UNIT 1:

INTRODUCTION TO TAX LAW

1.1 WHAT IS TAX LAW?

Tax law is a body of rules, policies and laws that govern the tax process in a country. The power to impose taxes is generally recognized as a right of governments. The tax law of a nation is usually unique to it, although there are similarities and common elements in the laws of various countries.

In general, tax law is concerned only with the legal aspects of taxation, not with its financial, economic, or other aspects. The making of decisions as to the merits of various kinds of taxes, the general level of taxation, and the rates of specific taxes, for example, does not fall into the domain of tax law; it is a political, not a legal, process.

Tax law falls within the domain of public law - i.e., the rules that determine and limit the activities and reciprocal interests of the political community and the members composing it—as distinguished from relationships between individuals (the sphere of private law). International tax law is concerned with the problems arising when an individual or corporation is taxed in several countries. Tax law can also be divided into material tax law, which is the analysis of the legal provisions giving rise to the charging of a tax; and formal tax law, which concerns the rules laid down in the law as to assessment, enforcement, procedure, coercive measures, administrative and judicial appeal, and other such matters.

The development of tax law as a comprehensive, general system is a recent phenomenon. One reason for this is that no general system of taxation existed in any country before the middle of the 19th century. In traditional, essentially agrarian, societies, government revenues were drawn either from nontax sources (such as tribute, income from the royal domains, and land rent) or, to a lesser extent, from taxes on various objects (land taxes, tolls, customs, and excises). Levies on income or capital were not considered an ordinary means for financing government. They appeared first as emergency measures. The British system of income taxation, for example, one of the oldest in the world, originated in the act of 1799 as a temporary means for meeting the increasing financial burden of the Napoleonic Wars. Another reason for the relatively recent development of tax law is that the burden of taxation—and the problem of definite limits to the taxing power of public authority—became substantial only with the broadening in the concept of the proper sphere of government that has accompanied the growing intervention of modern states in economic, social, cultural, and other matters.[1]

The area of tax law is exceedingly complex and in constant flux largely due to two reasons. The first is that the tax legislation has been used increasingly more often for objectives other than raising revenue, such as meeting political, economic and social agendas. The second reason is the manner in which the tax laws are amended.

1.2 THE TAXING POWER

Taxing power is the power of a government to impose and collect taxes within its jurisdiction. The power to impose taxes is usually granted under the provisions of a country's constitution. In most democratic systems of government this power is granted to the legislature, not the

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[1] Tax Law, 2016, *Encyclopædia Britannica Online*. Retrieved 28 February, 2016, from http://www.britannica.com/topic/tax-law

executive or the judiciary.[2] The constitutions of some countries may allow the executive to impose temporary quasi-legislative measures in time of emergency, however, and under certain circumstances the executive may be given power to alter provisions within limits set by the legislature.

In Zambia, for example, the power to impose taxes generally lies with Parliament. Prior to its amendment in 2016, the Constitution of Zambia[3] provided under Article 114 that: "taxation shall not be imposed or altered except by or under an Act of Parliament." The Constitution, however, authorised Parliament to confer upon any local government authority, power to impose taxation within the area for which that authority is established and to alter taxation so imposed.

The Constitution, as amended by Act No. 2 of 2016, now simply provides in section 199 that "a tax shall not be imposed, except as prescribed." The word 'prescribed' is defined in section 3 of the Interpretation and General Provisions Act,[4] to mean "prescribed by or under the written law in which the word occurs." Therefore, taxation can only be imposed in Zambia as prescribed by or under the Constitution.

The legality of taxation has been asserted by constitutional texts in many countries, including the United States, France, Brazil, and Sweden. In Great Britain, which has no written constitution, taxation is also a prerogative of the legislature.

The historical origins of this principle are identical with those of political liberty and representative government—the right of the citizens to take cognizance, either personally or through their representatives, of the need for the public contributions, to agree to it freely, to follow its use and to determine its proportion, basis, collection and duration (in the words of the Declaration of the Rights of Man and the Citizen proclaimed in the first days of the French Revolution, August 1789). Other precedents may be found in the English Bill of Rights of 1689 and the rule "no taxation without consent" laid down in the Declaration of Independence of the United States. Under this principle all that is necessary is that the rights of the tax administration and the corresponding obligations of the taxpayer be specified in the law; that is, in the text adopted by the people's representatives. The implementation of the tax laws is generally regulated by the executive power (the government or the tax bureau).[5]

1.3 WHAT IS TAX?

Tax is a compulsory monetary contribution to the state's revenue, assessed and imposed by a government on the activities, enjoyment, expenditure, income, occupation, privilege, property, etc., of individuals and organizations.

