Principles and characteristics of Taxation

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Co-funded by the European Union

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The tax system

- A tax system should ensure equity and fairness. Taxpayers should feel equal to the obligations they will have to pay.

- Taxes should be clear and simple. Taxpayers should know not only the tax obligations but also the time when they must pay them, how they will be paid and how they will be calculated.
- The simplicity of a tax system facilitates the work of taxpayers in the calculation of obligations and reduces the possibility of avoiding the payment of taxes and duties.

Characteristics of taxes

- The most important elements that determine a tax are: tax object, tax base and tax rates.

- The tax object is any activity or item that is subject to a tax. The tax object shows what is taxed.

- The taxable base is the value on which the tax liability is calculated. The taxable base is determined in cash (very rare cases in any other form). On the tax base, tax rates and taxes are applied to calculate the tax liability.

- The following serve as the taxable base:

  - income
  - property
  - consumption

- Taxes can be broad-based or narrow-based taxes.
- A broad-based tax is one that taxes the largest part of the potential tax base.
- For example, a broad-based sales tax is one that applies to almost all purchases of goods and services.
- A narrowly based tax taxes fewer items. A narrowly based tax is excise duty.

- To answer the question of who really bears the cost of taxes and duties, the traditional classification of them into:
- direct and indirect (indirect) comes to our aid.
- It is necessary to understand the notion of the tax bearer, that is, the person who will pay it.
- Thus, we take the example of increasing the tax on fuel, an example from the Albanian economy. Formally, the taxpayer appears to be the fuel trading company.
- But if the fuel company raises the price of fuel by the amount of the tax, then the real bearers of the tax will be the buyers of the fuel, or the vehicle owners.

- Direct taxes are taxes on income, wealth and profit.
- This group includes tax on personal income, tax on profit, tax on income from savings deposits, tax on income from alienation of property, etc.
- In the case of taxes and direct taxes, the natural or legal person who is forced to pay the tax liability is the same as the real bearer of this liability.

- From the increase in the price of fuel, the prices of bus tickets would increase (the transport company will try to pass the cost of the tax on to the passengers)

- In indirect taxes we can mention value added tax, excise duties, etc.

- In the case of these taxes and duties, the tax liability is paid by a natural or legal person, but the tax burden is carried by another natural or legal person, we have the transfer of the tax (tax) from one economic entity to another.
- We classify income tax as direct tax and value added tax as indirect tax, because VAT can easily be passed on to the buyer.
- From an economic point of view, this conclusion would not be complete, because an increase in VAT, if it can be passed on in the form of higher prices, or not, it will depend on the market conditions...

Average and Marginal Tax Rate

- By comparing the average and marginal rate of a tax we can come to the correct conclusion whether the tax structure is progressive or proportional.

- The average tax rate shows what part of the income, which serves as the taxable base, goes to pay taxes, that is, with what percentage the taxable base is taxed on average.
- The average tax rate is calculated by comparing the amount of the tax liability with the value of the taxable base.

The tax structures

- A progressive tax structure is a structure whereas the taxable base increases, the applicable tax rate also increases.
- The average tax rate increases but is less than the marginal tax rate.

- The tax structure is called proportional when the tax rate does not change with the increase of the taxable base.
- The marginal tax rate will be constant and equal to the average tax rate.

- The tax structure is regressive when, as the taxable base increases, the tax rate applied to the last earned money decreases.
- With the increase of earned income, the average tax rate decreases and at the same time the marginal tax rate also decreases.
- It is characteristic of the regressive structure that as the taxable base increases, the average tax rate decreases, but it is greater than the marginal rate.

Principles of taxation

- The principles of taxation are guidelines for how a tax system can be built for the purpose of economic development.

- The principle of equality (proportionality, progressiveness).
- Principle of clarity (simplicity)
- The principle of suitability
- The principle of efficiency

The principle of equality and fairness

- Taxpayers must pay to the government depending on its ability to pay and this principle is also known as the principle of ability to pay.
- Horizontal equality means that taxpayers with the same income and economic circumstances should pay the same duty and receive the same tax treatment.

- In vertical equality, a person with a higher income, that is, with a greater ability to pay, must pay more taxes compared to a person with a lower income.

The principle of clarity and simplicity

- The taxes and duties that an entity must pay must be clear and not arbitrary. Taxpayers must know in advance their obligations to the government, both in terms of the amount, as well as the form to pay.

- Clarity helps taxpayers to understand and agree with the tax and make the necessary predictions.
- Of course, it can also be seen as the level of confidence that the taxpayer will have in the accuracy of the tax calculation.

The principle of suitability

- The method and time of tax payment should be adapted to taxpayers as much as possible.
- For the same reason, income tax is paid at source, otherwise individuals could use the money for other purposes.
- The adequacy of the tax system would encourage people to pay taxes and the government would have more tax revenue.
- Some taxes are imposed for reasons unrelated to income, for example to reduce the level of consumption of an undesirable product or are imposed only on a certain activity.

The principle of efficiency

- The principle of efficiency means that even after the payment of the tax liability, the subjects must continue the activity and business plans without being affected by the amount paid.

- Although governments are interested in collecting as much tax revenue as possible, a tax system should not hinder the development of productive capacity because it would reduce efficiency throughout the economy.
- Tax authorities must collect these taxes at the lowest possible cost.

- Low-cost administration emphasizes that taxes should be collected at a reasonable cost to society.

- In a general context the costs of implementing the tax system are administrative costs and compliance costs.
- Administrative costs are the costs to the government (and ultimately to taxpayers, because they are covered by tax collection) of collecting tax revenue.