Define progressive, regressive and proportional taxes

1) Proportional tax:

- It is a tax where the rate of taxation is fixed, as 10% or 15% or 25%.
- The amount of the tax is a fixed proportion (say 20%) of one's income.
- It stays a fixed % of one's income, irrespective of how high or low the income is.
- Proportional taxes charge the same percentage of income as taxes from all taxpayers, regardless of their income.
- A proportional tax applies the same tax rate across low-, middle- and high-income taxpayers.

For example:

- A 10% proportional tax would mean that one making 100 dollars pays 10% or 10 dollars in taxes, while someone making 500,000 dollars pays 50,000 dollars in taxes.
- The rate of taxation does not change as income changes.
- In case of proportional taxes, the the marginal tax rate is equal to the average tax rate.
- In case of proportional taxes the incidence of taxes is equal, regardless of ones ability-to-pay
- Proportional taxes are also called flat tax.
- It may also encourage people to earn more since they do not have to pay at a higher tax rate.
- A sales tax is a type of proportional tax since all consumers, regardless of earnings, are required to pay the same fixed rate.

Many arguments exist for and against the proportional tax system:

- It is equal all across the income board and hence in theory is a fair system.
- It is fair since the incidence of taxes is same across all incomes.
- Since there are no exceptions, the rules are easy to understand and apply.
- The tax administration and collection is also simple and straight forward.
- It is difficult to evade.
- Another argument for a proportional tax system is the motivation factor, since people who earn more are not charged at a higher percentage rate
- The main argument against proportional taxes is that it is regressive in application.
- There is a greater economic impact of proportional taxes on the lower income group.

For example:

- 10% paid in taxes by one making a million dollars, still leaves 900,000 dollars for consumption, which is not a problem.
- But, 10% paid in taxes by one making 500 dollars, leaves 450 dollars for consumption.
- This is a problem because one's consumption is little with 500 dollars, but becomes very difficult with 450 dollars.
- Thus it places a greater tax burden on low-income individuals
- Proportional taxes on consumption is considered to be regressive.
- This is so because low income people tend to spend a greater percentage of their income on consumption goods and hence bear a greater proportion of the taxes.

For example:

- A spends 50% of his income (500 dollars out of 1000 dollar income) on consumption.
- If the proportional tax rate is 10%, he pays 50 dollars or 5% of his income as consumption tax.
- B spends 10% of his income (1000 dollars out of 10,000 dollar income) on consumption.
- He also pays 100 dollars or 1% of his income in proportional consumption taxes.
- Thus if the consumption tax rate is proportional, the lower income families end up paying a greater % of their income in taxes.
- This is why it is considered regressive.

Another example:

- If the sales tax is 10%, then for a $1000 TV purchase, the tax is $100.
- This $100 tax burden would be a higher percentage of income for low-income families than for high-income earners.
- The USA, India and Australia among others do not apply the proportional system for income taxes, but do so for sales taxes.

2) Progressive tax:

- It is a tax in which the tax rate increases as the tax base increases.
- Here the rate of taxation increases as the income increases.
- A progressive tax takes a larger percentage of income in taxes from the high-income group than it does from the low-income group.
- Personal income taxes in the USA are progressive and so, people with higher income pay a higher percentage of their income in taxes.
- On the other hand, people with lower income, pay a smaller % of their income in taxes.
- Progressive taxes reduce the incidence of taxes on people with lower incomes.
- Thus people with lower ability-to-pay, actually pay less.
- Under progressive taxes, the lowest income group including ones below the poverty level would pay little to nothing in taxes.
- Reversely, the incidence of tax increases for those with higher incomes and hence a higher ability-to-pay.
- In case of progressive taxes, the average tax rate is less than the marginal tax rate.

For example:

- The United States income tax rate is progressive.
- Taxpayers are broken down into categories based on taxable income.
- The more one earns, the more taxes they will have to pay.
- Thus there are different tax brackets.
- Individuals who earned up to $8,375 fell into the 10% tax bracket while on the other end of the spectrum, individuals earning $373,650 or more fell into the 35% tax bracket.

Arguments for and against:

- Progressive taxes are based on the logic of the "ability to pay" principle.
- Higher income people should pay more since they are capable of paying more.
- The fairness of progressive taxes are built on the fact that those who make more money should also contribute more to society in form of taxes.
- Those who make less, are less able to pay and so should pay less.
- The counter argument to progressive taxes is that it penalizes people who work harder and make more money.
- In a sense, you are being punished for your success.
- Ideologically progressive taxation is a means of "income redistribution."
- Individuals who earn more pay higher taxes.
- Those taxes are then used to fund social welfare programs that help raise the real income of the lower income group in different forms.
- Critics of the progressive tax consider it to be discriminatory and reduces the incentive to work hard and excel in life.
- The opposite of a progressive tax is a regressive tax, where the tax rate decreases as the income increases.
- In between the two extremes is a proportional tax, where the tax rate is fixed irrespective of ones income.

- Along with income tax, the sales tax in the USA is also progressive.
- Sales taxes can also be made progressive as is evidence in case of luxury goods which have a luxury taxes applied on them.
- Here, the tax rate is higher on high end consumption goods.

3) Regressive tax:

- "Regressive" means going from high to low.
- It is a tax imposed in such a manner that the tax rate decreases as the amount of taxable income increases.
- The higher income group pays less in taxes than the lower income group.
- Regressive taxes impose greater tax burden on the poor relative to the rich.
- In case of regressive taxes there is an inverse relationship between the tax rate and the taxpayer's ability to pay.
- People with low income and low ability to pay, will pay higher taxes.
- This means that it hits lower-income individuals harder.
- A regressive tax would require a higher amount of tax from the lower income class than from the higher income class.
- In case of regressive taxes, the average tax rate exceeds the marginal tax rate
- In case of a regressive tax, the average tax rate is lower for higher incomes.
- So income and average tax rate have an inverse relationship.
- Regressive taxes reduce the incidence of taxes on the rich relative to the poor.
- It shifts the incidence of taxation disproportionately to those with lower ability to pay.
- Payroll tax in the USA which has a cap, above which no taxes are paid, is an example of regressive taxes.
- A value added tax or sales tax on food, clothing and transportation can be regressive.
- Since each person pays the same amount of money, it is a lower proportion for people with higher incomes.
- Some say the "sin tax" on alcohol is regressive, since it is assumed that they are consumed more by the lower income people.
- Tobacco and gasoline taxes are highly regressive.

For example:

- If a person with 50 dollar income pays 5 dollars in gasoline tax, it is 10% of his income in taxes.
- But the person making 500 dollars, paying 5 dollars in gas taxes is only paying 1% of his income in this tax.
- Hence it is regressive.
- Extending on this idea, a lower income person with an old gas-guzzler car, consumes more gas and so pays a higher proportion of his income on gas taxes, than does a higher income person consuming less gas for his a modern energy efficient vehicle.
- It will be even more so regressive if the rich drive hybrid vehicles.
- Sales taxes on essentials like food, clothing and housing make up a higher percentage of a lower income persons budget.
- In this case, even though the tax may be uniform (such as 7% sales tax in the state of Georgia), the lower income group is more affected by it because they are less able to afford the tax.
- To reduce the extent of tax regression, some states make certain essentials like food non-taxable
- Lotteries are also regressive by nature.