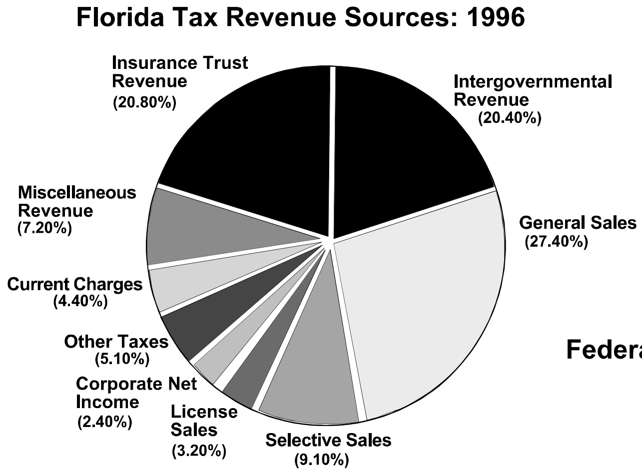
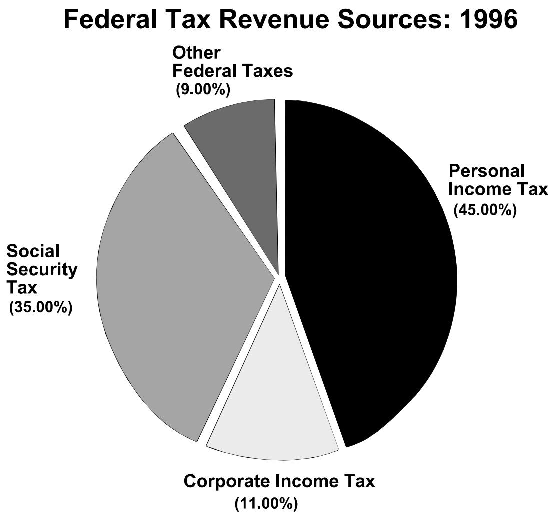
## Introduction

For a government to operate, it must have a constant and reliable source of income. A government gains some of that income by taxing its citizens or taking a share of its citizens' earnings and wealth. Government at all levels needs money in order to pay its expenses. For example, **property tax** is collected by local governments to run school systems. **Sales tax** is collected by state governments to repair roads and provide many state benefits. An **income tax** is collected by the federal government to fund national defense programs, run national agencies such as the Federal Bureau of Investigation (FBI) and Central Intelligence Agency (CIA), and to support hundreds, even thousands, of federal programs to improve the lives of its people. All of these taxes paid by the people make up **government revenue**.

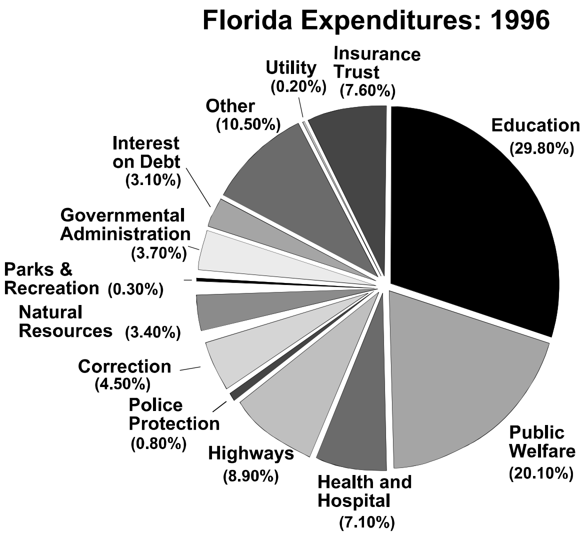
The State of Florida collects one of the largest sums of government revenue of any state government in the United States. The graphs below show the major areas of revenue for both the State of Florida and the federal government.

