TAXATION AND FISCAL POLICY

LECTURE 1

WINFRED

HISTORY OF TAXATION IN GHANA

- Taxation can be traced to Roman history.
- Notable people mentioned in the era of Jesus Christ were Zaccheus and Matthew.
- Jesus was asked about the legality of taxation and his reply was that " Render unto Caesar the things that are Caesar"
- In 1850 the first effort of taxation was made where imported goods were taxed at rate of ½% ad valorem
- In 1852, those were in British protected territory were asked to pay one shilling per head for every man, woman and child. This was short-lived due to demonstration and riot from locals.
- In September 1931, income tax introduction was fiercely resisted from the legislative assembly and tax was imposed on cocoa exports which yielded sufficient revenue.
- After the World War II, demand for cocoa in the world market experience significant dipped and government had no alternative than to introduce income tax . This was to Sir Allan Burns.

Definition

- Tax is a compulsory monetary contribution levied and collected by a public authority having tax jurisdiction pursuant to a legislation on an economic entity for which no direct benefit is guaranteed. This definition provides the following attributes
  - Taxes are unilaterally imposed rather than negotiated
  - Taxes are monetary
  - Taxes are imposed and collected by sovereign government/governmental agency
  - Taxes are imposed pursuant to a legislation
  - Payment of taxes do not guarantee any direct benefit
- According to Justice Oliver Wendell Holmes " Taxation is the price we pay for living in a civilised society"

Function and purpose of taxation in modern economy

- Revenue objective
- Tax as a tool for fiscal policy.
- Tax as a tool for wealth redistribution: This involves the use of progressive tax regime.
- Taxes as a tool for protecting of local industries
- Taxes can be used as a tool to discourage consumption of certain commodities
- Tax as a tool for stimulating economic growth

Canons of taxation

- Equity: Tax systems should be and be seen as fair to all tax payers. This is explained by horizontal and vertically equity
- Certainty: Taxpayer should be able to determine their true tax liability with a fair degree of accuracy. This is achieved with less ambiguous Tax ACT and competent tax administrators.
- Convenience: Good tax Act should be convenient for the government to administer for the people. Taxpayers should not suffer unduly to honour their responsibilities under the ACT.
- Economy: This deals with cost benefit analysis of tax administration.
- Productivity: A tax system should produce high tax yield but not so high to damage the source of that revenue
- Simplicity: A tax system ought to be simple, plain and intelligible.

Impact and Incidence and Taxable capacity

- The impact of a tax is the pinch of payment and this is on the person who pays the tax initially. This the first point of contact
- The incidence of a tax refers to the ultimate economic burden represented by the tax. The final resting place of the tax
- The taxable capacity is a limit of a country's capacity to accept and absorb taxation imposed by the Tax ACT. This is influenced by:
  - The real wealth of the nation
  - Attitude of the population to taxation
  - The type of taxes levied
  - The possibilities of tax evasion

TYPES OF TAX

- Direct tax: This tax is intended to be paid by the person or organization on whom/ which it is actually levied. The impact and incidence being on the same person or organization. Eg. Income tax, gains on realization of assets and liabilities, gift tax, corporate tax and property tax . The administering authority is Domestic Tax Revenue Division.
- Advantages

1. Incidence and yield easy to determine
2. The taxpayer knows with certainty amount expected to pay
3. Yield increases in relation wealth and population
4. It is generally progressive

Disadvantages

1. Heavy cost of administration

2. Easy to evade

Indirect tax

- Indirect tax is a tax charged on a person who consumes the goods and services and is paid indirectly to government. The tax burden is easily shifted to the another person. This tax is regressive in nature. Both poor and rich are levied equally. Eg VAT, Communication Service tax, Excise duty and custom duty.
- Advantages

1. Payment and collection of the tax are easy and convenient
2. Yield is elastic
3. Tax evasion is difficult
4. Restriction of harmful consumption
5. Incentive and enterprise are not harmed

Disadvantages

1. They are often regressive
2. Revenue may be uncertain where the demand for the taxed goods is elastic
3. Incidence is not easy to determine
4. It defeats equity system of tax administration

Principal sources of tax laws

- Domestic law: Eg Income Tax ACT,2015 (ACT 896), VAT ACT, 2013 (ACT 870) Communication services Tax Act, 2008 (Act 754)
- Court cases and ruling
- Statement of practice by the tax authorities
- Regulations of directives imposed by a supranational body
- International body

