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Tax and Taxation and its Character

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Abstract

This paper investigates whether an emissions tax (equivalent to an emissions cap) maximizes social welfare (defined as the sum of consumer and producer surplus) in the presence of incomplete regulation (leakage) or market power by analyzing an intensity standard regulating emissions per unit of output. This paper analyzes the effect of passive investment in rival firms on the setting of uniform taxes and uniform absolute emission standards by the government. This article is concerned with taxation in general, its principles, its objectives, and its effects; specifically, the article discusses the nature and purposes of taxation, whether taxes should be classified as direct or indirect, the history of taxation, canons and criteria of taxation, and economic effects of taxation, including shifting and incidence (identifying who bears the ultimate burden of taxes when that burden is passed from the person or entity deemed legally responsible for it to another).

Keywords: Types; OECD; Proportional; Excise.

1. Introduction

Most countries have a tax system in place to pay for public, common or agreed on national needs and government functions. Some levy a flat percentage rate of taxation on personal annual income, but most scale taxes based on annual income amounts. Most countries charge a tax on individuals' income as well as on corporate income. Countries or subunits often also impose wealth taxes, inheritance taxes, estate taxes, gift taxes, property taxes, sales taxes, payroll taxes or tariffs. Taxation, the imposition of compulsory levies on individuals or entities by governments. Taxes are levied in almost every country of the world, primarily to raise revenue for government expenditures, although they serve other purposes as well. For further discussion of taxation's role in fiscal policy, see government economic policy. In addition, see international trade for information on tariffs.

2. Tax and Taxation

A tax (from the Latin taxo) is a compulsory financial charge or some other type of levy imposed upon a taxpayer (an individual or legal entity) by a governmental organization in order to fund various public expenditures. A failure to pay, along with evasion of or resistance to taxation, is punishable by law. Let's say that you just got an awesome job working at a video game store. You know that you are making $10 an hour, and you are working ten hours a week after school. Because you're an ace in math class, you know that ten times ten is 100. So, your first paycheck should be $100, right? Unfortunately, you won't actually bring home $100 because the federal and state governments collect taxes from your income, or the amount of money you earn. Taxes consist of direct or indirect taxes and may be paid in money or as its labor equivalent. The first known taxation took place in Ancient Egypt around 3000–2800 BC. The use of taxes has been around for centuries, dating back to the first human civilizations. In ancient Mesopotamia, taxes were paid in the form of animals or goods since formal money had not yet been invented. Over the years, different forms of money were invented, and the collection of taxes continued. Today, taxes are collected in different ways and at various levels of government. Let's find out more about the collection and purpose of taxes.

In modern economies, taxes are the most important source of governmental revenue. Taxes differ from other sources of revenue in that they are compulsory levies and are unrequited—i.e., they are generally not paid in exchange for some specific thing, such as a particular public service, the sale of public property, or the issuance of public debt. While taxes are presumably collected for the welfare of taxpayers as a whole, the individual taxpayer's liability is independent of any specific benefit received. There are, however, important exceptions: payroll taxes, for example, are commonly levied on labor income in order to finance retirement benefits, medical payments, and other social security programs—all of which are likely to benefit the taxpayer. Because of the likely link between taxes paid and benefits received, payroll taxes are sometimes called "contributions" (as in the United States). Nevertheless, the payments are commonly compulsory, and the link to benefits is sometimes quite weak. Another example of a tax that is linked to benefits received if only loosely, is the use of taxes on motor fuels to finance the construction and maintenance of roads and highways, whose services can be enjoyed only by consuming taxed motor fuels.

In economic terms, taxation transfers wealth from households or businesses to the government. This has effects which can both increase and reduce economic growth and economic welfare. Consequently, taxation is a highly debated topic. Mark Twain once said that there were only two things in life that were as certain as the dawn, death, and taxes. It is true, we as a society have come to accept the inevitability of taxes. Everyone hates them, but we recognize their need.

Taxes are any payment on behalf of the individual to the government. Taxes are used to pay for all government services. Without taxes, the government would have no money to operate.

