<u>Taxes: A (Kind of) Brief Guide</u>

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What are taxes?

Chances are you have a pretty good idea of what taxes are. That being said, let's take a look at a more technical definition of taxes: "a compulsory contribution to state revenue, levied by the government on workers' income and business profits or added to the cost of some goods, services, and transactions." So basically, taxes are money that people and companies have to pay to the government. **This money is used to run the government and can even be used to manipulate the economy based on the specifics of the situation**. There are many different types of taxes. I've included the ones that are generally considered most relevant in the context of Congressional Debate: income tax, property tax, sales tax, capital gains tax, dividends tax, and estate tax.

What is the income tax?

The income tax is a levy that the federal government will place on the people and companies in its jurisdiction. Just for some history, the first personal income tax law in the United States was passed in 1861 to help fund the US Civil War, and it was made permanent in 1913 through the passage of the 16th amendment. There are two types of income tax we will discuss: individual income tax and corporate income tax

Let's talk about **individual income tax** first. This is the tax we all know and love; people who earn an annual salary lose part of their income to the government. How much you lose depends on how much you earn. The United States income tax is called a **progressive tax**. Everyone has to pay a certain percentage of their salary to the government. What percent they pay depends on how much they make. People with higher incomes have to pay a higher percentage of their salary than they people with lower salaries do. **Tax brackets** are essentially a range of income that determine how much people will have to pay. For example, the tax bracket of people earning $90,751 to $189,300 a year have a 28% individual income tax. There's a lot of debate about the progressive tax, with many people in favor of a **flat tax**. A flat tax is a standard tax rate that everyone must pay, regardless of income. For example, everyone in the country would have to pay 18% of their annual salary. For now, however, that's nothing more than an idea.

Individual income tax is collected at the end of each quarter (so every three months). Your employer sends a portion of your income to the government each quarter based on the information you give them when they hire you. The money they siphon away from your monthly salary and give to the **Internal Revenue Service (IRS)** goes towards Medicare, Social Security, and also covers your income tax. The extra money taken that goes towards Medicare and Social Security is called the **payroll tax**. In total, individual income tax accounts for 42% of the government's total tax revenue, while payroll tax accounts for 40% of the government's total tax revenue. The total amount that goes to the government straight from your employer is called **withholding**. The total amount of money you take home, after income tax, is called **take home pay**. So you're probably wondering, "Wait, but then what's the Tax Day in April?" That's when you have to send the IRS proof that all the money you are responsible for paying was paid. But it turns out that you can't just rely on your employer for everything. You're responsible for running all the calculations to see exactly how much money it is that you owe the IRS in income taxes annually. The withholding and the amount you owe the IRS **are usually different numbers**, because everyone's financial situation is different and your employer can't always calculate the exact amount to give the government. So if too much was paid, you get some money back from the IRS, and if too little was paid, you owe the IRS the remainder of the money by April 15 (Tax Day). For people who earn money on an hourly basis, like carpenters, or people who don't have an employer, like painters, they're responsible for documenting all their income and they just pay it in full to the IRS by April 15. Most states also have a **state income tax**, with the exception of Wyoming, Washington, Texas, South Dakota, Nevada, Florida, and Alaska. State taxes must also be filed by April 15. The IRS does not manage state income taxes; that is controlled by the state government.

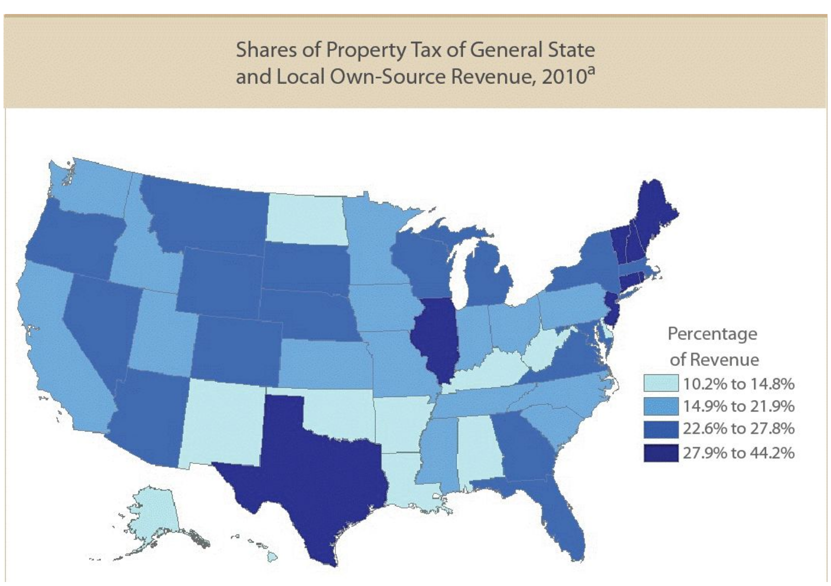
There's also a **corporate income tax**. This is a levy placed by the federal government on a company's earnings; corporate tax also has brackets. It's actually widely debated whether this tax is progressive or regressive, **regressive** meaning it shifts the burden of taxes towards the lower and middle level income workers. As seen in the image below, a business with a taxable income of revenue between 100,000 to 335,000, **which is a small business**, has to pay a higher tax rate than anyone else.

