# CAPACITARTE

# Curso de inglés económico, de finanzas y tributos
# Module 13

## Taxation

### What a Tax is

Governments provide certain public goods that generally are not provided by the market, such as street lighting, highways, law enforcement, and the court system, and aid for people in need. The most important source of government revenue is taxes.

A **tax** is a mandatory payment to the government. **Revenue** is government income from taxes and nontax sources. Nontax sources include borrowing and lotteries.

Government imposes taxes on various forms of income and wealth in order to raise the revenue to provide public goods and various their services. Each type of wealth subject to taxes is called a **tax base**.

The four most common tax bases are individual income, corporate income, sales, and property.

**Individual income tax** is levied on an individual's income from all sources: wages, interest, dividends, and tips.

**Corporate income tax** is levied on a corporation's profits.

**Sales tax** is levied on the value of designated goods or services at the time of sale. Generally, sales taxes are imposed on a wide range of goods and services. It is included in the final price that the buyer pays. The seller then passes the tax revenue collected from customers on to the government that has imposed the tax.

**Property tax** is levied on the value of an individual's or business's assets, generally real estate.

### Direct & Indirect Taxes

Direct taxes are collected by the government from the income of individuals and businesses.

Individuals pay **Income tax** on their wages or salaries, and other money they receive.

Most countries have **capital gains tax** on profits from the sale of assets such as stocks/shares. It is usually imposed at a lower rate than income tax.
A **capital Transfer Tax** (commonly called **death duty** in the UK) is imposed on inherited money or property. Other names for this tax are **inheritance tax/ estate tax** (US).

**Companies pay corporation tax** on their profits. These are generally taxed twice, as the company pays tax on its profits and the shareholders pay income tax on dividends they receive from these profits. In the US, this tax is called **Income Tax.**

**Social Security tax** (or National Insurance in the UK) is paid by companies and employees and is used by the government to finance social security spending.

**Indirect taxes** are levied on the production or sale of goods and services. They are included in the price paid by the final purchaser.

In most European countries, companies pay **VAT** (value-added tax), levied at each stage of production. It is based on the value added to the product at that stage. The whole amount is added to the final price by the consumer.

This tax is also called **goods and services tax** (GST) in Canada, Australia, new Zealand and Singapore. In the USA, there are **sales taxes,** collected by retailers levied on the retail price of goods.

Governments also levy **excise taxes or duties**, additional sales taxes on commodities like tobacco products, alcoholic drinks and petrol. Special Taxes, called **tariffs**, are charged on goods imported from abroad.

## Labor Taxes

In the U.S.A., there are taxes levied in order to ease hardships.

Firstly, we can find the **F.I.C.A.,** Federal Insurance Contributions Act, a payroll tax that provides coverage for the elderly, the unemployed due to disability, and surviving family members of wage earners who have died. Also known as social insurance, F.I.C.A. encompasses Social Security and Medicare. Both employees and employers make payments into F.I.C.A. accounts.

The **Social Security tax** is a federal program to aid older citizens who have retired, children who have lost a parent or both parents, and people with disabilities. The employer and employee each pay a percent of the employee's income up to an annual maximum.

**Medicare** is a national health insurance program for citizens over 65 and certain other groups of people. Employers and employees each pay a percent of employee income.

Unemployment compensation is a program which provides benefits for a certain period of time to employees who lose their jobs through no fault of their own. **Unemployment tax** is, for the most part, paid only by employers.

## Tax Structures

The way in which taxes are imposed on the different tax bases gives rise to three different tax structures. These tax structures differ one from another based on the percentage of income that a particular tax takes.

A **proportional tax** takes the same percentage of income from all taxpayers regardless of income level. It is sometimes called a flat tax, because its rate is the same for all taxpayers.

A **progressive tax** places a higher percentage rate of taxation on high-income earners than on low-income earners.

A **regressive tax** takes a larger percentage of income from people with low incomes than from people with high incomes.

**Tax brackets** are the divisions at which tax rates change in a progressive tax system (or an explicitly regressive tax system).
Essentially, they are the cutoff values for taxable income. Income past a certain point will be taxed at a higher rate. You can see an example of these divisions below.

