

► Objectives

1. Explain how the Constitution gives Congress the power to tax and places limits on that power.
2. Identify the most significant federal taxes collected today.
3. Describe nontax sources of revenue.

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► Key Terms

- **fiscal policy:** the methods used by the government to raise and spend money
- **progressive tax:** a tax whose rate increases with one's income
- **payroll tax:** taxes withheld from employee paychecks
- **regressive tax:** taxes levied at a fixed rate without regard to the taxpayer's ability to pay them

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► Key Terms, cont.

- **excise tax:** a tax on the manufacture, sale, or consumption of goods and services
- **estate tax:** a tax on the assets of someone who dies
- **gift tax:** a tax on gifts from one living person to another
- **customs duty:** taxes on goods brought to the U.S. from abroad
- **interest:** a charge for borrowed money, usually a percentage of the money borrowed

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Introduction AMERICAN GOVERNMENT

- How is the Federal Government financed?
 - The Federal Government is financed largely by direct and indirect taxes.
 - The major taxes are the individual income tax, corporation income tax, payroll taxes, excise taxes, estate and gift taxes, and customs duties.
 - The government also raises a smaller amount of nontax revenue through interest, fees, and sales.

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The Power to Tax AMERICAN GOVERNMENT


- The first power granted to Congress by the Constitution is the power to tax.
- Congress taxes to raise revenue to operate the federal government.
- Congress also uses the taxation power to require or deny licenses for certain activities in order to serve the public interest.

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The Power to Tax, cont. AMERICAN GOVERNMENT

- Though taxes are used to fund the programs that the public expects, many complain about the burden placed on taxpayers.

– How does this cartoon illustrate this view?



TOUGHNESS
"GIBBY, I SUBSIDIZED YOUR FEDERAL, STATE AND SOCIAL SECURITY TAXES AND MEDICAL FROM YOUR DRINKING AND YOU GAVE THE FIRM \$400,000."

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Direct vs. Indirect Taxes AMERICAN GOVERNMENT

- Checkpoint: How does a direct tax differ from an indirect tax?
 - A **direct tax** is levied upon a specific individual. Examples include taxes on personal property or income.
 - An **indirect tax** can be shifted to another person for payment. For example, a tax levied on a liquor producer is passed along to the consumers who buy the liquor in the form of higher prices.

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Limitations on Taxation AMERICAN GOVERNMENT

- Checkpoint: How does the Constitution limit the power to tax?
 - Congress can levy taxes only for public purposes.
 - Congress cannot tax U.S. exports.
 - Direct taxes on individuals must be distributed evenly among the States.
 - All indirect taxes must be set at the same rate in all parts of the country.
 - The federal government cannot tax the government functions of State or local governments, such as providing public education.

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Limitations on Taxation, cont. AMERICAN GOVERNMENT

- There are exceptions to these limitations:
 - The federal government *can* tax businesses operated by State and local governments if they are not considered to represent normal government functions.
 - The 16th Amendment, ratified in 1913, allows Congress to levy a direct individual income tax.

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Income Tax AMERICAN GOVERNMENT


- Income tax on individuals and corporations is the largest source of federal revenue.
- Income taxes are **progressive**—higher earnings are taxed at a higher rate.

Third \$25,000
of taxable income taxed at 30%

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Individual Income Tax AMERICAN GOVERNMENT

- Individual income tax is levied on each person's earnings for the previous year, minus certain exemptions and deductions.
- Tax returns for the previous year must be filed by April 15th. The IRS receives more than 120 million returns each year.




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Individual Income Tax, cont. AMERICAN GOVERNMENT

- Individual income taxes provide the bulk of federal revenue.
- Most people have income taxes withheld from their paychecks. Others pay estimated taxes.

Individual Income Tax
 A tax levied on individuals on their total income during the previous year less exemptions and deductions.



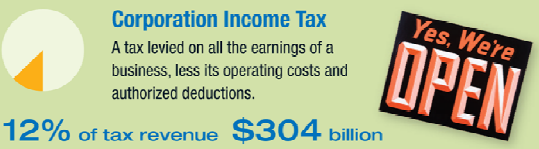
46% of tax revenue **\$1.14** trillion

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Corporation Income Tax AMERICAN GOVERNMENT

- Each corporation must pay income tax.
- There are many deductions allowed. For example, churches and nonprofit or charitable organizations pay no corporate income tax.

Corporation Income Tax
 A tax levied on all the earnings of a business, less its operating costs and authorized deductions.




12% of tax revenue **\$304** billion

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Payroll Taxes AMERICAN GOVERNMENT

- The federal government collects payroll taxes to finance Social Security, Medicare, and the unemployment compensation program.
- These are regressive taxes, paid at a fixed rate regardless of income.

Payroll Tax
 A tax applied to a percentage of a person's salary, matched by the employer, to fund specific social insurance programs conducted by the government.




36% of tax revenue **\$900** billion

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Excise Taxes AMERICAN GOVERNMENT

- Excise taxes are often figured into the retail price of goods and services.
- Excise taxes on tobacco, alcohol, and gambling are called sin taxes, while those on luxury goods are called luxury taxes.

Excise Taxes
 A tax placed on the manufacture, sale, or use of goods and/or for services rendered.



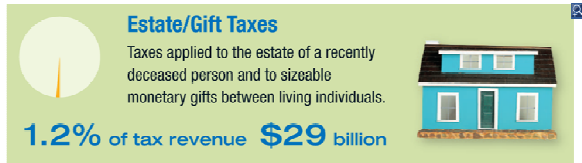
2.7% of tax revenue **\$67** billion

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▶ Gift and Estate Taxes

AMERICAN
GOVERNMENT

- Gift taxes are levied on gifts from one person to another, while estate taxes are levied on the assets of someone who dies.
- Most estates are not subject to the tax. Gifts up to \$12,000 in one year are tax-free.



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▶ Customs Duties

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- Customs duties, also called tariffs or import duties, are charged on many goods imported into the United States.
- They were once the main source of federal income, but are now minor.



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▶ Nontax Revenues

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- **Checkpoint:** What are three examples of federal nontax revenues?
 - The government receives interest on money borrowed from the Federal Reserve System and other loans.
 - The government also charges fees for issuing passports, copyrights, patents, and trademarks.
 - The sale or lease of public lands also generates government income.

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▶ Review

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- Now that you have learned about how the Federal Government is financed, go back and answer the Chapter Essential Question.
 - How should the federal budget reflect Americans' priorities?

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