CHAPTER 1

Taxation Principles and Theory

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[¶1.1] Introduction

Taxation is an ancient and ubiquitous concept that forms one of the central pillars around which civilisation has been built. In his 1925 treatise, *Taxation in Australia*, Stephen Mills noted that one of the certainties of history is that ‘no structural society has ever arisen without taxation’. Taxation plays a critical role in society and has the capacity to affect the lives of everyone within it. As Benjamin Franklin once stated: ‘In this world nothing is certain but death and taxes.’

What is taxation?

The *Oxford English Dictionary* defines a ‘tax’ as: ‘A compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc’. One of the earliest Australian judicial pronouncements on the notion of taxation is found in *R v Barger* (1908) 6 CLR 41, where Griffith CJ, Barton and O’Connor JJ said (at 68): ‘The
primary meaning of “taxation” is raising money for the purposes of government by means of contributions from individual persons.’

Taxes come in a variety of forms and are also known by different names, such as duties, levies, tariffs and charges. The etymology of the word ‘tax’ can be traced to the Latin word taxare, meaning evaluate, estimate, or assess.

Taxation is the principal means by which governments raise revenue. Without taxation, governments would be unable to finance their operations or deliver the many public goods and services they provide to the community. Other ways that governments can raise revenue include:

- charging fees for rendering services or granting licences
- imposing fines for breaches of the law, and
- generating returns from their assets and investments.

Taxes are a special kind of impost that can be distinguished from fees and fines on the basis that they are imposed on the community at large and are not specifically connected with the receipt of any particular services, the granting of any special rights or privileges, or the breach of any law by the payer. Taxpayers are compelled by law to pay taxes and are obliged to do so even though they may not necessarily receive any direct benefits in return. In Architecture of Australia’s Tax and Transfer System, the Australian Treasury recognised (at 11):

A core characteristic of a tax is that there is no clear and direct link between the payment of the tax and the provision of goods and services to the taxpayer. The funds that the government raises from taxes may be used to provide goods or services to the community as a whole, and this may provide a benefit to the taxpayer, but the payment will still be considered a tax if there is no direct relationship between the amount of the payment and the benefit to the taxpayer.

Similar observations were made by the Australian Bureau of Statistics in Australian System of Government Finance Statistics: Concepts, Sources and Methods, where it is noted that although ‘taxpayers expect provision of government services in return for the taxes they pay’, there is ‘usually no direct link between taxes paid by an individual taxpayer and the government services consumed by that taxpayer’.

**What is taxation law?**

Taxation law is the body of law that governs a person’s liability to pay tax to the government. It covers the rules that establish the incidence of tax and the tax base (ie who and what is subject to tax). It also extends to the rules relating to the administration and enforcement of the tax system, including the rules dealing with the collection and recovery of tax.

Australia, like other developed countries, has a vast body of taxation law. The primary source of this law is found in the many thousands of pages of tax legislation enacted by the Commonwealth, state and territory parliaments and the many hundreds of cases handed down by the courts and tribunals that have interpreted the statutory provisions over the years. Australia’s extensive body of statute and common law is complemented by a broad array of administrative rulings, guidelines and practice statements issued by the relevant revenue authorities.
Australia’s taxation laws operate subject to the Commonwealth Constitution and the terms of its international treaties, including many Double Taxation Agreements (DTAs) entered into with foreign countries.

Why study taxation law?
Taxation law is an extremely important and useful area of law to study, but is also incredibly challenging because of its voluminous nature, technical complexity and constant reform. Taxation law is particularly worth studying because of its wide social and economic impact and its practical relevance to all sorts of commercial transactions. It also raises interesting theoretical, ethical and philosophical issues, making it a discipline worth examining for purely academic purposes.

Taxation law does not operate in a vacuum. It intersects with many other areas of law, including aspects of commercial law, property law, corporate law and administrative law. Taxation is the major source of finance for most governments, and it affects all sorts of employment, business and investment dealings. In the commercial world, taxation is of great importance as it heavily influences the ways that entities are structured, investments are held and arrangements are financed. It is, frankly, impossible to properly appreciate how the government and the economy function without understanding basic notions of taxation. Each day, many millions of transactions are entered into that have taxation consequences.

