TAXATION

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Taxation

The most important source of revenue of the government is taxes. The act of levying taxes is called taxation. A tax is a compulsory charge or fees imposed by government on individuals or corporations. The persons who are taxed have to pay the taxes irrespective of any corresponding return from the goods or services by the government. The taxes may be imposed on the income and wealth of persons or corporations and the rate of taxes may vary.

What is Public Finance?

Public finance is the branch of knowledge which is concerned with the income and expenditure of public authorities and with the adjustment of one to another.’ It deals with the study of revenue and expenditure of the government at the center, state and local bodies.

The public authorities have to perform various functions such as maintenance of law and order, provision of defense, production for bringing in economic development. The performance of these functions require large amount of funds which is raised through taxes, fees, fines, commercial revenues and loans.

Public Revenue

This is one of the branches of public finance. It deals with the various sources from which the state might derive its income. These sources include incomes from taxes, commercial revenues in the form of prices of goods and services supplied by public enterprises, administrative revenues in the form of fees, fines etc. and gifts and grants.

Difference between Public revenue and Public receipts

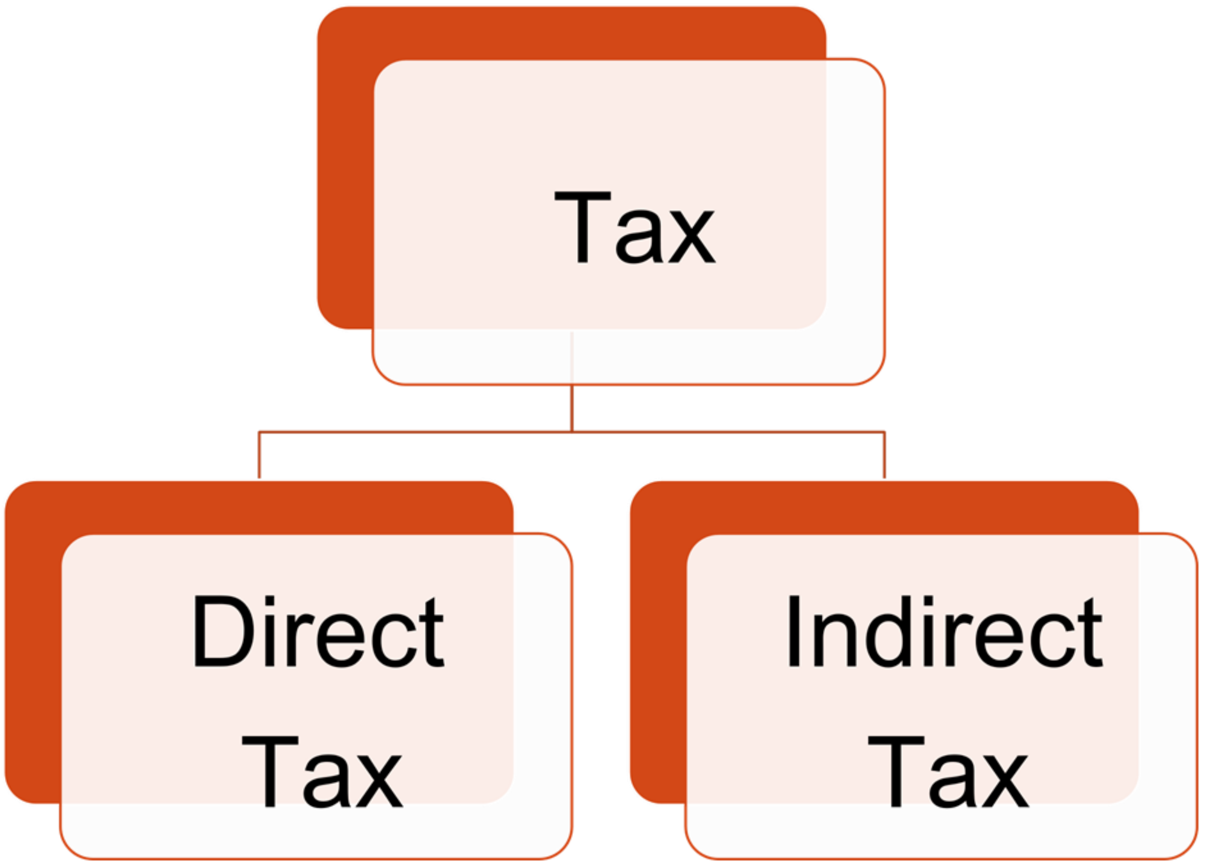
Public revenue includes that income which is not subject to repayment by the government. Public receipts include all the income of the government including public borrowing and issue of new currency. In this way public revenue is a part of public receipts.

