

# Progressive and Regressive Taxes

by L. Anne Emerson

We cannot avoid taxes. Supposedly, Benjamin Franklin wrote to a French man, "In this world, nothing can be said to be certain, except death and taxes," in 1789. We must therefore hope that our government administers this necessary awkwardness (taxes) in a sensible manner. This essay is for people who may not fully understand about progressive and regressive taxes or why we might want to be informed about them, as we decide for whom to vote.

The question that decision-makers have to consider is whether it is fair to expect everyone to pay the same taxes and, if not, how might we make the tax system fairer?

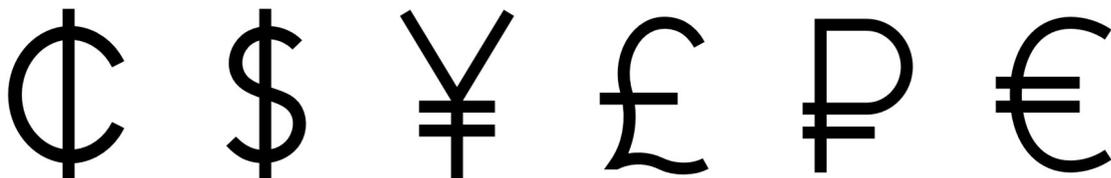
A **progressive** tax recognizes that people have different capacities to pay, and asks wealthy people to pay a larger share of their income or wealth in taxes. (We often express a share of something as a percent. 10 percent (=10%) is one-tenth, or 10 out of 100.) For example, if your income is \$30,000 per year, you may pay 10% in taxes, or \$3,000. If your income is \$90,000 per year, you may pay 30% in taxes, or \$27,000. Your income is three times as much (\$90,000 versus \$30,000), but you pay more than three times as much tax (\$27,000 versus \$9,000). The higher-income person not only pays more because their income is higher, but also pays a higher *proportion* of their total income.

If we ask people to pay a great deal of their income as tax, even if they are very wealthy, they are less likely to want to work hard for their money. So, there is a trade-off to be made, between government's taking a share of business people's income in order to pay for things that business doesn't do, and encouraging people to work hard in businesses that make a lot of money.

A **regressive** tax is one where lower-income people pay a larger share of their incomes in tax, even though they make less money to begin with. If everyone pays 6% when they buy something that is subject to a sales tax, such as food, then there is no allowance made for some people having a higher income than other people and being more able to afford the tax.

For example, if a typical household food budget is \$10,000 per year and the tax is 6%, then someone making \$30,000 per year and paying \$10,000 for food pays the same sales tax on food as someone making \$60,000 per month and paying \$10,000 for food (= \$600 per year in sales tax). That is  $\$600/30000 = 2\%$  of the budget, or  $\$600/60000 = 1\%$  of the budget. In other words, the sales tax takes half the percent share of the household making twice the money.

A household can adjust the food budget in order to minimize spending, but typically a lower-income household pays a larger share of its budget (2%) in sales tax on food than a higher-income household (1%), in our example. Tariffs are sales taxes on international goods. They are usually regressive (harder on lower-income people than on higher-income people). If people now cannot afford both the item and the tax (tariff), it is bad for business.



A **proportional** tax is one where everyone pays the same proportion of their income in taxes. Real estate taxes may look proportional if everyone pays the same rates. For example, if the assessed rate is \$1 per \$100 of home value, then everyone pays the same proportion of the assessed value. However, their incomes could be different.

Consider this situation: one homeowner has a property worth \$300,000, and an income of \$30,000 per year. Another homeowner has a property worth \$600,000 and an income of \$200,000 per year. The tax on the first home is \$3,000. This is  $\$3,000/\$30,000 = 10\%$  of income. The tax on the second home is \$6,000. This is  $\$6,000/\$200,000 = 3\%$  of income. This tax is regressive and will encourage ownership of large houses rather than small ones. This may well encourage building of large homes, not small ones.

If we want a good balance of small (or affordable) homes and larger ones, we should consider developing a schedule of real estate taxes that reflects the incentive system most likely to encourage the building of that type of mix of homes. Requiring builders to “fight the market” is unlikely to produce an optimal outcome. “The Market Fights Back” is a topic often covered in Principles of Economics textbooks. You may look there for other examples. Perhaps there is rent control. Then, apartments are not well maintained and building owners convert them to condos, making apartments both scarce and poorly maintained.

