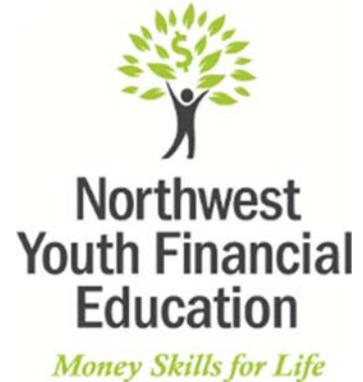


# The World of Taxes

(Levy Gulch - Full Article)

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“Two things in life are for sure.... death and taxes” (Finlayson, Martin & Vinson, 2006). Before America was on her own two feet the topic of taxes had already made a splash...literally. The Boston Tea Party was all about taxes and was one of the key events leading to the American Revolution. Unfortunately, taxes are not always easy to understand, and few young people enter adulthood with a true understand of what taxes are, the many different types of taxes that exist, how they are used, and when and how to pay them.



## What are Taxes?

The word tax is Latin for “I estimate” (Finance Maps of World, 2016). Modern usage has shifted away from this definition, though many people would agree that the tax system is so complicated that a certain amount of estimation is probably needed! Today taxes are defined as an obligatory fee imposed on an increase of income or property, or added to the cost of goods or services. Taxes are often used to provide public goods and services that help a society create and maintain a certain standard of living. Roads, parks, public schools, city water, and sewer systems are just a few examples of public goods funded by taxes (Godfrey, 2013). In the United States pretty much everyone pays taxes of some kind as part of having a job, owning a home, or making purchases.

## Why We Have Taxes

Franklin D. Roosevelt said, “Taxes, after all, are dues that we pay for the privileges of membership in an organized society” (Finlayson, Martin & Vinson, 2006). The government does its best to provide goods and services that otherwise might not exist, but in order to do this it has to find a way to pay for them. For this reason, taxes were implemented. Through taxes, citizens essentially fund their own public goods. For example, a new road complete with street lamps, sign posts, and ongoing maintenance provide a benefit to those who live on that road and who use it to get to work, the doctor’s office, the store, or to see friends. We may never know when we’ll need that road, but when we do, it’s ready for us to use. Unfortunately it’s not very fun to pay taxes, especially when the government uses tax funds in ways we don’t like. But, if we all simply stopped contributing to public goods through taxes, many of the daily conveniences we now enjoy and take for granted as part of Roosevelt’s “organized society,” would disappear.

## Why We Need to Learn About Taxes and Their Benefits

Many people pay taxes without understanding why or how it benefits them. But taking the time to understand taxes can make paying your share a lot easier. First, it will make you a more empowered citizen by making you aware of the way the government uses tax revenue; you can vote for leaders who will use your taxes more responsibly and in ways that you feel are most efficient. Second, understanding taxes can also lead to household deductions, tax credits for work, education, and more. As Mary Beth Franklin of Kiplinger's (2009) put it, "Ignorance is no excuse." Taxes are a fact of life. Making them work in your favor is *your* job (Lai, Zalilawati, Amran & Choong, 2013).

### Types of Taxes

The government receives tax revenue in four main ways: income, property, consumption, and miscellaneous taxes. As adults, most of us will end up paying quite a bit in taxes. But we can find some peace of mind if we become familiar with some of the specific types of taxes and how they are used.

#### Income Tax

When you get a new job your employer will have you fill out a tax form called a W-4. Many "first-timers" might worry that they will either overpay or underpay on taxes if they fill this form out wrong. Never fear, no matter how you fill out this form, you will still pay the same amount of taxes at the end of the year. So why bother with the form, then? This form actually tells the government how much you would like to put aside from your paycheck each pay period so that you can "save up" for your tax bill that comes due at the end of the year. The good news is that if you save too much you will get the rest of your money back as a "refund." On the other hand, if the amount you put aside is not enough, you will have to come up with some additional money to pay the bill at the end of the year. By filling out the W4 according to instructions, most people will end up over-saving a little, and will get a refund. This type of tax is called, "income tax." It is one of the most known forms of taxation, and probably the one that people like to complain about the most!

