Principles of Taxation

Musonda Kabinga, BA; reviewed by Dr. Jörg Alt SJ, MA, BD; Emmanuel Tendet Kiprotich, BA
1 INTRODUCTION

This chapter of the Tax Justice & Poverty research project recognizes first that there exist different definitions of tax and that they vary greatly depending whether they are made within an economic or legal context. The Organization for Economic Cooperation and Development (OECD) defines tax as “compulsory unrequited payments to general government.”¹ The Tax Justice Network Africa (TJNA) argue that tax, is ”a fee levied by a government or regional entity on a transaction, product or activity in order to finance government expenditure.”² Further, according to the Business Dictionary.com, a tax is ”a means by which governments finance their expenditure by imposing charges on citizens and corporate entities.”³ In all the three definitions, it is vividly clear that tax payments are made to the government and therefore, it is the government that has the responsibility of collecting tax revenue.

However, in our view, the definition given by TJNA and the Business Dictionary highlight one main motive of taxation which is *redistribution*.

The history of taxation stretches thousands of years in the past. Ancient civilizations including Greeks, Romans and Egyptians levied different taxes on their people to finance military operations, public services and maintain key strategic reserves of food stocks, gold to mention but a few.

In Europe the first approach to the income tax appears in some of the mediaeval town taxes, where the earnings of artisans and tradesmen were taxed as evidence of their ability to pay proportionally with property and land-owners. Some of the mediaeval states also taxed the rents of land, official salaries and professional gains. The first general income tax in Europe was imposed by William Pitt during the Napoleonic wars. In 1983 William Pitt become Britain’s Prime minister and in 1799 Pitt introduced new income taxes. These included; 10% tax on annual incomes over £ 200 and between 1-10% tax on annual incomes between £ 60–200. In time, though, the tax came to be accepted as a vital price for winning the war against Napoleon.4

Taxation in Africa started long before colonialism. Kings and Chiefs would demand that their subjects submit a portion of their harvest and/or livestock as a form of tax. Historical records show that many once power empires or kingdoms that existed in Africa had a tax system that supported or enabled these kingdoms to expand. The Zulu empire in southern Africa lead by powerful kings such as Shaka Zulu is a classic example. Zulu chiefs demanded steadily increasing tribute or taxes from their subjects in order to command/operate a mighty army that subjugated neighboring chiefdoms confiscating livestock and other valuable products.5 Further, there is also the humanity aspect to the issue of taxation. As individuals, any contributions (whether inform of cash or material things etc.) we make towards promoting the common-good is encouraging and commendable. In many African societies, a people are a people through “humanity” or “Ubuntu” and as such each individual is expected to support any undertaking that enhances the common-good. Taxation is therefore needed to underpin

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the contemporary African version of *ubuntu* as one of the fundamental responsibilities of every citizen.’ (Tax Justice Network Africa, 2011, p. 4f.)

With the coming of colonialism, the colonial masters had to introduce a number of tax laws in order to raise financial resources to run the colonial territories. In Northern Rhodesia now called Zambia, the British South African Company BSAC ostensibly a representative of Queen Victoria introduced a “*hut tax*” in 1900 and 1904. This tax was payable in money, labour, grain or stock and benefited the colonial authorities in various ways: it raised money and broadened the cash economy, aiding further development.⁶

To sum it up, taxation is not a new thing in many societies of the world. Taxes have been in existence for ages, however its worth mentioning that tax laws have not been static thus have kept changing with time.

### 2 CONTEMPORARY REASONS FOR AND GOALS OF TAXATION

This research project aligns itself with the Tax Justice Network and other NGOs advocating for a more just taxation policy. Famous are the “5 Rs” of the Financial Transparency Coalition, according to which good taxation policies should be characterized by the following:⁷

- Raise revenue;
- Reprice goods and services considered to be incorrectly priced by the market such as tobacco, alcohol, carbon emissions etc. and by providing tax reliefs e.g. for childcare;
- Redistribute income and wealth;
- Raise representation within the democratic process because it has been found that only when an electorate and a government are bound by the common interest of tax does democratic accountability really work; and finally to facilitate:

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• Reorganization of the economy through fiscal policy.

