Types of Taxes

". .. but in this world nothing can be said to be certain, except death and taxes."
Benjamin Franklin, November 13, 1789.

The kinds of taxes that a government (federal, state, city or other local entity) collects depend upon its purpose for taxing.

What are the purposes of taxation?

1. **Revenue –** taxes are used to provide the government with sufficient income to pay for its programs and services
2. **Regulation –** taxes are used to regulate and stabilize the economy. A tax cut might increase business activity because people would have more money to spend on consumer products
3. **Income Distribution –** taxes are used to reduce the income gap between the rich and the poor. To achieve this purpose, the rich would have to be taxed at a higher rate than the poor.
4. **Incentive for positive behavior –** taxation encourages people to act in economically useful ways. Example, a home owner could be encouraged to install solar panels to conserve energy for which they receive a tax break.
5. **Restraint on negative behavior –** taxes are used to discourage people from acting in certain ways. Example, smokers might be discouraged from buying tobacco products due to a high rate of tax.

<u>Taxation falls into two specific categories, Regressive or Progressive.</u>

Regressive Taxation: This is when a tax takes a proportionately larger share of income from the poor than from the rich.

Progressive Taxation: This is when a tax takes a proportionately larger share of income from the rich than from the poor.

Five Major Types of Taxes

Type of Tax	Tax Category	Description
SALES TAX	**REGRESSIVE**	**A tax paid by consumers on their purchases of goods and services. It is a certain percentage of its selling price. Merchants collect the sales tax from customers and then pay the tax to the government. It can be federal, state, city or local in assessment.**
PROGRESSIVE INCOME TAX	**PROGRESSIVE**	**This tax is on personal income that varies according to how much a person earns. Periodically, people report their earnings from employment and other sources to tax officials. [Tax Day is April 15th]. The percentage of their incomes that must be paid in taxes is proportionally higher for high incomes, lower for low incomes.**
PROPORTIONAL INCOME TAX	**REGRESSIVE**	**This is also known as a "FLAT TAX" because unlike Progressive Income Tax, the tax rate remains constant for all taxpayers, regardless of the different levels of income.**
PROPERTY TAX	**REGRESSIVE**	**This tax is based on the money value of different kinds of property. Taxes could be collected on real property (land and buildings) and on personal property (stocks and bonds) Within this type are important items such as school and library taxes.**
USER FEE TAX	**REGRESSIVE**	**This is a tax paid by the users of a particular government service such as highway and bridge tolls. The money is used to help maintain and repair state highways.**
VALUE ADDED TAX (V.A.T.)	**REGRESSIVE**	**This type of taxation is not used in the United States but is common in many other countries. It is a tax paid by businesses for the purchase of raw materials and other unfinished products. Whereas a sales tax is paid only by the last person to buy a product, a V.A.T. is paid at each level of production and distribution.**

What Are the Standard Payroll Deductions?

The standard payroll deductions are those that are required by law. They include federal income tax, Social Security, Medicare, state income tax, and court-ordered garnishments. Some cities, counties or school districts also levy a local income tax. An employer is obligated to withhold the required amounts from employees' paychecks and submit them in the required manner. There may also be voluntary payroll deductions for things such as insurance, retirement plans, or flexible spending accounts, depending on what the employer offers. **Withholding** is a term used for federal income tax, state income tax and FICA (Social Security and Medicare).

Federal Income Tax

Federal income tax is calculated on the employee's total pay. Use a Form W-4, Employee's Withholding Allowance Certificate, to acquire the employee's filing status and number of exemptions. Use this information and the withholding tables in IRS Publication 15 Employer's Tax Guide to determine the amount of federal income tax to withhold.

Social Security and Medicare Tax

Social Security and Medicare taxes are mandated by the Federal Insurance Contributions Act. As such, they are sometimes collectively called FICA taxes. FICA funds programs for retirees, children and disabled individuals. Today's workforce pays for current recipients' benefits, with the understanding that the next generation will do the same for them. The employer withholds 6.2 percent for Social Security and 1.45 percent for Medicare, and then matches those payments and submits them to the government.

State and Local Income Tax

All but seven states in the U.S. withhold state income tax, with rates varying from around 3 percent in North Dakota to a little over 13 percent in California. The states that do not have a state income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Consult your state's Department of Revenue for specifics and to check whether there are local income taxes levied in your area.

Court-Ordered Garnishments

An employer might receive a court order to start withholding funds from an employee's paycheck to satisfy a debt owed. The debt might be for child support, federal or state taxes, or other debts. The employer is required to begin garnishment by a particular date shown in the order or face penalties. There are limitations on the amount that can be garnished from each paycheck, as a matter of federal law.

Voluntary Deductions

While income taxes, FICA and garnishments are the standard deductions from an employee's paycheck, there can be many others. Often, health insurance, life insurance, retirement plans and flexible spending accounts are offered as fringe benefits for employees. The amounts that the employee pays are deducted from their paychecks. These voluntary deductions vary from business to business.

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