TaxEDU

Education. Discussion. Understanding.

# Taxes: The Price We Pay for Government

## What You'll Learn

1. Learn about the different tax types governments rely on to fund priorities like infrastructure, national defense, and social insurance programs and the share of total revenue each tax type generates.

2. See how the U.S. federal government raises revenue, as well as state and local governments, and compare taxes in the U.S. to those around the world.

3. Learn about the central role businesses play in the tax collection process.

TAX FOUNDATION

# Introduction

Have you ever wondered where the money comes from to build roads, maintain a national defense, or pay for programs like Social Security? Taxes.

Businesses, like your local convenience store, cover the cost of expenses like employee salaries and rent from the profits generated by selling products. Governments don't sell products and don't have profits so the only way they can cover the cost of their services is by asking us to pay taxes on the money we earn, the things we buy, and the property we own.

Different states and countries rely on different combinations of taxes to pay for government services depending on their unique economic situations and policy goals. Some principles, however, are true across the board.

A good rule of thumb is that the most efficient way to raise revenue is by placing a low tax on a broad, stable **tax base**. In other words, taxes should apply to a wide range of economic activity with few exceptions.

However, different types of taxes impact people, businesses, and the economy differently. As we'll see below, most economists also agree that taxes on income create more economic harm than taxes on consumption and property.

# Sources of Government Revenue in the United States

## How Much Tax Revenue is Raised in the U.S.?

The U.S. federal government collected $3.33 trillion in total tax revenue in 2018. Meanwhile, state governments collected a total of $1.04 trillion and local governments collected $0.44 trillion. Altogether, that means $4.81 trillion in tax revenues was collected in the U.S in 2018.

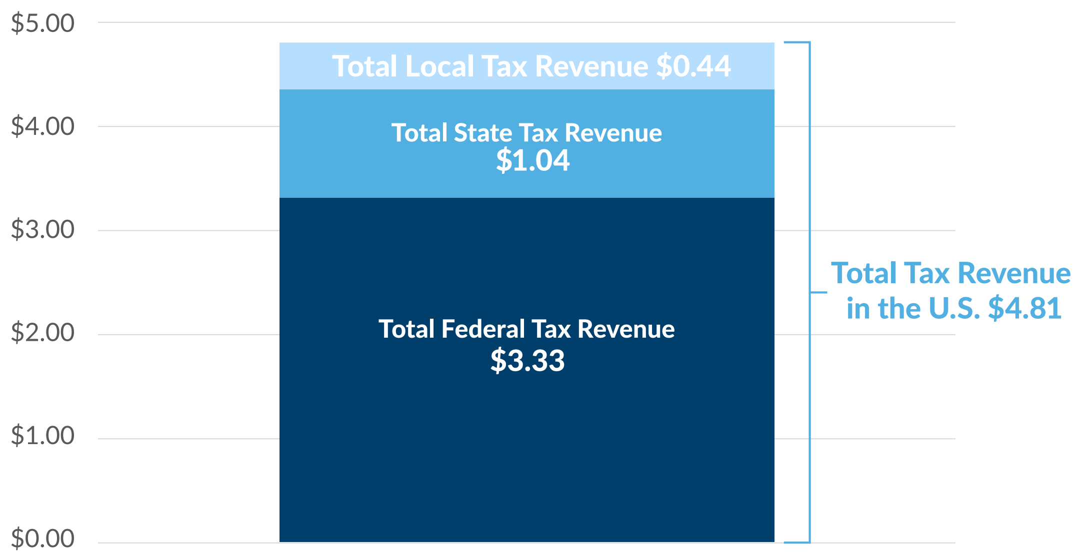
How *much* revenue governments raise is important, but it's also crucial to ask *how* they do so.

As you'll see below, the federal government raises revenue differently than the states, and state and local governments all raise revenue differently as well.

You might ask why it's all so complicated—can't every level of government just raise revenue the same way? But remember: no two governments are the same. They all have different economies, different constituents, and different priorities, so it makes sense that their taxes are different too.