3 PRINCIPLES OF TAXATION

Principles of taxation are those formal guidelines which are widely accepted and/or discussed and should be considered whenever specific laws are proposed, discussed and implemented.

3.1 HISTORICAL PRECEDENCE: ADAM SMITH AND DAVID RICARDO

An early categorization of taxation principles, which is still influential up to the present day, stems from Adam Smith’s book of 1776 about the “Wealth of nations”. (Smith) For our research project, especially Book V is of importance. There he explains in part I that the sovereign/commonwealth needs revenue to finance a standing army, in part II a system of Justice (separated from the executive), in part III, Art 1, revenue for paying infrastructure (“public works and institutions to facilitate commerce”); in Art 2 institutions for the education of the youth; in Art 3 institutions for the instruction of peoples of all age, and in part IV expenses of supporting the dignity of the sovereign. In the conclusion he emphasizes a federal principle, i.e. that expenses done by a province or local authorities should not put at the expense of the general public.

In Chapter 2 of Book V, Smith develops four principles of fair taxation, namely-

1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible ... in proportion to the revenue which they respectively enjoy under the protection of the state.

2. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself.

3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.
4. Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

Commonly, those four principles are discussed under the catchwords Proportionality/Equity/Progressivity, Certainty, Convenience and Simplicity, but some even detect more principles here, namely cost-effectiveness.\(^8\)

However, even those simple, sensible and intelligible guidelines evoked early contradiction. So, for example, 50 years after Smith published his book, David Ricardo, another pre-eminent British economist, criticized Adam Smith’s opinion upon taxation by saying that he ‘overlooked many important truths’ determining the relationship between different human communities, e.g. rent and the position of rent owners, which is why he ‘found it necessary to advert’ from some passages in Smiths writing and elaborated an own comprehensive treatise on taxation principles which, for example, addresses very modern issues such as rent from mines, raw products, foreign trade and profits. Ricardo emphasizes the important insight that any society undergoes stages in which the ‘whole produces of the earth’ are allotted different to the three classes of community, namely owner of land, owner of stock and capital and labourer via rent, profit and wage and that therefore ‘laws’ are needed ‘which regulate this distribution’ via taxation. (Ricardo, 1998, p. 7ff.)

It is not the task of this research project to present and comment on the history of developing, discussing and establishing those taxation principles which are widely accepted today. The interesting point which can be underscored is that at all times there was discussion about the “correct” taxation principles and/or the “just” taxation system and that at no time there were any unanimously agreed sets of principles. This should be borne in mind when we undertake research in a more adequate and just taxation system as well for our three countries.

In preparation of that, we present in the following some principles which are nowadays either established and widely supported or under recent discussion. In case of the latter we will explain why we sideline with those

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emerging concepts without delving into a detailed tax justice debate which will be done at a later stage.

3.2 EQUITY

Equity in taxation expresses the idea that taxes should be fair as one of the principles that guide tax policy. Equity can be either, vertical or horizontal. According to Kurt Wise and Noah Berger of the Massachusetts Budget and Policy Centre, “Horizontal Equity addresses questions of whether or not a tax system makes arbitrary distinctions among taxpayers, or distinctions based on irrelevant criteria. For example, it violates the principle of horizontal equity if one person buys an item in a local store and must pay sales tax, while another person buys the same item over the Internet, and does not pay sales tax. Vertical Equity addresses questions of how people at different income levels should be taxed, taking into account their relative abilities to pay. With vertical equity it is expected that high income earners pay a larger percentage of their income in taxes than lower income earners.”

The arguments of Wise and Berger regarding Vertical and Horizontal Equity are similar to those of TNJA. TNJA argues that a tax system is horizontally equitable if taxpayers, in similar circumstances, pay similar amounts of tax. With vertical equity people with a greater ability to pay, that is individuals earning higher incomes or rich people, should pay higher level of tax compared to poorer people.

3.3 EFFICIENCY

Another principle mentioned in literature is “Efficiency”. A tax is efficient if it distorts market processes as little as possible since economic agents attempt to limit, avoid and evade tax liability as much as possible (Nhekairo, 2014, p. 3).