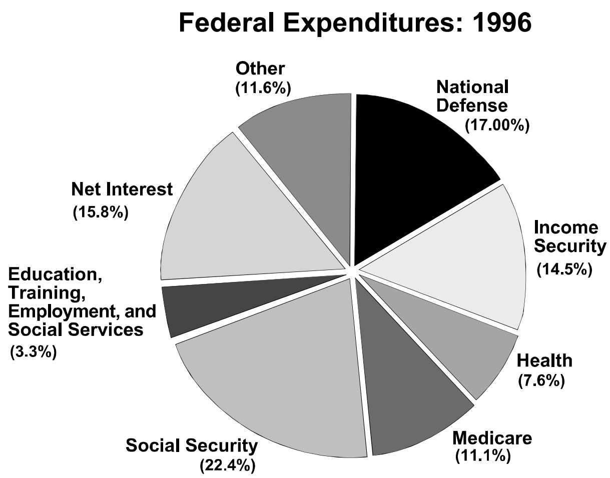



*Source: U.S. Bureau of the Census.*

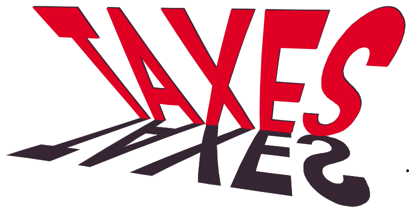
The graphs below show the major areas of expenditures for both the State of Florida and the federal governments for 1996.




*Source: U.S. Bureau of the Census.*

## How Our Government Determines Taxes




Taxes collected by government have five important characteristics. They are *ease of administration*, *understandability*, *fairness*, *flexibility*, and *adequacy of revenue*.

### Ease of Administration

The tax should be easy to collect. Tax collection should not require a large enforcement staff, yet it should be difficult for citizens to avoid payment.

> Imagine that you are driving down the Florida Turnpike when you see a sign that says: "PAY TOLL AHEAD." As you approach the toll gate, you see another sign on which the State of Florida has listed the toll for your vehicle. You pay the toll collector, the automatic arm lifts, and you are on your way. This tax is *easy to collect* and *difficult to avoid paying*. A turnpike toll is an example of a tax that meets the *ease of administration* requirement for taxes.

### Understandability

Tax laws should be easy to comprehend by both taxpayers and tax collectors.

> Consider that I recently found a shirt I wanted to buy. I brought the shirt to the cashier, and he punched in the purchase price of $14.00 on his register. The register automatically calculated the shirt's selling price *plus the sales tax*. The total cost showed up on the sales slip as $14.98—the cost of the shirt plus a seven percent sales tax of $0.98. Both the clerk and I knew that sales tax is seven percent, and if either of us wished to, we could have easily checked the register's calculation. Neither of us needed to be tax lawyers to know that shirts—and many other goods and services—are taxable items. The sales tax on the purchase of the shirt is an example of a tax that meets the *understandability* requirement for taxes.

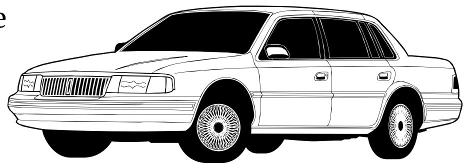
### Fairness

Tax laws should be imposed and enforced equally on each taxpayer.

A student who graduated from high school found a job paying $12,000 a year unloading trucks for a shipping company. The person has to pay $1800.00 a year in federal income taxes. The owner of the trucking company, on the other hand, earns $120,000 a year from his business. The owner pays $26,000 a year in federal income tax. The owner earns more than the worker and so is able to pay a *higher rate* of taxes. The federal income tax is an example of a tax that meets the *fairness* requirement for taxes.

### Flexibility

Tax laws should not have to be changed when economic conditions change.



If a person buys a $50,000 car, he or she will have to pay the federal **excise tax** on luxury cars. An *excise tax* is an additional tax the government collects on certain goods to either regulate or limit their sale or to raise additional revenue. If a year later the buyer's wages increase and she decides to buy a $70,000 luxury car, the government will collect more in excise tax. When the economy is growing, the excise tax revenue will increase; in bad times the amount of revenue collected decreases. Therefore, the federal excise tax meets the *flexibility* requirement for taxes.

