Tax Basics Lesson Plan Supplemental

What Is a Tax?

A tax is a mandatory payment or charge collected by local, state, and national governments from individuals or businesses to cover the costs of general government services, goods, and activities. Taxes are a direct link between a citizen and their government.

What Is the Purpose of a Tax?

The main purpose of taxes is to generate revenue. Taxes allow for projects and services that most people benefit from frequently: roads and infrastructure, emergency services, education, and national defense, just to name a few.

A Brief History of Taxation

Taxes have been around since early civilization. About 5,000 years ago, the first record of taxation occurred in ancient Egypt, where the Pharaoh collected a tax equivalent to 20 percent of all grain harvests. At the time, Egypt was without coined money, so grain represented a tangible store of value that could easily be collected, traded, and redistributed throughout society.

American colonies levied property taxes, excise taxes, poll taxes, and some early forms of income taxes, though tax rates and burdens were far less than their counterparts in Great Britain. Later, the issue of "taxation without representation" played a large role in the development of the American legislative system and is seen in Article I, Section 2 of the U.S. Constitution, which granted the elected representatives in Congress the exclusive power to impose taxes on all citizens.

What Is Taxed?

Generally, there are three types of taxes: taxes on what you earn, what you buy and what you own.

> **Tax base:** the total amount of income, property, assets, consumption, transactions, or other economic activity subject to taxation by a tax authority.
>
> **Tax rate:** the fraction of the base that is collected by taxation.

The more activity subject to taxation (a broader base), the lower the tax rate can be while raising the same amount of revenue.

> *Example: taxing 100 people at 1% and taxing 10 people 10% both raise $100 of revenue.*

Who Pays Taxes and How?

The simple answer is that everyone pays taxes. The reality of who pays how much is more complicated.

The amount of taxes an individual pays is highly dependent on where they live, how much they earn, what they buy, and what they own, among other factors.

Common Taxes

Individual income tax: the largest source of tax revenue in the U.S, his is a tax on the wages, salaries, investments, or other forms of income an individual or household earns. When you hear about people "filing taxes" or "tax refunds"," they are referring to individual income tax.

- The U.S. didn't always have an income tax. It was formally established by the federal government in 1913 when the 16th amendment was ratified, allowing for federal taxes on both business and individual income. It was later expanded during the World Wars to boost the national budget.
- The U.S. has a progressive income tax system, which means that tax rates increase as income increases. The range of income that is subject to a certain tax rate is called a tax bracket. The U.S. currently has seven tax brackets, ranging from rates of 10 to 37 percent.
- Most states also have an individual income tax with varying rates.

Sales tax: a tax on retail goods and services. The U.S. does not have a national sales tax, but 45 states and Washington, D.C. levy one. Sales taxes are also sometimes levied at the local level.

- Sales taxes are a good example to look at when discussing a tax bas. For example, many state sales taxes don't include groceries, resulting in a narrower amount of economic activity being taxed. If a state allowed groceries to be taxed at the sales tax rate, they could lower the tax rate to raise the same amount of revenue.

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

- Many excise taxes are imposed to minimize negative externalities, or societal costs associated with certain consumption and activities.

Property tax: a tax that is 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.

- Property tax rates vary greatly among states and localities and tend to be what taxpayers focus most on, but the property tax base—what is and isn't taxable—can also have a significant impact on business investment and location decisions.