Taxation is also a topical current affairs issue that features prominently in the media—stories relating to taxation appear frequently in daily newspapers and news broadcasts. The financial press, in particular, is peppered with articles on taxation. The pervasive nature of taxation means that it intrudes on many aspects of everyday life. It is therefore not surprising that people have strong and passionate views about taxation and that it is a perennial political issue that has the capacity to polarise public opinion. History vividly illustrates that taxation policies have the capacity to make or break governments and that good tax policies can lead to economic prosperity, while bad tax policies can result in social and political unrest.

On a personal level, having knowledge and skills in taxation law can be beneficial as it opens up many employment opportunities in the tax profession (in both the public and private sectors) as well as in related fields of law, accounting, business and finance. Understanding how the tax system works helps people run their businesses, plan their personal finances and comply with their reporting and other obligations under the law. Taxation awareness also provides people with a better appreciation of political and economic issues and enables them to engage more effectively in public debate in these areas.

What is the aim of this book?
This book provides an introduction to the policy, principles and practices that underpin the Australian tax system. It is designed to be used by students studying taxation law and as a general reference guide for taxation academics, researchers and practitioners. My principal objective is to explain the foundations of Australian taxation law in a clear, concise, straightforward and structured manner without oversimplifying the law or avoiding discussion of complex concepts that have important practical ramifications.
More than 100 different taxes are levied in Australia. This book focuses on three of the most widely encountered Commonwealth taxes: income tax, goods and services tax (GST) and fringe benefits tax (FBT). In addition, it examines a number of other Commonwealth taxes, including a range of superannuation taxes and various levies and charges. It also briefly touches on some of the main state, territory and local government taxes.

Although the book is designed as a legal text, it does not just present the reader with a bunch of technical rules. The objective is to place taxation law in its proper commercial context and to synthesise the legal analysis with discussion of related social, political, economic and policy issues. By weaving in these broader perspectives, taxation law can be better understood and its practical relevance better appreciated.

How is this book structured?
This book is divided into 15 parts, consisting of 46 chapters. The discussion progresses gradually from basic principles to more advanced and specialised concepts, as outlined below:

- **Part A—Introduction to Taxation and Australia’s Tax System.** Chapter 1 introduces the concept of taxation and discusses a number of issues relating to taxation theory. Chapter 2 outlines the primary sources of taxation law (statute and common law) and the broad range of secondary material that can be used in researching tax problems. It also examines some basic principles of statutory interpretation. Chapter 3 provides a historical background to Australia’s system of government and examines the constitutional foundations that underpin Australia’s tax laws. Chapter 4 introduces the main Commonwealth, state, territory and local government taxes. Chapter 5 discusses the ways in which tax policy is formed in Australia and the politics of tax reform. Chapter 6 examines the roles of the Australian Tax Office and tax professionals.

- **Part B—Goods and Services Tax.** Chapter 7 focuses on the GST system. It examines core concepts such as taxable supplies, input taxed supplies, GST-free supplies and creditable acquisitions. GST accounting, reporting and invoicing issues are also discussed as well as a number of special topics.

- **Part C—Income Tax.** Chapter 8 examines the way income tax liability is calculated. It explains the concepts of taxable income, tax rates and tax offsets and discusses the Medicare levy (ML), Medicare levy surcharge (MLS) and the Higher Education Loans Program (HELP).

- **Part D—General Jurisdictional Rules.** Chapter 9 outlines the general jurisdictional rules around which Australia’s income tax laws are framed. These rules determine the territorial scope of Australia’s income tax laws and are based on two key concepts, ‘residence’ and ‘source’.

- **Part E—Income.** Chapter 10 examines the concept of ordinary income. Chapter 11 examines some commonly encountered statutory income provisions. Chapter 12 deals with exempt income and non-assessable non-exempt income.
• **Part F—Deductions.** Chapter 13 examines the general deduction provision. Chapter 14 focuses on a number of specific deduction provisions. Chapter 15 deals with various provisions that deny or restrict deductions.

