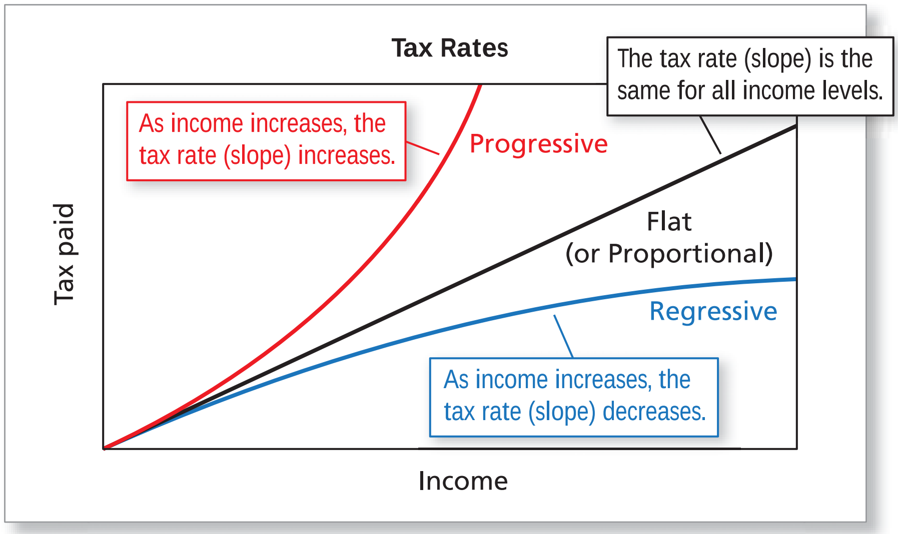
Identifying Types of Taxes

A **regressive tax** is a tax that takes a smaller proportion of an income as the income rises. In other words, it is a tax that affects people with low incomes more than people with high incomes. A **progressive tax** (or *graduated tax*) is a tax that takes a larger proportion of an income as the income rises (see Section 5.2). So, based on tax rates and income, taxes can be classified in three ways.



EXAMPLE 3 **Identifying Types of Taxes**

Determine whether each tax is regressive, flat, or progressive.

a. Medicare tax of 1.45% of gross personal income

b. Sales tax of 5%

c. Federal income tax

SOLUTION

a. The upper wage limit for the Medicare tax was eliminated in 1994, meaning that the tax is now applied to all wages. The rate is the same for all wage earners, so it is an example of a flat tax.

b. Sales tax is commonly used as an example of a regressive tax. Suppose, for example, that a family earning $50,000 a year buys a new car for $20,000 and pays $1000 in sales tax. This is 2% of the family's income. If a family earning $100,000 a year buys the same car and pays $1000 in sales tax, the family is paying only 1% of its income.

c. Federal income tax is a classic example of a progressive tax. People with low taxable incomes pay 10% federal income tax. People with higher taxable incomes pay up to 35% federal income tax.

Checkpoint

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Determine whether each tax is regressive, flat, or progressive.

d. An annual automobile registration fee of $35 per car

e. Federal estate tax

f. Capital gains tax of 15% on the profit from the sale of a stock investment