

# Intro to Taxation

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Taxes are an involuntary fee levied on individuals or corporations that is enforced by a government entity, whether local, regional or national in order to finance government activities. Unlike most transfers of money, which are entered into voluntarily, taxation is compulsory. In previous classes we showed that government must intervene in order to provide adequate amount of public goods. We also showed that contributions to support public services need to be compulsory to avoid the free rider problem.

## Is Taxation theft?

Such forced transfers have been likened to theft. However there is a major difference: transfers through the government wear the mantle of legality and respectability conferred upon them by the political process. When the political process in a country becomes detached from the citizenry and is used to transfer resources to the groups in power, the distinction between taxation and theft becomes blurred at best.

## Adam Smith's four principles for taxation

1. Equality: taxes should equally burden all individuals or entities in similar economic circumstances.
  - Equality of sacrifice: the burden of taxation should involve an equal sacrifice for every individual.
  - Ability to pay: taxes should be levied according to a taxpayer's ability to pay.
2. Economic Efficiency: tax collection efforts should not cost an inordinately high percentage of tax revenues.
3. Convenience: taxes should be enforced in a manner that facilitates voluntary compliance to the maximum extent possible.
4. Certainty/Predictability: collection of taxes should reinforce their inevitability and regularity.

## More principles of Taxation

**Adequacy** : taxes should be just-enough to generate revenue required for provision of public services.

**Broad Basing** : taxes should be spread over as wide as possible section of the population, or sectors of economy, to minimize the individual tax burden.

**Neutrality** : taxes should not favour one group or sector over another, and should not be designed to interfere-with or influence individual decisions-making.

**Simplicity** : tax assessment and determination should be easy to understand by an average taxpayer