Chapter 9 Sources of Government Revenue

1. Section 1: The Economics of Taxation
2. Taxes can affect productivity and economic growth by changing the incentives to save, invest, and work.
3. In order to make taxes as effective as possible taxes must meet the criteria:

a. Equitable

b. Simple

c. Efficient

1. Taxes are based on two principles: those who benefit from government goods and services should pay in proportion to the amount of benefits they receive. Also people should be taxes according to their ability to pay, regardless of the benefits the receive.
2. Three types of taxes:
3. Proportional tax imposes the same percentage rate of taxation on everyone, regardless of income.
4. Progressive tax imposes a higher percentage rate of taxation on persons with higher incomes.
5. Regressive tax imposes a higher percentage rate of taxation on low incomes than on higher incomes.
6. Payroll Deductions: In most cases the individual income tax is paid over time through a payroll withholding system, a system that requires an employer to automatically deduce income taxes from an employee's paycheck and send it directly to the government.
7. Internal Revenue Service (IRS): the agency that receives the tax payment, is the branch of the U.S. Treasury Department in charge of collecting taxes.
8. Tax Return: an annual report to the IRS summarizing total income, deductions, and the taxes withheld by employers.
9. The Federal Tax System
10. Progressive Income Tax: when a tax is progressive, the average tax rate goes up with income goes up.
11. Indexing: an upward revision of the tax brackets to keep workers from paying more in taxes just because of inflation.
12. FICA is the Federal Insurance Contributions Act tax levied on both employers and employees to pay for Social Security and Medicare.
13. Medicare: a federal health-care program available to all senior citizens, regardless of income.
14. Payroll taxes are taxes deducted from your paycheck.
15. Social Security Taxes: a cap of $84,900 are collected for Social Security regardless of income .\*Rate of pay based on income.
16. Medicare: there is no cap on the income taxed.
17. Corporate income taxes: the tax a corporation pays on its profits is a progressive tax.
18. Other Federal Taxes:
    1. Excise Taxes: a tax on the manufacturing or sale of selected items, such as gasoline and liquor- is the fourth larges source of federal government revenue.
    2. Luxury good (or Service): if the demand for the good rises faster than income when income grows.
    3. Estate and Gift taxes: the tax the government levies on the transfer of property when a person dies. Taxes from 11 to 50%, exempt if less than $675.000
    4. Gift tax: a tax on donations of money or wealth and is paid by the person who makes the gift.
    5. Custom Duties: is a change levied on goods brought in from other countries.
19. State and Local Tax Systems

Intergovernmental revenue: funds collected by one level of government that are distributed to another level of government for expenditures.

1. These funds contribute to welfare, education, highways, health and hospitals.
2. Sales Tax is a percentage of the final price that is added in addition to the final price that the customer pays. The merchants turn the taxes over to the government, but some government agencies allow the merchant to keep a small portion of the taxes.
   1. It is the largest source of revenue for states, approx 20.8% of total revenues.
   2. The fourth largest source of state revenue is individual income tax, which is about five times as large as the tax collected from corporations.
   3. Only five states don’t have general sales tax: Montana, Delaware, Oregon, Alaska and New Hampshire.
3. Mainly, states collect taxes and other fees for state retirement plans and pension plans.These employee retirement plans proved to be the third largest source of
4. Surplus funds; tuition and other fees from state owned colleges, universities, and technical schools; corporate income taxes; and hospital fees account for the remaining revenues.
   1. States that don’t have sales tax must collect another type of taxes in order to make up for the type of taxes not collected.
5. REMEMBER TINSTAFL IS ALWAYS IN EFFECT, so it isn’t a matter of if or if not a state is going to collect taxes, but what kind of taxes will be collected.
6. Local governments receive the greatest revenue, which is a little bit more than one third. The funds received are used for local things such as education and public welfare.
7. The second largest revenue for local governments is property taxes.
8. Property taxes is a tax on tangible and intangible possessions such as real estate, buildings, furniture, automobiles, stocks, bonds, and bank accounts.
9. A tax assessor is the person who assigns value to property for tax purposes.
   1. Things that aren’t really assessed are fine silver, coin collections, clothing, and other common items that everyone has, but instead, they evaluate buildings, real estate, and automobiles.
10. Public utilities and state-owned liquor stores account for the third largest source of local revenue.
11. Most towns and cities have their own sales taxes.
12. Local governments also collect funds from hospitals and personal income taxes.
13. Since most states take out taxes directly from your paycheck, you should pay close attention to the payroll withholding statement.
14. The payroll withholding statement is the summary statement that comes attached to the paycheck which summarizes income, tax withholdings, and other deductions.
15. Current Tax Issues
16. Tax reform has received considerable attention in recent years due to more changes in the tax code and more changes in direction, than any time in our nation’s history.
    * + - 1. There have been four major tax revision bills since 1980. The first reduced income tax, the second made it more proportional, the third made it more progressive, and the fourth and final one in 1997, provided wealthy individuals with significant tax relief for long term investments and modest relief for child and educational expenses.
          2. Recent talk of tax reform has centered around a Value Added Tax (VAT), which is a tax on consumption rather than income, and a flat tax, which would replace all tax brackets with a single tax rate.
17. The inevitability of Future Reforms. Several factors further change.
    1. The tax code is more complex now than ever, a fact that guarantees no future attempts to simplify it.
    2. There is no guarantee that economic growth will continue without interruption until 2010.
    3. Unexpected political events may require additional and unplanned expenditures.
    4. Political change is not like economic change, which is gradual and generally evolutionary.
    5. Dramatic change is tempered by the reluctance of politicians to give up some of the power they currently exercise through the tax code-power vested in the ability to modify behavior, influence resource allocation, support pet projects, and grant concessions to special interest groups.