**How Much Tax Revenue Is Raised in the United States?**

*U.S. Federal, State, and Local Tax Revenue, 2018 (Trillions of Dollars)*



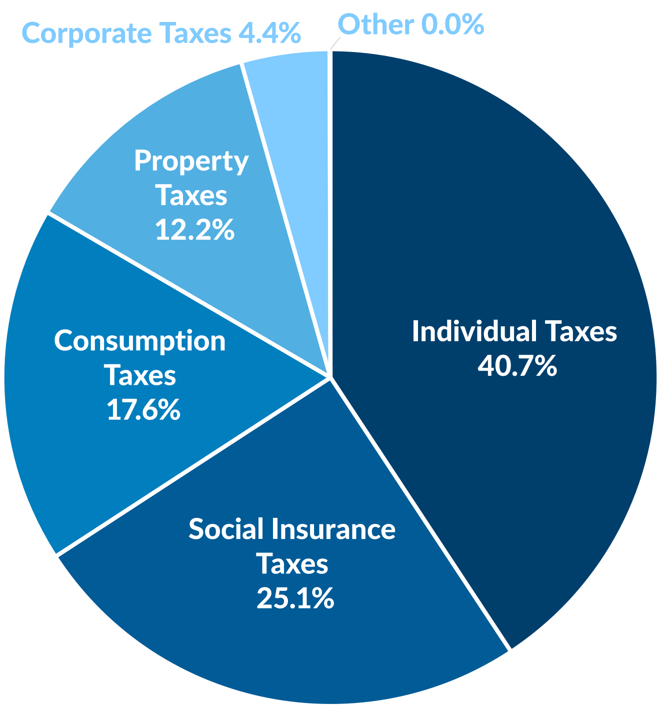

Sources: U.S. Census Bureau, Quarterly Summary of State & Local Taxes; U.S. Office of Management and Budget, Historical Tables of the Budget of the U.S. Government.

## Federal Revenue

In the United States, individual income taxes are the primary source of tax revenue when looking at all local, state, and federal tax collections combined.

Social insurance taxes like **payroll taxes** make up the second-largest share of revenue, followed by consumption taxes, **property taxes**, and **corporate income taxes**.

### Sources of Tax Revenue in the United States, 2018




Source: "OECD Global Revenue Statistics Database," https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL.

## State and Local Tax Revenue

The exact mix of taxes used to raise revenue among U.S. states and localities varies greatly, though the majority of revenue comes from four primary sources: property taxes, sales taxes, individual income taxes, and corporate income taxes.

Other taxes used to raise state and local revenue include **excise taxes**, such as those on alcohol, tobacco, or motor fuel; **estate taxes**; and severance taxes, which are imposed on the extraction of non-renewable natural resources, such as crude oil.

As you can see in the table below, some states forgo major tax types, such as Florida, which collects no individual income tax, or New Hampshire, which collects no sales tax.

Given the proximity of states, the decision whether to impose certain taxes and the level at which those taxes are imposed can have significant effects on where businesses and individuals choose to locate.