• **Part G—Asset Taxation Rules.** Chapter 16 examines the capital write-off and allowance rules. Chapter 17 discusses the trading stock rules. Chapter 18 explores the capital gains tax (CGT) regime.

• **Part H—Fringe Benefits, Superannuation and Employment.** Chapter 19 focuses on the FBT regime. It examines the nature of a fringe benefit and explains how FBT is calculated. Chapter 20 focuses on Australia’s superannuation regime and outlines the way superannuation funds are regulated and superannuation contributions, investments and benefits are taxed. Chapter 21 examines the taxation of employment termination and related payments. Chapter 22 deals with the taxation of benefits under employee share schemes.

• **Part I—Special entities.** Chapter 23 discusses the special rules that apply to small business entities, primary producers and special professionals. Chapter 24 examines how companies and their members are taxed and explains how the imputation system operates. Chapter 25 examines how the tax law applies to partnerships. Chapter 26 examines how the tax law applies to trusts. Chapter 27 discusses the taxation of special corporate, partnership and trust entities. Chapter 28 deals with the taxation of consolidated groups.

• **Part J—Tax Losses.** Chapter 29 explains how tax losses are calculated and treated under the tax law.

• **Part K—Tax Incentives and Reliefs.** Chapter 30 focuses on various tax incentives designed to encourage particular kinds of investments. Chapter 31 examines some of the special tax reliefs available for business and entity restructures.

• **Part L—Financial Transactions.** Chapter 32 examines a number of special financial taxation regimes.

• **Part M—International Transactions.** Chapter 33 deals with international tax issues, including the foreign income tax offset. Chapter 34 examines Australia’s DTAs and their impact on the general income tax rules. Chapter 35 discusses tax havens and base erosion and profit shifting. Chapter 36 examines the transfer pricing rules. Chapter 37 examines withholding taxes. Chapter 38 discusses the accruals regimes, which tax certain income sheltered offshore. Chapter 39 explains how foreign currency transactions and foreign exchange gains and losses are taxed.

• **Part N—Tax Avoidance.** Chapter 40 discusses the concept of ‘tax avoidance’ and contrasts it with the concepts of ‘tax evasion’ and ‘tax planning’. Chapter 41 examines the general anti-avoidance rules in the income tax legislation. Chapter 42 focuses on a number of specific anti-avoidance provisions targeted at income alienation schemes.

• **Part O—Tax Administration.** Chapter 43 examines various administrative aspects of the tax system, including the rules relating to tax returns, assessments, rulings, appeals and audits. Chapter 44 discusses the Tax File Number (TFN), Australian Business Number (ABN) and Pay As You Go (PAYG) systems. Chapter 45 outlines
the record-keeping and reporting rules and discusses the Commissioner’s tax recovery powers. Chapter 46 focuses on tax offences and penalties.

Each chapter commences with a broad introduction to the topics covered, followed by a detailed discussion of the core legal principles. Although the chapters deal with discrete topics, they are closely linked and comprehensively cross-referenced to show how the rules interrelate. The chapters are peppered with diagrams, tables and examples to synthesise the law, explain complex concepts and illustrate practical situations. Each chapter also contains a set of study questions that tests the key issues covered. The questions are designed to be used in tutorial discussions and to assist students with their exam preparation. At the end of each chapter is a list of references to selected books, articles, reports, rulings and other material for those interested in conducting further research.

**PowerPoint slides and solutions to study questions**

A special feature of the book is that it is supported by more than 1,000 PowerPoint slides directly cross-referenced to specific topics covered in the chapters. The slides are designed to serve as a handy teaching and learning aid for distilling the key points. They can be accessed online from www.oxfordascend.com using the code provided on the inside cover of this book. In addition, solutions to the study questions in the book (which have been independently prepared by Tom Delany and Toni Chardon) are available free of charge to lecturers using the book from their Oxford University Press sales consultant. Students can also access solutions to selected questions via www.oxfordascend.com using the code provided on the inside cover of the book.

