proposed are studied. Finally, the paper evaluates these reverse taxes in light of accepted principles of good tax policy.

INTRODUCTION

In recent years, there have been an increasing number of sales tax holidays, tax rebates, or other tax schemes to "help" the average taxpayer, to stimulate the economy, to return a surplus to the taxpayers, or achieve some other goal. Sales tax holidays have taken on many forms, from exempting sales taxes on back to school items, to exempting sales taxes on hurricane supplies, or simply a blanket tax holiday on all purchases up to a certain amount. Tax rebates have been given to income tax payers in general or for targeted purposes. The Federal Tax Code contains a number of tax credits, some of which are refundable credits and can be considered in this same arena. Other proposals have been made but not enacted for a variety of reasons. For purposes of this paper, the options discussed are referred to as "reverse taxes."

There is some debate about the effectiveness of these "reverse taxes." This paper will consider the effectiveness of these, but that is not the main thrust of this effort. There are certain principles that are considered to constitute good tax policy. Although there is no universal definition of what constitutes a good tax, there seems to be general agreement on the structure, if not the form, of these principles. This paper presents various principles to assist the reader in understanding of what are the common, basic principles of good tax policy (Section 1).

After defining a "good tax" the next section (Section 2) discusses "reverse taxes". Each of these "reverse taxes are then evaluated in view of the principles of good tax policy (Section 3).

Section 1. TAX POLICY PRINCIPLES

In his 1776 classic, *The Wealth of Nations*, Adam Smith set forth four principles that should guide the making of tax policy. These principles serve as the foundation for today's tax policy decisions. These principles are:

- The subjects of every State ought to contribute toward the support of the Government as nearly as possible in proportion to their respective abilities.
- The tax which each individual is bound to pay ought to be certain and not arbitrary. The time, manner , and amount of payment ought to be clear and understandable to the contributor and to every other person.
- Every tax ought to be so levied either at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.

- Every tax ought to be so contrived to both take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State (Tax Analysts, 2006).

In today's terminology, we see these principles in the broad objectives of Equity, Simplicity, and Efficiency (Tax Analysts, 2006). In 2001, the American Institute of Certified Public Accountants (AICPA) issued a Tax Policy Concept Statement outlining a framework for evaluating tax proposals. This framework listed ten guiding principles of good tax policy. The AICPA states that the ten principles are all of equal importance (AICPA, 2001) but it is noted that the first four stem from Adam Smith's tax policy maxims.

The AICPA (2001) "Ten Guiding Principles of Good Tax Policy are:

- Equity and Fairness – Similarly situated taxpayers should be taxed similarly.
- Certainty – The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid should be determined.
- Convenience of payment – A tax should be due at a time or in a manner that is most likely to be convenient to the taxpayer.
- Economy in collection – The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
- Simplicity – The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
- Neutrality – The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
- Economic Growth and Efficiency – The tax system should not impede or reduce the productive capacity of the economy.
- Transparency and Visibility – Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
- Minimum Tax Gap – A tax should be structured to minimize noncompliance.
- Appropriate Government Revenues – The tax system should enable the government to determine the amount and when tax revenue will likely be collected.

In an Organisation for Economic Co-operation and Development (OCED) Policy Brief (March 2006), the issue of "Reforming Personal Income Tax" was addressed. In this report, the OCED emphasizes three overriding issues that must be addressed in the arena of individual income taxes: efficiency, horizontal equity, and simplification. The authors apparently feel that the tax system is out of balance with these principles in particular, and are attempting to restore some balance in the application of tax policy principles in the area of personal income taxation.

C. Eugene Steuerle, in his book *Contemporary U. S. Tax Policy,* expounds six basic principles of tax policy, which he labels "Principles of Public Finance." These principles are similar to principles expounded by others. However, Steuerle lists his six principles in a basic, foundational setting and builds on those principles. Rather than list "equity" as a principle, Steuerle breaks it into two separate entities, recognizing the differences between horizontal and vertical equity. **Horizontal equity**, he states is almost universally accepted as a principle. By horizontal equity, Steuerle asserts that those with equal ability pay equal taxes. Referring to this as the "queen of all principles affecting government policy," he states that politicians pay homage to this principle, but frequently side step it. Even when one group is favored by a tax policy, horizontal equity is achieved internally within that group. As an example, if the law allows a deduction for charitable contributions, the group making such contributions is the favored group, receiving specialized treatment compared to other taxpayers. However, horizontal equity is applied internally to those with the group, allowing a charitable contribution for all who make such contributions (Steuerle, 2004).

