Colorado Fiscal Institute

Principles for Evaluating Tax Policy

Tax policies make up tax systems. Based on the work of the National Conference of State Legislatures (NCSL), a sound tax system produces adequate and timely revenue that is simply and fairly collected. Tax systems ensure funding for the essential government services that help our state and economy work: public education, health care, roads, sewage, water, and parks, among others. Tax systems are integral to well-functioning societies – when revenue is raised adequately, predictably, and fairly, these fundamental systems work smoothly, and it's easier for people to live, communities to thrive, and businesses to operate.

Tax policy also serves as a powerful tool for equity. It can either fuel economic opportunity for everyone, or it can end up holding us back. Tax policies that govern how we raise and spend revenues serve as vehicles for critical public investments that should help all Coloradans thrive. They should not be policy tools that use public dollars to reinforce or widen disparities in wealth and power. Tax policy is an important tool, one that is too often overlooked in the fight against growing income and racial inequality. Tax policies should be evaluated with this broader context of equity impact in mind.

The Colorado Fiscal Institute (CFI) promotes tax and budget policies that check growing income and racial inequality, that meet the goals of a sound taxation system, and that are effective, economically efficient, fair, transparent, and accountable.

CFI's principles for evaluating tax policy:

1. ***Is the tax policy effective?*** When evaluating a new or changing tax policy, such as a new tax expenditure, CFI considers whether it has been proven to meet a targeted goal. Did the policy result in the desired outcome in other states, counties, or past iterations of the policy itself? CFI also considers the return on investment from the proposed tax policy when compared to investing in other state priorities.
2. ***Is the tax policy economically efficient?*** A good tax policy will produce its intended outcome without significant additional cost or disruption to public spending or the economy. CFI also considers the behavior the tax policy is intended to incentivize and if this behavior would occur without any monetary incentive. For example, tax expenditures (credits, deductions, and exemptions) are often used to incentivize certain behaviors but should never be given to reward behavior that would have happened anyway.
3. ***Is the tax policy fair?*** CFI examines a tax policy's fairness through the lens of horizontal and vertical equity. Horizontal equity is the idea that people in the same circumstances should be treated the same way. Vertical equity is the idea that people with higher incomes should take on a greater share of the responsibility for paying for public services because they have a greater ability to pay taxes.
4. ***Is the tax policy transparent?*** Tax policy, like any policy, needs publicly available data about how taxes are raised, how revenues are being used, and who benefits from the policy. The Tax Profile and Expenditure Report, published by the Department of Revenue every two years, contains this type of data.
5. ***Does the tax policy contain accountability measures?*** In order to determine if a tax policy is achieving its targeted goal, a clear set of objectives must be used to review and evaluate it regularly. For example, lawmakers can use sunset provisions to ensure a tax expenditure receives regular review and evaluation. Each Colorado tax expenditure is audited by the State Auditor's office every five years.

CFI prioritizes policies that meet the criteria for sound tax policy, that broadly benefit working families or that foster equity and widespread economic prosperity. CFI generally opposes legislation that creates special tax treatment for small groups of high-income or high-wealth taxpayers, widens racial inequity or income inequality, subsidizes behaviors already occurring without the incentive, or lacks accountability and transparency. CFI staff analyze the balance between the benefit promised by the proposed tax policy and the impact of the change in revenue in order to determine the best investment of taxpayer dollars. Based on these principles, CFI is supporting and opposing the following bills this legislative session: