

End-of-chapter Questions

Chapter 14: Applying Ability-to-pay Principles: Federal Personal Income Tax

1. Describe the main ways in which the tax base under the federal personal income tax differs from the ideal tax base of Haig–Simons income?
2. What is the economic justification for allowing an exemption of the first dollars of income under an income tax? Is it the same justification as for the exclusions and deductions? Explain.
3.
 - a. What does it mean to say that capital gains are taxed on a realized basis under the federal personal income tax?
 - b. How should capital gains be taxed under the ideal of Haig–Simons income?
 - c. Why does taxing capital gains on a realized basis amount to giving interest-free loans to taxpayers?
 - d. Why might these ‘loans’ violate vertical equity?
4.
 - a. Do the exclusions and deductions under the federal personal income tax violate horizontal equity? Vertical equity? Explain.
 - b. What are some other important economic implications of allowing the exclusions and deductions relative to the ideal of Haig–Simons income?
5. Why are the exclusions and deductions under the federal personal income tax called ‘loopholes’? Do you think these loopholes should be removed? Defend your answer.
6. Why does inflation cause income from capital to be taxed more heavily than wage income under the federal personal income tax?
7.
 - a. What is the marriage penalty under the federal personal income tax?
 - b. Why must some married couples be penalized under the current tax?
 - c. Are there any reforms of the current tax that would eliminate the marriage penalty?
 - d. What might be some undesirable implications of the reform(s) you mentioned in your answer to (c)?
8.
 - a. What is the main economic argument in favor of replacing the federal personal income tax with a personal expenditures tax?
 - b. What is the main economic argument against this reform?

9.
 - a. What is the prepayment option for the taxation of assets under a personal expenditures tax?
 - b. Why is the prepayment option acceptable to proponents of a personal expenditures tax whereas it might not be acceptable to proponents of the personal income tax?
10. Why might a switch from the federal personal income tax to a personal expenditures tax not matter very much to a large number of taxpayers in the U.S.?
11.
 - a. What is a graduated tax? And what is a flat tax?
 - b. What issues discussed in the chapter would disappear if the federal government changed the personal income tax from a graduated tax to a flat tax? What new issues might arise? Explain.