

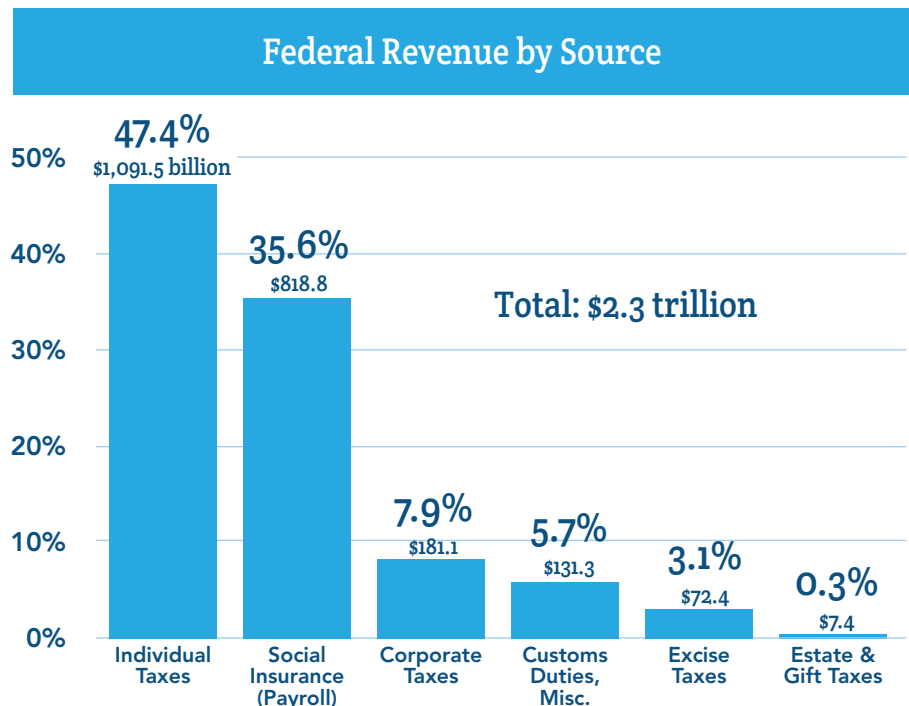
Taxes may not be popular, but they pay for government programs and public services. Taxes in the United States are collected through a complex, overlapping set of systems. We have federal, state, and local income taxes, plus taxes on property, sales, high-end estates and gifts. We also have user fees that add to the cost of many things including car rentals, airline tickets, hotel rooms, and toll roads.

There is little agreement on the proper level of taxation in America, but nearly everybody in the tax debate agrees the current tax structure is too complicated. The federal income tax code alone runs more than 70,000 pages. It contains many special credits, deductions, and exemptions that offer ways for people and organizations to pay less tax.

Before we look at some approaches to changing our tax code, let's first look at some basics.

Personal income taxes are the largest portion of total **federal revenues**. Social Security and Medicare payroll taxes are the second-largest source. Corporate taxes and other sources make up the rest and are a much smaller proportion.

FACT: As a percentage of the nation's total economic output, federal tax revenue is at its lowest level in 60 years: 15 percent of GDP, well below the postwar average of 18 percent.



Federal Income Taxes

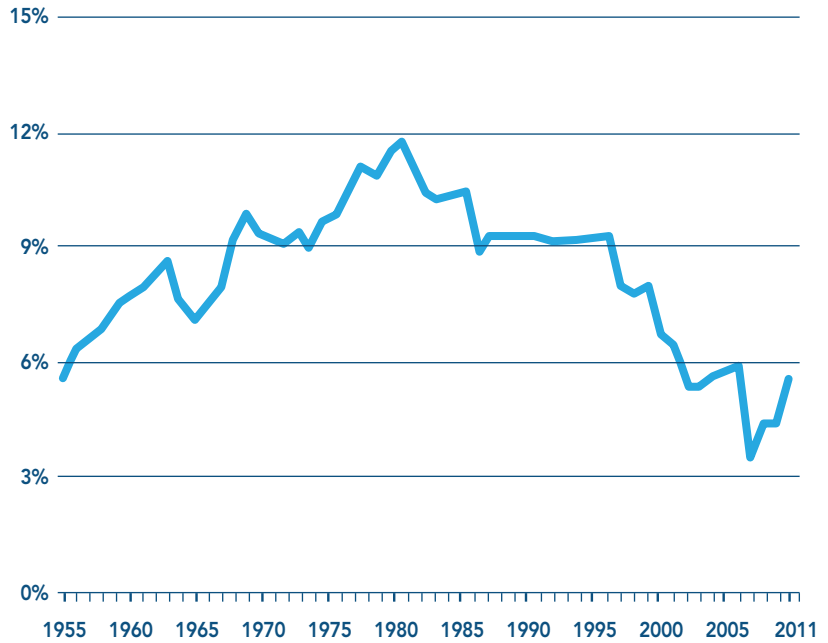
The **Federal Income Tax** is a tax on the annual earnings of individuals, corporations, trusts and other legal entities.

