

Taxes: Why they're important

The phrase “Death and Taxes” suggests that taxes are both inevitable and unwelcome. However, taxes serve a vital function in society. In fact, it is through taxation that we are able to make the world a better place for everyone. To explain this, let's start at the basics.

The term tax refers to the [amount of money](#) which an individual must pay to the government. Taxation has a long [history](#), with origins stretching back to ancient Greek and Roman civilisations. However, taxes played a minor role in these societies. But then, as complex systems started developing, human requirements increased. This meant that taxes started to become a key [factor](#) in determining the economy of a country.

Types of taxation

There are two [classes of tax](#); which are [direct](#) taxes and [indirect](#) taxes.

1. Direct taxes - Tax paid [directly](#) to the government that imposes it. Some common examples of this are income tax, property tax or taxes on assets.
2. Indirect tax - Tax [imposed on a manufacturer or a supplier](#), who then passes on the tax to the consumer. Examples include Value Added Tax (VAT) or an excise tax on alcohol and cigarettes. There are also pollution taxes, such as a [carbon tax](#).

Why do we pay taxes?

Governments [require funds](#) to provide the community services such as [education](#), health, defence, and [infrastructure](#). They collect the money through taxes, which is also referred to as [revenue](#). Governments use taxes to [fund](#) research, environmental protection, pensions, and unemployment benefits. Furthermore, taxes [contribute](#) to the gross domestic product (GDP) of a country.

[Income tax](#) is one of the main sources of a government's revenue. The term refers to payments which a government imposes on an individual or business. The amount taxed is [based on income generated](#) by the individual or business. This tax funds education, health, security and provides infrastructure facilities. For this

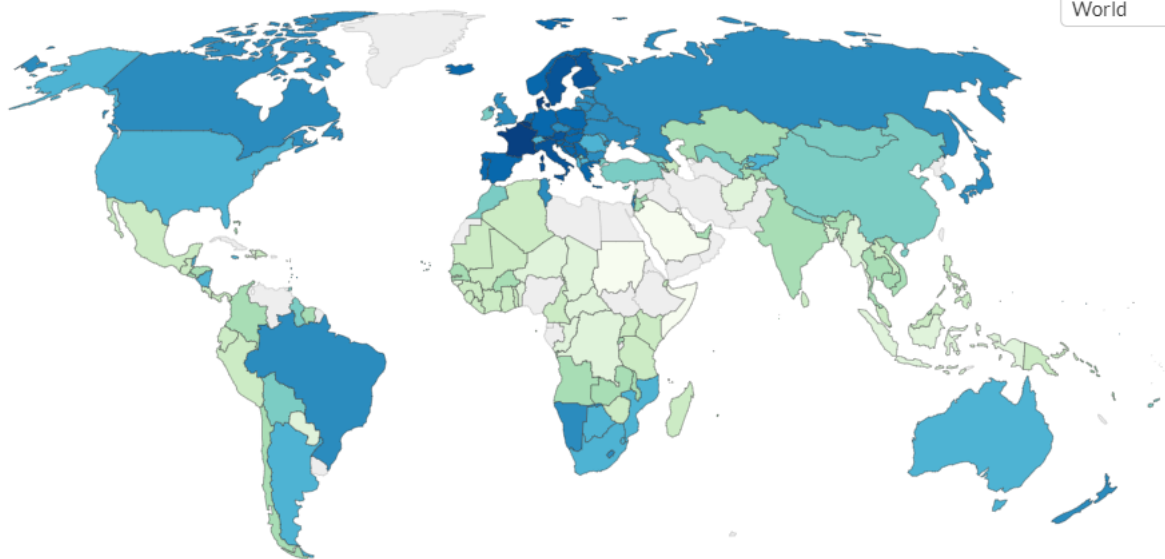
reason, most countries have an [income tax system](#).

Total tax revenues, 2020

Total revenue from social contributions, direct and indirect taxes given as share of GDP.