Taxable Income ($)	Tax Rate
0 to 50,000	15%
50,000 to 75,000	$7,500 + 25% Of the amount over 50,000
75,000 to 100,000	$13,750 + 34% Of the amount over 75,000
100,000 to 335,000	$22,250 + 39% Of the amount over 100,000
335,000 to 10,000,000	$113,900 + 34% Of the amount over 335,000
10,000,000 to 15,000,000	$3,400,000 + 35% Of the amount over 10,000,000
15,000,000 to 18,333,333	$5,150,000 + 38% Of the amount over 15,000,000
18,333,333 and up	35%

At 35%, America's corporate tax rate is actually ranked as the **highest among the 34 countries part of the Organization for Economic Cooperation and Development (OECD)**, which has made the rate a subject for lots of debate. The OECD is basically a compilation of all the economically developed countries. Like individual income tax, there is also a state corporate tax in most states. However, there are exceptions, such as Wyoming. **Not having to pay a state corporate tax is often incentive for corporations to move their headquarters to that state, while a large portion of their business will function elsewhere.** Some states, such as Virginia, have a flat corporate tax, meaning they don't have different brackets. **The corporate tax rate is actually extremely complex, which has allowed many companies to exploit its numerous loopholes**. For example, there's a research and experimentation tax credit. This allows businesses such as pharmaceutical companies a 20% tax break on "qualified research expenses." The problem is that most of these large corporations would have made those expenses regardless because they needed to do the research anyway. Over the period of 5 years, just this loophole alone is enough to cost the federal government 6 billion dollars a year. Companies also have to pay a tax on any earnings in foreign countries, which results in a double tax on those earnings - this double tax is not present in most developed countries. As a result, **many companies move their headquarters to foreign countries to save money** because of how excessive they feel the American federal corporate tax is.

What is the property tax?

There is no federal property tax. At the same time, there are state and local property taxes, which often also include personal property like cars, instead of just real estate. Property taxes are a stable way for state and local governments to generate a constant source of revenue. States without sales tax and/or income tax tend to rely more heavily on property tax.



The property tax is generally very unpopular. The house's value is based upon the calculated **fair market value**, which is determined by local officials, though property owners are allowed to dispute it. The **tax rate** applied to the fair market value depends on the state and region, but many states do place restrictions on the maximum tax rate a local government can charge someone in property tax. Ever since the 2008 recession, property tax revenue has significantly decreased, greatly due to the overall decrease in real estate value.

What is the sales tax?

The **sales tax** is a levy placed on the price of taxable goods and service. The rate of the tax depends on the state you live in. The rate can also be higher in local areas that have higher county or city taxes. The sales this taxation occurs on are called **retail sales**. The retail sale is defined as any sale, lease, or rental of tangible personal property, digital goods, or services, made to a person or organization for their own use. **Tangible property** is sometimes rather challenging to define, but is essentially things that are physical and can be touched, including computers, computer software, office supplies, utilities, and food. The sales tax is present in 45 of the 50 states. If you buy something in a state that has no sales tax, and then bring it into your state, you'll usually have to pay a **use tax**. To explain through an example, if I live in a state with a 6% sales tax and I buy something in a state without sales tax, I may have to pay 6% tax on my purchase when I bring it back to my home state. I said "may" because it depends on the item - you usually have to take a look at the specifics to find out whether or not you are responsible for paying. This process or finding out where the sale took place and determining if taxes should be imposed on the sale, and if so, which taxes apply, is called **sourcing**.

What is the capital gains tax?

To understand what the capital gains tax is, you first need to know what is being taxed - capital gains. **Capital gains** are an an increase in the value of capital from the time something was purchased to the time it was sold. The **capital** that I just mentioned can include a home, a business, stocks, etc. An example is if you buy a house for $200,000 and in 10 years your house value has risen up to $300,000. The capital gain would be the difference between the original price and the sale price, so the tax would be on $100,000. There are **two rates for capital gains taxes at the federal level**: 15% for those with a gross income below $200,000 and 20% for those with a gross income above $200,000. **States can also tax capital gains** but the rate depends on the state.