Vertical equity is the principle that those with greater ability to pay should pay more in taxes. This is reflected in our income tax system of progressively higher marginal tax brackets as income increases. It is argued that this is a desirable principle, as those in lower economic straits cannot afford to pay an equal share for the support of the government. Given this premise, Steuerle then asserts that the issue then becomes not whether government should be involved in a redistribution of wealth, but the progressiveness of that redistribution (Steuerle, 2004).

Efficiency suggests that programs should not operate in a way that makes someone better off at the expense of making someone else worse off. This situation can rarely be achieved in the tax policy arena. However, the argument is made that tax policy in this area must seek to produce gains in the overall economic output even at the expense of losses to some individuals. Since by their very nature, taxes distort behavior, efficiency is lost as this change in behavior increases. Therefore, the principle of efficiency should seek to minimize these changes, not eliminate them. Taken a step further, it is stated that the changes in behavior that occur should be justified by gains from the programs the taxes support (Steuerle, 2004).

The principle of **individual equity** states that individuals are entitled to the fruits of their own labors and a fair return on their investment. Whenever mandatory taxes are levied, this principle is violated, as there is no *quid pro quo* (Steuerle, 2004). However, this is one of those principles that government cannot reasonably expect to achieve. The best that can be hoped for is to minimize the violation of individual equity.

Steuerle's fifth principle is that of **simplicity**. He states that since government does not exist to simplify itself, the issue is what weight the principle is given in the legislation and administration of tax law. Complexity in the tax system arises as government pursues various objectives. Therefore, the road to simplification is to eliminate tax preference or subsidies. Transparency is enveloped in the principle of simplicity. This states that the purpose of tax policy and the mechanisms of who pays and does not pay be presented in an open manner (Steuerle, 2004).

Raising of revenues is presented as the final principle with the acknowledgement that it is more of a goal rather than a principle, but due to its primacy, it cannot be overstated and is therefore elevated to this status. Steuerle relates revenue raising to efficiency in the sense that government must pay for what society needs and avoid the economic costs of unsustainable deficits. Simply put, raising of revenues allows government to achieve it purposes and run its functions (Steuerle, 2004).

In a section entitled "The Government Principles," Steuerle does not list a number of principles related to government, but examines the process of creating tax legislation. He laments that the process often fails to give principles of taxation their due. One reason cited for this is that policies are developed by offices that lack knowledge of or concern for broader tax principles (Steuerle, 2004). Tax policy is enacted to correct a problem, to achieve a social objective, and to enact economic objectives in addition to raising revenues.

This brief study demonstrates that there is no universal standard, or agreements, on what should be included as principles of good tax policy. However, there appears to be a common foundation, expressed in different terms. For the purposes of this paper, it seems that six of the principles are particularly relevant in the analysis of the concept of reverse taxes. Therefore, this paper evaluates the various "reverse tax" legislation and proposals using the following tax policy principles:

- Horizontal equity.
- Vertical equity.
- Efficiency.
- Economy of Collection.
- Simplicity.
- Economic growth.

This list incorporates Adam Smith's foundational principles of equity (horizontal and vertical), simplicity, and efficiency. Economy of collection is sometimes combined with efficiency, but is evaluated separately here as it is an important aspect of reverse taxes. This paper includes the principle of economic growth due to the current trend of using taxation for purposes other than revenue raising and its relevance to the concept of reverse taxes.

Section 2. "REVERSE TAX" LEGISLATION AND PROPOSALS

Reverse taxes may be categorized as sales tax holidays, Social Security holidays, rebates, fuel rebates or moratoriums, and refundable credits. Some were enacted, others merely proposed and rejected.

Sales Tax Holidays

Sales tax holidays began in 1997 in the state of New York. For a one-week period in January, the state suspended the 4% state sales tax on most purchases of clothing and shoes. In signing the bill, then Governor George Pataki claimed that this legislation would "put more than $20 million in the pocketbooks and wallets of New Yorkers." Florida began the practice the following year, followed by Texas in 1999. As of 2006, thirteen states plus the District of Columbia had had sales tax holidays (Davis, 2001).