### Adequacy of Revenue

The money collected through taxes should be enough to meet government needs.


When you buy gasoline from the gas station, some of the money goes to the federal, some to the state, and some to the local government to build and maintain our roads. While we would like better roads to be built, most citizens agree that we have a fine system of roads in the United States. The gasoline tax adequately provides for road building and maintenance. Therefore, this tax is an example of tax that meets the *adequacy of revenue* requirement for a fair tax.

## Three Types of Taxes: Progressive Taxes, Regressive Taxes, and Proportional Taxes

Almost all taxpayers are concerned about how much they pay in taxes. The best way for people to determine how much tax they pay is to figure their taxes as an effective tax rate. An *effective tax rate* is the percentage of a person's income he or she pays in taxes.

Let's look at the effective tax rate of Joanne Walters. Joanne made $10,000 last year and paid $1,000 in taxes. Therefore, her effective tax rate was 10 percent. You can figure this rate by dividing the tax she paid, $1,000, by the wages she earned, $10,000. (1,000 ÷ $10,000 = .1 or 10 percent)


Taxes are classified according to how the effective tax rates are adjusted in relation to a taxpayer's earnings. A tax is termed a **progressive tax** if the effective tax rate increases as a person's income increases. For example, a person who makes $10,000 a year may have an effective tax rate of 10 percent, whereas a person who makes $15,000 may have an effective tax rate of 15 percent. Income tax is an example of a progressive tax.

A tax is termed a **regressive tax** if the effective tax rate decreases as a person's income increases. Consider, for example, John and Wendy, both of whom use the same type and amount of gasoline each week. Each pays $300 a year in taxes on the gasoline they purchase. John makes $30,000 a year. He pays one percent of his income in taxes on gasoline. However, Wendy makes $300,000 a year. She pays only 0.1 percent of her income in taxes on gasoline. And if Wendy's income goes up, the percentage of her wages she will pay in taxes on gasoline will go down.

A tax is termed a **proportional tax** if the effective tax rate stays the same regardless of a person's income. In this case, a person making $10,000 a year and a person making $15,000 a year both would be taxed at an effective tax rate of 10 percent.

Remember, taxes are created to raise revenue or to limit or regulate the use of products and services. Taxes are used for schools, roads, police and fire protection, national defense, and other government functions. Look at the government office pages of the telephone book to get an idea of the variety of agencies supported by taxes at the federal, state, and local level.

## Case Study: Importance of Taxes

### Shay's Rebellion

In 1781 the United States adopted the Articles of Confederation as the basis for the new government. The Articles placed severe limits on the national government to prevent abuses of power such as they had experienced under the rule of Great Britain. The Articles placed greater emphasis on states' rights.

The Articles gave states the power to issue their own money and to impose taxes on themselves and other states with whom they traded. This led to many quarrels and disagreements as states levied higher and higher taxes on their own citizens and others to raise money.

In 1786 Daniel Shay, a veteran of the Revolutionary War and farmer from Massachusetts, was deep in debt and extremely angry about the high taxes in Massachusetts. Shay organized a protest along with 1,200 other poor, angry farmers against the Massachusetts government, which at the time was the most powerful economic state government in the United States.

Shay's Rebellion was eventually controlled by the Massachusetts militia but not before it caused panic throughout the nation. Every state had farmers who were in debt. Would the rebellion spread?

The national government could not issue money nor could they raise taxes. This left the country vulnerable or open to conflict both at home and from abroad. Because the national government had such severe limits placed upon it, it was unable to solve many of the country's problems. It became apparent to the leaders of the nation that a stronger national government was needed.

In May of 1787, delegates from all the states except Rhode Island met in Philadelphia to strengthen the Articles of Confederation. Within days, the Articles were thrown out, and the delegates decided to form a whole new government. After four months of debate and compromise, a flexible constitution was finally created which has stood the test of time and is still in place today. One of the most important powers the new constitution provided for was a system of taxation shared by both the national and state government.