[¶1.2] Kinds of taxes

**Historical background**

Taxation is deeply rooted in history. Records of taxation date back in antiquity to the times of the earliest civilisations. Evidence of taxation can be found on an inscription on an ancient Sumerian tablet from the city of Lagash (located in what is now Iraq) which states: ‘You can have a Lord, you can have a King, but the man to fear is the tax collector.’ Taxation also featured in the times of the ancient Egyptians and Greeks. Scribes of the Pharaohs collected tax on cooking oil, while the Athenians imposed taxes on slaves and foreigners. During the Roman Empire, customs duties, land taxes, farming taxes and sales taxes all featured prominently. In medieval England, feudal property and inheritance taxes were levied by kings and landlords. The famous *Domesday Book* (commissioned by William the Conqueror in 1086) was the first recorded survey of property holdings in England undertaken for the purpose of assessing taxes. Over the years, virtually every kind of product has been taxed in some form or another, including even the most basic commodities such as sugar and salt.

The fact that taxes can be imposed on virtually anything is vividly illustrated by the British window tax, which was levied between 1696 and 1851. The tax was imposed on property owners and was payable at rates that varied according to the number of windows in a dwelling. The aim was to tax the wealthy, who were more likely to have larger houses...
with more windows. Critics, however, cynically viewed it as a tax on daylight, and some property owners simply bricked up their windows to avoid the tax.

It is fascinating to note that there have even been great archaeological discoveries related to tax. The most notable example is the famous Rosetta Stone discovered by a French soldier serving under Napoleon near the Nile. The Rosetta Stone contains inscriptions in Egyptian hieroglyphics, demotic script and ancient Greek, and has been prominently displayed at the British Museum since the early 1800s. The inscriptions were the key to deciphering hieroglyphics, which ultimately unveiled to the modern world many of the hidden mysteries of ancient Egypt. Less well known, however, is the fact that the Rosetta Stone contained a decree recording a tax immunity granted by King Ptolemy V to the priesthood. This led Alvin Rabushka from the Hoover Institute at Stanford University to quip: ‘Which is why, of course, it was engraved in stone and not written on papyrus.’

**Income tax**

The most important and widely imposed modern tax is income tax. As its name suggests, income tax is a tax on income (i.e., earnings). Income tax was first introduced in Great Britain in 1799 by the Prime Minister, William Pitt, to fund the war against Napoleon. The tax was repealed for a short time in the early 1800s following the signing of the *Treaty of Amiens*. However, renewed fighting resulted in Henry Addington, who had replaced William Pitt as Prime Minister, reintroducing income tax in 1803. Income tax continued to be levied until 1816 (one year after Napoleon’s defeat by the Duke of Wellington at the Battle of Waterloo). It was subsequently reintroduced for budgetary reasons in 1842 by Robert Peel and it has been levied in the United Kingdom ever since.

The introduction of income tax in the United Kingdom was radical and controversial at the time. Taxing income was regarded by many as an inappropriate intrusion by government into the personal affairs of its citizens, and was criticised as being a tax on the fruits of labour that discouraged work. Despite these objections, income tax was found to be an effective and practical way to raise revenue. Personal income tax is now levied by almost every country in the world (some notable exceptions include the Bahamas, the United Arab Emirates, the Cayman Islands, Oman, Qatar, Monaco, Brunei and Vanuatu). One of the first countries to follow the United Kingdom in imposing income tax was the United States, which levied income tax from 1862 to 1872 to pay for the Civil War. Congress reintroduced income tax in 1894. However, the United States Supreme Court held in *Pollock v Farmers’ Loan & Trust Co* (1895) 157 US 429 that the legislation imposed a ‘direct tax’ and therefore breached the provisions of the Constitution, which required direct taxes to be apportioned among the states. This eventually led to the *Sixteenth Amendment to the Constitution* in 1913, which allows Congress to levy income tax without apportionment among the states. Income tax is the bedrock of the United States tax system and has been the largest single source of federal revenue for many decades. Income tax is also levied by more than 40 states. State income tax is allowed as a deduction in calculating federal income tax.