These holidays frequently coincide with either back-to-school or Christmas shopping. Massachusetts joined the bandwagon in 2005 with a holiday in August exempting sales tax on all purchases up to $2,500. The first Massachusetts holiday was only one day, a Saturday. The following year it was extended to two days to accommodate observant Jews who do not shop on Saturdays (Reidy, 2005). Although this holiday is relatively short, it does have a great deal of simplicity in that all items below the $2,500 threshold are excluded. Since the only criterion is the dollar threshold, the merchant's task of collecting tax on included items is simplified.

North Carolina's three-day holiday in August has a laundry list of excluded items and dollar amounts. Excluded is clothing with a sales price of $100 or less, sport or recreational equipment with a sales price of $50 or less, computers with a sales price of $3,000 or less, computer supplies with a sales price of $250 or less, and school supplies with a sales price of $100 or less (North Carolina, 2006). This approach requires definitions of what constitutes clothing, sports and recreational equipment, computers, computers supplies, and school supplies. Then, merchants must properly interpret the explanations and apply them to their situation. The state provides lists of included items, but includes the caveat that the lists are or are not all-inclusive. This approach also burdens the merchant with the task of collecting the tax on excluded items, while excluding the tax on included items. This holiday has continued with the excluded amount on computers being raised to $3,500 (Wolf, 2008a)

Georgia enacted a conservation-focused sales tax holiday in 2005. For a four-day period in October 2005, certain Energy Star merchandise was exempt from the state sales tax. Included were Energy Star qualified dishwashers, clothes washers, air conditioners, ceiling fans, fluorescent light bulbs, dehumidifiers, programmable thermostats, and refrigerators with a price below $1,500. This limit applies to each item purchased. If the items cost in excess of that amount, the entire purchase is taxable. In addition, this did not exempt local sales taxes (Georgia, 2005). This holiday created some difficulties for merchants, as they were required to identify eligible “Energy Star” appliances, set the $1,500 ceiling, and still collect the local tax on these items. This holiday has been repeated annually through 2008 (Office of the Governor, 2007; Georgia Environmental Facilities Authority, 2008)

As one of the early entrants to the sales tax holiday fray, Florida has tried a number of approaches. The original tax holiday in the Sunshine State was in 1998, exempted clothing, and was about a week in duration. The holiday was not held in 2002 or 2003 due to budget problems, but returned in 2004. For 2006, the holiday was July 23-31, and exempted state and local sales taxes on clothes, footwear, books, and certain accessories valued at $50 or less. In addition, certain school supplies of $10 or less were exempted. This approach does relieve the merchant from having to collect local and not state taxes, but the issue still remains that the merchant must accurately determine which items are exempt. The economic impact of this holiday saved taxpayers an estimated $45 million in state and local taxes (Royse, 2006).

In the wake of hurricanes Charley, Frances, Jeanne, and Ivan in 2004, the Florida State Legislature enacted a second tax holiday in 2005 which was repeated in 2006. For a ten-day period prior to hurricane season, this sales tax holiday exempts certain hurricane supplies from state and local taxation. There are several dollar thresholds for purchases to be included within the exemption. They are qualifying items selling for:

- $10 or less – Blue ice or items sold as artificial ice.
- $20 or less - Portable self powered, light source, battery-powered flashlights, battery-powered lanterns, gas-powered lanterns, tiki-type torches and candles.
- $25 or less – Any gas or diesel fuel container.
- $30 or less – AAA, AA, C, D, 6 volt, 9 volt batteries, coolers, and ice chests.
- $40 or less – Cell phone chargers.
- $50 or less – Radios, two-way radios, weather radios, tarpaulins, plastic sheeting, ground anchor systems, tie-down kits, bungee cords, and ratchet straps.
- $60 or less – Cell phone batteries.
- $75 or less – Carbon monoxide detectors or any package consisting of 2 or more of the previously listed items.
- $200 or less – Storm shutter devices.
- $1,000 or less – Portable generators (Florida, 2006).

Merchants do not have to worry about collecting local taxes, as they are also exempt. However, the task of properly determining which items are exempt and which remain taxable can be a daunting task, given the numerous dollar thresholds included in this holiday. Both Florida holidays were repeated in 2007 (Alexander, 2007). Due to budgetary constraints, Florida eliminated the hurricane holiday for 2008 but maintained the back-to-school tax break (Kennedy, 2008)

Other states having sales tax holidays in 2005 included Iowa, Missouri, South Carolina, and Texas. For 2008, fourteen states plus the District of Columbia have scheduled tax holidays.
(Wolf, 2008a) These are similar to the back-to-school holidays previously discussed with one notable exception. Missouri’s enabling legislation make the tax holiday permanent every year beginning the first Friday in August and ending the following Sunday (Gada, 2005). Most tax holidays are annual events, with the legislature approving the holiday on a year-to-year basis.

