Big Question: Assess the role for Government (regulator) to redistribute income?

Webnote   2340
Syllabus: 106 - 112

Syllabus Ref.

3.6 Taxation: The simple approach

Fig 1: Indirect taxes are regressive.
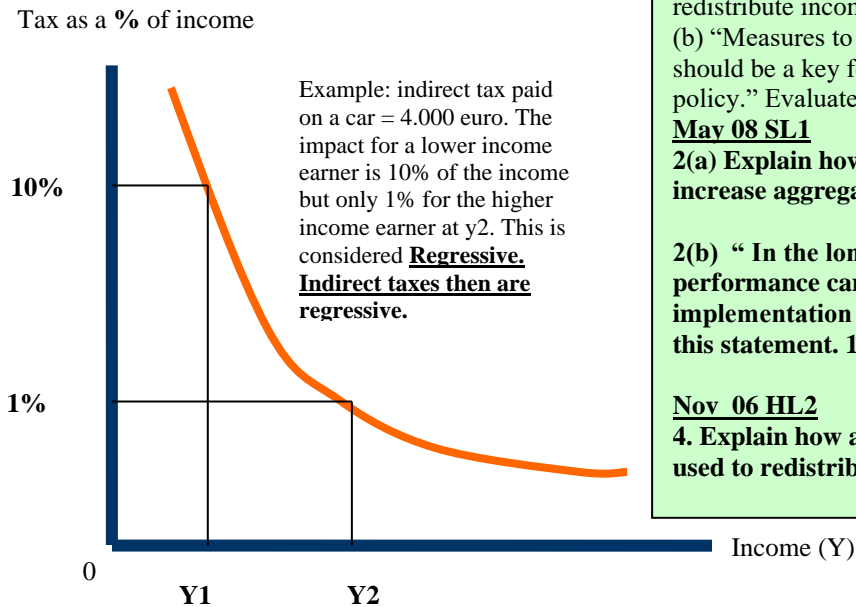
Tax as a **%** of income

10%

Example: indirect tax paid on a car = 4.000 euro. The impact for a lower income earner is 10% of the income but only 1% for the higher income earner at y2. This is considered **Regressive. Indirect taxes then are regressive.**

1%

Income (Y)

0

Y1   **Y2**

How is the regressive nature of the indirect system redressed?

The Progressive Direct Tax system

Band 5 = 80.001 and higher

Income tax rate = 60%

Band 4 = 30.000- 80.000

Income tax rate = 40%

Band 3 = 15001- 30.000   **Income tax rate = 25%**

Band 2 = 5001-15.000   **Income tax rate = 15%**

**Band 1 =0-5000**   **Tax Free Allowance on all incomes:**
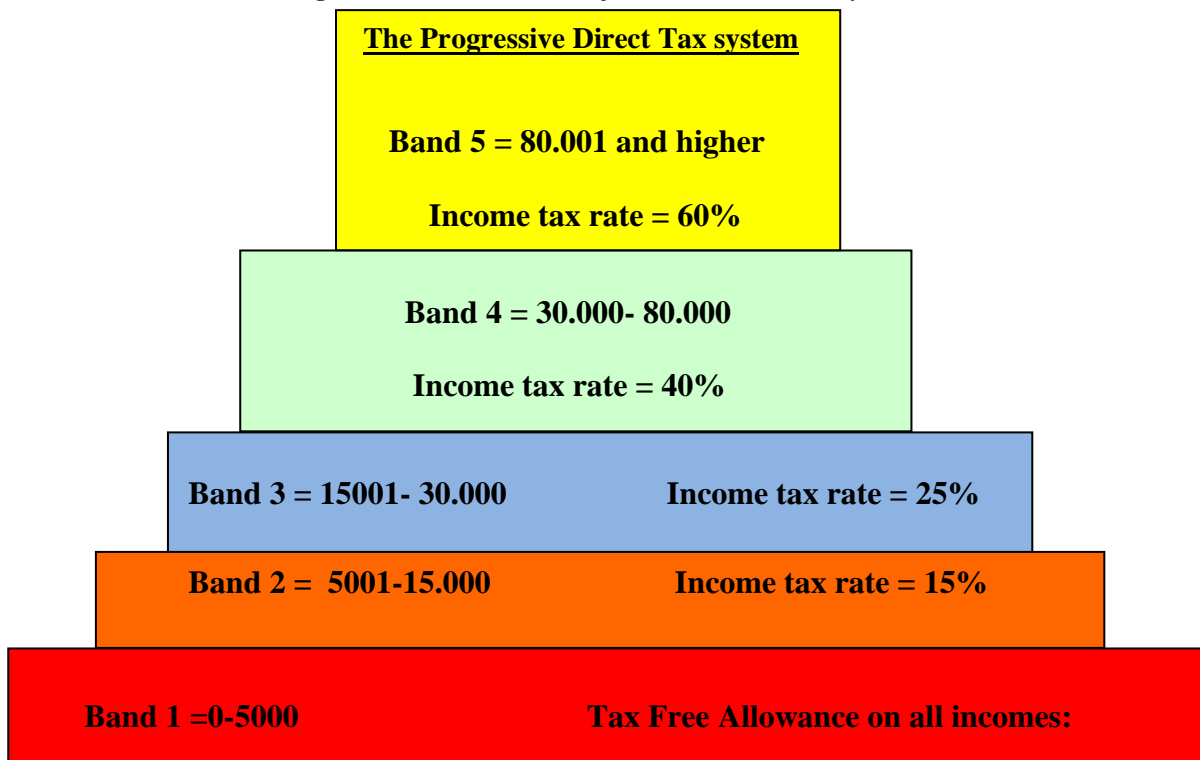
Task:
1. Calculate the disposable income for an income of 120.000 euro
2. how much direct income tax is paid on an income of 120000 euro
3. how much direct tax is paid on an income of 45.000 euro
4. calculate the average tax rate on incomes of 45.000 and 120.000