## Sources of State & Local Tax Collections, Percentage of Total from Each Source, Fiscal Year 2017

| State | Property | General Sales | Individual Income | Corporate Income | Other Taxes (a) |
|---|---|---|---|---|---|
| Alabama | 17.3% | 30.8% | 22.8% | 3.2% | 25.9% |
| Alaska | 51.8% | 7.7% | -- | 2.9% | 37.6% |
| Arizona | 31.7% | 39.5% | 14.1% | 1.5% | 13.3% |
| Arkansas | 18.5% | 37.8% | 23.0% | 3.3% | 17.4% |
| California | 26.0% | 20.2% | 34.6% | 4.2% | 15.0% |
| Colorado | 31.6% | 27.4% | 24.8% | 1.9% | 14.3% |
| Connecticut | 39.5% | 15.5% | 29.2% | 3.3% | 12.5% |
| Delaware | 18.9% | -- | 26.5% | 5.4% | 49.2% |
| Florida | 36.4% | 36.2% | -- | 3.1% | 24.2% |
| Georgia | 31.0% | 23.9% | 28.2% | 2.5% | 14.4% |
| Hawaii | 18.6% | 36.6% | 22.2% | 2.0% | 20.7% |
| Idaho | 27.4% | 25.9% | 26.0% | 3.4% | 17.2% |
| Illinois | 38.8% | 19.6% | 18.0% | 3.9% | 19.7% |
| Indiana | 26.7% | 29.1% | 23.4% | 4.0% | 16.8% |
| Iowa | 32.7% | 22.6% | 24.0% | 2.8% | 18.0% |
| Kansas | 33.4% | 31.8% | 17.2% | 2.9% | 14.7% |
| Kentucky | 21.3% | 20.1% | 33.7% | 3.7% | 21.1% |
| Louisiana | 20.8% | 42.8% | 14.6% | 1.4% | 20.4% |
| Maine | 40.3% | 20.4% | 21.7% | 2.5% | 15.1% |
| Maryland | 25.8% | 12.1% | 37.9% | 2.6% | 21.5% |
| Massachusetts | 37.1% | 13.9% | 32.7% | 4.9% | 11.5% |
| Michigan | 33.8% | 22.1% | 24.0% | 2.9% | 17.3% |
| Minnesota | 25.9% | 17.8% | 31.9% | 3.6% | 20.9% |
| Mississippi | 27.7% | 32.1% | 16.7% | 3.7% | 19.9% |
| Missouri | 27.2% | 27.4% | 28.1% | 1.6% | 15.6% |
| Montana | 40.4% | -- | 28.8% | 3.1% | 27.7% |
| Nebraska | 38.2% | 22.8% | 22.7% | 2.7% | 13.6% |
| Nevada | 22.5% | 41.1% | -- | -- | 36.4% |
| New Hampshire | 67.6% | -- | 1.0% | 8.7% | 22.8% |
| New Jersey | 46.9% | 15.5% | 22.5% | 3.4% | 11.7% |
| New Mexico | 19.2% | 39.0% | 15.5% | 1.1% | 25.2% |
| New York | 32.0% | 17.1% | 31.7% | 6.0% | 13.2% |
| North Carolina | 24.6% | 25.9% | 29.7% | 1.9% | 17.9% |
| North Dakota | 24.8% | 22.1% | 6.3% | 1.2% | 45.5% |
| Ohio | 28.1% | 28.6% | 25.8% | 0.4% | 17.2% |
| Oklahoma | 20.6% | 33.5% | 22.4% | 1.1% | 22.4% |
| Oregon | 31.4% | -- | 42.7% | 3.7% | 22.2% |
| Pennsylvania | 29.6% | 17.3% | 25.9% | 4.3% | 22.9% |
| Rhode Island | 43.3% | 17.0% | 21.1% | 2.2% | 16.5% |
| South Carolina | 34.1% | 21.6% | 23.4% | 2.1% | 18.8% |
| South Dakota | 38.0% | 38.7% | -- | 0.8% | 22.5% |
| Tennessee | 25.7% | 40.9% | 1.1% | 7.6% | 24.7% |
| Texas | 45.0% | 34.3% | -- | -- | 20.7% |
| Utah | 25.5% | 26.4% | 28.7% | 2.6% | 16.8% |
| Vermont | 44.2% | 10.4% | 19.7% | 2.2% | 23.6% |
| Virginia | 34.4% | 13.4% | 32.1% | 2.0% | 18.0% |
| Washington | 28.0% | 46.4% | -- | -- | 25.6% |
| West Virginia | 24.0% | 19.2% | 25.2% | 1.6% | 30.0% |
| Wisconsin | 33.8% | 19.8% | 27.5% | 3.4% | 15.5% |
| Wyoming | 44.5% | 23.8% | -- | -- | 31.8% |
| District of Columbia | 32.6% | 18.4% | 26.3% | 7.4% | 15.3% |

(a) "Other Taxes" include excise taxes (such as those on alcohol, tobacco, motor vehicles, utilities, and licenses), severance taxes, stock transfer taxes, estate and gift taxes, and other miscellaneous taxes.
Note: Percentages may not add to 100 due to rounding.
Sources: U.S. Census Bureau, "Annual Survey of State and Local Government Finances"; Tax Foundation calculations.

