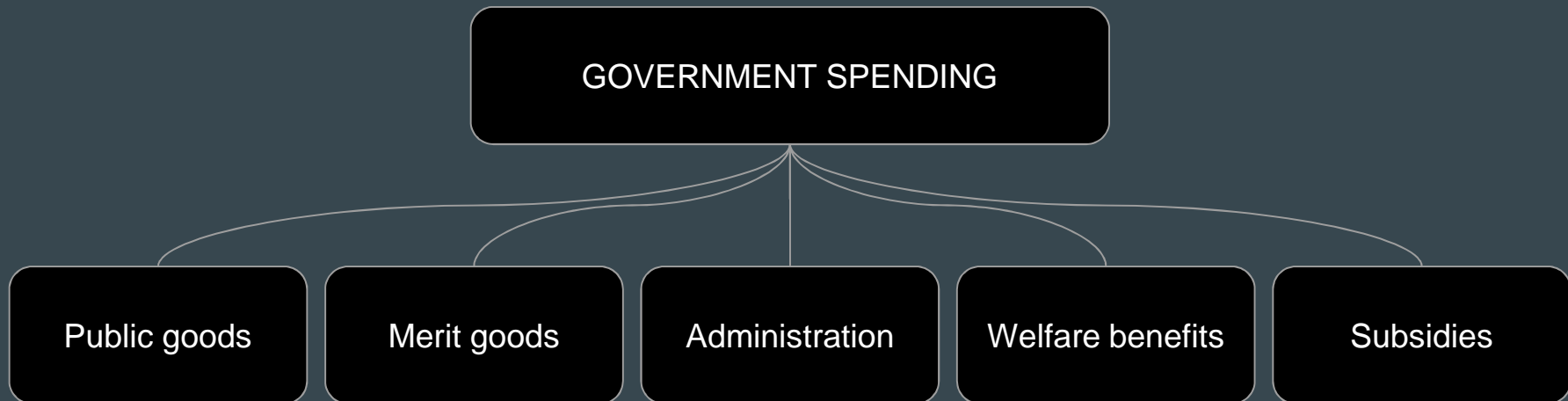


# Taxes – direct and indirect

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The main purpose is to raise finance for government spending.



# CANONS OF TAXATION

## Adam Smith's criteria for 'good' tax

equitable - those who can afford to should pay more

economic - the revenue should be greater than the costs of collection

transparent - tax payers should know exactly what they are paying

convenient - it should be easy to pay

**Direct tax** - one that taxes the income of people and firms and cannot be avoided

Income tax

National insurance  
contributions paid by  
employers and employees

Corporation tax

They are paid directly to the government by taxpayers, individuals, and companies

Indirect tax - a tax that is levied on goods and services

Value-added tax (VAT)

Excise duties on fuel,  
Value-added tax (VAT)  
alcohol, tobacco products

Council tax

They are collected for the government by retailers and  
government bodies

UK Government Spending 2010/11 (£bn)

