Economics of taxation

Lecture 1: The definition of taxes, types of taxes and tax rules, types of progressivity of taxes

OECD (1996), *Definition of taxes*, DAFFE/MAI/EG2(96)3
James, Nobes (1998)
Introduction

- Objective of the course
- Theory and practice in taxation
- Objectivity and ideology
- Economics of taxation is mathematics?
- Final result of the course
The definition of taxes

A tax is a compulsory, unrequited payment to general government.

"...Taxes are unrequited in the sense that benefits provided by government to taxpayers are not normally in proportion to their payments..."

"...General government consists of supra-national authorities, the central administration and the agencies whose operations are under its effective control, state and local governments and their administrations, social security schemes and autonomous governmental entities, excluding public enterprises..."
A tax is a compulsory levy made by public authorities for which nothing is received directly in return.

(James and Nobes, 1997)

“...Taxes are, therefore, transfers of money to the public sector, but they exclude loan transactions and direct payments for publicly produced goods and services ...”
The classification of taxes

**OECD classification:**
- depending on the object of taxation,
- useful for international comparisons,
- not very useful for economic discussion,
- does not show the economic characteristics of taxes.
The classification of taxes

The classification by nominal source of taxation:

• i.e. by the way of collecting taxes;
• direct and indirect taxes;
• direct tax – assessed and collected directly from the individuals who are intended to bear it;
• indirect tax – **not** collected directly from the individuals who are intended to bear it.
The classification of taxes

The direct tax:

• usually collected through an intermediary;

• the most popular intermediary is your employer (income tax);

• it is possible that you have no contact with tax authorities;

• can depend on individual circumstances;

• it is possible to change the average tax rate.
The indirect tax:

- paid by one person but collected from another;
- included in the price, but not always visible on a bill;
- cannot depend on individual circumstances;
- can depend on the object you buy.
# The classification of taxes

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<thead>
<tr>
<th>Direct taxes</th>
<th>Indirect taxes</th>
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<td>+ It is easier to spread equally the tax burden.</td>
<td>+ More stable and systematic source of revenue.</td>
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<td>– Delayed tax revenue.</td>
<td>+ Collection fast and constant.</td>
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<td>– High cost of gathering.</td>
<td>+ Costs are low.</td>
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<td>– Developed tax administration.</td>
<td>– Can impose higher burden on poorer people.</td>
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<td>– People try to avoid them.</td>
<td>– Depend on the cycle.</td>
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The classification of taxes

The classification by the tax base:
1. Base is a stock;
2. Base is a flow.

Problem: how to distinguish stocks from flows?

The classification by the relationship of the amount of the tax to the size of the tax base:
1. Taxes that depend on the existence of the tax payer – poll tax;
2. Taxes that depend on the weight or size of the tax base – e.g. 1 PLN per 1 kg.
The classification of taxes

The classification by the authority imposing and collecting taxes:

• Central, regional or local taxes;
• Difference between imposing and collecting.

The classification by the source of origin:

1. Families;
2. Firms;
3. Financial institutions;
4. Foreign entities...
Types of progression

• Progressivity ≈ rate structure;
• By changing the rate structure one can try to achieve social and political goals through taxes;
• Very controversial – are we really helping the poor by taking money from the rich?
• Three types:
  1. Progressive;
  2. Proportional;
  3. Regressive.
Additional definitions

Tax evasion – illegal manipulation of one’s affairs in order to reduce the taxes due.

Tax avoidance – manipulation of one’s affairs within the law in order to reduce the tax dues.

Tax planning – arranging one’s affairs to take advantage of the obvious and often intended effects of tax rules in order to maximize one’s after-tax returns.