Just about every taxpayer complains about the high rate of taxes, yet if one were asked if they would trade the tax for the removal of service, they would rather pay the tax. In order for taxes to be acceptable, however, they must meet certain criteria. In order for a tax to be successful, it must be equitable, simple, and efficient. For most Americans, it is believed that taxes should be impartial and fair. However, there is a dispute over the level of equity of a tax. Some believe that a tax is fair only if everyone pays the same amount- a flat tax. Others argue that a tax is only fair if wealthier people lay more than those with lower incomes- progressive tax is are. Many also argue over the equity of tax loopholes seeing that they allow some people to get out of paying certain taxes. A second standard for taxes is simplicity. Tax laws should be written in an intelligible manner so that both the taxpayer and the tax collector can understand them. Though it is not an easy task, people are more willing to pay their taxes if they understand them. Efficiency is the final principle of taxation. A tax should be easy to administer and to gain money from. The income tax fits into this category. An employer withholds a portion of each employee's pay and then sends a single check to the government on a regular basis. At the end of the year, the employer notifies each employee of the amount of tax withheld. Other taxes are less efficient. Those collected in toll booths are considered so because the state invests millions of dollars into reinforcing booths, but the cost to commuters is the damage to their automobile from having to slow down and use the booths. Efficiency also means that the tax should raise enough revenue to be worthwhile. If it doesn't, or it hurts the economy, it has little value.

3. Principles of Taxation

The benefit principle of taxation is based on two ideas. The first and foremost is that those who benefit from services should be the ones who pay for them. Secondly, people should pay taxes in proportion to the number of services or benefits they receive. But there are two limitations of this type of taxation. First, many government services provide the greatest benefit to those who can least afford to pay for them (i.e. welfare). The second limitation is that the benefits often are hard to measure.

The second principle of taxation is the ability-to-pay, which is based on the idea that people should be taxed according to their ability to pay, regardless of the benefits they receive. This type of tax recognizes that societies are not always able to measure the benefits derived from government spending. It also assumes that persons with higher incomes suffer less discomfort paying taxes than a person just getting by on their income would.

4. Purposes Of Taxation

During the 19th century, the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have utilized taxation for other than merely fiscal purposes. One useful way to view the purpose of taxation, attributable to American economist Richard A. Musgrave, is to distinguish between objectives of resource allocation, income redistribution, and economic stability. (Economic growth or development and international competitiveness are sometimes listed as separate goals, but they can generally be subsumed under the other three.) In the absence of a strong reason for interference, such as the need to reduce pollution, the first objective, resource allocation, is furthered if tax policy does not interfere with market-determined allocations. The second objective, income redistribution, is meant to lessen inequalities in the distribution of income and wealth. The objective of stabilization—implemented through tax policy, government expenditure policy, monetary policy, and debt management—is that of maintaining high employment and price stability.

5. The Three Types of Taxes

The three types of taxes are the proportional tax, the progressive tax, and the regressive tax. A proportional tax imposes the same percentage of taxation on everyone, regardless of income. If the percentage tax rate is constant, the average tax rate is constant, regardless of income. This means that if a person's income goes up, the percentage of total income paid in taxes doesn't change.

The second tax, the progressive tax, imposes a higher percentage rate of taxation on those with higher incomes. Progressive taxes use a marginal tax rate that increases as the number of taxable income increases. Therefore, the percentage of income paid in taxes increases as income goes up.

The final tax is the regressive tax, which imposes a higher percentage rate of taxation on low incomes than on high incomes. For example, if the state sales tax were 5%, the person with the lower income would pay a greater percentage of their total income in sales tax.

6. Tax Revenue

Where income tax is the largest form of income for the federal government, the sales tax in the largest source of revenue for states. Rates for the sales tax varies for each state. By definition, a sales tax is a general tax levied on consumer purchases of nearly all products. It is added to the final price the consumer pays, and merchants collect the sales tax at the time of sale. The taxes are then given to the proper state government agency on a weekly or monthly basis. The sales tax is an effective way for states and cities to raise revenue. The tax is difficult to avoid and because of that, it raises huge sums of money. The sales tax, however, is a regressive tax because it is the same percentage rate for all people, meaning the percentage of income paid in sales tax goes up as the income goes down. The second-largest source of revenues for state governments are funds that they receive from the federal government. These funds help finance highways, health, hospitals, education, and welfare. The third-largest source of state revenue comes from the individual income tax. Generally, individual income tax revenues are about five times as large as the income tax collected from corporations. Lastly, many states impose taxes, fees, or other assessments on their employees to cover the cost of state retirement funds and pension plans.