Social Security Holidays

As a part of an economic stimulus package, a proposal was made to enact a one-month holiday for employers and employees from paying Social Security payroll taxes. This proposal has numerous problems, not the least of which is the reprogramming of payroll programs to not deduct the tax from employees. In addition, the IRS and Social Security Administration would need to prepare new forms for what amounts to a one-time use (Davis, 2001b). The anticipated benefit to employers and workers is $38 billion. This would only be for the Social Security portion, not the Medicare tax. The loss to the Social Security Trust Fund would be covered through a transfer from the general treasury (Davis, 2001a). This is a plan that would benefit both individual workers and businesses as both parties are receiving a tax break. From a macro viewpoint, however, one must realize that the decrease in tax social security tax collections would be paid with borrowed funds, as the general treasury is currently running a deficit.

Rebates

Rebates, both actual and proposed, have taken many forms over the years. Common to all of these is that a taxpayer receives a rebate, or refund, of taxes paid in for a given period. These programs vary in the amount of rebate and the basis on which the rebate is determined.

The federal government provided rebates in 2001 amounting to a windfall of between $300 and $600 for taxpayers and totaled $38 billion. These rebates were received by approximately two-thirds of American households. Research indicated that the average household spent 20 to 40 percent of the rebate on non-durable goods and that two-thirds of the rebate was spent during the quarter of receipt. Specifically households spent an additional $51 on food and $179 on non-durable goods. This represents a 2.7 percent food increase and a 3.2 percent increase in expenditures on non-durable goods (NBER, 2005). These results indicate that the rebates did not result in one-time purchases of appliances, equipment, or similar goods. Instead, consumers used a large portion of the rebates to treat themselves to consumables. An additional economic stimulus rebate was approved by Congress in January, 2008. This rebate is up to $600 per taxpayer plus $300 each for dependent children (Stancil, 2008). Although most Americans state an intention to save the funds or pay off debts, it is expected that two-thirds of the rebate will be spent within six months (Linn, 2008)

Oklahoma paid a rebate of $45 to individuals and $90 to couples in 2005. In order to receive the rebates one had to file a 2004 return, claim a personal exemption, and not be a prison inmate (Knapp, 2006). Timed for receipt during the Christmas season, one questions how effective this small amount was as an economic incentive. Nevada enacted a rebate for 2005 that was implemented in two stages. The first payment of $75 went to individuals age 65 or over on January 1, 2005 who had a Nevada state identification card, but had no vehicle registered in the state. Stage two sent payments to taxpayers (individuals and businesses) who had a vehicle registered in Nevada during 2004. This rebate was either $75 or the amount of basic governmental services tax registration fee paid by the taxpayer up to $275 per vehicle (IRS Fact Sheet). The purpose of this rebate was to return to the taxpayers some of the 2004 budgetary surplus. The rebate raised the unintended consequence of taxable income for Federal purposes to some of the recipients (IRS Fact Sheet).

Fuel Rebates/ Moratoriums

As gasoline and other fuel prices have increased, there has been an increased demand to do something to help the working person. There is no shortage of proposed or enacted rebates in this area. At the forefront was a proposal before Congress to send rebate checks of $100 to “at least 100 million taxpayers (Tax Analysts, 2006). At today’s prices, this would cover less than two weeks of gas for the average consumer. Although billed as a gas rebate, it apparently bears no relation to gas purchases.

New Mexico enacted a 2005 "Income Tax Energy Rebate." The purpose of this rebate was to help citizens offset the rising costs of gasoline and heating fuel. However, the amount of the rebate was dependent on the taxpayer's adjusted gross income and the number of exemptions claimed. The rebate varied from $64 to $289 (Goodman, 2006). In addition to being an income tax rebate under the guise of energy relief, this was a complicated rebate that likely created a great deal of work on the part of the Department of Revenue in issuing the rebates for the proper amounts and confusion on the part of taxpayers about the amount of rebate to be received. New York Governor George Pataki called for a $500 heating fuel credit to "thousands of seniors across New York." Idaho Governor Dirk Kempthorne proposed sending a $50 energy-relief check to every resident. Some perspective on these various proposals was offered by Washington Governor Christine Gregoire, "While the roller coaster is fun at the amusement park, it is no model for state budgeting." (Solomon, 2006).

