

WHAT IS A FAIR TAX?

PART 1: THE CRITERIA

Read over the four criteria for a fair tax below, and then answer the questions on the next page.

1. Ability to Pay

A fair tax should equally tax individuals with equal ability to pay. People with different amounts of wealth or income should pay different amounts of taxes.

- ☞ A proportional tax (sometimes called a flat tax) takes the same percentage of income of wealth from all taxpayers.
- ☞ A progressive tax means that those with higher incomes or those who are wealthier pay a higher proportion of their income in taxes.
- ☞ A regressive tax means that poor people pay a higher proportion of their income in taxes than those with higher income or those who are wealthier.
- ☞ Income tax policy in the United States has generally reflected the idea that a progressive tax is fair. However, interest in proportional taxes is commonly expressed.

2. Efficiency

A fair tax should not inhibit productive activities. It should not discourage people from working or investing in new businesses. It should not encourage individuals to be wasteful in buying goods because of their tax benefits rather than their value. A fair tax should not favor less productive businesses over more productive ones.

3. Simplicity

A fair tax should be simple. One frequent complaint about the federal income tax, often voiced around April 15, when taxes are due, is that the system is very complex, with forms that require many hours to complete. Increased complexity encourages people to make mistakes, promotes cheating, and builds resentment. Another example comes from residential property taxes. To figure a property tax, a government official must decide the value of a person's home. Formulas for assessing values vary widely, and the assessed values mayor may not reflect the market values. This system can be very confusing to taxpayers.

4. Benefits received

A fair tax should tax individuals according to the benefits they receive from government services. Those who receive numerous benefits should pay more than those who receive few. For example, in some states, revenues generated from gasoline taxes are used to maintain and improve roads. Therefore, people who drive more pay more tax to support roads.

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PART 2: APPLYING THE CRITERIA

Mark a plus or minus sign under each criterion to indicate whether the tax in question meets the criterion. IF IT DOES NOT, BRIEFLY EXPLAIN WHY.

Tax/Fee	Criteria			
	Ability to Pay	Efficiency	Simplicity	Benefits Received
Driver's license fee (a fixed amount for each driver)				
Personal income tax (a % of wages and salaries up to a limit)				
Social Security tax (a % of wages and salaries up to a limit)				
Sales tax (a % of the pre-tax retail price of covered goods or services)				
Property tax (a % of the property's value)				

TAXES AS INCENTIVES?

THE NATIONAL COMMISSION OF TAXATION MAKES ITS ANNUAL FORECASTS

WELCOME TO THE NCT

You have just been appointed by the President of the United States to the National Commission of Taxation (NCT). The purpose of the NCT is to forecast how changes in tax laws might change individual behavior. Every year, the NCT presents its forecasts to members of Congress and to the President for their consideration. And, every year, people are amazed at how well the NCT is able to predict changes in people's behavior.

BACKGROUND FOR NCT MEMBERS

There is a simple rule that guides the work of NCT members. They understand that taxes act as incentives. Changing the types of taxes levied and tax levels can influence people's behavior. Sometimes government deliberately raises or lowers taxes on particular goods and services to encourage or discourage certain types of behavior. For example, the first internal tax levied by the federal government was a tax on distilled spirits produced in the United States. This tax was justified not only as source of revenue but also as a way to discourage the use of alcohol. At other times, government leaders are not very certain about how changes in tax laws might change people's behavior. Ill-considered tax laws often result in unintended consequences.

A second rule is that there are substitutes for everything. If, for example, government makes one type of activity more expensive by increasing the tax on it, people often make substitutions. Applying this understanding has helped the NCT to predict actions that other government leaders had not considered.

YOUR JOB

Your job is to read each of the following situations and forecast how people's behavior might change. Form your response so that you identify what people might substitute in each case.

Situation 1: Congress increases the federal income tax by 25 percent for all income groups. How might individuals respond?

Situation 2: Your state raises the fee for a driver's license to \$500 per person. How might individuals respond?

Situation 3: Complaints are increasing every year about tourists overcrowding the U.S. National Parks. The federal government increases the National Parks' camping fee to \$50. How might individuals respond?

Situation 4: Freeways are very busy and travel is slow during morning and evening rush hours. The state government decides to make the freeways tollways during the peak hours (from 7:00 a.m. until 8:30 a.m. and from 4:00 p.m. until 5:30 p.m.) by imposing a \$5.00 fee per car at each entrance ramp along the most-traveled 10-mile stretch of freeway. How might individuals respond?

Situation 5: Congress changes federal law so that homeowners are no longer permitted to deduct home mortgage interest from their taxable income. How might individuals respond?