Taxation

Taxation is a term for when a taxing authority, usually a government, levies or imposes a tax. The term "taxation" applies to all types of involuntary levies, from income to capital gains to estate taxes. Though taxation can be a noun or verb, it is usually referred to as an act; the resulting revenue is usually called "taxes."

A tax is a compulsory payment to the government as per the rules and laws enacted by it. The tax payer cannot expect any service or benefit from the government, in return. If a person fails to pay tax, he is liable to penal action.

Characteristics of a Tax

Main features of a tax are as follows:

1. Tax is a compulsory payment.
2. The revenue received through tax is spent for public welfare.
3. The tax payer does not get any direct service in return for a tax.
4. A tax payer does not get the benefits from the government in proportion to the amount of tax.
5. Payment of taxes is a personal responsibility of an individual.
6. Tax is imposed legally and properly.

Classification of Taxes

Economists have classified taxes from different angles. The various taxes may be classified under the following major heads:

1. Direct and Indirect Taxes

Direct Tax is paid directly by an individual or organization to the imposing entity. A taxpayer, for example, pays direct taxes to the government for different purposes, including real property tax, personal property tax, income tax, or taxes on assets. A direct tax is that tax which is borne by the person on whom it is levied or its burden cannot be shifted to others.

"Direct taxes are levied directly on people." **– Samuelson**

Indirect taxes are those whose burden can be shifted to others so that those who pay these taxes to the Government do not bear the whole burden but pass it on wholly or partly to others. For instance, excise duty on the production of sugar is an indirect tax because the manufactures of sugar include the excise duty in the price and pass it on to buyers. Ultimately, it is the consumers on whom the incidence of excise duty on sugar falls as they will pay higher price for sugar than before the imposition of the tax.

"Indirect taxes are usually defined as taxes that are levied against goods and services and thus only indirectly on people." **– Samuelson**

2. Proportional, Progressive, Regressive and Degressive Taxes

Proportional Taxes implies that the rate of tax does not change with the change in income. A fixed portion of income is levied as tax from all people. For instance, if rate of income tax is 25 per cent, a person with income of Rs. 25,000 will pay Rs. 6,250 as the tax. As against it, a person with income of 50,000 will pay Rs. 12,500 as the tax. Thus, even under proportional income tax, a richer person has to pay greater amount of tax though rate of the tax is the same.

In case of a **progressive tax**, rate of the tax increases as the amount of the tax base (income, wealth or any other object) increases. The principle underlying a progressive tax is that greater the tax base, the higher the tax rate. In India income tax, an important direct tax levied by the Central Government, is progressive. Suppose, a man has an income of Rs. 5,000 per year, and he has to pay 10% tax. If his income increases to Rs. 10,000, the rate of tax may be 15%. Similarly, the rate of income tax may be 20% if the income rises up to Rs. 20,000.

Regressive Taxes implies that the rate of tax decreases with the increase in income. A regressive tax is the opposite of a progressive tax. Thus, under regressive tax system, the burden of the tax is relatively more on the poor than on the rich. A regressive tax is therefore inequitable and no civilized Government in the world today will levy such a tax. This system is unjust and improper.

Degressive Tax is the tax in which the rate of tax begins to increase simultaneously with the increase in income. In other word, the tax rate is progressive. Degressive tax is a combination of the progressive tax and proportional tax.

3. Specific and Ad Valorem Taxes

Indirect taxes can be either specific or ad-valorem. A specific tax on a commodity is a tax per unit of the commodity, whatever its price. Thus the amount of total specific tax will vary in accordance with the changes in total output or sales of the commodity and not with the total value of output or sales.

On the other hand, an ad-valorem type of an indirect tax is levied according to the value of the commodity. For instance, sales tax in India is an ad-valorem tax as the rate of sales tax in case of several commodities is 10 per cent of the value of sales of the commodities. Ad-valorem taxes are progressive in their burden on consumers whereas specific taxes are regressive.

Value Added Tax (VAT) or Ad-Valorem tax is such an indirect tax which is, imposed on Value Added at the various stages of production. Value added tax (VAT) refers to the difference between value of output and value of intermediate consumption. This concept is prevalent in most countries of the world. VAT in fact is the multi-stage sales tax. It is imposed at each stage of production.

Value Added = Total Sales – Cost of Intermediate Consumption = Final Sales = Gross Domestic Product = Rent + Interest + Profit + Wages

4. Single and Multiple Taxes

Single Tax means that only one tax should be levied in the country. For example, if income tax is to be levied, then no other tax, like sales tax, excise duty, land revenue, etc. is to be simultaneously levied. Similarly, if expenditure tax is imposed then income tax or any other kind of tax is not to be simultaneously imposed. This tax may be proportional, progressive, regressive, direct or indirect – of any kind. Thus, **"Single tax is the tax which is imposed on one thing – either income or expenditure."**

Multiple Taxation System is that system in which several kinds of taxes, such as, income tax, expenditure tax, sales tax, etc. are levied simultaneously. This taxation system is prevalent in most of the countries of the world. This system is more flexible, extensive, as well as practical.

Taxes should be levied within limits so that people are not compelled to avoid them and the government should earn adequate revenue without adversely affecting the production and saving in the economy. Taxes should help equal distribution of income and economic development.

Characteristics of Good Taxation System

A good taxation system should have the flowing characteristics:

1) The burden of taxation should be **equitable** across different individuals. System of taxation should be such that each individual contributes a fair share to the tax-income of the government.

2) It should involve **minimum interference** of the government in the free play of the market forces.

3) The system of taxation should be **conducive to growth** of the economy. In no way should it impede the process of growth.

4) A good taxation system should be **simple and clear**, implying the absence of any unnecessary and avoidable complexities.

5) A good taxation system is the one that involves **minimum possible expenditure** by the government to collect it and by the tax-payer to pay it.

6) It should ensure **maximum social advantage**. Taxation should be used to finance public services.

7) The entire structure of the tax system should have **built-in flexibility**, so that changes are possible according to the changing conditions of a dynamic economy.

8) A good taxation system should be **balanced** in nature. It implies that the various taxes should be in some balanced proportion.

9) The tax system should be **multiple**, but then took a great multiplicity is not desirable. A good taxation system has to be also a reasonably efficient administrative system.

10) A good taxation system should be **financially productive**. It should yield adequate revenue. It should also possess the requisite degree of **flexibility**.

In short, a good taxation system is the one that cares for the problems as well as economic rights of the tax-payers. The system should aim at equitable distribution of income and wealth promotion of social welfare as well as growth of the economy.