Interestingly, the average tax rate across the OECD (I mentioned it before) is 16%, while it's an average of 28% across the entirety of the United States. One of the biggest complaints about the capital gains tax is that it's a "**double tax**." The larger businesses that are in the highest tax bracket have to pay a 35% corporate tax, decreasing their total earnings. At the same time, shareholders well then get taxed and have to pay at least 15% or 20% on their profits there. So because there's both a corporate tax for the company, and then a tax on the profits of the shareholders, the capital gains tax is regarded by many as a form of double taxation. **At the same time, investments are usually perceived as a risk**. Some argue that this risk fuels the entrepreneurial spirit that allows businesses to thrive in America, but taxing investments is going to discourage this kind of risk taking. Some also argue that this is good because it **decreases unnecessarily risky decisions** and allows our economy to remain stable. Also, often people sell their assets at inflated prices to make a quick buck, so this is simply going to tax an inflated asset value, meaning the **actual return value will be significantly lowe**r, and the **value of the dollar will decline rapidly**. In addition, while most feel that the capital gains tax only truly hurts the wealthy because they write the most checks and have the most investments, **the effect of the capital gains tax is felt nationwide**. Lower levels of investment results in **less capital circulating in the economy**. Please read my guide, "How the Economy Works: A (Kind of) Brief Guide" for an understanding of why this is so important.

What is the dividends tax?

Dividends are when a company distributes a portion of its profits to its shareholders. As usual, I think this will be better understood through an example. Let's say I own shares in Company X. Since **shareholders are considered owners of a company**, they'll get part of the profit, as Company X will give a small portion of its profit to shareholders each year. This portion that each shareholder will get is called a **dividend**. To clarify, **not every company has to pay a dividend**. They could choose to just reinvest all their money into the company or they might not even be making a profit. So if Company X pays a quarterly dividend of 25 cents, I'll get 25 cents for each share that I bought every 3 months. Companies can pay dividends quarterly, semiannually, and annually. In this example, if I bought 100 shares, I would make 100 dollars. Dividends are often a way for companies to **encourage investors to hold onto their shares**. Dividend paying companies **usually increase their dividends over time**. Dividends **can be paid in cash or stock**. If you get the shares and you really want cash, you can just sell them.

So the **dividends tax** is simply a taxation on these dividends. Because companies have to pay corporate tax to determine their total profit, taxing the profit when they distribute in the form of dividends is often regarded as **double taxation**. There are two types of dividends: qualified and unqualified. They're taxed as per the category they're placed in. **Qualified dividends** are paid by US corporations or corporations located in countries that are eligible for certain benefits as per any of the United States tax treaties. For **common stock**, shareholders have to own the stock for more than 60 days (including the ex-dividend date) to qualify for tax benefits. For **preferred stock**, shareholders must own the stock for more than 90 days (including the ex-dividend date) to qualify for tax benefits. The **ex-dividend date** is when you buy the stock too late to receive the dividends for that cycle, but if you hold on to the stock, you'll get the dividends at the next scheduled time. The ex-dividend date is **usually two days before the record day for stocks**. The **record date** is a date when the company reviews all its records to review who is a shareholder for the sake of dividend payouts. To clarify, common stock tends to have lower dividends than preferred stock, and common stockholders won't receive any money until preferred stockholders are all paid out. Preferred stock is usually more expensive. **Nonqualified dividends** are any dividends that aren't eligible for the United States tax treaty benefits. All dividend information is recorded on **1099-DIV forms** for the sake of taxation; this will all be reported by the corporation or mutual fund that you invested in. They are responsible for sending you the report with all this information.

Dividend taxation is based on your income tax bracket. Qualified dividends are tax free for those in the 10% and 15% income tax brackets. For people in the 25% to 35% income tax brackets, qualified dividends are taxed up 15%. For those are above the 35% income tax bracket they must pay 20% tax on their qualified dividends. Nonqualified dividends are **taxed at the same rate as income**, which will vary as per each person's tax bracket.

What is the estate tax?

The **estate tax** is a tax on someone's estate - shocking, right? An **estate** is whatever someone leaves behind when they die, such as a house, car, boat, etc. Because of this, the estate tax is **also called the inheritance tax or the death tax**. The best way to explain this is through an example. Let's suppose our fictional character Bob is worth 3 million dollars. Unfortunately, Bob passes away. His will leaves everything to his daughter. Thankfully, Bob doesn't have to pay any inheritance tax - **the first 5 million dollars are exempt**. However, if Bob was worth 6 million dollars, while the first 5 million would be tax exempt, the last 1 million would be taxed by the estate tax, which is a rate that's actually always changing. To give you an idea, it was 35% in 2011. So what happens to that last 1 million? Well the government gets 35% of it, but Bob's daughter will still get 5.65 million dollars in inheritance. If the estate tax is filed for as a couple, the exemption is doubled to 10 million dollars. The estate **only reaches the richest 0.0002%** of our country, with an average tax cut of 3 million dollars per estate. It **earns the government about 269 billion dollars a year in federal revenue**. While some suggest repealing it, this would only increase the federal deficit **while increasing taxes the the rest of us would have to compensate for**. Some suggest increasing the estate tax - this would decrease income inequality, seeing as 1% of Americans have 42% of the nation's entire wealth, while the bottom 90% only has 23% of the country's wealth. Many suggest we increase the estate tax rate to the higher rates of the 1990's which had supposedly resulted in economic growth.