

**Characteristics of an Effective Tax System** A good tax system should meet five basic conditions: fairness, adequacy, simplicity, transparency, and administrative ease. Although opinions about what makes a good tax system will vary, there is general consensus that these five basic conditions should be maximized to the greatest extent possible.

- **Fairness, or equity,** means that everybody should pay a fair share of taxes. There are two important concepts of equity: horizontal equity and vertical equity. Horizontal equity means that taxpayers in similar financial condition should pay similar amounts in taxes. Vertical equity is just as important, however. Vertical equity means that taxpayers who are better off should pay at least the same proportion of income in taxes as those who are less well off. Vertical equity involves classifying taxes as regressive, proportional, or progressive.

**Regressive tax:** A tax is regressive if those with low incomes pay a larger share of income in taxes than those with higher incomes. Almost any tax on necessities, such as food purchased at a grocery store, is regressive because lower income people must spend a larger share of their income on these necessities. Oklahoma's sales tax is one example.

**Proportional tax:** A tax is proportional if all taxpayers pay the same share of income in taxes. No taxes are truly proportional. Property taxes often come closest since there is typically a close relationship between a household's income and the value of the property in which they live. Corporate income taxes often approach proportional because one rate applies to most corporate income.

**Progressive tax:** A progressive tax requires higher-income individuals to pay a higher share of their income in taxes. The philosophy behind progressive taxes is that higher income people can afford and should be expected to provide a bigger share of public services than those who are less able to pay. The federal income tax is the best example of a progressive tax; the Internal Revenue Money received by a government entity.... While no system of taxes is perfect, it is important to seek horizontal equity because taxpayers must believe they are treated equally. It is just as important to seek vertical equity so government does not become a burden to low-income residents.

- **Adequacy** means that taxes must provide enough revenue to meet the basic needs of society. A tax system meets the test of adequacy if it provides enough revenue to meet the demand for public services, if revenue growth each year is enough to fund A self-balancing economic activity of the type being taxed so rates can be kept relatively low.
- **Simplicity** means that taxpayers can avoid a maze of taxes, forms and filing requirements. A simpler tax system helps taxpayers better understand the system and reduces the costs of compliance.
- **Transparency** means that taxpayers and leaders can easily find information about the tax system and how tax money is used. With a transparent tax system, we know who is being taxed, how much they are paying, and what is being done with the money. We also can find out who (in broad terms) pays the tax and who benefits from tax exemptions, deductions, and credits.
- **Administrative ease** means that the tax system is not too complicated or costly for either taxpayers or tax collectors. Rules are well known and fairly simple; forms are not too complicated; the state can tell if taxes are paid on time and correctly, and the state can conduct audits in a fair and efficient manner. The cost of collecting a tax should be very small in relation to the amount collected.