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ANSWERS

Fig2. Progressive, regressive and proportional taxation (for direct taxation)

Total Tax Paid

P

T6

P = Progressive Taxation

T5

T2

T1

O   y1   y2   y3   y4
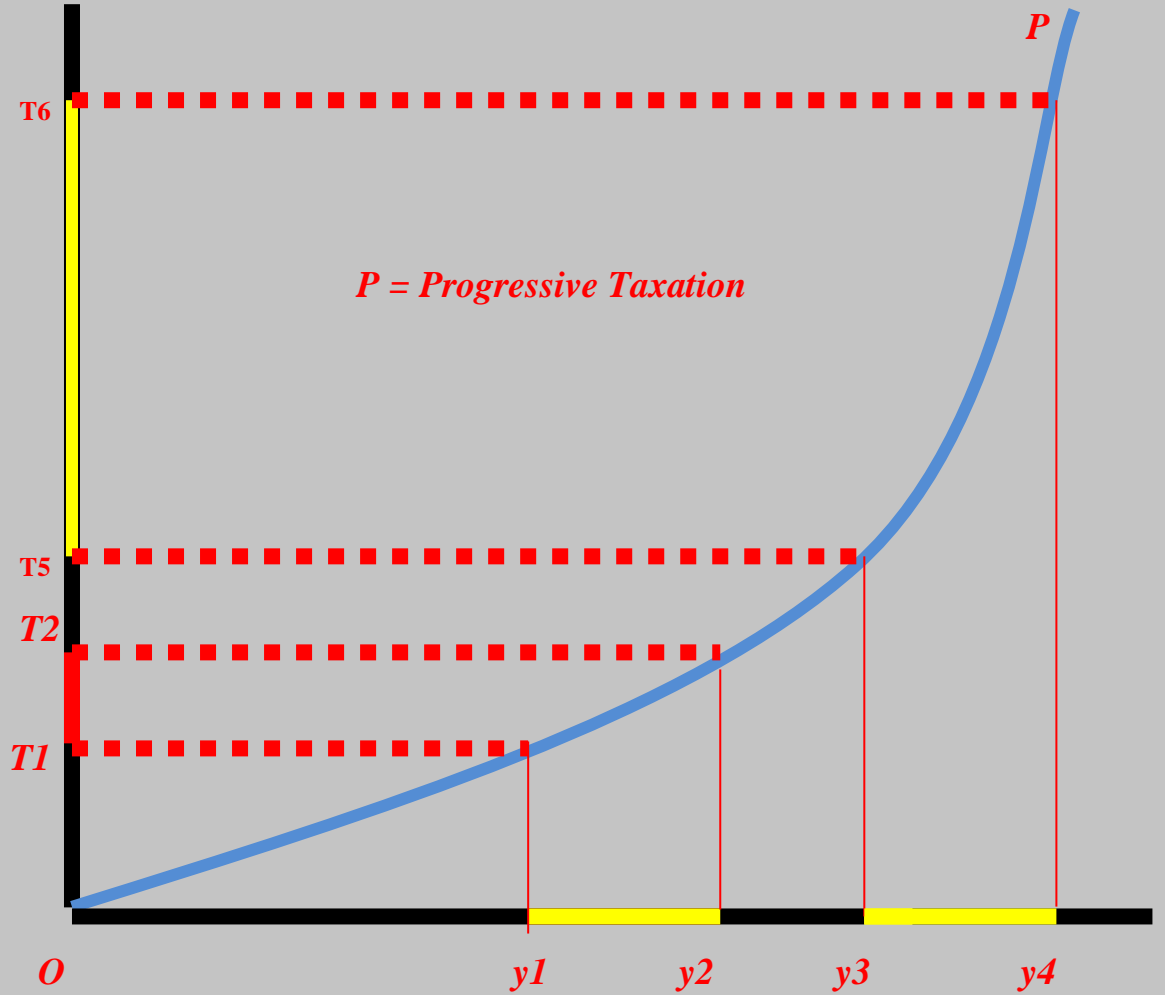
(Y)=income

P = progressive as average rate of tax increases as income Y increases y1 to y2 the tax paid increases from t1 to t2 but for income y3 to y4 the tax rises substantially to t5 to t6.

Calculations: Disposable Income

Can you understand from the numbers why this system of direct taxation is progressive?

Tax Band	Income 120.000 Disposable	Income 120.000 Tax Paid	Income 45.000 Disposable	Income 45.000 Tax Paid
Band 1	5000	0	5000	0
Band 2	8500	1500	8500	1500
Band 3	11250	3750	11250	3750
Band 4	30000	20000	9000	6000
Band 5	16000	24000		
Total	70.750	49.250	33.750	11.250
	Avg % Tax: 41%		**Avg % Tax: 25%**	