A majority of the revenues for local governments come from intergovernmental transfers from state governments. They are generally for the purpose of education or welfare. A smaller amount comes from the federal government, mostly for urban renewal. The second-largest source of revenue for local governments comes from the property tax- a tax on real property and tangible and intangible personal property. Real property includes real estate, buildings, and anything permanently attached such as central heating. Tangible personal property includes all tangible items of wealth not permanently attached to land or buildings. Intangible personal property is property with an invisible value and is represented by paper documents such as stocks, bonds, or checks. However, out of all of these property taxes, the real estate tax raises the most revenue. Taxes on personal property are rarely collected because of the problem of valuation. In addition, it would be neither efficient nor effective to have a tax assessor view everyone's personal property, and come up with values for all of them. The third-largest source of revenue for local governments is utility and state-owned liquor store income. Finally, many towns and cities impose their own sales taxes in order to increase revenue. Merchants collect these taxes right along with the state sales tax and the point of the sale.

Many of the taxes paid to the federal, state, and local governments are deducted from one's paycheck. A worker will have taxes taken out for the federal, state, and city governments with the amount taken out decreasing in this order. FICA is also taken out. Sometimes if a worker has insurance payments or retirement contributions, purchases savings bonds, or puts money into a credit union, even more, deductions will appear on the paycheck, though they are not taxes. The only major taxes that don't appear on the paycheck are state sales taxes, local property taxes, and federal excise taxes.

7. About OECD

Tax is at the heart of our societies. A well-functioning tax system is the foundation stone of the citizen-state relationship, establishing powerful links based on accountability and responsibility. It is also critical for inclusive growth and for sustainable development, providing governments with the resources to invest in infrastructure, education, health, and social protection systems. Across the whole range of policy issues facing governments today, tax finds itself playing a central role, whether it is about collecting sufficient resources to fund the infrastructure of a society or acting as a policy lever to reflect attitudes and choices about such diverse areas as climate change, gender equality, education, health. The OECD and its Centre for Tax Policy and Administration have worked tirelessly to shepherd these issues and provide a focal point for an inclusive conversation that leads to world-class standards and effective implementation, always recognizing the full range of contexts and constraints faced by countries. We have achieved great success in tackling tax evasion through the Global Forum on Transparency and Exchange of Information for Tax Purposes (which has more than 150 members) – it is estimated that by June 2018, jurisdictions around the globe have identified EUR 93 billion in additional revenue (tax, interest, penalties) as a result of voluntary compliance mechanisms and other offshore investigations put in place since 2009. Moreover, the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project now has over 115 members in its BEPS Inclusive Framework, all working together to ensure that tax is paid where value is created. In the midst of this great transformation of the international tax environment taxpayers and governments raised the issue of uncertainty in tax matters from the perspective of businesses and tax administrations. In response to the call from G20 Leaders, the OECD and the IMF have produced a report identifying the sources of uncertainty in tax matters. The Organisation for Economic Co-operation and Development (OECD; French: Organisation de coopération et de développement économiques, OCDE) is an intergovernmental economic organization with 36 member countries, founded in 1961 to stimulate economic progress and world trade. It is a forum of countries describing themselves as committed to democracy and the market economy, providing a platform to compare policy experiences, seek answers to common problems, identify good practices and coordinate domestic and international policies of its members. Most OECD members are high-income economies with a very high Human Development Index (HDI) and are regarded as developed countries. As of 2017, the OECD member states collectively comprised 62.2% of global nominal GDP (US$49.6 trillion) and 42.8% of global GDP (Int$54.2 trillion) at purchasing power parity.OECD is an official United Nations observer.

8. Accumulated Earnings Tax

The accumulated earnings tax is a tax imposed by the federal government on companies with retained earnings deemed to be unreasonable and in excess of what is considered ordinary. Essentially, this tax encourages companies to issue dividends, rather than retain their earnings. C corporations that have a habit of accumulating their earnings or profits, instead of distributing them as dividends to shareholders will be subject to the accumulated earnings tax if the amount of earnings retained is above a certain level. These companies may accumulate earnings up to $250,000 without incurring an accumulated earnings tax; any amount higher is deemed by the Internal Revenue Service as beyond the reasonable needs of the business. A business whose principal function is performing services in the fields of accounting, actuarial science, architecture, consulting, engineering, health (including veterinary services), law, and the performing arts has an exemption amount of $150,000.