3.4 NEUTRALITY

In as much as one of the key functions of taxation is to raise revenue, the OECD observes that, taxation should seek to be neutral and equitable between forms of business activities. A neutral tax will contribute to efficiency by ensuring that optimal allocation of the means of production is achieved. A distortion, and the corresponding deadweight loss, will occur

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when changes in price trigger different changes in supply and demand than would occur in the absence of tax. In this sense, neutrality also entails that the tax system raises revenue while minimising discrimination in favour of, or against, any particular economic choice.\textsuperscript{11}

A good tax system should raise revenue and promote or support the growth of investments. It is imperative to understand that when a tax system supports the growth of investment undertaking, ultimately more investments triggers an expanded tax base that will lead to more tax revenue collection.

### 3.5 PREDICTABILITY AND/OR CERTAINTY

Adam Smith argues that “the tax which each individual is bound to pay ought to be certain, and not arbitrary” (see 3.1). A predictable tax system is – among other reasons – essential for business planning. Business entities prefer to plan costs well ahead in advance and this includes tax liabilities. In this regard, a predictable tax system makes business planning easy. A predictable tax system is an important ingredient in enticing investment in an economy. Although a tax system changes overtime due to alterations in the local economy, these changes in the tax system should be timely and inclusive.

In Zambia for instance, according to the latest (2015) tax changes, every 5\textsuperscript{th} of the month is the deadline for the filing of manual returns relating to Pay As You Earn (PAYE) and Turnover Tax. Further, mandatory electronic filing of Turnover Returns is expected for every taxpayer whose turnover exceeds K200,000 per annum. The example given shows the expected time period in which a tax return is supposed to be filed and also the manner of payment or filing of turnover tax returns where turnover exceeds K200, 000 per annum. While this system now is predictable and certain, there is still discussion whether businesses contribute according to their ability, especially when regarding the proper taxation of business profits. Here, a lot of uncertainty was the consequence of public debate: Over the past years and even now, there are changes in the mining tax regime particularly regarding the area of Corporate Income Tax, Windfall Tax and Mineral Royalty Tax – all of which provides neither predictability nor certainty and therefore delays urgently needed investments.

3.6 PROPORTIONALITY AND PROGRESSIVITY

Adam Smith argued further that “subjects of every state ought to contribute towards the support of the government, as nearly as possible in proportion to the revenue which they respectively enjoy under the protection of the state.” (see 3.1). But this does not automatically justify progressive taxation. This is, however, our conviction and position, because:

Taxation is key in promoting equity in society. Although no society or country in the world is entirely equal, societies with huge inequalities more often are prone to crime and instability. Christian Aid (CA) and TJNA claim, “Inequality damages us all. It damages our societies and our relationships and it lies at the heart of the poverty that deeply affects so many of the world’s citizens. Inequality is not only a difference in income or economic power, it includes all types of difference based, for example, on gender, ethnicity or locations that determine how individuals and groups control their own lives and prospects.” (Christian Aid, 2014, p. 12) As has been discussed already in chapter I/II/3.3 and I/IV/2.7, countries with high inequalities have also experienced high crime rates. To give one more example: In Southern Africa, South Africa is a highly unequal society facing a lot of crime. The number of aggravated robberies increased from 101,203 in 2011 to 105,888 in 2012. The African National Congress (ANC) spokesman Jackson Mthembu observes that there is urgent attention to be given to certain areas where crime is high.\footnote{Vyk C. van (2013, September 30). Alarming Crime Statistics released in South Africa. In: The Africa Report. Retrieved February 23, 2015 from http://www.theafricareport.com/Southern-Africa/alarming-crime-statistics-released-in-south-africa.html}

Although addressing inequality requires a multidimensional approach which also centres on efficient public spending, it has been indicated already in chapter I/IV/7 that taxation plays a big role when advancing social justice. Even though tax spending is not a focus of this research it is necessary to realize that public spending cannot take place without revenue. In other words, a state must have revenue before spending can take place. An effective and stable tax system generates more tax revenue.

