Course: Advanced Taxation

Lecture 1: Introduction to Taxation

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WELCOME!

INTRODUCTION TO TAXATION

- All governments share a responsibility, to varying degrees, to deliver essential services to their citizens, including maintaining a legal system, ensuring defense, providing healthcare, and developing infrastructure like roads.
- Financing these public services requires obtaining funds, with taxation being the primary method, although borrowing is also an option.
- Taxation is necessary to cover public spending and involves mandatory charges imposed on taxpayers, though it can serve additional social and economic purposes beyond funding government activities.

- In the 19th century, the prevailing notion was that taxes primarily served to fund government activities. However, throughout history and once again today, governments have employed taxation for purposes beyond fiscal needs.
- An insightful framework proposed by American economist Richard A. Musgrave delineates taxation's objectives into resource allocation, income redistribution, and economic stability.
- While economic growth, development, and international competitiveness are sometimes considered separate objectives, they generally fall within these three categories.

- Resource allocation, the first objective, is best served when tax policies refrain from disrupting market-driven allocations unless there's a compelling reason, such as the necessity to address pollution.
- Income redistribution, the second objective, aims to mitigate disparities in income and wealth distribution.
- Stabilization, the third objective, involves maintaining high employment and price stability through tax policy, government spending, monetary measures, and debt management.

- Conflicts may arise among these objectives.
- For instance, adjustments in tax levels or structures to enhance resource allocation may disproportionately affect low-income households, undermining redistributive goals.
- Similarly, highly redistributive taxes might impede the efficient allocation of resources needed for economic neutrality.

- Throughout history, taxation has been primarily driven by administrative needs, evolving from ancient levies like consumption taxes and rates to more complex systems such as property taxes during times of conflict.
- Moreover, wars have profoundly influenced tax systems, often leading to the introduction of temporary measures like income and turnover taxes.

- Taxation entails moving funds or assets from individuals or the private sector to the government without offering direct compensation. It diminishes individual income and spending capacity, influencing microeconomics by changing consumption habits.

- Characteristics inherent in the concept of taxation in Indonesia are:
    1. Mandatory contribution
    2. Compulsory for every citizen
    3. Citizens do not receive direct compensation
    4. Strong legal basis

- Typically, governments levy taxes for three primary reasons: **to provide public goods, ensure resource distribution, and stabilize the economy.**
- Public goods encompass goods and services not efficiently provided by the private sector but essential for societal well-being.
- Taxes serve not only to finance public goods but also for redistributive purposes, reallocating resources from the private sector based on societal needs.
- Another objective of taxation is economic stabilization, addressing fluctuations in employment, inflation, and currency values. Governments can utilize taxation as a tool to mitigate these fluctuations, exerting influence on economic conditions.

- Flexibility within the tax system is crucial for governments to effectively influence the economy. This flexibility enables governments to adapt to changing economic conditions. Hence, tax systems often encompass a variety of tax types to cater to different economic needs, ensuring responsiveness to dynamic economic circumstances.

- The functions of taxes paid by taxpayers:
    1. Budgetary function
    2. Regulatory function
    3. Stability function
    4. Income redistribution function

- Generally, the tax collection system in Indonesia consists of three methods:
    1. Official assessment system
    2. Self assessment system
    3. Withholding assessment system

- Every tax has three essential elements: a base, a rate of tax and someone to pay it, a taxpayer.
- The tax base represents the subject of taxation, encompassing what is being taxed. Typically, taxation operates on four primary bases: consumption taxes on expenditures, wealth taxes on possessions, income and profit taxes on earnings, and poll or head taxes on individuals themselves.
- The rate of taxation plays a crucial role in assessing its impact. Tax rates are commonly discussed in terms of their average and marginal rates.
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- A progressive tax rate features an average rate lower than the marginal rate, resulting in higher rates for larger tax bases.
- A regressive tax rate scale exists where the average tax rate decreases as the tax base value increases, leading to a marginal rate consistently lower than the average rate.

- Every tax necessitates a taxpayer to bear its burden, and understanding the concept of a taxpayer typically involves distinguishing between the impact and the incidence of taxation.
- The legal taxpayer, as defined by legislation, is accountable for paying the tax and experiences its direct impact. On the other hand, the economic taxpayer is the one who ultimately bears the financial burden by parting with the cash.