In effect, an accumulated earnings tax of 20% is applied on retained earnings that exceed the exemption amount. The government imposed this tax to deter investors from negatively influencing a company's decision to pay dividends since investors or shareholders would avoid paying tax on dividends if the company does not distribute the earnings in the first place. The premise behind this tax is that companies that retain earnings typically experience higher stock price appreciation. Although this is beneficial to stockholders as capital gains taxes are lower than dividend taxes, it is detrimental to the government because tax revenues decrease. By adding an extra tax upon a firm's retained earnings, the taxman will either collect more taxes from the company or persuade them to issue dividends, thereby, allowing the government to collect from the stockholders.

A corporation that has an unreasonable accumulation of earnings may be liable to pay the accumulated earnings tax unless the business can show that the earnings were not accumulated to allow its shareholders to avoid tax. If a C corporation retains earnings (doesn't distribute them to shareholders) above a certain amount, an amount which the IRS concludes is beyond the reasonable needs of the business, the corporation may be assessed tax penalty called the accumulated earnings tax (IRC section 531) equal to 20 percent (15% prior to 2013) of accumulated taxable income.

9. Ad Valorem Tax

Ad Valorem tax simply means a tax charged by state and municipal governments that depends on the assessed value of the asset such as real asset or personal property. It comes from a Latin word known as "according to value". The most common example of Ad valorem tax is property tax in which public tax assessor periodically review the value of a property of real asset and charge the tax based on that value. An ad valorem tax is a tax based on the assessed value of an item, such as real estate or personal property. The most common ad valorem taxes are property taxes levied on real estate. However, ad valorem taxes may also extend to a number of tax applications, such as import duty taxes on goods from abroad. The Latin phrase ad valorem means "according to value." All ad valorem taxes are levied based on the determined value of the item being taxed. In the most common application of ad valorem taxes, which are municipal property taxes, the real estate of property owners is periodically assessed by a public tax assessor to determine its current value. The assessed value of the property is used to compute a tax annually levied on the property owner by a municipality or other government entity. The Latin phrase ad valorem means "according to value." All ad valorem taxes are levied based on the determined value of the item being taxed. In the most common application of ad valorem taxes, which are municipal property taxes, the real estate of property owners is periodically assessed by a public tax assessor to determine its current value. The assessed value of the property is used to compute a tax annually levied on the property owner by a municipality or other government entity. An ad valorem tax (Latin for "according to value") is a tax whose amount is based on the value of a transaction or of property. It is typically imposed at the time of a transaction, as in the case of a sales tax or value-added tax (VAT). An ad valorem tax may also be imposed annually, as in the case of a real or personal property tax, or in connection with another significant event (e.g. inheritance tax, expatriation tax, or tariff). In some countries, stamp duty is imposed as an ad valorem tax.

10. Excise tax

Excise tax refers to an indirect type of taxation imposed on the manufacture, sale or use of certain types of goods and products. Excise taxes are commonly included in the price of a product, such as cigarettes or alcohol, as well as in the price of an activity, often gambling. Excise taxes may be imposed by both Federal and state authorities.

Excise taxes usually fall into one of two types:

Ad Valorem; meaning that a fixed percentage is charged on a particular good or product. This administration of the tax is less common.

Specific; meaning that a fixed currency amount may be imposed depending on the quantity of the goods or products that are purchased. Specific is the most common type.

For example, a bottle of wine that normally costs $10 may have a specific excise tax of $2 imposed on it. As per the intent of the excise tax, the additional cost of the wine is passed onto the consumer, making the retail cost of the bottle $12. While this seemingly does not affect the maker of the wine, who still gains $10 in revenue, an increase in price does reduce quantity demanded, which would indeed affect his balance sheet.