**2006 Tax Rates: Schedule X—Single**

| If your taxable income is: Over— | But not over— | The tax is: |
|---|---|---|
| $0 | $7,550 | 10% of the amount over $0 |
| 7,550 | 30,650 | $755 plus 15% of the amount over $7,550 |
| 30,650 | 74,200 | $4,220 plus 25% of the amount over $30,650 |
| 74,200 | 154,800 | $15,108 plus 28% of the amount over $74,200 |
| 154,800 | 336,550 | $37,676 plus 33% of the amount over $154,800 |
| 336,550 | No limit | $97,653 plus 35% of the amount over $336,550 |

## Tax Exemption

**Tax exemption** refers to a removal from taxation of a particular item or a class of items.

Tax exempt status can provide complete relief from taxes, reduced rates, or tax on only a portion of items. It also refers to a statutory exception to a general rule rather than the mere absence of taxation in particular circumstances, granted to certain organizations, persons, income or property.

Many tax systems provide complete exemption from tax for **recognized charitable organizations**, including religious organizations, social clubs, public charities, or any other organization considered to serve public purposes. The U.S. system exempts from federal and many state income taxes the income of organizations that have qualified for such exemption. The UK generally exempts public charities from business rates, corporation tax, income tax, among others.

Certain classes of persons may be granted a full or partial tax exemption within a system. Common exemptions are for **veterans, clergymen or taxpayers with children** (who can take "dependency exemption" for each qualifying dependent who has lived with the taxpayer).

In tax-free shopping, the goods are permanently taken outside the jurisdiction, thus paying taxes is not necessary. It is usually available in dedicated **duty-free shops**.

Most states imposing sales and use taxes in the United States exempt resellers from sales taxes on goods held for sale and ultimately sold. In addition, most such states exempt from **sales taxes** goods used directly in the production of other goods (i.e., raw materials).

Jurisdictions may enter into Cross-border Tax Agreements with other jurisdictions that provide for reciprocal tax exemption. Such provisions are common in an **Income Tax Treaty**.
These reciprocal tax exemptions call for each contracting jurisdiction to exempt certain income of a resident of the other contracting jurisdiction.

There are also multi-jurisdictional agreements for tax exemption. For example, the European Union members are all parties to the EU multi-country **VAT harmonisation rules.**

## Tax Deduction

**Tax deduction** can be defined as a reduction of income that is able to be taxed and is commonly a result of expenses, particularly those incurred to produce additional income. Different regions have different tax codes that allow taxpayers to deduct a variety of expenses from taxable income.

Tax deductions set by government authorities are often used to entice taxpayers to participate in community service programs for the betterment of society. Often, deductions are subject to conditions, such as being allowed only for expenses incurred that produce current benefits.

Many jurisdictions allow certain classes of taxpayers to reduce taxable income for certain inherently personal items. A common such deduction is a **fixed allowance** for the taxpayer and certain **family members** or other **persons supported by the taxpayer**.

In the U.S., this deductions are called **"personal exemptions",** for the taxpayer and certain members of the taxpayer's household. In the UK, they are known as **"personal allowance."**
Both in the U.S. and UK, allowances are phased out for individuals or married couples with income in excess of specified levels. There is also a reduction of taxable income for certain categories of expenses not incurred in connection with a business or investments.

Taxpayers have the option to take a standard deduction or to itemize deductions. If a taxpayer chooses to itemize deductions, then deductions are only taken for any amount above the standard deduction limit.

In the U.S., this is referred to as ***"itemized deductions"*** for individuals. The equivalent of this in the UK is **"personal reliefs".** These include:

- Medical expenses (with some limitations)
- State and local income and property taxes
- Interest expense on certain home loans
- Gifts of money or property to qualifying charitable organizations, subject to certain maximum limitations
- Losses on non-income-producing property due to casualty or theft
- Contribution to certain retirement or health savings plans and certain educational expenses.

## Tax Incentives

A **tax incentive** is the use of taxes to encourage or discourage certain economic behaviors.

By providing **tax credits or rebates**, the government may encourage behavior that it believes is good for the economy and for society. They are often imposed on products or activities considered to be unhealthful or damaging to society, such as gambling, alcohol, and cigarettes.

This kind of taxes is targeted at both individuals and corporations:

**Individual tax incentives** include deductions, exemptions, and credits. For example, government may give tax credits to consumers for activities such as recycling or using energy more efficiently.

**Corporate tax incentives** are often directed at individual companies. For example, providing these to businesses for opening new factories, offices, and stores in economically depressed areas.