Our World
in Data

World



No data 0% 5% 10% 15% 20% 25% 30% 35% 40% 45% >50%

Source: ICTD/UNU-WIDER Government Revenue Dataset, August 2021

OurWorldInData.org/taxation/ • CC BY

▶ 1980

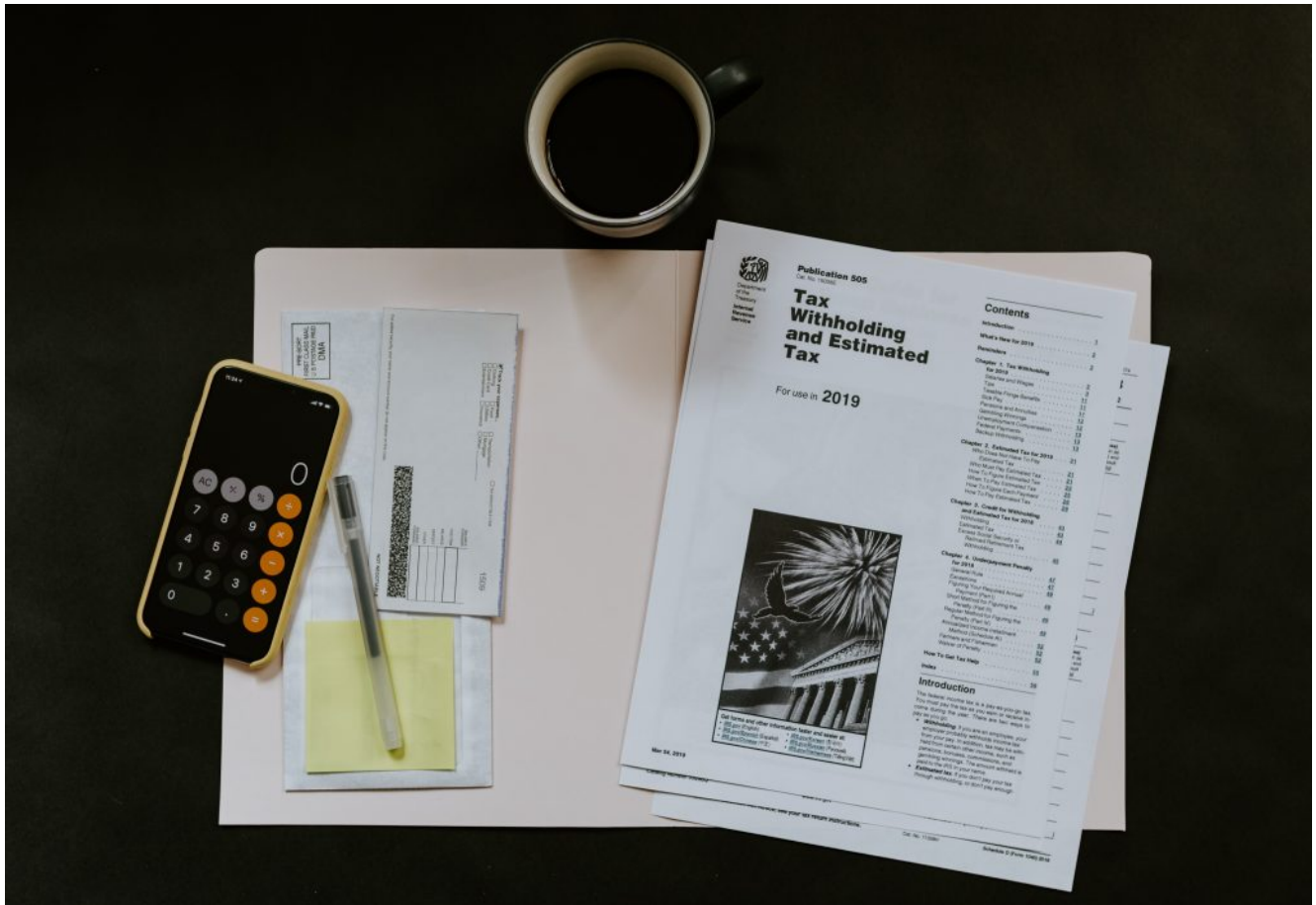
○ 2020

Total tax revenues collected by different countries in 2020. Source: [Our World in Data](#)

Tax Compliance

To practice tax compliance is to [act in accordance](#) with tax laws and regulations. This often means paying accurately, and on time. It is thus important for any individual or business to plan their tax payments. Some things tax [plans](#) consider include:

- The size and timing of purchases
- Expense planning
- Deduction and credit opportunities



A tax plan helps with tax compliance. Photo by [Kelly Sikkema](#) on [Unsplash](#)
 Planning the tax payments will provide short- and long-term benefits such as...