11. Federal income tax

Federal income tax is a tax on a range of certain kinds of income. Taxpayers generally calculate and pay federal income tax by filing an IRS Form 1040 by April 15 of each year. The United States has a progressive tax system, which means that different portions of a person's or company's income are taxed at increasing rates (that's why the rates are often referred to as marginal tax rates). For example, the IRS might tax a single filer's $100,000 income as follows:

The first $8,025 is taxed at 10% = $802.50
The next $24,525 is taxed at 15% = $3,678.75
The next $49,100 is taxed at 25% = $12,275
The next and final $18,350 is taxed at 28% = $5,138
Total tax owed: $21,894.25

The highest federal tax bracket changes often, but it is usually around 35% of any income over about $375,000 (note that this excludes state taxes and social security/Medicare, which can add as much as another 17% to 18% in taxes, for a total of as much as 53% in taxes on additional income). Federal income taxes generate about 42% of the governments total tax revenue, according to the Tax Policy Center. This amounted to $2.2 trillion in 2010.

Not all taxpayers have to pay federal income tax. The amount owed is a function of a myriad of circumstances, including income levels, personal status, and eligibility for deductions and credits. In some cases, taxpayers have remitted more than they owe, which generates a refund.

In general discourse, it is important to know the difference between federal tax brackets and federal tax rates. Many people assume that when they're in the 28% tax bracket, for example, that all of their income is taxed at 28%, which is not the case. As our example shows, you can be in the 28% federal tax bracket but actually, have a 21.89% effective tax rate on your income. It is also important to note that states may impose their own income taxes on taxpayers, which will be over and above the federal income tax.

12. Proportional Tax Defined

A proportional tax system is one in which income tax is the same percentage of income from every person no matter how much income the person makes. A proportional tax system, often also referred to as a flat tax, does not consist of income tax brackets, as the U.S. federal income tax does. The Internal Revenue Service does claim that the United States overall comes close to having a proportional tax system because it mixes a progressive -- higher tax rate as income rises -- income tax with the regressive Social Security and property taxes -- lower tax rate as income rises. A proportional tax is an income tax system where the same percentage of tax is levied on all taxpayers, regardless of their income. A proportional tax applies the same tax rate across low, middle, and high-income taxpayers. In contrast, the progressive tax system adjusts tax rates by incomes. A proportional tax is a tax imposed so that the tax rate is fixed, with no change as the taxable base amount increases or decreases. The amount of the tax is in proportion to the amount subject to taxation. "Proportional" describes a distribution effect on income or expenditure, referring to the way the rate remains consistent (does not progress from "low to high" or "high to low" like income or consumption changes), where the marginal tax rate is equal to the average tax rate. A marginal rate taxing system, such as the flat tax, has a constant rate for both businesses and individual taxpayers. In some instances, a sales tax can also be considered a type of proportional tax since all consumers, regardless of earnings, are required to pay the same fixed rate. The sales tax rate applies to goods and services, and the income of the purchaser is not a part of the equation. Other examples include poll taxes and the capped portion of the Federal Insurance Contributions Act (FICA) payroll deductions. Proportional taxes are a type of regressive tax because the tax rate does not increase as the amount of income subject to taxation rises, placing a higher financial burden on low-income individuals. A tax is said to be regressive if it has an inverse association where the average tax carries less impact on higher-income individuals or businesses. Opponents of the proportional tax have claimed that higher-income earners should pay a higher percentage than poorer taxpayers. They see the system as placing a more significant burden on middle-income earners to carry a large portion of government spending. While the percentage of tax is the same, which can be regarded as fair, the after-tax effect on low-income earners is more burdensome than for high-income earners. To understand a proportional tax system, it is important to also look at how it defines income. If a system has generous deductions, then low-income earners may be exempt from tax, thus eliminating, at least in part, the regressive aspects of the tax. Variations of the proportional tax include allowing mortgage deductions and setting lower income levels.

13. Conclusion

Governments impose charges on their citizens and businesses as a means of raising revenue, which is then used to meet their budgetary demands. This includes financing government and public projects as well as making the business environment in the country conducive for economic growth. Without taxes, governments would be unable to meet the demands of their societies. Taxes are crucial because governments collect this money and use it to finance social projects. Governance is a crucial component in the smooth running of country affairs. Poor governance would have far-reaching ramifications on the entire country with a heavy toll on its economic growth. Good governance ensures that the money collected is utilized in a manner that benefits citizens of the country. This money also goes to pay public servants, police officers, members of parliaments, the postal system, and others. Indeed, with a proper and functioning form of government, there will be no effective protection of public interest.

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