The duty of Zambian citizens to pay taxes is enshrined in the Constitution. Article 43(1) (b) of the Constitution[6] provides that "a citizen shall…pay taxes and duties lawfully due and owing to the State…"

1.4 SOURCES OF TAX LAW

The primary source of tax law is statutes. In Zambia, for example, the main statute laws for taxation include:

[2] Ibid.
[3] Chapter 1 of the Laws of Zambia
[4] Chapter 2 of the Laws of Zambia
[5] Supra, note 1.
[6] As amended by Act No. 2 of 2016.

(a) the Income Tax Act, Chapter 323 of the Laws of Zambia (for income tax);

(b) the Value Added Tax Act, Chapter 331 of the Laws of Zambia (for value added/sales tax);

(c) the Customs and Excise Act, Chapter 318 of the Laws of Zambia (for customs and excise duties); and

(d) the Property Transfer Tax Act, Chapter 340 of the Laws of Zambia (for tax on property transfers).

Also included in the primary sources rules and regulations issued pursuant to statute laws.

Statutory provisions have, however, been the subject of extensive interpretation by the courts and as such, case also forms an important source of tax law.

1.5 REASONS FOR IMPOSING TAXES

Governments around the world commonly raise money by imposing taxes on consumer spending, investment and business activity. As in many other countries, tax revenue in Zambia generally funds government operations. This includes all the facilities, salaries, and logistics involved in running the country. According to the 2016 Budget Speech delivered by the Minister of Finance, tax revenue estimated at a total of K30.4 billion was expected to finance 57.2 percent of the 2016 national budget. To ensure the flow of tax revenue, agencies such as the Zambia Revenue Authority (ZRA) ensure that taxes are collected efficiently.

Government Services

One of the largest government expenses is providing services to people. For instance, governments are generally responsible for education, health and social security services. These services are commonly paid for by tax revenues. Similarly, local authorities are responsible for emergency services such as fire brigade services, which are funded from taxes collected by the local authority.

Infrastructure

Tax revenue allows government agencies to play a key role in developing infrastructure. At the national level, the government funds programmes targeted at modernizing and improving areas of national significance. For instance, the 2016 National Budget includes a K6.6 billion budget to fund road infrastructure projects.

Public Goods

Taxes also generate revenue to fund public goods from which every citizen benefits. In economic terms, public goods are consumed by everyone, and the production of public goods has no competition. For instance, military and law enforcement officers are public goods. According to the 2016 Budget Speech, for example, the 2016 defence budget stands at K3.1 billion, while the budget for law enforcement stands at K1.8 billion.

1.6 DIRECT AND INDIRECT TAXES

Taxes can be either direct or indirect.

A **direct tax** is one that the taxpayer pays directly to the government. These taxes cannot be shifted to others. A land owner for example pays property taxes directly to the government

upon disposal of the land. Types of direct taxes include individual income tax, corporate tax and property transfer tax.

An **indirect tax** is a tax whose effective incidence of tax falls on a person who does not himself remit the tax to the government, i.e. the tax can be passed on to another person or group. A business may recover the cost of the taxes it pays by charging higher prices to customers. A tax shift occurs when the business shifts its taxes to others. Types of indirect taxes include value added tax (VAT) and excise duty.

1.7 QUALITIES OF A GOOD TAX SYSTEM

A good tax system is said to be based on the following main principles:

(a) Neutrality;

(b) Efficiency;

(c) Certainty;

(d) Simplicity;

(e) Effectiveness and fairness; and

(f) Flexibility; and

(g) Equity.

Neutrality

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 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. This implies that the same principles of taxation should apply to all forms of business, while addressing specific features that may otherwise undermine an equal and neutral application of those principles.

Efficiency

The principle of efficiency entails that tax compliance costs to taxpayers and tax administration costs for governments should be minimised as far as possible. In a good tax system, the costs of complying with tax laws and the cost of administering tax laws will be minimal in comparison to the taxes collected.

Certainty and simplicity

Tax rules should be clear and simple to understand, so that taxpayers know where they stand. The computations, tax compliance procedures and tax laws should not be ambiguous. A simple tax system makes it easier for individuals and businesses to understand their obligations and entitlements. As a result, businesses are more likely to make optimal decisions and respond to intended policy choices. Complexity also favours aggressive tax planning, which may trigger deadweight losses for the economy.

Effectiveness and fairness

Taxation should produce the right amount of tax at the right time, while avoiding both double taxation and unintentional non-taxation. In addition, the potential for evasion and avoidance should be minimised. For example, if there is a class of taxpayers that are by law subject to a tax, but are never required to pay the tax due to inability to enforce it, then the taxpaying public may view the tax as unfair and ineffective. As a result, the practical enforceability of tax rules is an important consideration for policy makers. In addition, because it influences the collectability and the administerability of taxes, enforceability is crucial to ensure efficiency of the tax system.