The "energy rebates" discussed to this point have no apparent linkage to energy consumption, but are simply a device to assist the taxpayer. Therefore, they will not be evaluated as general rebates.

In 2004, Florida enacted a moratorium on its eight-cent gasoline tax for the month of August. According to the American Automobile Association, gas prices decreased by 11 cents in Florida, while the national average was a 2.3 cent drop, so it would appear that consumers received the benefits. The cost of this moratorium was $59.7 million. General revenues were diverted to the State Transportation Trust Fund to make up for the lost revenues and not affect road maintenance (Florida, 2004). In September 2005, Georgia suspended its motor fuel taxes. This was an executive order by Governor Sonny Perdue but was subsequently approved by the state legislature (Office of Georgia Governor, 2005)

A proposal for a two-month moratorium on the Nevada's 17.7 cent gas tax was made in that state with the shortfall in taxes coming from the state's "rainy day fund." Senate Majority Leader Bill Raggio expressed concern over the lost revenues, stating, "We can't go too far in draining the fund. If gas prices are still up after two months, what would we do? We can't just continue draining the fund." (Riley, 2005)

Oklahoma Senate Pro-Tem Mike Morgan proposed a three-month suspension of that state's 17-cent gasoline tax. This would have amounted to a $103 million break for motorists but interestingly the proposal does not include a suspension of the state's 14-cent diesel fuel tax (Pitts, 2005).

James May, chief executive of the Air Transport Association, lobbied Congress for a one-year holiday from the 4.3 cents per gallon tax on aviation fuel in order to help the struggling airline industry cope with high fuel prices (Geewax, 2005). This would have given the airlines an estimated $600 million break, hardly enough to be a significant boost to the troubled industry.

Refundable Credits

Although the federal government has enacted a number of tax credits into the tax code in recent years, only two are refundable credits for individuals – the earned income credit (EIC) and the additional child tax credit. With both of these credits the taxpayer can receive more refund than has been withheld over the course of a year, resulting in a negative income tax. The EIC is available to taxpayers whose income falls below a certain dollar amount and meets other criteria. The additional child tax credit applies to taxpayers with either more than two dependent children or who received less than the full amount of the child tax credit (IRS, Publication 17). The EIC can be as high as $4,400 and the additional child tax credit can be as much as $1,000 per child.

Section 3. "REVERSE TAXES" EVALUATED

This section will evaluate the “reverse tax” legislation and proposals presented in section 2 using the criteria discussed in section 1. The results of the evaluation are presented in Table 1.

Sales Tax Holidays

Sales tax holidays meet two policy principles – horizontal equity and efficiency.

Horizontal equity. From one view, sales tax holidays do not violate this principle, as everyone receives forgiveness of sales taxes based on the amount of exempt purchases. However, those with greater resources may make larger expenditures and have a greater amount of taxes forgiven. Although not perfectly met, sales tax holidays seem to meet this principle at least as well as most taxes.

Efficiency. Those who receive the greatest amount of tax forgiveness are the ones benefiting from the sales tax holidays. It is difficult to determine who, if anyone, is worse off as a result. The sales tax holidays create a revenue shortfall, a portion of which may be recaptured through increased sales. The remainder of the shortfall is covered by reduced governmental expenditures or by transferring funds from another existing revenue source. Since no specific group can be identified as being made worse off, this principal is met by sales tax holidays.

Social Security Holidays

Social security holidays meet four policy principles, more than any other type of “reverse taxes.” The principles met are horizontal equity, efficiency, simplicity, and economic growth.

Horizontal Equity The sales tax holiday proposal would result in a degree of horizontal equity as employees would receive reduced social security taxes directly proportional to the level of their income for the holiday month. However, self-employed individuals would receive twice as large a reduction as they bear the employee and employee portions of the tax. This means that two individuals, one an employee and the other self-employed would receive differing benefits with the same level of income. Additionally, employers would receive benefits in proportion to the level of their payroll, so it is generally true that horizontal equity is present in the social security holiday proposals.

Efficiency Any wage-earning individual, whether an employee or self-employed would benefit from the social security holiday proposals. Likewise, any company with employees would benefit. It is difficult to pinpoint who, if anyone, would be damaged by this proposal, as the shortfall in social security taxes would be taken from the general treasury. Therefore, the social security holiday proposal meets the efficiency principle.