- [Retirement planning](#) for individuals, thus maximising savings and economic stability
- [Saving time and reducing errors](#), ultimately decreasing overall tax liability

There are online tools from government tax departments, banks and tax consultants to calculate taxes. These include the [International Tax calculator from Thomson Reuters](#), the [Australian Taxation office](#) (ATO), [Suncorp](#) (Australia) and [H&R BLOCK](#).

Tax evasion

[Tax evasion](#) or tax fraud is an illegal activity where one deliberately avoids paying a true tax liability. As such, people who commit this crime are [subjected](#) to criminal charge. Accordingly, they could face substantial penalties. [Examples](#) of ways people evade tax include:

- Failing to reveal income accurately

- Underreporting income
- Deliberately underpaying taxes
- Increasing the expenses and deductions
- Hiding money

Fairness of taxes imposed, tax knowledge and moral obligation are some [factors](#) that influence taxpayers to engage in tax evasion.

Finally, government tax office can apply [penalties](#), if one fails to meet a tax obligation. Such penalty rates can differ according to the country. Overall, tax [evasion](#) reduces the tax revenue to governments. This can consequently weaken the economy and destabilise the financial systems.

Tax evasion vs tax avoidance

Unlike tax evasion, tax avoidance differs in that it is [compliant with the law](#). Instead of unlawful behaviours, it involves [legitimately](#) minimising taxes. This can occur through taking tax credits (such as paid family leave to employees) or setting up tax deferral plans. Claiming allowed tax deductions is a [common tactic](#) in tax avoidance.

Examples of [this process](#) include:

- Home office expenses
- Vehicle and travel expenses
- Gifts and donations
- Investment income

The biggest issue with tax avoidance is tax [havens](#). These are places where wealthy people keep money in offshore accounts. Tax havens have cost governments [\\$200 billion](#) a year in lost global tax revenue. About 40% of [multinational profits](#) are shifted to tax havens. Most of these [major tax havens](#) are located in British Virgin Islands, as well as the Bermuda and Cayman islands. Tax havens with [private wealth](#) are mostly located in Switzerland, USA and Cayman Islands.