Flexibility

Taxation systems should be flexible and dynamic enough to ensure they keep pace with technological and commercial developments. It is important that a tax system is dynamic and flexible enough to meet the current revenue needs of governments while adapting to changing needs on an ongoing basis. This means that the structural features of the system should be durable in a changing policy context, yet flexible and dynamic enough to allow governments to respond as required to keep pace with technological and commercial developments, taking into account that future developments will often be difficult to predict.

Equity principle

The equity principle of taxation states that a taxpayer should pay according to his ability to pay in terms of the income he has received and the capacity to derive benefits. A good tax system should therefore be equitable in this sense. In a complex economic and social environment, it may not be possible to design and administer a tax system that is equitable in an absolute sense. However, a tax system that is generally perceived as equitable is a desirable and achievable goal.

Equity in taxation was the first canon of taxation on which Adam Smith laid a good deal of stress. Adam Smith established "four maxims with regard to taxes," one of which was the need for equality in a tax system. Equity is traditionally delivered through the design of the personal taxes, i.e. personal exemptions, deductions and graduated tax rates.

There are two prominent theories put forward to devise a fair or equitable tax system. They are:

(a) benefits received theory and

(b) ability to pay theory.

Benefits Received Theory

According to this theory of taxation, citizens should be asked to pay taxes in proportion to the benefits they receive from the services rendered by the Government. This theory is based upon the assumption that there is an exchange relationship or quid pro quo between the tax payer and Government.

The Government confers some benefits on the tax payers by performing various services or providing them what are called social goods. In exchange for these benefits individuals pay taxes to the Government. Further, according to this theory, equity or fairness in taxation demands that an individual should be asked to pay a tax in proportion to the benefits he receives from the services rendered by the Government.

However, there are some difficulties in application of this theory. The most crucial problem faced by benefits received approach is that it is difficult to measure the benefits received by an

individual from the services rendered by the Government. For example, how much benefit an individual tax payer derives from providing for national defence and education, and maintaining law and order by the Government cannot be measured with any objective criterion. Secondly, most of the Government expenditure is incurred on common indivisible benefits so that the division of benefits of Government expenditure is not possible.

Further, benefits received theory militates against the very notion of a tax. A tax is defined as a payment for general purposes of the State and not in return for a specific service. The benefit theory can have meaning if the benefits of the Government services to the community as a whole are considered. But this will only indicate how much total tax revenue the community should pay to the Government. This will not help us in dividing the tax liability among various individuals comprising the community. It may be noted that most important common benefits are peaceful enjoyment of life, liberty and property. So far as life and liberty are concerned, Government's protection is the same for all. This will indicate levying of a toll tax. But toll tax has long been discarded as it was found to be highly regressive and also a small yielder of revenue.

The benefit theory is applicable only in cases where the beneficiaries can be clearly identified. Thus for example, the benefit theory is applied to the collection of road tax from vehicle owners. This is also applied when local authorities collect special levies for the services such as construction of sewers and roads they render to the people of their locality.

Ability to Pay Theory

The ability to pay is another criterion of equity in taxation. This theory requires that individuals should be asked to pay taxes according to their ability to pay. The rich have greater ability to pay, therefore they should pay more tax to the Government than the poor.

Essentially, the ability to pay approach to equity in taxation requires that burden of tax falling on the various persons should be the same.

Horizontal and vertical equity

There are two concepts of equity, namely horizontal equity and vertical equity based on the principle of ability to pay.

Horizontal equity suggests that equals should be treated equally, i.e. persons with the same ability to pay should be made to bear the same amount of tax burden. This encourages tax compliance as taxpayers will be confident with a tax system that treats taxpayers in similar circumstances equally.

Vertical equity, on the other hand, suggests that unequals should be treated unequally, i.e., how the tax burden among people with different abilities to pay should be divided with taxpayers in better circumstances than others bearing a larger part of the tax burden as a proportion of their income. In practice, the interpretation of vertical equity depends on the extent to which countries want to diminish income variation and whether it should be applied to income earned in a specific period or to lifetime income.

In both these concepts of equity, what is exactly meant by ability to pay has been considered as a subjective measure by some, and an objective measure by others.

In the subjective approach, the concept of sacrifice undergone by a person in paying a tax occupies a crucial place. It is argued that in paying a tax, a person feels a pinch or suffers from some disutility. This pinch or disutility felt by a tax payer is the sacrifice made by him. In this

subjective approach to ability to pay, tax burden is measured in terms of sacrifice of utility made by the tax payers.

The objective approach considers what should be objective base of taxation which measures ability to pay correctly. While there is no one agreed base of taxation which is said to measure ability to pay, income is generally considered to be the best measure of ability to pay. This is because a person's income determines a person's command over resources during a period to consume or to add to his wealth. Justification of progressive income tax is based on this understanding. Wealth of a person is another objective measure of ability to pay that has been suggested as a tax base. The ownership of the property or wealth of an individual determines how much resources he has accumulated. Saving from every year's income adds to his wealth. The wealth or property is therefore said to be a better index of taxable capacity.