Simplicity Social security holidays are an easily understood type of reverse taxes. The tax is simply not collected for a given period of time. Although there are certain to be areas of uncertainty, these do not appear to be difficult hurdles to overcome or understand. Even though there may be costs to employers in complying with this holiday, this does seem to be a simple proposal, fulfilling this principle.

Economic Growth Proponents of a social security holiday tout the economic growth to be derived from such a holiday. It is argued by some that, by reducing payroll costs, employers will hire more workers giving the economy a boost (Davis, December 8, 2001). This seems to sell employers short, as the lower payroll costs are very much transitory. However, *Food Service Directory* magazine observes that individuals will have a one-time boost in income coming in the form of a larger paycheck. In their opinion, this will result in an upsurge in consumer spending, especially in retail stores and restaurants around the country (Food Service Director, 2002). The fact that the additional income is received through the regular channel of a paycheck and not in the form of a “bonus” rebate check may lend some credence to this argument. Therefore, it appears that a social security holiday may give an economic boost.

Rebates

Rebates meet two of the policy principles, efficiency and simplicity.

Efficiency As with previous reverse tax proposals evaluated, rebates usually come from the general treasury so identification of any group that is made worse off by these rebate is difficulty to determine. Therefore, this principle is met.

Simplicity Most of the rebate legislation pays a fixed amount to taxpayers or other identified group. With full access to tax return data, this is a relatively simple process in determining both eligibility and the amount of the rebates. Admittedly, this may consume a significant amount of time. In the balance, this principle is met by most rebate proposals.

Fuel Moratoriums

Fuel moratoriums meet the two principles of horizontal equity and simplicity.

Horizontal Equity Fuel moratoriums on gasoline taxes do result in a semblance of horizontal equity, as the amount of forgiven taxes is in proportion to the consumption of gasoline. Therefore, those using more fuel receive more of a tax break. This criteria is met.

Simplicity Fuel moratoriums appear to be an understandable concept in most cases. The tax is simply not paid at the pump upon purchase. For moratoriums on other types of fuel, there do not appear to be any difficulty with the understanding or administration for consumers or merchants. This criteria is met.

Refundable Credits

Refundable credits meet the principles of horizontal equity and economic growth.

Horizontal Equity The two refundable credits in our federal tax code are designed specifically to assist those in the lower economic brackets who pay little or no income tax. The earned income credit increases as earned income increases to a point, then decreases and phases out above a certain level of income. The additional child tax credit becomes a refundable credit only when the amount of the credit exceeds the individual’s tax liability. There is an assumption of increased need as the number of dependents increase. It would appear that this principle is met, as individuals in equal economic situations would get an equal amount of the credit.

Economic Growth Refundable credits appear to have a substantial impact on economic growth. The earned income credit is the largest poverty reduction program in the United States and is seen as being particularly effective in targeting relief to only low-income working families. In addition, it has been shown to increase labor force participation (wikipedia.org). Refundable credits do provide economic growth.

SUMMARY

This study shows that no “reverse tax” scheme meets all the proposed criteria of good tax policy. However, this is to be expected, as very few taxes today meet these criteria. Two types of reverse taxes, Social security holidays and fuel moratoriums meet four of the six tax policy principles evaluated. The other three types of reverse taxes - sales tax holidays, rebates, and refundable credits - only met two each of the six principles.

None of the five types of “reverse taxes” met the vertical equity principle. The fact that “reverse taxes” are usually distributed as a lump sum or as a percentage of expenditures results in a failure to achieve vertical equity. With its emphasis on low-income wage earners, refundable credits comes closest to achieving this principle.

Four of the five types evaluated met the efficiency criteria, with only the refundable credits failing at this juncture. This is due to the fact that most reverse taxes come from the general treasury and have no discernable group that is negatively impacted. If you regard all taxpayers of all types of taxes as being impacted, a case could be made that this principle is not met by any of the reverse taxes.

In terms of simplicity, three of the reverse tax methods were found to be easily understood and easy to comply with. Failing this criteria, however, were possibly the two most significant reverse tax methods – sales tax holidays and refundable credits.

Economic growth is probably the most significant of the principles presented, given that it is the stated purpose of most of these “reverse taxes.” Only social security holidays and the refundable credits meet this criteria.

CONCLUSION

It appears that “reverse tax” schemes are here to stay. They are frequently politically motivated with little or no attention paid to the concept of tax principles. Indeed, given their political nature “reverse taxes,” are likely to be limited only by the imaginations of Washington politics and the various state capitals. No reverse tax enactment or proposal presented in this paper met the criteria of a “good tax.”

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