How Does One Evaluate a Tax System?

There are a number of factors used to evaluate a tax system. While opinions on what qualifies as a good tax system differ, there is general agreement that some of the most important factors are adequacy, fairness and transparency.[30]

Adequacy

A tax system is considered adequate if it collects enough revenue to pay for the services required by residents and policymakers. One threat to the adequacy of a tax system is a structural deficit. In states with a **structural deficit**, revenues do not grow at the same rate as the costs of providing government services. If revenues do not keep up with these increased costs, the state must either raise taxes or cut services.

Key Terms

Structural Deficit – A situation in which a government's tax structure is not designed to collect increased revenue to pay for increased costs of services.

Ability to Pay Principle – A fair tax systen asks citizens to contribute to the cost of government services based on their ability to pay. This principal suggests that persons with higher incomes, or greater ability to pay, should pay more in taxes than those with lower incomes.

Fairness

The main area of thought on ***tax fairness*** is the **ability to pay principle.** Based on this principle, taxes can be categorized into three types:

- *Progressive:* A tax system is progressive if persons with higher incomes pay a greater percentage of their income in taxes than those with lower incomes. Most income taxes, including the federal income tax, are designed to be progressive.
- *Proportional:* A tax system is proportional if all persons, regardless of income level, pay the same percentage of their income in taxes. Flat taxes are proportional.
- *Regressive:* A tax system is regressive if persons with lower incomes pay a higher percentage of their income in taxes than those with higher incomes. Sales taxes are generally regressive, because families with lower incomes tend to spend a larger fraction of their income on taxed goods than do higher-income families.

Transparency

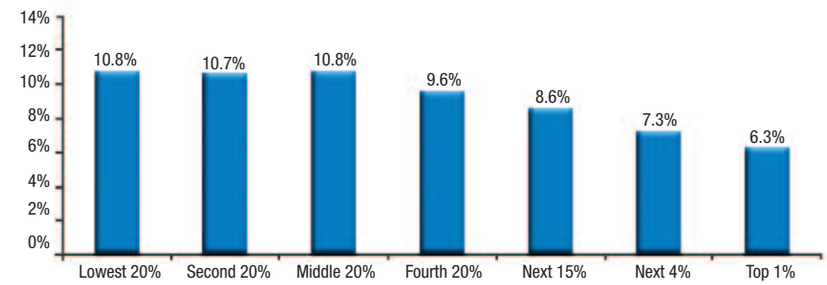
The transparency of a tax system indicates whether or not information about the tax system is easy to obtain. Available information should include who and what is taxed, the process for making tax decisions and how the funds collected are spent. Some states with high transparency use tools like fiscal notes and tax incidence analysis. ***Fiscal notes*** provide an estimate of the revenues gained or lost for a proposed change in law. ***Tax incidence analysis*** provides an estimate of how different income groups are affected by a tax or proposed tax change.

Evaluating Mississippi's Taxes

Our state's bundle of taxes has some progressive elements and some regressive elements.

As a whole, Mississippi's state tax policies are regressive. This is due to the fact that the top 20% of income earners pay the lowest percentage of their income toward state and local taxes, while the bottom 40% pay the highest percentage of their income toward state and local taxes (*Figure 10*).

Figure 10: Total Taxes Paid as a Percentage of Income by Income Groups in 2007

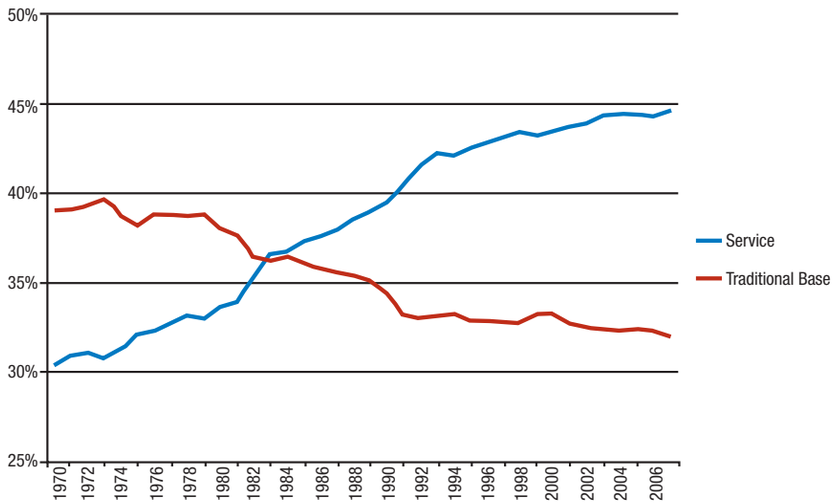


Income Range	Less than $15,000	$15,000 - $24,000	$24,001 - $39,000	$39,001 - $70,000	$70,001 - $135,000	$135,001 - $319,000	$319,001 or more
Average Income	$9,100	$19,000	$31,600	$53,600	$94,500	$184,200	$806,700

