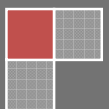




AN HONEST TAX SYSTEM

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A nation's tax system is often a reflection of its communal values or/and the values of those in power. To create a system of taxation, a nation must make choices regarding the distribution of the tax burden—who will pay taxes and how much they will pay—and how the taxes collected will be spent. In democratic nations where the public elects those in charge of establishing the tax system, these choices reflect the type of community that the public and/or government wish to create. In countries where the public does not have a significant amount of influence over the system of taxation, that system may be more of a reflection on the values of those in power.

The resource collected from the public through taxation is always greater than the amount which can be used by the government. The difference is called *compliance cost*, and includes for example the labour cost and other expenses incurred in complying with tax laws and rules. The collection of a tax in order to spend it on a specified purpose, for example collecting a tax on alcohol to pay directly for alcoholism rehabilitation centres, is called **hypothecation**. This practice is often disliked by finance ministers, since it reduces their freedom of action. Some economic theorists consider the concept to be intellectually dishonest since (in reality) money is fungible. Furthermore, it often happens that taxes or excises initially levied to fund some specific government programs are then later diverted to the government general fund. In some cases, such taxes are collected in fundamentally inefficient ways, for example highway tolls.

In every place where the authority deducts taxes from the income of residents, there is always a system. Some are more established and professional than others. Each of these systems operates based on certain principles that are determined by factors such as party ideology, religious factors and historical factors. However, there are certain principles which broadly define what a good system should be all about. Here are three of them:

Economy of Collection

A good tax system must be designed in such a way that the cost of collecting the taxes is low for both the collecting agency and the taxpayer. At the same time, the cost of enforcing the

rules must also be low for the overseeing authorities. For example one should not spend Rs.10, 000 in following up someone to pay Rs.1, 000, unless one expects to use him or her as an example to the rest.

Sometimes tax agencies can be overzealous in trying to make sure that each and every taxpayer pays their taxes. With such an attitude, an agency might end up fulfilling the Pareto principle where 80% of the agency's resources are directed towards following up only 20% of the taxpayers.

The Principle of Equity

The principle of equity is another characteristic of a good tax system. Though the exact definition of an equitable tax system is rather blurred, the basic idea here is that everyone must pay according to his or her own ability.

This may mean that people should pay at a fixed rate but different amount depending on their income (proportional tax,) or pay taxes at different tax rates depending on their income (progressive tax.)

Another thing that usually comes up when people talk about equity and fairness in tax systems is the fact that different income sources should not be treated differently. Income that comes from working as a politician should be taxed at the same rate as that which comes from working as a teacher.

The Principle of Simplicity

Another important principle of taxation is simplicity. The process of calculating and submitting tax returns should be simple enough without the need for specialized training. However, we know that this rarely happens. Filling returns is one of the most difficult jobs that the average citizen engages in during the year.

Simplicity is important in a tax system because it helps reduce the cost of filling returns by preventing the hiring of tax specialists. Again, it also helps one to pay the right amount of taxes by avoiding overestimating or underestimating the taxable income. Complexities in the tax process also form many loopholes that can be used by those people who would love to evade or avoid taxes.

These three principles of taxation are not exhaustive. However, they form good basis for coming up with and establishing tax systems.

Although some people equate a good tax system to socialism where the rich are "punished" for being rich, these principles will actually help the society to increase both communal and individual wealth...

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