- The differentiation leads to the classification of taxes into two main types: direct and indirect.
- Direct taxes cannot be shifted to others, and the legal taxpayer must directly bear their burden.
- In contrast, indirect taxes allow the burden to be transferred to another party, typically the consumer, even though they are initially paid by a different entity like the seller of goods or services.

- When contemplating the taxpayer, it's essential to assess the structure of the taxpayer or tax entity.
- Questions arise regarding whether individuals exclusively bear the tax responsibility or if the tax liability can be shared among family members, in which case, the government's definition of 'family' becomes significant.
- Additionally, considerations extend to how governmental entities address other entities such as corporations, trusts, and partnerships.

- How does a government determine the combination of taxes to incorporate or revise in a tax system?
- Various established standards are used to assess taxes and tax systems, albeit described differently across different countries' tax literature.

- In the realm of taxation, equity is synonymous with fairness, suggesting that a just tax system is deemed favorable.
- When it comes to individual taxpayers, fairness typically entails a tax structure aligned with their financial capabilities, reflecting their economic resources. Horizontal equity advocates for equal tax burdens among individuals with similar financial capacities, while vertical equity argues that those with greater financial means should bear a heavier tax burden.
- Another approach to ensuring fair distribution of the tax burden is known as the 'benefit principle,' which suggests that taxes should be imposed based on the utilization of government services.

- The principle of economic efficiency, also known as neutrality, posits that taxes should not disrupt decision-making processes, such as choices related to employment, spending, saving, or investment. Ideally, taxes should remain neutral, allowing for rational business and commercial decisions free from tax-related influences.
- Achieving perfect neutrality is complex, though, as governments often intervene to shape behaviors by incentivizing or discouraging certain actions through tax policies.

- Taxes are imposed on individuals or entities that meet subjective and objective criteria with the aim of being a source of state revenue and used for the equitable distribution or renewal of various public facilities and infrastructure that can be enjoyed by all citizens.
- In terms of tax collection, the state cannot make arbitrary policies because tax collection involves justice, authority, and the rights of citizens.
- Therefore, guidelines or standards are needed so that tax collection can proceed smoothly and also not disadvantage any party. These guidelines can be referred to as the principles of tax collection.

- According to Adam Smith, the principles of tax collection are as follows:
    1. Equality
    2. Certainty
    3. Convenience
    4. Economy

- According to W.J. Langen, the principles of tax collection are as follows:
    1. Ability-to-pay
    2. Benefit
    3. Welfare
    4. Security
    5. Minimal burden

- According to Adolf Wagner, the principles of tax collection are as follows:
    1. Financial policy
    2. Economic
    3. Justice
    4. Administrative
    5. Legal

- Principles of tax collection in Indonesia:
    1. Residence principles
    2. Nationality principles
    3. Source principles

- Tax law is a collection of official and written regulations that govern the relationship between the government as the tax collector and the citizens as taxpayers.
- In this regard, the government, represented by the Directorate General of Taxes of the Ministry of Finance of the Republic of Indonesia, is authorized to obtain wealth from individuals in the form of tax payments to be managed and returned to the community.
- This indirect transfer can be made through public services, which will later be obtained from the state treasury.

- Tax law is defined as a set of regulations that cover the government's authority to take an individual's wealth and surrender it to the state treasury.
- Tax law regulates the relationship between the government and taxpayers because tax law is part of public law.
- Understanding tax law can provide guidance for tax law enforcers in using their authority and obligations in enforcing tax law.

- Tax law is part of public law. Tax law in Indonesia adheres to the imperative doctrine.
- Civil law regulates the relationship between one individual and another individual. Meanwhile, public law regulates the relationship between the government and its citizens.
- Material tax law contains norms that explain actions, conditions, legal events subject to taxation (tax objects), the amount of tax levied (tax rates), as well as everything related to the emergence and extinguishment of tax liabilities and the imposition of sanctions in the legal relationship between the government and taxpayers.
- Formal tax law is the law that pertains to procedures for realizing material tax law into a reality or implementation.

- Consumption-based taxation involves the consumer being taxed on his or her spending on goods and services.
- The scope of a consumption tax base can vary from broad to narrow.
- Various considerations arise when determining the rate structure of a consumption tax. Will it be a single flat rate or a progressive system with multiple rates? Will different goods and services be subject to varying rates?