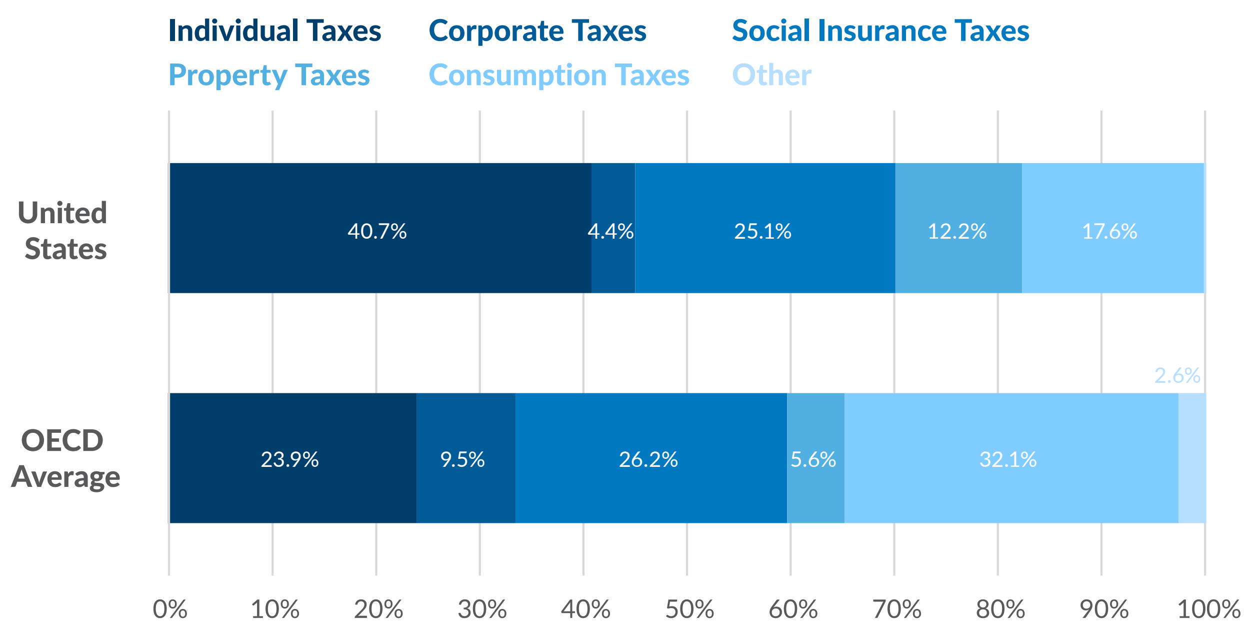
# How Does the U.S. Compare to the Rest of the World?

In many ways, the United States is unique in the way it raises revenue. One important difference is that it relies significantly more on **individual income taxes** compared to other countries in the Organisation for Economic Co-operation and Development (OECD), a group of 36 countries with advanced economies.

The United States also relies much less on consumption taxes. This is because all OECD countries except the United States levy a **value-added tax (VAT)** at a relatively high rate. State and local **sales tax** rates in the United States are low by comparison.

In fact, OECD countries raise about one-third of their total tax revenue with consumption taxes such as the VAT, making consumption taxes the largest revenue source on average.

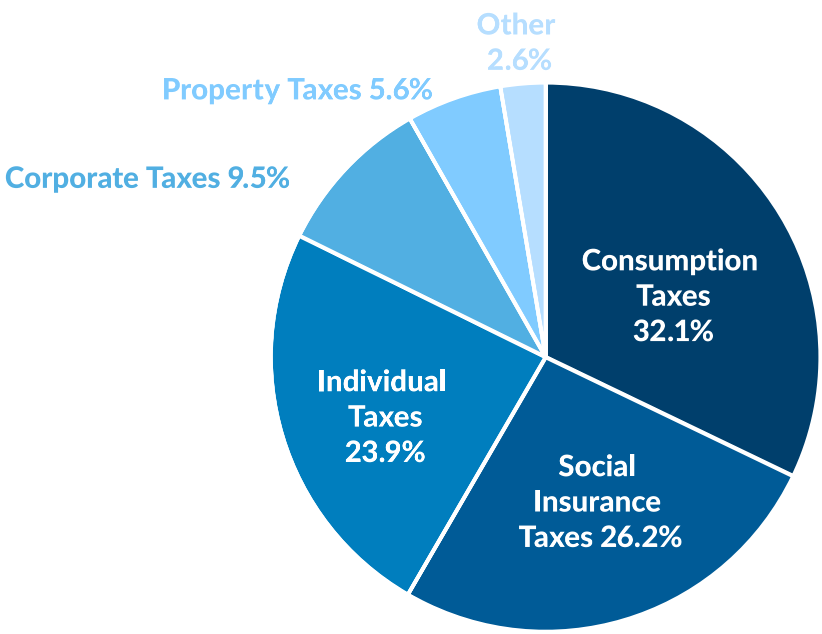
## Sources of Tax Revenue in the United States Compared to the OECD Average, 2018




Source: "OECD Global Revenue Statistics Database," https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL.