The federal government taxes a portion of your income to fund government programs and projects, like the military, healthcare, government employees, interest on the national debt, veterans' benefits, etc. A percentage of the money you earn is collected by the Internal Revenue Service (IRS), and then distributed to each program based on the government's budget. Some income is exempt from taxes but most is not, so don't be surprised when you have a tax bill to pay after working (Internal Revenue Service, n.d.).

## **Sales Tax**

This is the type of tax that most of us encountered first in our lives. A child may dig through the couch cushions, save allowance, or do chores to earn just enough for a specific toy that they have had their eyes on, but when they get to the cashier they find that they are still a little short (Kids.gov, 2016). Where did they go wrong? Of course they were probably not aware of sales tax. Sales tax applies to most common purchases, and is a percentage of every dollar spent. Stores usually apply this tax at checkout. Sales taxes are usually imposed by individual states, and each state has a different tax rate based on state legislation which can range between 0% (like Alaska) to 7.5% (like California). Sales tax is one of the largest forms of tax revenue for many states.

## **Property Tax**

Everyone is taxed on income and purchases, so it will probably come as little surprise that citizens are taxed on property too. Each year property is taxed by the county or local jurisdiction where the property is located. Even if you rent, you often pay this tax indirectly as part of your total rental costs. Property tax revenue is used for local police and fire departments, local government staff, traffic and street lights, local roads, public transportation, libraries, etc., (Godfrey, 2013). If you own property it is important to plan on this bill every year so that it doesn't sneak up on you.

## **Estates, Gifts, Capital Gains, etc.**

Gifts to others may be taxed, but usually only large and expensive gifts, worth at least \$12,000 or more. A person's estate can be taxed quite a bit when they die, but wills and trusts can be used to reduce these kinds of taxes. Capital gains must be paid if you sell large assets like stocks or a house. Accountants and financial advisors can be helpful in answering specific tax questions, but being aware of the need to ask these questions in the first place is important and often overlooked (Finance Maps of the World, 2016). There are many other kinds of taxes, too many in fact to address them all in this article.

## **When Taxes Begin**

Part of the taxation process is based on the honor system. It's true, the IRS does conduct audits and can even impose fees and penalties if you have not been paying your taxes correctly. But this doesn't happen every year. The fact is that there are way too many tax payers for the IRS to check up on all the time (Franklin, 2009). The tax code is also very complicated with many deductions and exceptions that it can sometimes be a challenge to correctly pay your taxes. One of the most common concerns is understanding when youth should start paying income taxes, and how to do it.

## **Children and Taxes**

There is some debate about what constitutes earned income and is therefore taxable. Is formal employment, where the child receives a W-2, the only concern, or is informal income like babysitting, mowing lawns, or allowance also taxable (Witmer, 2016)? IRS publication 929 shows that total gross income under \$6,300 for a child is not taxable, so in many cases defining the income type is not too important because it is not enough to be taxed anyway. However, if child is really industrious or splits income between formal and informal earnings and earns more than \$6,300, it is important to get professional advice on how to pay taxes on that income (Intuit Turbo Tax, 2016). There can also be benefits to having parents claim their child's earnings on their own taxes. The questions can go on forever and still you might find a way to question the circumstance. The safe thing to do with your specific tax questions is to ask your local accountant or tax adviser.

### Parents and Teachers

There are many challenges to growing up. Probably too many to list here. Suffice it to say that for many, understanding and paying taxes can be one of those challenges. Parents and teachers can work with youth to give them a better understanding of taxes, how to pay them, and the benefits of being a responsible tax payer. Encourage children to learn about the process of paying taxes and to appreciate the public goods and services available (White, 2014).

Download the educational game "Levy Gulch" at <http://www.uidaho.edu/nw-youth-financial-ed>.

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