- Consumption taxes can be single-stage, imposed once in the production-consumption cycle, or multi-stage, applied at multiple points.
- The prevalent form of consumption tax in recent times is the multiple-stage tax.
- A retail sales tax is collected at the final consumer point of sale.

- A wealth tax can either be an annual levy on assets or a tax on the transfer of wealth, like inheritance and gifts.
- Wealth taxes ensure that individuals with similar financial capacities contribute proportionally.
- Land and property taxes can be viewed as forms of wealth taxes and are usually imposed on an annual basis.

- Income tax is levied on a taxpayer’s income.
- Taxes on individual income and corporate profits serve as significant revenue streams for most developed countries and are increasingly prominent in the tax systems of many developing nations.
- The design of an income tax system also requires decisions about the nature of the tax base.

- Capital gains refer to the profits derived from the appreciation in value of assets that are not regularly traded by the owner, such as property or investments.
- Two specific challenges arise concerning the taxation of capital gains.
- Firstly, there is the issue of determining when capital gains should be acknowledged for taxation purposes.
- The second challenge involves addressing inflationary gains.

- In most countries, a company or corporation is a separate legal entity. This means that it has an existence independent of its ultimate owners, the shareholders.
- Treating corporations as distinct taxpayers apart from their shareholders enables governments to directly impose income tax on them.
- Another approach considers corporations as mere channels through which profits pass to shareholders.

- In what is commonly referred to as the 'classical' or 'separate' system of corporate taxation, corporations are treated as separate taxable entities from their shareholders.
- At the other end of the scale, a full integration system adopts the view that the company is a mere conduit and company income is taxed in the hands of the shareholder on an attribution basis.
- Partial integration is a compromise approach between the separate and conduit views of companies and their shareholders.

- Partial integration may take a number of different forms as follows:
  1. Dividend deduction
  2. Split-rate system
  3. Dividend exemption
  4. Dividend imputation
- In international business settings, it's typical to find operations managed by a network of companies under shared ownership.

Types of taxes in Indonesia:

1. According to category:
    a. Direct taxes
    b. Indirect taxes
2. According to nature:
    a. Subjective taxes
    b. Objective taxes
3. According to the collector:
    a. Central taxes
    b. Local taxes

- Tax collection methods:
    1. Actual system
    2. Fictitious system
    3. Mixed system

- Every tax entails compliance costs, which are the costs incurred by the taxpayer in meeting the requirements of the legislation.
- These include the cost of engaging tax advisers to assist them in fulfilling their obligations under the legislation as well as suggesting how to minimize tax liabilities, legitimately or otherwise.
- Administrative costs are costs to the government of administering the tax system. Because compliance costs are borne by the taxpaying population, they tend to be more hidden than administrative costs.

- In recent times, there has been a notable transformation in the administration of tax systems.
- Departing from the conventional 'command and control' model, there is a shift towards a more 'responsive' regulatory approach.
- This reflects concerns that taxpayer compliance with the tax system is influenced by the strategies employed by revenue authorities.

- Several tax administrations have embraced a 'compliance pyramid' model, aiming to align administrative actions with taxpayer behavior.
- The pyramid structure symbolizes the presumed distribution of taxpayer behavior within society.
- At the base of the pyramid lie the majority of taxpayers who are inclined to comply with the tax system and require primarily educational and supportive interventions from the revenue authority.

- The term 'tax avoidance' typically denotes the legal practice of minimizing tax obligations by working within or exploiting the law in ways unintended by the government.
- Tax avoidance differs from tax evasion, where a taxpayer fails to pay an existing tax liability, such as by not reporting all income in a tax return.
- Many jurisdictions implement some variation of a general anti-avoidance rule, empowering tax authorities to nullify tax benefits obtained through transactions solely for tax purposes.

- Tax policy encompasses a government's strategy regarding the structure and execution of its tax system, encompassing the selection of various taxation forms and their specific design elements.
- Tax policy involves the governmental strategy for crafting and executing its tax system, encompassing decisions on the variety of taxes to be utilized and their specific design characteristics.
- Comparing taxes across different countries is exceedingly challenging due to various factors, including differing economic, social, and institutional frameworks.

SUMMARIES

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THANK YOU

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