Social insurance taxes followed by individual income taxes are the second and third most important sources of tax revenue in the OECD. Countries collect very little from corporate income taxes and property taxes on average.

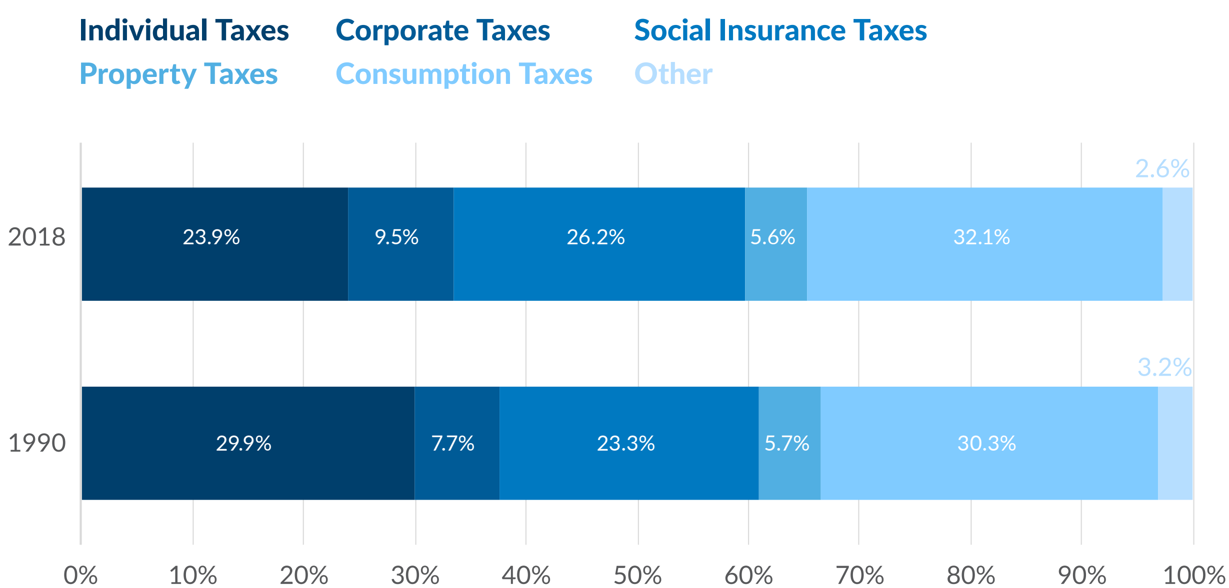
## OECD Average Sources of Tax Revenue, 2018




Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL

Since 1990, there has been a noticeable shift among OECD countries away from individual income taxes and towards social insurance and consumption taxes. Revenue from corporate income taxes has also increased slightly.

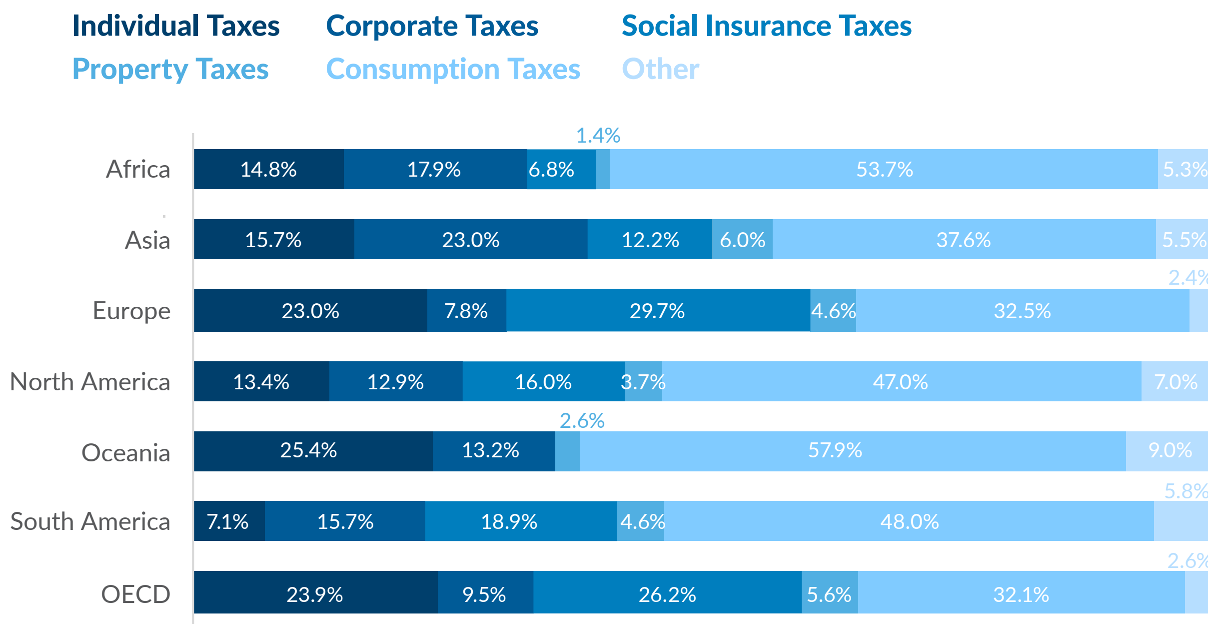
## OECD Tax Revenue Sources, 2018 and 1990