There are other kinds of tax incentives:

**Tax abatement** programs reduce or eliminate the amount of property tax owners pay on new construction, rehabilitation or major improvements. They won't completely eliminate the property tax bill - but the savings can be substantial.

**Tax Holidays** is a temporary reduction or elimination of a tax. It may be granted to specific activities, in particular to develop a given area of business, or to particular taxpayers. They stimulate community revitalization, retain city residents, attract homeowners to the City, and reduce development costs for home-ownership and rental projects.

**Tax credits** are tax incentives which allow certain taxpayers to subtract the amount of the credit they have accrued from the total they owe to the government. It may also be a credit granted in recognition of taxes already paid. In the last case, a synonym of this is a **tax rebate**, which is a refund on taxes when the tax liability is less than the taxes paid.

**Tax competition**, a form of regulatory competition, exists when governments are encouraged to lower fiscal burdens to either encourage the inflow of productive resources or discourage the exodus of those resources. Often, this means a governmental strategy of attracting foreign direct investment, foreign indirect investment (financial investment), and high value human resources by minimizing the overall taxation level and special tax preferences, creating a comparative advantage.

## Withholding Tax

A withholding tax, also called a **retention tax**, is a government requirement for the payer of an item of income to withhold or deduct tax from the payment, and pay that tax to the government.

In most jurisdictions, withholding tax applies to **employment income**. Many jurisdictions also require withholding tax on payments of interest or dividends.

In most jurisdictions, there are additional withholding tax obligations if the recipient of the income is resident in a **different jurisdiction**, and in those circumstances withholding tax sometimes applies to royalties, rent or even the sale of real estate.
Governments use withholding tax as a means to combat tax evasion, and sometimes impose additional withholding tax requirements if the recipient has been delinquent in filing tax returns, or in industries where tax evasion is perceived to be common.

The amount of withholding tax on income payments other than employment income is usually a fixed percentage. In the case of employment income the amount of withholding tax is often based on an estimate of the employee's final tax liability.

## Double Taxation

Double Taxation can be defined as the levying of tax by two or more jurisdictions on the same declared **income**, **asset**, or **financial transaction**.
This double liability is often **mitigated** by **tax treaties** between countries, for example, **Bilateral Double Taxation Agreements.**

The term 'double taxation' is additionally used, particularly in the USA, to refer to the fact that **corporate profits** are taxed and the shareholders of the corporation are (usually) subject to personal taxation when they receive dividends or distributions of those profits.

Other cases of double taxation include:

Among foreign countries, the country where the gain arises deducts taxation at source (**"withholding tax"**) and the taxpayer receives a compensating **foreign tax credit** in the country of residence to reflect the fact that tax has already been paid. To do this, the taxpayer must declare himself in the foreign country to be non-resident there. In this case, two taxation authorities exchange information about such declarations, and so may investigate any anomalies that might indicate tax evasion.

Within a single country, this happens when subnational jurisdictions have taxation powers, and jurisdictions have competing claims. For example, in the United States, a person may legally have only a single domicile. However, when a person dies different states may each claim that the person was domiciled in that state. **Intangible personal property** may then be taxed by each state making a claim. In the absence of specific laws prohibiting multiple taxation, and as long as the total of taxes does not exceed 100% of the value of the tangible personal property, the courts will allow such multiple taxation.

**Tax Non-Compliance**

Multinational companies often register their head offices in **tax havens,** small countries where income taxes for foreign companies are low (for example, Monaco, the Cayman Islands, the Bahamas).
Using legal methods to minimize **tax burden** (the amount of tax you have to pay) is called **tax Avoidance** (also known as **tax planning, tax sheltering).** This often involves applying **loopholes** (errors or unclear provisions in the applicable laws).

Using illegal methods (such as not declaring income or reporting it inaccurately) is called **tax evasion**. It is criminal and may give rise to substantial monetary penalties.

Individuals who do not comply with tax payment include tax protesters and tax resisters.

**Tax Protesters** attempt to evade the payment of taxes using alternative interpretations of the tax law. For example, they believe that taxation under the Federal Reserve is unconstitutional.

**Tax resisters**, on the other hand, refuse to pay a tax for moral reasons. They typically do not take the position that the tax laws are themselves illegal or do not apply to them. They are more concerned with not paying for what they oppose than they are motivated by the desire to keep more of their money.

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