Basic principles of taxation

- The entity variable: This focuses on individuals and companies as the two types of taxpaying entities involved in business and investment transaction
- Time period variable: This looks the present value of tax liability to be paid.
- Jurisdiction variables. This deals with where the entity is located
- Character variable. This deals the characteristics of income subject to tax

Tax avoidance and Tax evasion

- Tax avoidance takes the form of taking advantages of all entitlement, reliefs, rebates exemptions or any other loophole in the tax Act. It is a legal way of operating within the ambit of the law to pay what is due. To be successful in avoidance, thorough understanding of tax provision is paramount.
- Tax evasion refers to failing to pay legally due taxes or using illegal means to reduce taxes. It involves understatement of income and overstatement of expenditure. Tax evasion is criminal and punishable under the law of Ghana in the form of heavy fines and imprisonment.
- Ways by which companies evade tax include:
  - Underreporting income
  - Inflating deductions or expenses
  - Hiding money
  - Hiding interest in offshore accounts

Fiscal policy

- Fiscal policy is the use of government spending and taxation to influence the economy. Government uses fiscal policy to promote strong and sustain growth as well as reduction in poverty level of citizenry.
- Taxation as instrument of fiscal policy: This involves government deliberate use of taxes to move the economy in the desired direction. This involves inflationary and deflationary gap analysis.

a. Inflationary gab: this is where government transfers private sector funds to public sector through increase in the tax rates. This is done to reduce the disposable income of the business and individual to keep inflation in check.

b. Deflationary gab: . In other hand during the sluggish period, government stimulates the economy through reducing tax rate and granting of tax relief and incentives to individual and private sector businesses. To individuals tax cuts and relief increases their disposable income and hence the aggregate demand for goods and services.

Objectives of Fiscal Policy

- Employment creation and full employment
- Price Stability:
- To Accelerate the Rate of Economic Growth: Taxation be used properly so that production, consumption and distribution will not have negative effect
- Optimum Allocation of Resources: Fiscal measures like taxation can greatly affect the allocation of resources in various occupations and sectors of the economy
- Equitable Distribution of Income and Wealth: A redistributive tax policy should be highly progressive and aim at imposing heavy taxation on the richer and exempting poorer sections of the community
- Economic Stability: addressing balance of payment
- Capital Formation and Growth
- Promotion of investment

automatic stabilizers and ***discretionary*** fiscal policies

Automatic stabilizers This where some tax and expenditure programs change automatically with the level of economic activity. These are called Automatic Stabilizers.Automatic stabilisers refer to how fiscal instruments (taxes and government spending) will influence the rate of growth and help counter swings in the economic cycle

- **Discretionary Fiscal Policy:**Discretionary fiscal policy refers to deliberate changes in taxes or spending. The government cannot control certain aspects of the economy related to fiscal policy.The government can control tax rates but not tax revenue. Tax revenue depends on household income and the size of corporate profits. Government spending depends on government decisions and the state of the economy

The Objectives of public expenditure as a fiscal tool

- Provide social goods
- Reduce unemployment
- Increase Production
- Exploitation and Development of Mineral Resources
- Promote Price Stability
- Promote Balanced Growth
- Reduce Inequality of Income:

Public Debt

- **Public debt** is defined as how much a country owes to lenders outside of itself. These can include individuals, businesses, and even other governments. The term "public debt" is used interchangeably with the term sovereign debt. Public debt is the accumulation of annual budget deficits. It's the result of years of Government spending more than they take in via tax revenues. **Public debt includes Treasury bills, notes, and bonds, which are typically bought by large investors**.
- Types of Public Debt

  Domestic

  a. short b. long term debt

  External debt

Domestic Debt

- Reasons for domestic debt
- To meet ever-increasing government expenditure
- Budget deficit financing
- Meeting government socio –economic responsibilities
- Meeting government short fall in domestic tax revenue
- Avoid the cost associated with external debt

External Debt

- To free domestic debt market
- huge capital required
- currency stability
- Increase in domestic import

Public Debt as an Alternative to Taxation

- Public borrowing has an important advantage over taxation
- When public project has long gestation period and tax is being moved from current to future generations.
- Public debts enable governments to facilitate growth take-offs by investing in a critical mass of infrastructural projects and social sectors of the economy where taxation capacity may be limited
- Public debt is a safe way for foreigners to invest in a country's growth by buying government bonds
- public debt improves the standard of living in a country whilst Taxation increase the cost of living of citizens

Consequences of Public Debt on the Economy

- Large public debt implies high interest payments and these are borne by tax payers
- Government borrowing increases the total demand for credit in the economy, driving up the cost of borrowing in the process
- Currency collapse or currency depreciation when monies are printed to finance public debts