

How Taxes Work

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By: *Chuck Piola*

A friend shared with me the following tax analogy. It is so humorously true that I want to pass it along. Although this story has been circulated on the Internet, there are plenty of people who will read it for the first time here. It comes from an unknown source via Thomas Davies, Professor of Accounting and Chair of the Division of Accounting and Business Law at The University of South Dakota School of Business. According to Snopes.com, the story was given to Professor Davies who then distributed it to his graduate students without commentary in an effort to get them to think outside the box. Davies noted, "It is rather easy to focus on the myriad of complex rules and forget that tax policy frequently influences taxpayer behavior beyond what may have been intended."

Let's put tax cuts in terms everyone can understand. Suppose that every day, ten men go out for dinner. The bill for all ten comes to \$100. If they paid their bill the way we pay our taxes, it would go something like this:

The first four men — the poorest — would pay nothing; the fifth would pay \$1, the sixth would pay \$3, the seventh \$7, the eighth \$12, the ninth \$18, and the tenth man — the richest — would pay \$59.

That's what they decided to do. The ten men ate dinner in the restaurant every day and seemed quite happy with the arrangement — until one day, the owner threw them a curve (in tax language, a tax cut). "Since you are all such good customers," he said, "I'm going to reduce the cost of your daily meal by \$20." So now dinner for the ten only costs \$80.00.

The group still wanted to pay their bill the way we pay our taxes. So, the first four men were unaffected. They would still eat for free. But, what about the other six — the paying customers? How could they divvy up the \$20 windfall so that everyone would get his "fair share?" The six men realized that \$20 divided by six is \$3.33. But if they subtracted that from everybody's share, then the fifth man and the sixth man would end up being PAID to eat their meal. So the restaurant owner suggested that it would be fair to reduce each man's bill by roughly the same amount, and he proceeded to work out the amounts each should pay. And so the fifth man paid nothing, the sixth pitched in \$2, the seventh paid \$5, the eighth paid \$9, the ninth paid \$12, leaving the tenth man with a bill of \$52 instead of his earlier \$59. Each of the six was better off than before. And the first four continued to eat for free.

But once outside the restaurant, the men began to compare their savings. "I only got a dollar out of the \$20," declared the sixth man who pointed to the tenth. "But he got \$7!" "Yeah, that's right," exclaimed the fifth man, "I only saved a dollar, too . . . It's unfair that he got seven times more than me!"

"That's true!" shouted the seventh man, "Why should he get \$7 back when I got only \$2? The wealthy get all the breaks!"

"Wait a minute," yelled the first four men in unison, "We didn't get anything at all. The system exploits the poor!"

The nine men surrounded the tenth and beat him up. The next night he didn't show up for dinner, so the nine sat down and ate without him. But, when it came time to pay the bill, they discovered a little late, what was very important. They were FIFTY-TWO DOLLARS short of paying the bill! Imagine that!

And that, boys and girls, journalists and college instructors, is how the tax system works. The people who pay the highest taxes get the most benefit from a tax reduction. Tax them too much, attack them for being wealthy, and they just may not show up at the table anymore. Where would that leave the rest?