This is particularly true for Africa: Christian Aid and TJNA believe that a fair tax system means those who have more should pay more, whilst those who have less should pay less. Progressive taxation is both an ethical important as well as undeniably necessary if African societies are to become more equal.
Regarding progressive taxation two important factors need to be considered: Firstly, when governments tax the rich more heavily and redistribute income to the poor, the poor benefit through public spending by government. Secondly, when the poor are taxed less as compared to the rich, they are able to save or invest in order to improve their livelihood. Therefore, in either way the poor benefits when taxation is used to promote equity.

3.7 SIMPLICITY

A tax assessment and determination should be easy to understand by an average taxpayer. A tax system should be easy for tax payers to comply. This among other reasons includes the design of a tax system. Normally taxpayers find it easy to comply when a tax system is easy to deal with. When taxpayer’s for instance find it easy and convenient to make a tax payment, the likelihood to comply is high. The opposite is also true.

This affects also the ability of the taxpayer to understand his/her obligations in the first place. The principle of simplicity is one of principles of taxation and it advocates that Tax system should be plain, simple to understand by the common taxpayers. It should not be complicated to understand how to calculate and ultimately ascertain.

Achieving simplicity in a tax system does not stop with legislation but extends to tax administration. It would greatly require the continuous transformation or modernization of Revenue administration. By and larger it is the responsibility of each Revenue Agency to not only collect revenue but to ensure that revenue is collected efficiently and does not burden taxpayers. Consequently, it is necessary that Revenue Agencies strive to transform and become efficient. This would involve having the best latest technology/software programs that makes it easy to administer taxes.

Some countries are modernizing their revenue administration systems to make it simple for taxpayers to pay taxes. In Zambia, the Zambia Revenue Agency (ZRA) recently (2014) introduced the tax online system. The tax online system allows taxpayers to declare and pay taxes online. To sum it up a tax system can be simple there are effective revenue administration reforms.
DISCUSSION – THE MISSING PRINCIPLE OF ENFORCEABILITY

Building upon our initial presentation of tax justice views based upon Catholic Social Teaching in chapter I/IV/7, we wanted to present principles of taxation which are presently established or emerging in the debate about efficient and just taxation systems. These principles have been discussed and considered as necessary by many prominent economist and experts such as Adam Smith and others. Additionally, modern day tax advocacy institutions such as TJNA have acknowledged that some of these principles are necessary for an effective well-functioning tax system.

But it is already clear to us right from the outset, that modern times require another principle: The Principle of Enforceability. There are wonderful tax policies and tax laws, but administrations and states lack means to enforce those laws and policies, while people at the bottom (informal and shadow economy) and at the top (private, corporate and criminal wealth holder) avoid and evade with impunity that which is legally due in taxes and mandatory social security contributions. Hence: It is not enough to have good policies and laws. Wherever those exist one also has to think about resources for administrations and/or international legal requirements such as transparency regarding financial flows etc. We will come back to this in our specific chapters on tax ethics (e.g. E/III).

Our presentation might not be exhaustive, as they could be other principles of taxation that other have developed. However, in our view, the principles presented in this paper are imperative and should be seriously considered in the development of any tax system.

Perhaps the big question around these principles is whether the highlighted principles should be wholly considered and applied for a tax system to thoroughly operate or only selectively. The author of this paper did not come across any findings or literature discussing this question, but is of the view that these principles are necessary and should be considered wholly. Taxation is a complex subject that should take into account many factors which have been presented in this chapter. Further, economic and social conditions change overtime necessities changes in tax laws and, ahead of any detailed tax justice debate based upon Catholic Social Teaching, those widely supported principles need to be considered first whenever assessing and reforming existing or proposing new tax laws.
5 CONCLUSION

Taxation is cardinal in financing development undertaking. Revenue raised through taxation is more sustainable than reliance on borrowing. However, in order to raise sufficient revenue, there is need to have an effective tax system which should be developed by taking into account the discussed principles. Lastly, there could be other principles of taxation that have been developed but we affirm our earlier sentiments these principles presented in this paper are very vital and should be highly considered when developing tax laws.

6 Bibliography