In Australia, income tax was introduced by the Commonwealth in 1915 to support the country’s World War I effort. Earlier on, the colonies (which subsequently became the states) had already introduced their own income taxes. The Commonwealth and the states
levied income tax in parallel until the middle of World War II, when the Commonwealth took over the income tax field as a consequence of the introduction of its Uniform Tax Scheme [¶4.2]. Ever since, income tax has remained Australia’s major source of federal tax revenue.

Although Australia was influenced by the United Kingdom’s income tax laws, Australia did not adopt the United Kingdom’s ‘schedular’ model for its legislation. Under the United Kingdom legislation amounts were only taxed if they fell within one of six schedules. The schedules covered items such as rents from land and buildings (Sch A), farming profits (Sch B), interest and annuities from public funds (Sch C), trading and professional profits and income not covered by the other schedules (Sch D), employment income, annuities and pensions (Sch E) and dividend income (Sch F). Each schedule had its own computation rules. As a result, different rates of tax could be charged on different categories of income, and deductions relating to one category of income could not be applied against income of another category.

By contrast, Australia’s income tax legislation does not use schedules to assess taxpayers. Instead, income tax is simply levied on a taxpayer’s ‘taxable income’, which is calculated as the taxpayer’s ‘assessable income’ less ‘deductions’ [¶8.5]. Different rates of tax do not apply to different categories of income and there are no general quarantining rules which specify that deductions relating to particular categories of income can only be applied against income of the same category. Australia’s income tax legislation is, therefore, based on a ‘global’ model, as it generally allows all kinds of income and deductions to be considered together and set off against each other.

Despite the underlying structural differences between the Australian and United Kingdom income tax legislation, Australia has nevertheless borrowed certain concepts from the United Kingdom. Most importantly, like the United Kingdom, Australia distinguishes between ‘income’ and ‘capital’ amounts, and the Australian courts have drawn considerably on the United Kingdom jurisprudence in this area to help characterise various receipts. Australia also followed the United Kingdom in introducing a statutory CGT regime, which forms an integral part of its overarching income tax system [¶18.1].

In Australia, income tax is payable by individuals, companies and certain other entities, such as trustees of superannuation funds.

**Consumption taxes**

In addition to income tax, most countries also impose some form of consumption tax. A consumption tax is a tax whose economic incidence falls on the consumer (eg through the increased cost of goods or services). It is the antithesis of income tax, as it taxes consumption rather than earnings.

The most widely encountered consumption tax is value added tax (VAT). VAT was first imposed in France in 1954 and has been adopted throughout the European Union (EU). It is a requirement for EU membership that Member States impose VAT at a minimum rate of at least 15% (although reduced rates are allowed for certain supplies).

Australia imposed its own version of VAT, known as GST, on 1 July 2000 [¶7.1]. Interestingly, it was the last of the Organisation for Economic Cooperation and
Development (OECD) countries to do so (apart from the United States, which still does not have a VAT/GST).

VAT/GST is directed at taxing the value that has been added to the supply of goods and services. Registered entities charge VAT/GST on supplies they make, and are generally allowed credits for VAT/GST charged on their acquisitions. The cost of VAT/GST is ultimately borne by end consumers who are not registered and, therefore, not entitled to credits for the VAT/GST charged on their acquisitions.

VAT/GST may be contrasted with sales tax, which is a much older and more traditional form of consumption tax. Sales tax is imposed on the sale of goods and is payable by the seller, who adds the tax to the price charged for the goods so that the burden of the tax is ultimately passed on to the purchaser. In the United States, many states impose retail sales tax. To ensure that this tax is charged only on retail sales and not on wholesale sales, registered persons who acquire goods for resale (i.e., not for their own consumption) provide a resale certificate to the seller, which enables them to acquire the goods free of sales tax.