One of the most misunderstood concepts in the income tax debate is **tax rates**.

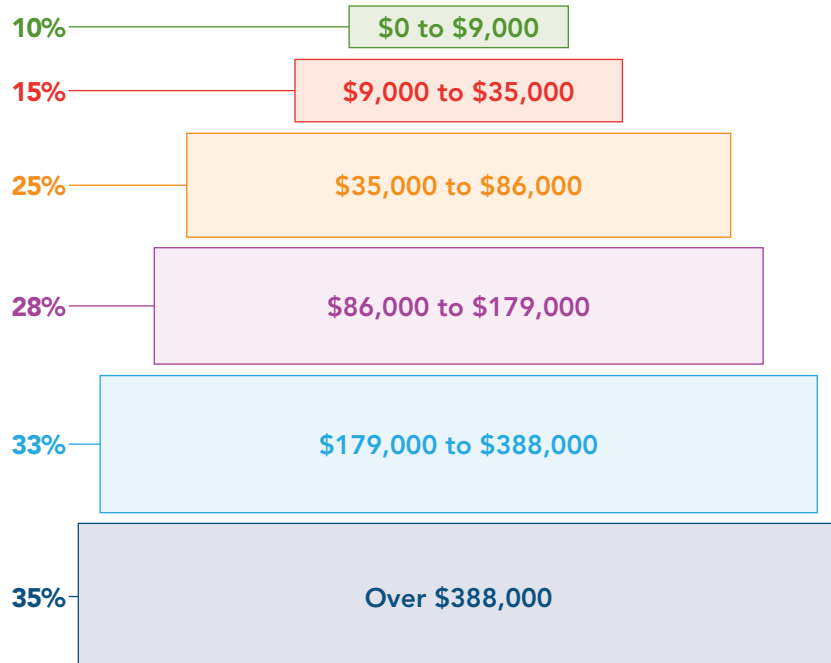
Our income tax rate system is **progressive**. It is like a tiered pyramid, with higher tax rates applied to higher tiers of income. For example, a person who earns \$100,000 pays a higher tax rate of 28 percent, but only on the top \$14,000 of income. The first \$86,000 is taxed at lower rates. So it's incorrect to conclude someone with a six-figure income is paying 28 percent income tax. The higher rate is applied only to the dollars in the margin between \$86,000 and \$100,000. That's why it's called the **Marginal Tax Rate**.

A person's **Effective Tax Rate**, however, expresses the "real" rate he or she pays – total income tax divided by total income, after all the allowed deductions are figured in. Depending on deductions, our \$100,000 earner might end up paying \$13,000 in income tax, for an effective tax rate of 13 percent – a big difference from her marginal tax rate.

Average Federal Income Taxes Rates Over The Years Average Federal Tax Rate For a Median-Income Family of Four



Marginal Tax Rates Per Income



Payroll Taxes

Payroll taxes are the second largest contributor to federal revenue.

These accounted for 40 percent of all federal revenue in 2010. Payroll tax is the tax an employer and the employee pay based on the employee's wages or salary. Revenues from payroll taxes help fund such programs as Social Security, Medicare, unemployment compensation, and worker's compensation. Most Americans pay more in payroll taxes than in federal income taxes.

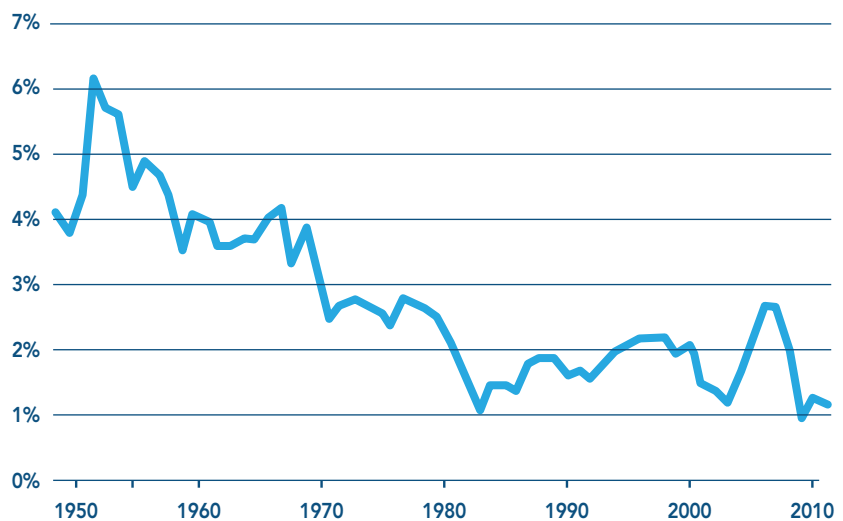
FACT: 47 percent of US households pay no federal income tax. But almost all pay Social Security and Medicare payroll deductions, state and local taxes, and more.

