

Understanding Taxes



Theme 3: Fairness in Taxes





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“The taxpayer—that’s someone who works for the federal government but doesn’t have to take the civil service examination.”

– President Ronald Reagan



Understanding
Taxes 

- Government services are funded by taxes.
- Taxes pay for and provide services the taxpayer cannot fund alone.
- The government needs taxpayers, and taxpayers need the government.
- How do taxpayers satisfy the needs of government?

(Government services are funded through money raised from taxes; the daily operations of government are paid for.)

How does the government satisfy the needs of taxpayers?

(Government provides services on a larger scale; it pays for services that individuals would not otherwise be able to afford.)

Explain President Reagan’s comparison between taxpayers and federal workers.

(Answers may vary. Students should recognize the intertwining relationship between government and its citizens.)

Photo Credit: National Archives



Fairness and Taxation



Understanding
Taxes 

- One of the guiding principles of taxation is fairness.
- Taxes also need to be flexible in order to meet the changing financial needs of society and government.
- To limit inflation during times of economic growth, taxes are often increased.
- A decrease in taxes is used during periods of economic decline. This technique is used to prevent a recession.



How to Measure Tax Fairness

- Ability to Pay
- Benefits Received



Understanding
Taxes 

- A primary concern of government is the fair taxation of citizens.
- When measuring the fairness of taxes, two criteria are used:
 - Ability to pay
 - Benefits received
- Ability to pay assumes that people with different amounts of income or wealth should pay different amounts of taxes.
- Benefits received assumes that those who receive or benefit from a public service should pay for it.



Ability to Pay



Understanding
Taxes 

- Ability to pay assumes that people with different amounts of income or wealth should be taxed at different rates.



Taxes and Benefits Received



Understanding
Taxes 

- Benefits received assumes that only those who benefit from a public service should pay for it.
- Different taxes help to fund different public services.
- The gasoline tax funds the maintenance of roads; property tax funds education and police and fire protection; income tax funds defense.

What would happen if our system of taxation followed only the Benefits Received principle? (Students will realize that it would be impossible to pay for only the services you use.)



Regressive Taxes

Everyone pays the same fixed amount



Understanding
Taxes 

- Regressive taxes may seem fair because everyone pays the same fixed amount, regardless of income level.
- Some people think regressive taxes are unfair because they take a larger percentage of income from low-income groups than from high-income groups. For example, a 20 cent per gallon tax on gasoline would take a larger portion of the wages of someone who earned \$10,000 than of someone who earned \$100,000.
- Regressive taxes are used in the following ways:
 - As taxes on tobacco or alcohol, sometimes called “sin” taxes because they are also used to discourage people from consuming those items
 - As gasoline taxes
 - As taxes on luxury items or services, such as jewelry, perfume, or travel
- State and local sales taxes also have a regressive effect.
- Our federal income tax is not a regressive tax.



User Fees

- Fund public services



- User fees are used to fund public services.
- User fees may be in the form of a license or supplemental charge.
- User fees can be considered regressive; although the fee or charge is the same for all income groups, a larger portion of income is taken from those with lower incomes.
- User fees include:
 - Fees for business or professional licenses
 - Fees for hunting and fishing licenses
 - Tolls for roads or bridges
 - Fees for parking
 - Entrance fees to museums, parks, and monuments



Progressive Taxes

Higher Income = Higher Taxes



Understanding
Taxes 

- Progressive taxes take a larger percentage of income from high-income groups than from low-income groups. The tax rate increases as the taxable income increases.
- This method is based on the ability-to-pay principle.
- It is considered the fairest means of taxation.
- Our federal income tax is progressive.



Tax Brackets

U.S. Tax Brackets - 2011	
Single Taxpayer	Rate
\$0-\$8,500	10%
\$8,500-\$34,500	15%
\$34,500-\$83,600	25%
\$83,600-\$174,400	28%
\$174,400-\$379,150	33%
\$379,150-and above	35%

Understanding
Taxes 

- Our federal system of taxation is progressive. People who earn more are taxed at a higher percentage rate.
- Tax brackets illustrate the amount a person is taxed based on his or her taxable income.



Wealth and Income

- Wealth: houses, cars, stocks, savings
- Income: wages, interest



Understanding
Taxes 

- Both wealth and income are taxed by our government.
Wealth includes assets such as houses, cars, stocks, bonds, and savings accounts.
Income includes wages, interest and dividends, or other payments.
Inheritance is also taxed.



Proportional Tax



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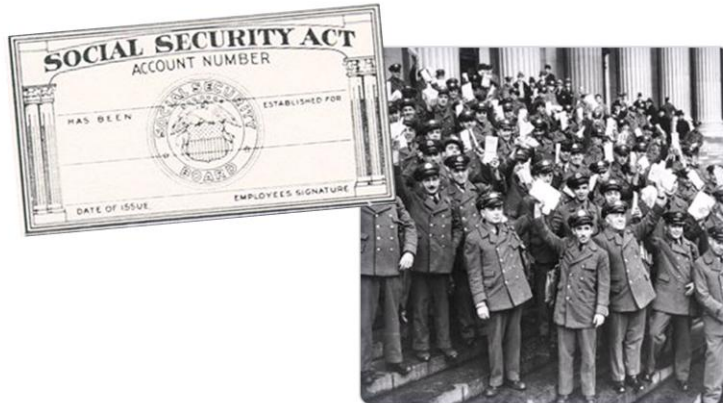


Understanding
Taxes 

- A proportional (or flat) tax taxes all income levels at the same percentage rate.
- Proportional taxes may appear fair; all are taxed at the same percentage rate.
- However, proportional taxes have a regressive effect on a taxpayer's total income. Proportional taxes take a larger portion of income from those in lower-income groups.
- Examples of proportional taxes:
 - sales tax
 - real estate tax



FICA & Social Security



Understanding
Taxes 

- The FICA tax is levied on employers, employees, and some self-employed individuals.
- The FICA tax is withheld from each paycheck.
- The FICA tax is proportional because everyone pays the same fixed percentage rate.
- Collected revenue goes to Social Security retirement and Medicare.
- It was designed to provide aid to the elderly and disabled.
- Income from interest and dividend payments is not charged this Social Security tax.

Photo Credits: Social Security Administration



Sales Tax Holiday



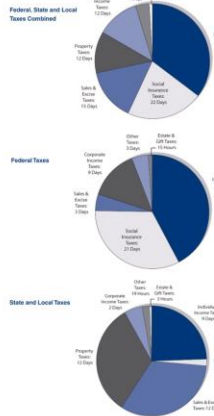
- Sales tax holidays are designed to provide tax relief on items of necessity.
- Sales tax holidays designate a period of time when the sales tax is lifted.
- The removal of the sales tax encourages sales and helps people with lower incomes meet the needs of their families.



Theme 3: Fairness in Taxes

Fairness in taxes

Figure 2
How Long Americans Work to Pay All Federal, State and Local Taxes
Calendar Year 2011



Tax Freedom Day



- Tax Freedom Day is the day of the calendar year on which taxpayers have earned enough money to pay their taxes.
- Money earned each day thereafter until December 31 is theirs and is not owed to the government.
- The largest percentage of American wages is spent to pay individual income taxes.

Source: Tax Foundation (www.taxfoundation.org/taxfreedomday)