

Topic**Key Points****Taxes****Define the term *tax*.**

Legally mandated payment to the government that is not made in exchange for a good or service

Examples: income tax, sales tax, property tax, excise tax

Taxes are used to fund projects that benefit society

Define the term *income tax*.

Tax that is based on the amount of money a person earns or receives

Define the term *sales tax*.

Tax placed on the retail sale of almost all goods purchased

Certain types of goods (i.e., food, medicine) are sometimes excluded from sales tax

Define the term *excise tax*.

Tax placed on a specific good

Excise taxes can be used to discourage consumption of a product or to raise some easy money on products that the government knows people will continue to purchase, regardless of the tax

Example: gasoline tax, cigarette tax, beer and liquor tax

Define the term *property tax*.

Tax placed on real estate, and in some cases, on personal possessions (e.g., boats, vehicles, etc.)

Define the term *revenue*.

Income

Explain the importance of taxes in a market economy.

- Taxes are the primary source of revenue for the government sector.
- In a market economy, some services such as national defense, roads, and education can be more efficiently produced by the government instead of private individuals.
- In addition, the government is responsible for creating the infrastructure necessary for commerce. The banking system, national defense, and the transportation system are all part of this infrastructure.
- If taxes did not exist, then these services would likely not exist either.

Define the term *expenditure*.

Money paid out; spending

The term "government expenditures" is often used to refer to spending by the government sector

Discuss sources of tax monies paid to different levels of government, along with ways that these tax monies are used.

Federal Government:

- Sources of Tax Monies: Income taxes, Excise taxes
- Expenditures: National defense, Education, Transportation systems, Judicial system, Social Security and Medicare, Medicaid, Veterans services, etc.

State Governments:

- Sources of Tax Monies: Income taxes, Sales taxes, Excise taxes
- Expenditures: State police protection, Education, Operation of state government, etc.

Local Governments:

- Sources of Tax Monies: Property taxes, Sales taxes, Income taxes
- Expenditures: Education, Public health and safety (local fire and police protection), Sanitation, etc.

Explain how certain government expenditures are financed through specific taxes.

- Roads, highways, and bridges are financed through the gasoline excise tax. Only those people who purchase gasoline—those who use the transportation system—pay the gasoline tax.
- The Social Security system, which provides income to retired workers, receives its monies from retirement taxes.

Discuss the duties of the Internal Revenue Service.

- To collect federal income taxes
- To enforce federal revenue law
- To help taxpayers with tax law
- To pursue taxpayers who are not in compliance with tax law

Describe types of tax structures.

- **Proportional:** A tax structure in which everyone pays the same percentage of income in taxes, regardless of income level. (Few taxes are completely proportional in nature.)
- **Progressive:** A tax structure in which those who earn more pay a higher percentage of income in taxes. In other words, as the income increases, the tax rate increases. The Federal income tax is a progressive tax.
- **Regressive:** A tax structure in which those who earn more income pay a lower percentage of income in taxes. As income increases, the tax rate decreases. Sales and excise taxes are considered to be regressive taxes, because those people with lower incomes ultimately pay a larger percentage of their income in sales and excise taxes.

Explain the impact of taxation on the circular flow of income model.

- The circular flow model illustrates the constant movement of production inputs, goods, services, and money in the economy. For a good introduction on a simple circular flow of income model, have the students watch the flash movie/tutorial *The circular flow of income model* by Manfred Gartner at <http://www.fgn.unisg.ch/eurmacro/tutor/circularflow.html> (Do **NOT** continue on to the interactive Java applet—it goes into much more detail than is required for this lesson.)
- After this short introduction to the circular flow model, consider the role of the government—specifically, taxes—in the economy. How does the government fit into the circular flow of income model?
- The government sector can be added to the center of the circular flow model, and taxes are the flow between the household sector and the government sector. The government insists that households divert some monies away from consumption and spending to go toward the government. Direct your students to the AmosWEB website *Taxes* at http://www.amosweb.com/cgi-bin/awb_nav.pl?s=wpd&c=dsp&k=taxes for a good illustration of the circular flow model including the government sector and taxes.

Based on:

AmosWEB. (2000-2009). *Taxes*. Retrieved October 27, 2009, from http://www.amosweb.com/cgi-bin/awb_nav.pl?s=wpd&c=dsp&k=taxes