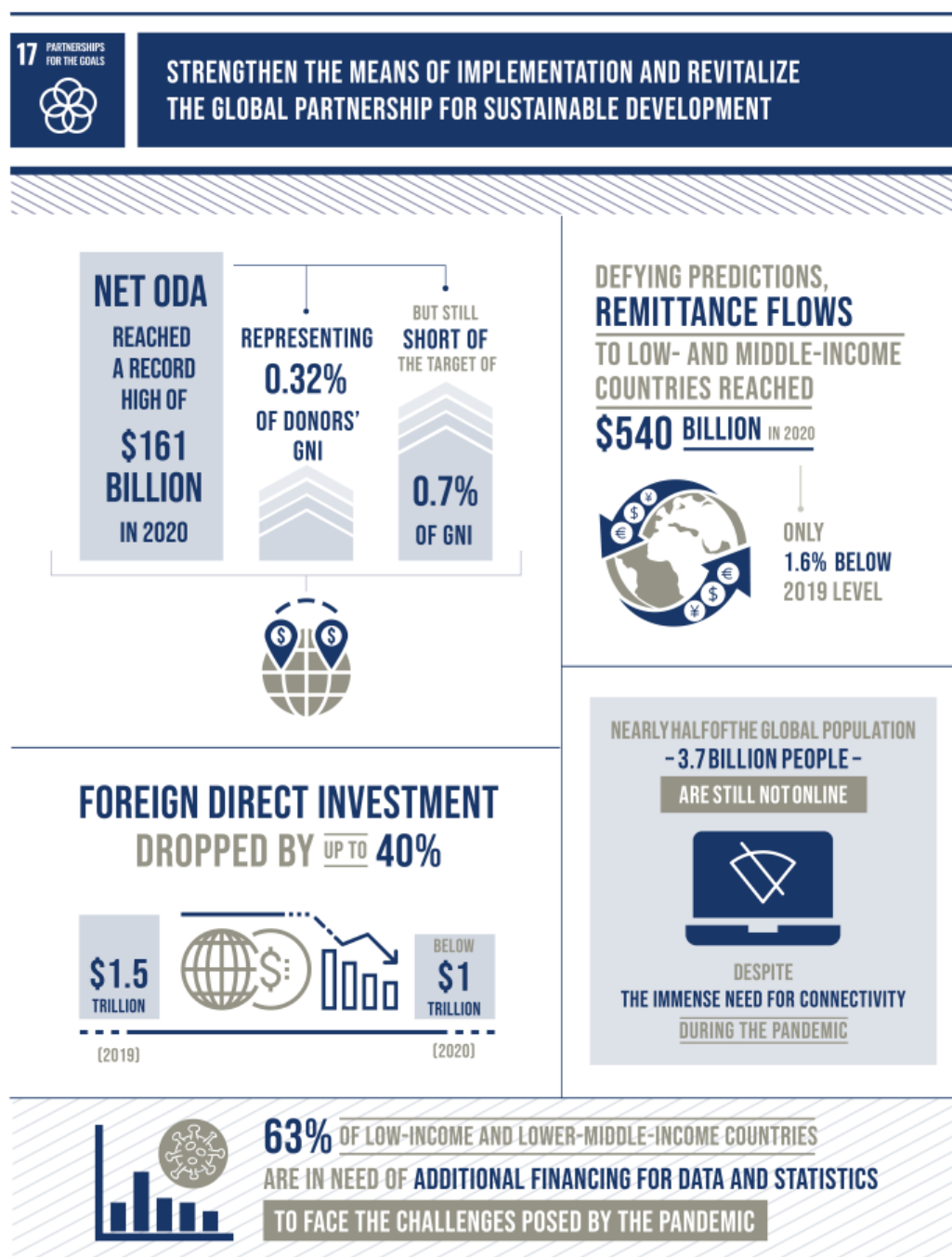
The Cayman Islands are a popular tax haven. Photo by [Marc Babin](#) on [Unsplash](#). The [Panama papers](#) and [Luxembourg leaks](#) revealed who uses these tax havens. This then led the [Organisation for Economic Co-operation and Development](#) (OECD) to launch two projects to counter these. These projects are [Common Reporting Standard](#) (CRS) and [Base Erosion and Profit Shifting](#) (BEPS) project. CRS aims to help authorities [track offshore holdings](#) of their taxpayers. Likewise, BEPS works to improve the [transparency of multinational corporations](#). In essence, it wants to realign taxation with economic substance.

Socioeconomic impacts of tax avoidance

Clearly, taxation is a [powerful tool](#) that can help governments achieve SDGs. However, tax evasions and avoidance are [hidden causes](#) of inequality and [poverty](#). Thus, governments need to maintain strict tax regulation policies. We require those policies to promote investments, job opportunities and economic growth. Taxation is essential to [mobilise domestic resources](#) and strengthen the country's infrastructure.

In 2020, [remittance flows](#) to low and middle income families reached \$540 billion. [Foreign direct investment](#) dropped by 40% in the same year. To achieve the [SDG](#)

[17 goal of global partnerships](#), we must provide international support to developing countries. To do so, we need to improve domestic capacity for tax and other revenue collection.



THE SUSTAINABLE DEVELOPMENT GOALS REPORT 2021: [UNSTATS.UN.ORG/SDGS/REPORT/2021/](https://unstats.un.org/sdgs/report/2021/)

SDG Goal 17. Source: [UN Dept. of Economic and Social affairs](#)

Taxes play an important role in the sustainable development of any country. Therefore, having proper tax systems and policies is essential to avoid any tax fraud. For more information on other similar issues that exist on our planet, visit

our [THRIVE](#) blog. Here we share more information on the problems our world faces and offer solutions.