CONCEPT: TAX EFFICIENCY

● *Tax efficiency* implies that one system of collecting taxes can be more efficient than another system

□ There are two efficiency problems that arise from imposing a tax system:

- ***Deadweight Loss*** – inefficiencies that arise from trades that do not occur due to restriction on free trade

> Taxes raise the prices consumers pay and lower the revenues producers receive

- ***Administrative Burden*** – resources used in ______________ and _______________ of tax policies

> Taxpayers must spend time filling forms and keeping records for tax purposes

> The government must employ the IRS and agencies to enforce compliance

> These "wasted" resources are also a type of deadweight loss

● Two tax calculations are important when compromising between an efficient and equitable tax system:

$Average\ Tax\ Rate = \frac{Total\ Taxes\ Paid}{Total\ Income}$ The average rate you pay on all your income	$Marginal\ Tax\ Rate = \frac{\Delta Taxes}{\Delta Income}$ The amount that taxes increase from an additional dollar of income

EXAMPLE: The government taxes the first $50,000 earned at a rate of 20%, while all income above $50,000 is taxed 50%. Calculate the average tax rate and marginal tax rate for a person earning $80,000.

● The most efficient possible tax system would be a _____________ tax

□ Example: The government imposes a tax of $5,000 on every citizen. Every person owes the same amount.

□ This tax would not cause deadweight losses insofar as it does not affect decision making.

- The *marginal tax rate* on earning additional income is ______________

□ The ease of calculating taxes would also minimize the *administrative burden* (no paperwork, simple enforcement)

□ This system is uncommon because there are two goals for a tax system: efficiency and ___________

$10,000 in income	$25,000 in income	$100,000 in income