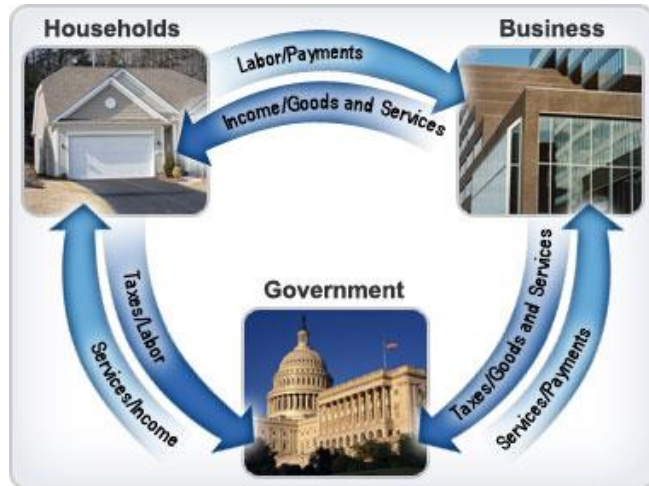


What are Taxes?

The United States is a market economy consisting of three main sectors: households, businesses, and the government. The graphic below demonstrates the circular flow that occurs between these sectors.

The chart shows that households (consisting of individuals) provide labor to businesses. In return, the individuals receive goods and services from businesses. Businesses are taxed on the goods and services they produce and receive services from the federal, state, and local governments. Individuals are taxed by the government on their income, which is usually from the labor they provide to businesses. In return, they receive services that the federal, state, and local governments provide.

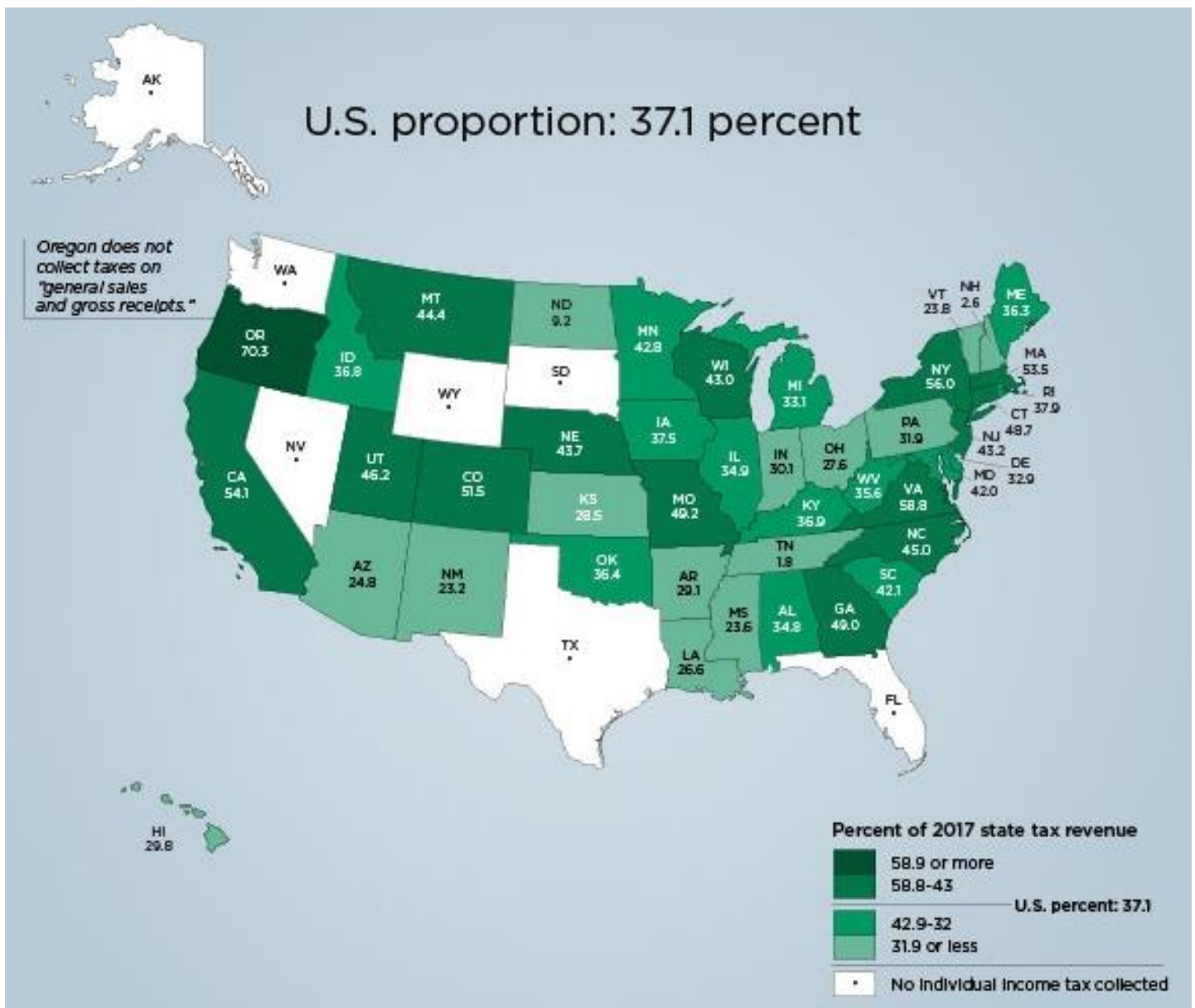


The government receives a variety of taxes from individuals and businesses. The tax money collected is used to pay for items the government provides at the federal, state, and local level. These items are usually considered public goods, or things that benefit most individuals. Some examples include transportation, education, and health care. For individuals, there are three main types of taxes: transaction (when you purchase something), income, and property taxes.

For instance, at the federal and state levels, taxes are collected from income individuals earn. The Internal Revenue Service, also known as the IRS, collects taxes from individuals earning income at the federal level. This means taxes are collected by the IRS from everyone under the age of 65 who earns at least \$10,000. Each state has its own rules for how it taxes individuals within their state. The Illinois Department of Revenue is responsible for collecting taxes for residents. Counties are responsible for collecting taxes on houses and other properties individuals own. Let's look closer at each type of tax:

- **Income Taxes:** Taxes are based on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Individuals and businesses pay income taxes. For individuals, they are referred to as personal income taxes and businesses pay corporate sales taxes. The federal and state governments usually collect income taxes.
- **Transaction Taxes:** These are taxes on purchased goods, such as what you buy at retail or grocery stores, gas for your cars, or other items. Transaction taxes are also called consumption taxes, meaning items that you consume. A transaction tax is usually based on a set percentage (retail) or by a unit (gasoline). These taxes are usually at the state or local levels and help provide services such as education, healthcare, along with emergency services such as police and fire protection.
- **Property Taxes:** This tax is based on property or real estate that individuals or businesses own. Each county and local municipality has a different tax rate. The county commonly collects property taxes which helps pay for schools, emergency services, libraries, parks, water, and sanitation.

Not all states have income taxes. Below is a chart from the U.S. Census indicating which states have income taxes. For those states that do have a state income tax, the chart indicates what proportion of revenue is received from individual income tax.



Next time you use a public good, think about how it was paid for- through citizens' taxes.