Source: MEPC Analysis of data from the Institute of Taxation and Economic Policy

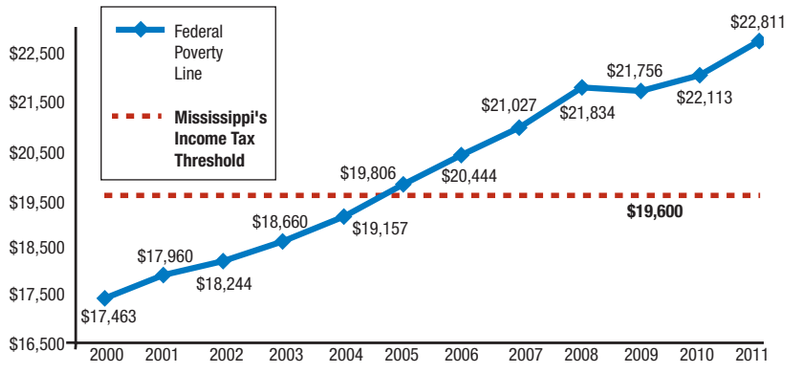
The following analysis of Mississippi's sales and income taxes illustrates some of the strengths and weaknesses of Mississippi's tax system.

Figure 11: Household Consumption of Items Composing Traditional State Sales Tax Base vs. Household Consumption of Services 1970 – 2007



Source: MEPC Analysis of data from the Institute of Taxation and Economic Policy

Figure 12: State Income Tax Threshold and Federal Poverty Line for a Family of Four with Two Children (2000-2011)



Source: Center on Budget and Policy Priorities

Mississippi Sales Tax

As seen in *Figure* 8, our state's sales and use tax represents nearly half of state tax revenues. States with a strong emphasis on a sales tax tend to have more regressive tax systems because people with low incomes pay a higher proportion of their income on taxed items—for example, groceries and clothing—than people with high incomes.

Sales taxes can be made more or less regressive depending on what goods or services are taxed. *Figure 11* shows our state's trend in household consumption of traditional sales tax base items versus household consumption of services.

Mississippi's sales tax is more regressive than other states because Mississippi taxes food at the full 7%. With Arkansas' reduction of sales tax on groceries in July of 2007, Mississippi is now one of only two states to fully tax food without any offsets.[31]

Mississippi Individual Income Tax

Mississippi's individual income tax is progressive but only slightly so. The top tax rate of 5% starts at $10,000 of taxable income or $29,600 of gross income for a family of four. Thus, a family of four that earns $30,000 pays the same marginal tax rate as a family of four earning $300,000 or $3,000,000. In reality, Mississippi's personal income tax operates more like a proportional, or flat, tax than a progressive tax.

Additionally, since 2005, Mississippi has collected taxes on the income of families below the federal poverty line (*Figure 12*). The poverty line is adjusted each year for inflation. Whereas the poverty line for a family of four was $21,834 in 2008, the poverty line rose—along with the costs of living expenses, like food and gas – to $22,811 in 2011.

During the same period, Mississippi's tax threshold—the amount of income on which Mississippians start paying income taxes—remained the same at $19,600. A family's tax threshold is determined by calculating how much income they can earn without paying taxes via standard exemptions and deductions. Without adjustment, the number of families in poverty subject to state income taxes will increase each year, as the federal poverty level increases, but the tax threshold remains the same.

Mississippi's Corporate Income Tax

Our state currently offers a range of corporate tax breaks to stimulate economic development. The different types of breaks are also called **tax expenditures**. Tax expenditures allow persons and or businesses to pay less in tax—in essence providing them with resources without using direct appropriations. Tax expenditures are usually less visible than other types of public spending and are not required to be reviewed annually like direct appropriations. This makes it harder for policymakers and the public to evaluate them.

Key Terms

Tax Expenditure: A targeted tax cut provided to particular groups of individuals or businesses.

Annual Tax Expenditure Report: A list of tax breaks and their costs.

For example, the **Annual Tax Expenditure Report** estimates that employers will claim Job Tax Credits of about $6,000,000 against their corporate income tax in 2012.[32] However, there is no way to answer questions about the number of jobs that are created through the credit because of the way it is reported through the tax filing system. A system of making the incentive impact information publicly available and easily accessible would increase accountability to ensure the overall effectiveness of the incentive program.

Mississippi's taxes and business climate

You often hear that in order to be competitive states must cut their business taxes. However, other factors like education, public safety and workforce development are also important to a state's economic competitiveness and require adequate state revenue.

Putting the Parts Together– Evaluating Mississippi's Tax System

- While Mississippi's tax system has some progressive elements and some regressive elements, it is regressive overall because of its heavy reliance on the sales tax.
- The Mississippi sales tax is regressive. People with low incomes pay a higher proportion of their income towards the tax than people with high incomes. Mississippi's sales tax is especially regressive because it fully taxes groceries—an expenditure that low-income working families cannot avoid making.
- The income tax is structured to be progressive, but a large proportion of taxpayers pay the tax at the top rate. Additionally, in 2013, some families in poverty will pay income taxes due to tax thresholds that have not been updated in several years.
- Taken together, the bundle of state tax policies is not as fair as it might be: The top 20% of income earners pay the lowest percentage of their income toward state taxes, while the bottom 40% pay the highest percentage of their income toward state taxes.