Corporate Taxes

The third largest contributor to federal revenue, supplying 9 percent in 2010, is corporate income tax. Corporate taxes are taxes on profits earned by businesses, with different rates applied to different levels of profits.

FACT: As a percent of GDP, the United States takes in less in corporate taxes than the average of the 34 countries in the Organization for Economic Co-operation and Development, which includes many of the developed countries in North and South America, Europe, and Asia.

Corporate Tax Revenues as a Percentage of GDP



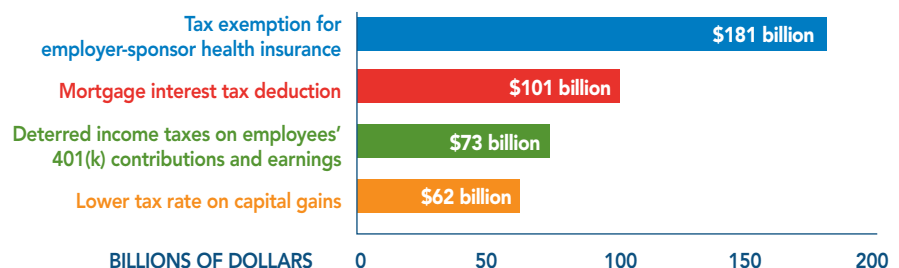
Tax Breaks

As noted earlier, the US income tax system is complicated by many credits, deductions, and exemptions designed to encourage certain activities, like owning a home or contributing to charity. These are popularly referred to as **tax breaks**.

One example is the First-Time Homebuyer Tax Credit that provided a tax credit up to \$8,000 for qualified purchasers of primary residences. It was created in 2009 to help the weak housing market and expired in 2012.

There is perpetual debate over the fairness and cost of tax breaks.

The four largest tax breaks based on fiscal 2013 estimates



FACT: Mortgage deductions, often characterized as a benefit for the middle class, are used by 69% of households earning \$100,000 or more, while only 31% of households making less than \$100,000 take advantage of the deduction.

State & Local Taxes

Many Americans pay no federal income tax, because they have low earnings or tax breaks reduce their obligation to zero or result in them getting money back from the government. But almost everybody pays payroll taxes and some form of state and local taxes.

State taxes vary from state to state. 41 states levy an income tax. Seven have no income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. (Tennessee and New Hampshire tax investment income only, not wages.) Only five states charge no sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon. States also levy all kinds of fees to fund specific things. When you pay bridge or turnpike tolls, license plate “tab fees,” or state park admission fees, those are taxes, too.

Local taxes are collected in many forms. Property taxes (no matter where you go in the U.S., real estate owners are charged a form of property tax, though rates and available tax breaks vary greatly), sales taxes, utility and telecom surcharges, permits for everything from hunting and fishing to running a business, and occasionally income taxes. Local taxes help fund local resources such as police and fire departments and public schools.

Do you know which taxes cost you the most?

Approaches to the Issue

Improving The Tax Code

Very few people seem satisfied with our current tax system, but there is little or no consensus about what to change.

Many believe Americans are taxed enough as it is, especially when the economy is fragile, and there is no need for increases. They want lower individual tax rates for all, including more affluent Americans and for businesses, arguing that broad tax relief sets the stage for business growth, job creation, and a healthier economy. When taxes are minimal, they argue, people have more disposable income to spend, save or invest.

Many others favor another approach: raising certain taxes, in particular income taxes on more affluent Americans, to fund government spending. This is a generally progressive tax plan based on a taxpayer’s ability to pay. Advocates say it generates job growth and injects more new money into the economy.

- Do you think the current tax code requires reform?
- Which approaches do you most agree with?
- What ideas would you add?
- How do you feel about the amount of tax revenue collected?

Interested in finding out more about this issue?

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