Chapter 25: Local Government and Finance

Section 4

Lecture Notes

AMERICAN GOVERNMENT

PEARSON

Objectives

1. Describe the major Federal and State limits on raising revenue.
2. List the four principles of sound taxation.
3. Identify major tax and nontax sources of State and local revenue.
4. Explain the State budget process.

► Key Terms

- **sales tax:** a tax placed on the sale of various goods, paid by the buyer
- **regressive tax:** a fixed tax for which the percentage of income paid in taxes decreases as income increases
- **income tax:** a tax levied on the income of individuals and corporations
- **progressive tax:** a tax that increases as the income of the taxpayer increases

Key Terms, cont.

- **property tax:** a tax on real or personal property
- **assessment:** the process of determining the value of property to be taxed
- **inheritance tax:** a tax levied on the heir's share of an estate
- **estate tax:** a tax levied directly on an estate
- **budget:** a financial plan for using public money

Introduction

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- How do State governments raise money to pay for services?
  - State governments use a variety of taxes, particularly income and sales taxes, to raise revenue.
  - States also operate public enterprises, charge licensing, operating, and usage fees, run lotteries, and issue bonds.
  - States also receive federal grants.

Limits on Taxation

- Checkpoint: What are the constitutional limits on State taxes?
  - States cannot tax interstate and foreign trade.
  - The 14^{th} Amendment requires taxes to be applied fairly regardless of race, religion, or other factors.
  - Taxes cannot be unreasonably heavy and must be used only for public purposes.
  - State constitutions also limit maximum tax rates and the taxing power of local governments.

Principles of Taxation

- Adam Smith outlined four basic principles of a fair tax system:
  - Everyone should contribute a fair share of taxes, proportional to their income.
  - Taxes should not be arbitrary.
  - Every tax should be levied in a time and fashion that is convenient for the person paying it.
  - Every tax should cost the people as little as possible while paying for government expenses.

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- Sales taxes account for the largest portion of State tax revenue.

- Some 45 States levy a sales tax, usually of 5 or 6 percent.
  - A general sales tax applies to most goods.
  - A selective sales tax is levied on only certain goods.

Sales Tax, cont.

- All States impose a selective sales tax on some items.
  - These include things like gas, cigarettes, and alcohol.

- Sales taxes are regressive, falling most heavily on those least able to pay.

- States cannot tax most Internet purchases. Many States complain that this ban costs them needed revenue.

Income Tax

- Taxes on the incomes of individuals and corporations provides a third of State tax revenue.
- Some 43 States have a personal income tax.
- Individual income State tax rates are progressive—the higher the income, the more tax is paid.
  - These rates ranges from 2 to 9 percent.
- Corporate income tax rates are usually fixed.

Property Taxes

- Property taxes are levied mainly by local governments. They provide about three-fourths of all local government income.

- **Real property** includes land and buildings.

Property Taxes, cont.

- **Personal property** includes tangible property (such as computers, cars, and books) and intangible property (stocks, bonds, mortgages, and bank accounts).
- Local officials assess the value of property to be taxed.
- Critics claim that it is hard to assess fair values for all property.
- Supporters argue that government both protects property and increases its value, and so has a right to tax it.

Other Taxes

- Every State has some form of **estate or inheritance tax**.
- Most States use a variety of **business taxes** beyond corporate income tax.
  - States tax the removal of natural resources such as timber, oil, and ore.
  - States require various business and occupational licenses for businesses to operate.
- States also use **payroll taxes** and require **licenses** for drivers and motor vehicles.

Other Sources of Income

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- States receive large amounts of federal grant money.
- Some 42 States run lotteries.
- State and local governments also make money from public enterprises.
  - These include ferries, toll roads and bridges, and State-owned liquor stores.
  - Many cities run their own water, electricity, and bus systems.
  - Users must pay fees for public services such as hospitals, airports, parks, sewers, and garbage disposal.

AUDIO TOUR

How Government Works

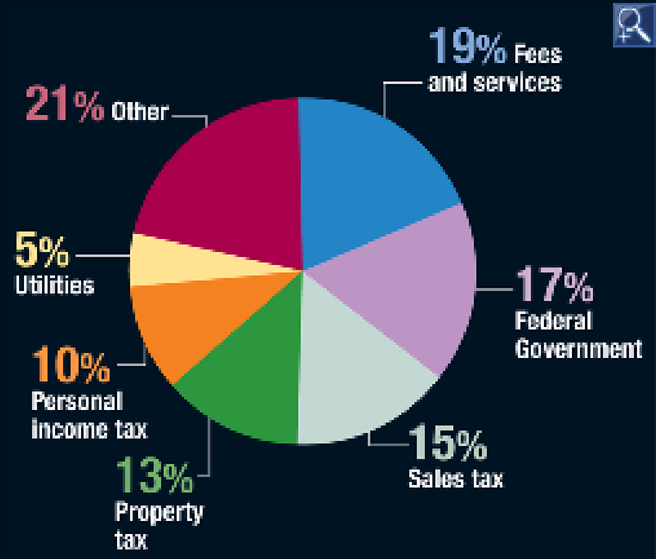
State and Local Revenues

Which sources of revenue draw most heavily from young people?

17% FEDERAL GOVERNMENT grants help pay for various programs administered by the States.

10% PERSONAL INCOME TAX is levied by 43 States.

15% SALES TAX is the largest source of tax revenue for State and local governments.



Borrowing

- Checkpoint: How and why do State and local governments borrow money?
  - States and local governments often issue bonds to borrow money for major projects.
  - Most State constitutions put strict limits on how much governments can borrow.
  - States debts total about $900 billion
  - Local governments owe more than a trillion dollars.

State Budgets

- A budget is both a financial and political plan in which the State sets its spending priorities.
- The State budget process was once poorly organized.
- All but three States now use the executive budget.
- This gives the governor the power to prepare the State budget and to manage the spending of funds.

Budget Process

- The budget process typically works as follows:
  - Each agency prepares budget estimates.
  - These are reviewed and revised, then combined into a State budget that the governor presents to the legislature.

Budget Process, cont.

- The legislature decides what parts of the budget to approve or expand, passing revenue measures as needed.

- The governor supervises the spending of funds, subject to an independent check of spending practices called a post audit.

Review

- Now that you have learned about how State governments raise money to pay for services, go back and answer the Chapter Essential Question.
  - How local should government be?