Principles of Taxation & their Relevance Today

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What is Taxation?

What is Taxation?

- A **tax** is a financial charge or other levy **imposed** upon a taxpayer (an individual or legal entity) by a **state** or the functional **equivalent** of a state to fund various public expenditures.

- A failure to pay, or evasion of or resistance to taxation, is usually punishable by law.

Why Tax?

- The main purpose of taxation is to accumulate funds for ru nning governments world over.
- Administrative systems and development agendas require funds.
- Taxation is the main system of generating these funds.

Theories of Taxation

- *Four Rs of Taxation*
- *Canons of Taxation*

The purpose of Taxation

The Four R's of Taxation.

Taxation has four main purposes or effects

1. **Revenue –** to spend on services

2. **Redistribution –** transferring wealth from rich to the poor

3. **Repricing –** encourages/discourages consumption

4. **Representation –** rulers tax citizens, who then demand accountability

The purpose of Taxation

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Tax Base

- The tax base is the measure or value upon which a tax i s levied.

Marginal versus Average Tax Rates

- The **average** tax rate is the total amount of tax you pay divided by your total income.
- The **marginal** tax rate is the tax rate you pay on a ny additional income you earn.

Classification of Taxes

The most common and traditional classification of taxe s is as follows:

- **Direct tax**

This is a tax whose burden is borne by the person on whom it is levied.

- *Examples*

PAYE, corporation tax, capital gains tax, wealth tax etc.

- *Considered to be **progressive***

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Classification of Taxes

- **Indirect tax**

Paid by consumers when they spend on goods and services and include

  - vat,
  - excise tax,
  - customs duty

- May result with higher retail price
- Levied equally irrespective of income
- *considered to be* ***regressive***

- *However its good to note that some taxes may exhibit both characteristics*

Canons of Taxation

- **Adam Smith**

In his book “**the Wealth of Nations**” he postulated t he four canons of taxation in 1776.

By canons of taxation we simply mean the **character istics** or **qualities** which a good tax system should possess. The four are canons of

- equity
- certainty
- *economy*
- *convenience*

Canons of Taxation

- **Equality** This states that persons should be taxed according to their ability to pay taxes.

- **Certainty** The time of payment, the manner of pa yment and the amount to be paid should be clear to every tax payer and not arbitrary.

Canons of Taxation

- **Convenience** the mode and timings of tax payme nt should be convenient to the tax payer. It means that the taxes should be imposed in such a manner and at the time which is most convenient for the ta x payer.

- **Economy / efficiency** Every tax has a cost of coll ection. The canon of economy implies that the cost of tax collection should be minimal.

History of Taxation

- The First known system of taxation was in **Ancient Egypt** a round 3000BC – 2800 BC
- In **Biblical** times, tax is already prevalent. According to G enesis 47:24:

"But when the ***crop*** *comes in,* ***give*** *a fifth of it to pharaoh. The other four-fifths you may keep …."*

History of Taxation in Kenya

- **Tribute** was the residence tax during the Spanish times
- **Portuguese** in 1502 charged *Sultan Ibrahim Malindi* annua l tribute (tax) of 1,500 meticals of gold
- The **British** introduced
  - Hut and Poll Tax in 1901,
  - land tax 1908,
  - Graduated personal tax 1933

History of Taxation in Kenya

The main taxes in Kenya are :

National Government taxes	County Government taxes
• Income tax	• Property tax
• Value added tax (VAT)	• Entertainment tax
• Excise tax	• Other taxes
• Custom duty/import duty	

Source: RoK, Constitution of Kenya 2010

OECD – *Organisation of Economic Cooperati on & Development*

OECD

- The Organization for Economic Cooperation and Development (OECD) is a unique forum where the governments of **34 democracies** with market economies work with each other, as well as with more than 70 **non-member** economies to promote
  - economic growth,
  - prosperity, and
  - sustainable development.

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OECD

- The OECD's origins date back to 1960, when 18 Europea n countries plus the **United States** and **Canada** joined forc es to create an organisation dedicated to economic devel opment.

- Today, 34 Member countries span the globe, from North and South America to Europe and Asia-Pacific.
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- The **committee on fiscal affairs**, one of the many committ ees, is mandated to come up with international **tax policy** , **guidance** and **standards**.
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OECD

- Some key output from this committee include
- drafting of the **model tax convention**
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- The **transfer pricing guidelines**
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- **BEPS** project
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MNEs – *Multinational Enterprises*

MNEs

- The Rapid advancement in **technology, transportation** and **communication** have given rise to a large numbe r of multinational enterprises (MNEs).

- MNEs have the flexibility to place their enterprises and **activities anywhere** in the world.

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MNEs

- Hence it follows that a significant volume of global trad e nowadays consists of international transfer of
  - **goods** and **services**
  - **capital** (such as money) and
  - **intangibles** (such as intelectual property)
- Globally intra-group trade is growing steadily and ar guably accounts for more than **30 percent** of all interna tional transactions

MNEs

- The **problem** is that MNEs are known to engage in prac tices that seek to **reduce** their overall tax liability by
-
  - utilising **tax losses** of an associate
  - Booking **higher expenses** to a subsidiary in a **high corporat e tax rate** country or jurisdiction.
- These techniques are commonly sited as **profit shifting** strategies.

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BEPS – *Base Erosion & Profit Shifting*

BEPS

- **BEPS** : Base Erosion & Profit Shifting (BEPS) is the result of tax planning designed to take advantage of **gaps** in the interaction of different tax systems to
  - **artificially** reduce taxable income or
  - **shift profits** to low-tax jurisdictions in which littl e or no economic activity is performed

BEPS

- **OECD** : instituted the BEPS project to deal with thi s problem.
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- The BEPS project has **15 action** points that are ai med at minimising the profit shifting problem.
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Questions

The END

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