The American Tax System and its Effect on National Economy

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Keywords: American Tax System, National Economy, Characteristics Study

Introduction

The federal, state and local governments constitute the administrative structure of the United States. At the foundation of the nation, the administrative power was mainly concentrated at the state and local level, but the authority of the federal government had strengthened over the 30-year period since the First World War. The US fiscal system, similarly divided into federal, state and local levels, centralized along with the federal government. While the state and local still retain their own budgets and relatively independent financial rights, the central government holds most legislative power.

Revenue Structure

Direct taxes dominate a large proportion of the US tax revenue. In 2005, the United States direct taxes (personal income tax, corporate income tax and social security tax) revenue accounted for 71.5% of the total tax revenue. Among the direct taxes the personal income tax accounted as high as 34.7% of the total tax revenue, rendering it the most important item in US tax system. This revenue structure is different from those of other OECD member countries because the US has yet to levy value-added-tax, which is common among other OECD countries. As the US social society system grew gradually, the tax revenue of social security tax increased accordingly from 23% of the total tax revenue of the federal government in 1970 to 38.1% of the total tax revenue in 2005, making it another crucial source of federal tax income. The soaring income and social security taxes help enhance American government’s ability to regulate income distribution.

The US constitution grants independent tax legislation (to the extent that it does not contradict the federal tax code) to state government and the rights of managing and collecting taxes to both state and local government. In 2005, tax revenue of the state and local levels accounted for 34.5% of the national tax revenue, a relatively large percentage compared to 5.5%, 19.7% and 23.3% in the United Kingdom, France and Italy, respectively. The composition of state and local tax income is different from that of federal tax income: while the federal government, as stated above, relies heavily on personal income tax and social security tax, the state and local governments collect mostly sales tax, personal income tax and property tax, accounting for 41.2%, 21.2% and 30.5% of their tax revenue. For comparison, sales tax and property tax amount to less than 5% of the federal tax revenue, and similarly social security tax contributes only 2.1% of the state and local tax revenue.

Organization of the US Federal Tax Agency

The US Internal Revenue Service has set up four direct departments, namely large and medium-sized enterprise bureau, wages and investment bureau, small and private enterprise bureau and tax exemption and government entities bureau, to cover all types of taxpayers. The four departments across different regions have their own regional offices and employees, centralized for the corresponding types of taxpayers’ needs such as tax services, assessment, audit, etc. Among the departments, the wages and investment bureau is responsible for providing tax services, collecting personal income taxes and dealing other related tax matters for more than 122 million natural
person taxpayers. Staffed by more than 50,000 people, half of them temporary employees, the bureau has more than 400 office locations in the nation. Large and medium-sized enterprise bureau provides services to entities with assets of greater than 10 million US dollars. Under this bureau are industry-specific branches located across the nation, including natural resources branch in Houston and retail food and medicine branch in Chicago. The small and private enterprise bureau on the other hand provides various tax services to entities and individuals with assets of less than 10 million US dollars. Tax exemption and government entities bureau is mainly responsible for the taxation of various non-profit social organizations such as pension and securities funds, retirement benefits funds, etc., and government agencies such as municipalities and small community organizations, and universities.

The services provided by these bureaus can be summarized into three categories: information services, procedural services and equity services. For the information services, the four functional departments and their branches along with the national computer information center provide tax law publicity and tax advice to the taxpayers. For the procedural services, the bureaus set up ten tax collection centers nationwide to facilitate filing tax returns and to provide support services. Among the ten tax collection centers, eight of them primarily deal with personal declaration, and the rest two accept corporate reporting. For the equity services, the taxpayer's rights office is responsible for providing tax administrative reconsideration, tax litigation and other rights services with its seven regional offices, 74 community offices (at least one in each state), and three branch offices per business office.

While providing tax services, the US Internal Revenue Service (IRS) has further strengthened the role of its tax crime investigation department to reliably combat tax evasion. Currently, the crime investigation department is a department under the domestic income bureau, but it can report directly to the secretary. The tax crime investigation department has 4,400 employees, six regional divisions and 326 field offices, including 10 tax centers and six foreign offices. In addition to the investigation department, the IRS has an information center, a service center, a finance department, an administrative security department, a national advisory committee, a tax research analysis and statistics department and various other departments to fulfill various functions from tax collection to employee training. These departments do not have branches.

**Tax Reform**

The United States reforms its tax system to promote economic development and to serve political goals. Tax reform does not change the income tax as the main source of the overall revenue. Through the process of reform, the more effective system brings strength and vitality enterprises and national economy without adding much burden to the taxpayers. Excessive tax burden will negate the enthusiasm of the labor and inhibit the vitality of the enterprise, hamper the growth of economy. Therefore, the US income tax is structured as progressive tax system, as taxpayer with higher income is required to pay a larger portion of their income as tax, while taxpayer with the lowest income is exempted from taxation. However, the original progressive income tax system discouraged people’s willingness to work, because the rates of higher bracket were viewed as penalizing. The new tax system is simplified and the marginal tax rate drastically reduced, thus minimizing the adverse effect on people’s productivity. It was estimated that the new tax system reduces the income tax burden of taxpayers with annual income of more than $ 200,000 by 26%, and the per capita tax burden of the whole country is reduced by 6.4%, with 6 million people of low income exempt from income tax. The total tax cut for the following five years was expected to be over $ 150 billion, and for the next decade, the disposable income will increase by $ 900 per annum per household. In the five years from 1987 to 1991, household expenditure increased by $ 131.5 billion. Although the reform resulted in lower tax revenue in short-term, overall, in the long run, the benefit will be far-reaching. It is believed that the reform had a significant impact on American lifestyles, changing people's spending habits and investment activities, improving business efficiency and promoting steady growth of the national economy.
Conclusion

The US tax system consists federal and state and local governments, each with different revenue structures and legislations. The system thus requires robust tax agency to ensure reliable tax collection and provide various tax-related services. Tax reform has brought the nation massive tax cut and improved the economy growth and citizen’s life standard.

References