Note: The OECD included 24 countries in 1990 and 36 countries in 2018. Therefore, the average revenue sources in 2018 are based on more countries than the average sources in 1990.
Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL

When looking at sources of tax revenue by region, including non-OECD countries, there is great variation reflective of economic and social differences across regions.

## Sources of Tax Revenue by Region or Group, 2018




Data for Australia, Japan, Mexico and non-OECD countries is from 2017 because 2018 data was not available yet.Note: Below the list of countries covered by region. Africa: Botswana, Burkina Faso, Cameroon, Cabo Verde, Congo, Democratic Republic of the Congo, Côte d'Ivoire, Egypt, Equatorial Guinea, Ghana, Kenya, Madagascar, Mali, Mauritania, Mauritius, Morocco, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Eswatini, Togo, Tunisia and Uganda; Asia: Israel, Japan, Korea, Indonesia, Kazakhstan, Malaysia, Philippines, Singapore, and Thailand; Europe: Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, and United Kingdom. North America: Canada, Mexico, United States, Bahamas, Barbados, Belize, Costa Rica, Cuba, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Nicaragua, Panama and Trinidad and Tobago;Oceania: Australia, New Zealand, Cook Islands, Fiji, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Vanuatu;South America: Chile, Argentina, Bolivia, Brazil, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and Venezuela
Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL

# Businesses: Government's Biggest Tax Collector

When people think about paying their taxes, they likely think of the Internal Revenue Service (IRS). But the days of the tax collector going door-to-door to fill the government coffers are long gone. In fact, the primary collectors of taxes, and certainly payers of taxes, are businesses.

Businesses are absolutely essential to the tax *collection* process. You would literally need millions of federal, state, and local tax agents to do what businesses do for governments every day.

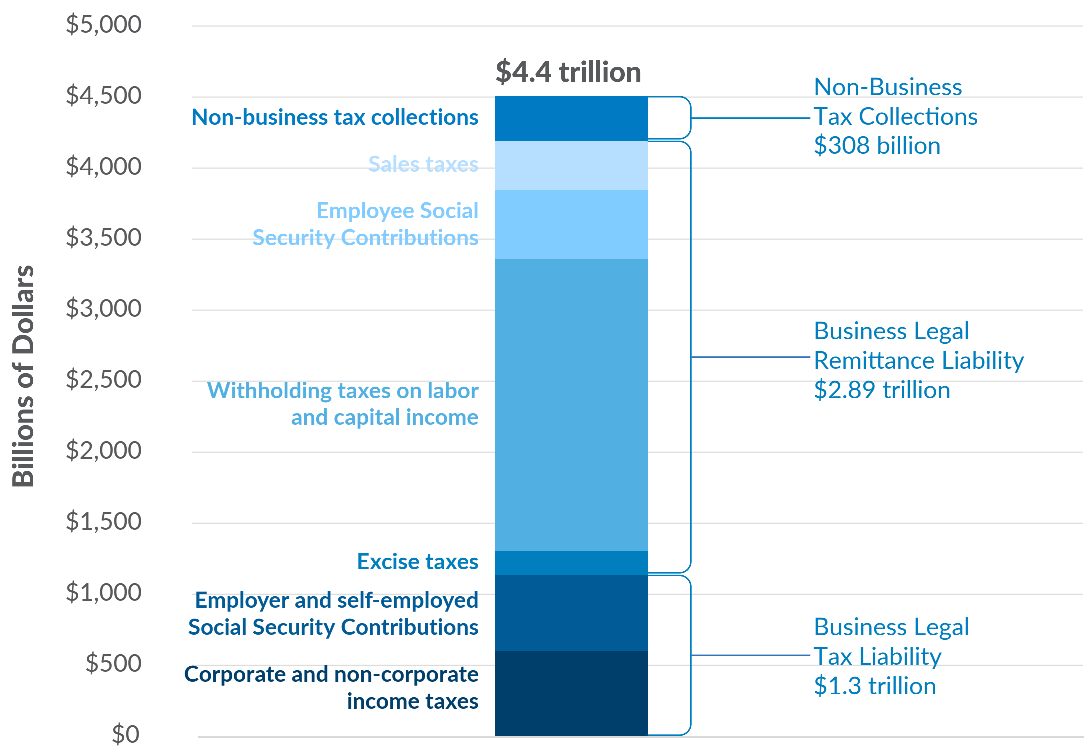
In addition to the numerous taxes they *pay*—such as income taxes and property taxes—businesses *collect* taxes for the government in three main ways:

- Withholding taxes on labor and capital income—this is what comes out of your paycheck if you're a salaried employee
- Remitting the *employee*-share of social insurance taxes—what you contribute to fund safety-net programs like Social Security in the United Sates
- Sales and value-added taxes (VATs)—the taxes you see on a receipt after purchasing a good or service

The U.S. is one of the most "business dependent" tax systems in the industrialized world. In 2014, U.S. businesses paid about 29 percent of all taxes collected in the country and remitted another 64 percent—adding up to 93 percent of all taxes collected in America that year.

**Businesses Are Central to U.S. Tax Collections**

*Total Federal, State, Local Tax Collections in 2014 (Billions of Dollars)*




Source: Milanez, OECD 2017

# Glossary

### Corporate Income Tax
A corporate income tax (CIT) is levied by federal and state governments on business profits. Many companies are not subject to the CIT because they are taxed as pass-through businesses, with income reportable under the individual income tax.

### Estate Taxes
Estate taxes are imposed on the net value of an individual's taxable estate, after any exclusions or credits, at the time of death. They are paid by the estate itself before assets are distributed to heirs.

### Excise Taxes
Excise taxes are taxes imposed on a specific good or activity. They are commonly levied on cigarettes, alcoholic beverages, soda, gasoline, insurance premiums, amusement activities, and betting, and make up a relatively small and volatile portion of state and local tax collections.

### Individual Income Tax
An individual income tax (or personal income tax) is levied on the wages, salaries, investments, or other forms of income an individual or household earns. The U.S. imposes a progressive income tax where rates increase with income. Individual income taxes are the largest source of tax revenue in the U.S.

### Payroll Taxes
Payroll taxes are taxes paid on the wages and salaries of employees to finance social insurance programs like Social Security, Medicare, and unemployment insurance. These social insurance taxes comprise 23.05 percent of combined federal, state, and local government revenue, the second largest source of that combined tax revenue.

### Property Taxes
Property taxes are primarily levied on immovable property like land and buildings, as well as on tangible personal property that is movable, like vehicles and equipment. Property taxes are the single largest source of state and local revenue in the U.S. and help fund schools, roads, police, and other services.

### Sales Tax
Sales taxes are levied on retail sales of goods and services and, ideally, should apply to all final consumption with few exemptions. Many governments exempt goods like groceries; base broadening, such as including groceries, could keep rates lower. Sales taxes should exempt business-to-business transactions which, when taxed, cause tax pyramiding.

### Tax Base
The tax base is the total amount of income, property, assets, consumption, transactions, or other economic activity subject to taxation by a tax authority. A narrow tax base is non-neutral and inefficient. A broad tax base reduces tax administration costs and allows more revenue to be raised at lower rates.

## Value-added Tax (VAT)

A Value-Added Tax (VAT) is a consumption tax assessed on the value added in each production stage of a good or service. Every business along the value chain receives a tax credit for the VAT already paid. The end consumer does not, making it a tax on final consumption.