Public Receipts = Public revenue + Public borrowing + Issue of new currency

Objectives of Taxes

- Raising Revenue
- Regulation of Consumption and Production
- Encouraging Domestic Industries
- Stimulating Investment
- Reducing Income Inequalities
- Promoting Economic Growth
- Development of Backward Regions
- Ensuring Price Stability

Taxes can be classified into two types:



Direct Taxes

A direct tax is that tax whose burden is borne by the same person on whom it is levied. The ultimate burden of taxation falls on the person on whom the tax is levied. It is based on the income and property of a person.

The examples of Direct taxes are:

- **Corporation Tax**
- **Income Tax**
- **Wealth Tax**
- **Gift Tax**
- **Property Tax**

Indirect Taxes

An indirect tax is that tax which is initially paid by one individual, but the burden of which is passed over to some other individual who ultimately bears it. It is levied on the expenditure of a person.

Examples of Indirect Taxes are:

- Excise Duty
- Sales Tax
- Custom Duties
- Value Added Tax(VAT)

On the basis of degree of progression of tax, it may be classified into:

- Proportional tax
- Progressive tax
- Regressive tax
- Degressive tax

Proportional Taxation

A tax is called proportional when the rate of taxation remains constant as the income of the tax payer increases. In this system all incomes are taxed at a single uniform rate, irrespective of whether tax payer's income is high or low. The tax liability increases in absolute terms, but the proportion of income taxed remains the same.

- ## Progressive Taxation

When the rate of taxation increases as the tax payer's income increases, it is called a progressive tax. In this system, the rate of tax goes on increasing with every increase in income.

- ## Regressive Taxation

A regressive tax is one in which the rate of taxation decreases as the tax payer's income increases. Lower income is taxed at a higher rate, whereas higher income is taxed at a lower rate. However absolute tax liability may increase.

Degressive Taxation

A tax is called degressive when the rate of progression in taxation does not increase in the same proportion as the increase in income. In this case, the rate of tax increases up to a certain limit, after that a uniform rate is charged. Thus degressive tax is a combination of progressive and proportional taxation. This type of taxation is often used in case of income tax.

Canons of Taxation

A good tax system should adhere to certain principles which become its characteristics. A good tax system is therefore based on some principles. Adam Smith has formulated four important principles of taxation. A few more have been suggested by various other economists. These principles which a good tax system should follow are called canons of taxation.

Adam Smith's four canons of taxation

- Canon of Equality
- Canon of Certainty
- Canon of Convenience
- Canon of Economy

- **Canon of Equality**

This states that persons should be taxed according to their ability to pay taxes. That is why this principle is also known as the canon of ability. Equality does not mean equal amount of tax, but equality in tax burden. Canon of equality implies a progressive tax system.

- **Canon of Certainty**

According to this canon, the tax which each individual is required to pay should be certain and not arbitrary. The time of payment, the manner of payment and the amount to be paid should be clear to every tax payer. The application of this principle is beneficial both to the government as well as to the tax payer.

- ## Canon of Convenience

According to this canon, the mode and timings of tax payment should be convenient to the tax payer. It means that the taxes should be imposed in such a manner and at the time which is most convenient for the tax payer. For example, government of Pakistan collects the income tax at the time when they receive their salaries. So this principle is also known as ‘the pay as you earn method’.

Canon of Economy

Every tax has a cost of collection. The canon of economy implies that the cost of tax collection should be minimum.

Conclusion

To conclude, we can say that the instrument of taxation is of great significance on

- increasing the level of economic activity - Regressive taxation
- reducing income inequalities - progressive taxation
- promoting economic growth – Funds could be reinvested

Social-Welfare Objective - Tax payment helps reduce the gap between the haves and have-nots. As it helps in mobilizing the surplus income from the haves and reinvesting them for public welfare, it helps these surplus funds to reach the have-nots.