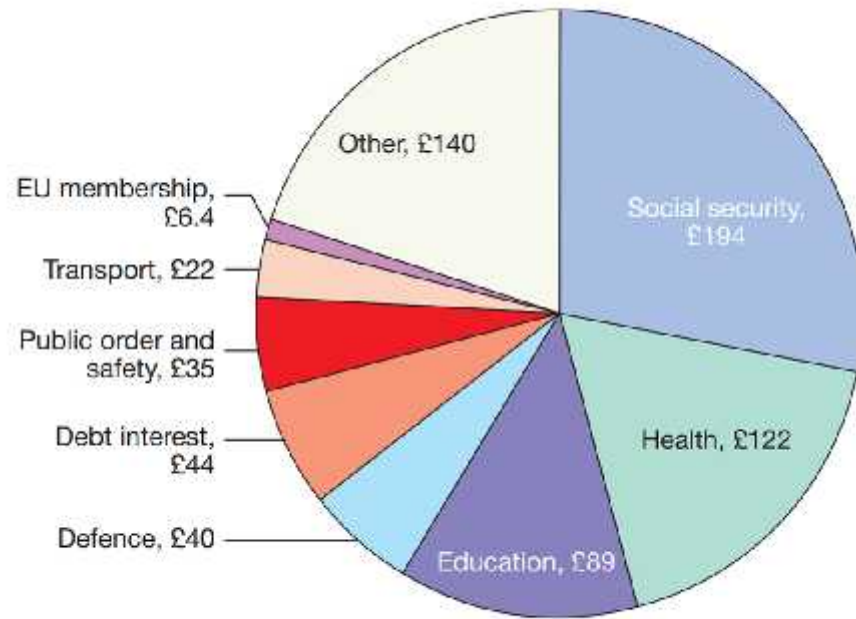


Figure 3.3 UK government spending in 2010/2011

UK Tax Revenue % 2010/11

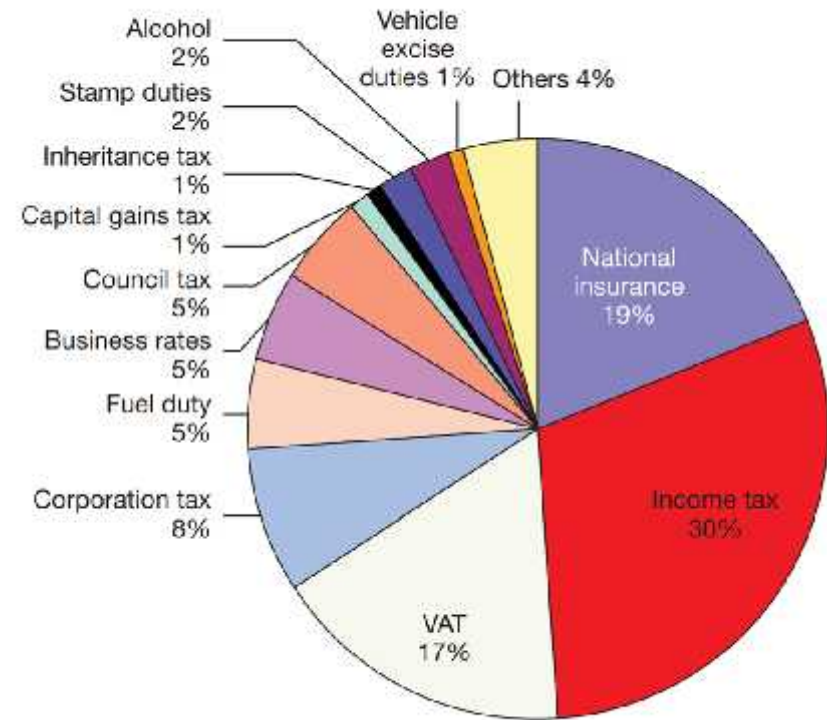


Figure 3.4 UK tax revenue in 2010/2011

## INDIRECT TAX

```
graph TD; A[INDIRECT TAX] --> B[Ad valorem tax]; A --> C[Specific tax]; B --- D["proportion or percentage of the price charged by the retailer<br/>the final price paid by consumers is inclusive of such taxes<br/>the tax element may be included in the published retail price"]; C --- E["specific taxes in the form of a fixed amount per unit purchased<br/>widely used to tax fuel, cigarettes, and alcohol<br/>the tax is based on a measurable quantity<br/>the final price will incorporate this tax"];
```

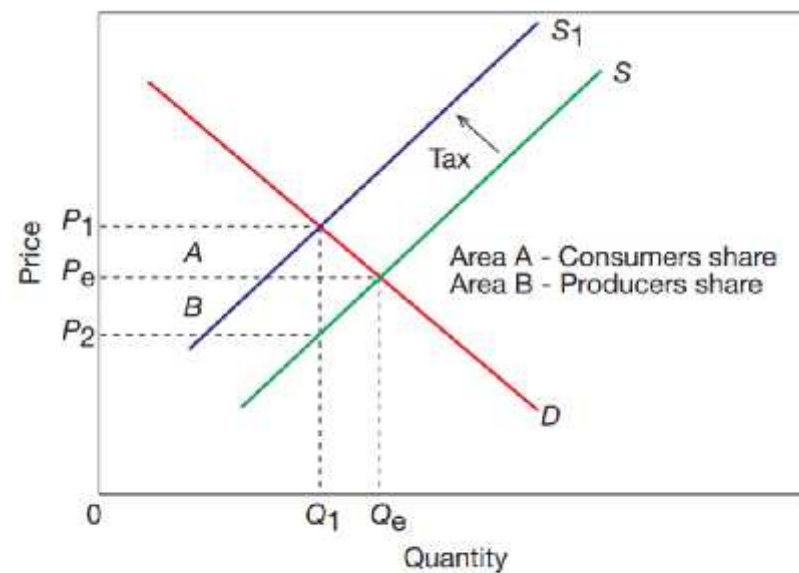
### Ad valorem tax

proportion or percentage of the price charged by the retailer  
the final price paid by consumers is inclusive of such taxes  
the tax element may be included in the published retail price

### Specific tax

specific taxes in the form of a fixed amount per unit purchased  
widely used to tax fuel, cigarettes, and alcohol  
the tax is based on a measurable quantity  
the final price will incorporate this tax

**Incidence** - the extent to which the tax burden is borne by the producer or the consumer or both.



**Figure 3.5** The effects of imposing an indirect tax



# The price elasticity of demand

The more price inelastic the demand, then the easier it is for the seller to pass on the tax to the consumer in the form of higher prices.

The more price elastic the demand, then consumers will invariably buy less of the product as price rises, resulting in the producer having to absorb a greater part of the indirect tax.

The average rate of taxation is defined as the average percentage of total income that is paid in taxes.

**Proportional tax** - one that takes the same proportion or percentage from all who have to pay it

**Progressive tax** - a tax that takes a higher percentage from those with higher incomes, income tax

**Regressive tax** - a tax that takes a greater percentage from those on lower incomes, VAT

