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Major taxes for US governments

PAD 642

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Personal income tax

- $Adjusted\ Gross\ Income\ (AGI) - deductions\ = Taxable\ Income$
- $Taxable\ Income \times Tax\ rate = Tax\ Liability$
- $Tax\ Liability - \ Tax\ Credits = Final\ tax\ owed$
- Taxable income
  - Includes salaries, wages, dividends, interest, etc. (p. 125)
  - Exclude: pension contributions, food stamps, interests on government bonds, etc. (p. 125)
- Deductions:
  - Standard deduction
  - Itemized deduction: home mortgage interest, state and local taxes (cap at $10,000), charitable contributions, business expenses, etc. (p. 126)

Example 5-1, p. 127

- Read the example on p. 127: Computation of the Federal Income Tax in 2018
- Step 1: Adjusted Gross Income = Salaries ($150,000) + Interest ($20,000) = $170,000
- Step 2: Taxable income = AGI ($170,000) – Itemized deduction ($28,000) = $142,000
  - Itemized deduction include: $25,000 home mortgage interest + $2,000 state and local taxes + $1,000 charitable contribution.
  - Note: They can also use standard dedication INSTEAD of itemized deduction.
- Step 3: Tax liability = $19,050 * 10% + $58,350 * 12% + $64,600 * 22% = $23,119
  - Note: Tax brackets/rates change over time. (see the 2024 rates)
- Step 4: Tax paid = Tax liability ($23,119) – Tax credit ($1,600) = $21,519
  - Note: Tax credits reduce tax liability dollar-for-dollar.

Further discussions on personal income tax

- State income taxes: Many states also levy a personal income tax, often using a tax base similar to the federal income tax. A common concern is that residents may move to states with no income tax or lower income tax.
- Deductions and preferential treatment: Some high-income taxpayers may still pay relatively low effective tax rates due to exclusions and preferences (e.g., unrealized capital gains, charitable contributions).
- Alternative Minimum Tax (AMT): The AMT is intended to apply to high-income taxpayers, but there have been concerns that it has affected a broader group of taxpayers.
- Enforcement challenges: Enforcement is challenging because the income tax relies heavily on self-reporting. Some income—especially cash payments—may go unreported.
- Tax expenditures: Tax expenditures are revenues that could be collected, but are not, due to exclusions, deductions, exemptions, or credits in the tax code. Examples include exclusions for certain capital gains and deductions for contributions to pension plans.

Corporate Income Tax

- Tax base: Net corporate earnings
  - Gross receipts – expenses (capital losses, operating losses, depreciation, R&D expenditures, etc.)
- Federal tax rate: 21% (currently)
- State corporate income taxes: 44 states levy a corporate income tax; rates vary widely (e.g., about 11.5% in New Jersey vs. 2% in North Carolina). (Tax Foundation 2026)

Payroll tax

- Tax base: salaries and wages
- Federal payroll tax rates (FICA):
  - Social Security Tax Rate: 6.2% for employees and 6.2% for employers. (with a ceiling)
    - Funds Social Security benefits
  - Medicare Tax Rate: 1.45% for employees and 1.45% for employers.
    - Funds Medicare benefits

Property tax

- Property tax funds local services (cities, counties, school districts, towns, villages).
  - Local services benefit residents and can increase the value of property.
  - Signal of local preferences: the level of property tax ↔ the quality/quantity of local public services.
- Tax base: the assessed value of property, determined by a local assessor.
- Tax rate: local governments first determine how much revenue they need to raise (the levy), and then set a property tax rate that will raise that amount given the total assessed value.

Assessment of property value

- Assessment approaches:
  - Market value: sales price of similar properties where a market price can be observed. (family housing)
  - Income approach: future returns from ownership of properties. (Apartments, stores, offices, hotels, agricultural land, parking lots)
  - Cost approach: estimated value by adding the costs of improvements. (manufacturing facility, museums)
- Assessment cycles:
  - Mass cyclical assessment: assessment in a particular year
  - Segmental assessment: 1/3 in 3 years
  - Annual assessment: database with annually adjustments

Equity issue with property tax

- Equity issues:
  - Long-time residents
  - Higher-income taxpayers tend to hold a larger share of their wealth in assets not subject to property taxes.
  - Landlords may pass property taxes on to renters.
- Exemptions:
  - Organizations: Government property; religious, educational, charitable, and nonprofit
  - Individuals: Homestead exemption; veteran and senior exemptions
- Circuit Breakers: property tax assistance based on individual income levels
- Deferrals: Individuals (elderly, disabled, limited-income, farm owners) whose property values have risen dramatically may be permitted to pay taxes based on prior values.

Tax limitations

- Overall property tax limitation: limits the maximum annual percentage increase.
- Specific property tax limitation: limits property tax use for education or certain services.
- Property tax levy limit: limits how much total property tax can be collected (not just the rate)
- General revenue or expenditure increase limit: limits annual revenues or expenditures.
- Property tax assessment increase limit: limits increases in assessed value.

- Are tax limits effective?
  - Possible consequences: greater reliance on non–general-revenue sources, alternative finance measures (user charges), reduced service levels

Sales tax

- Two types:
  - General sales tax: applied to general retail sales (percentage of price)
  - Specific sales tax (excise tax): applied to specific goods (tax per unit), e.g., luxury goods; liquor; cigarettes; gasoline
- General fund or earmarked
  - General fund: general sales taxes are collected for the general purposes of government
  - Earmarked: excise taxes often are spent on specific purpose (e.g. gasoline taxes for transportation expenditures)

Equity issue

- Regressive: lower-income households spend a larger share of their income on taxable goods; higher-income households can spend more on items not subject to sales tax, such as home purchases and improvements, private school tuition, professional services, etc.
- Exemptions:
  - Groceries for at-home consumption
  - Prescription drugs
  - Clothing (often exempt up to a dollar threshold)

More discussion about general sales tax

- Sales tax on services
  - Many services are not taxed (e.g., medical services, legal services, personal services such as haircuts, laundry, accounting)
  - Some services are taxed, especially those tied to taxable goods, such as:
    - Leases/rentals of tangible personal property (e.g., vehicles, equipment)
    - Repair, installation, and maintenance of tangible personal property
    - Some utility services (varies by state)
  - Trend: consumer spending is shifting toward more services and fewer goods, which can narrow the sales tax base
- Sales tax holidays (in some states)
  - Examples: back-to-school purchases; disaster preparedness supplies

More discussion with excise tax

- Luxury excises: products uniquely or predominantly consumed by higher-income households.
  - Examples: jewelry, yachts, expensive vehicles, private aircraft
- "Sin" excises: products that are unhealthy or unsafe.
  - Examples: alcohol, tobacco, and marijuana
  - Problems: limited behavioral impact; regressivity; greater burden on lower-priced brands
- Benefit-based excises: taxes paid by users to help fund related public services
  - Examples: Fuel taxes to fund highways, bridges, and public transportation; taxes/fees on airline tickets to support airports and airport security

Other revenues

- User charges: charges and fees for services
  - Examples: museum admissions; school fees; parking fees; sewer, water, or trash collection fees; bus/subway fares; tolls
  - Rationale: link payment to use; manage demand; recover costs
  - Privatization: some services can be contracted out or provided by private/third-party operators
- Lotteries, casinos, and other gambling
  - Revenues can be volatile
  - Regressivity concerns
  - High administrative costs: prizes, advertising, operational costs