In 1930, Australia introduced a wholesale sales tax. This tax was levied at the last point of wholesale sale of goods (e.g., from wholesaler to retailer). From the point of view of end consumers, wholesale sales tax was a ‘hidden tax’, as it was charged by wholesalers rather than retailers. The cost of the tax was, nevertheless, embedded in the price of the goods charged by retailers. As a result of the introduction of GST, wholesale sales tax was repealed from 1 July 2000. One of the main reasons for replacing sales tax with GST was that GST is levied on a much broader base, as it applies to the supply of goods and services (not just to the sale of goods).

Other taxes
A broad range of other kinds of taxes is also levied around the world. For example, many countries impose customs duties (on the importation and exportation of goods) and excise duties (on the production and manufacture of goods).

It is also common for countries to levy land taxes (on the ownership of real estate) and estate duties (on the assets of deceased estates). These taxes are really forms of wealth taxes as they are levied on the value of a person’s property. There are also several kinds of employment taxes, including payroll taxes (on the payment of wages) and fringe benefits taxes (on the provision of non-salary remuneration). In addition, there are many varieties of transactional taxes, such as stamp duties (on the execution of certain documents), gambling taxes (on betting at casinos, races and lotteries), financial taxes (on deposits and withdrawals to and from bank accounts) and bed taxes (on accommodation provided in hotels).

Some countries also impose taxes on profits from the exploitation of their natural resources. In 1987, Australia introduced a petroleum resource rent tax (PRRT) on profits from petroleum projects [¶4.3]. In 2012, the Gillard Labor Government introduced a minerals resource rent tax (MRRT) on profits from iron ore and coal mining projects [¶5.9]. At the same time, it also introduced a carbon tax on large greenhouse gas emitters to combat climate change [¶5.10]. The Abbott Liberal–National Coalition Government, however, abolished both the MRRT and carbon tax in 2014.
Determining the mix of taxes

As each nation has the sovereign right to determine its own tax system, virtually anything can be made the subject of taxation. In R v Barger (1908) 6 CLR 41, Griffith CJ, Barton and O’Connor JJ recognised (at 68):

The power to tax necessarily involves the power to select the subjects of taxation. In the case of things the differentiation or selection is, in practice, usually made by reference to objective facts or attributes of the subject matter, so that all persons or things possessing those attributes are liable to the tax. The circumstance that goods come from abroad or from a particular foreign country, or that particular processes or persons have been employed in their production, or that they possess certain ingredients, are instances of attributes which have been chosen for the purpose of differentiation.

Ultimately, each country determines who and what it subjects to tax and the particular attributes of its tax system. Each country inevitably adopts its own mix of taxes designed to suit its particular needs and circumstances. While there are many similarities between tax systems around the world, there are also many differences in the ways that taxes can operate, making each country’s tax system unique.

Before examining how Australia’s tax system works, it is necessary to have a conceptual framework for studying taxation law. In particular, it is important to recognise that taxation has wide-ranging social, political and economic dimensions that need to be considered in parallel with any legal analysis. This chapter canvasses some of these broader policy issues and lays the theoretical foundations for the detailed technical discussion contained in the rest of the book.

[¶1.3] Functions of taxation

Taxation’s revenue-raising function

The most important and immediately recognisable role of taxation is its revenue-raising role. It is widely acknowledged that without taxation, a government would not be able to properly function. As the United States Supreme Court stated in Nicol v Ames (1899) 173 US 509 (at 515):

The power to tax is the one great power upon which the whole national fabric is based.
It is as necessary to the existence and prosperity of a nation as is the air he breathes to a natural man. It is not only the power to destroy, but the power to keep alive.

At the most basic level, taxes redirect economic resources from citizens to governments for use in their spending programs. Taxation therefore involves diverting wealth from the private sector to the public sector. Governments use revenue raised from taxes to fund the public service and defence force, to provide a legal system and law enforcement, to construct roads and airports, to run hospitals and education institutions, and to pay social security benefits. Without taxation, governments could not provide their citizens with the many kinds of infrastructure and services that they have come to expect. Government spending is often justified on the basis that in a capitalist society, certain ‘merit’ goods and services may not necessarily be adequately provided by the free-market, and it is therefore
both necessary and appropriate for the government to intervene and provide these things to make society a better place.

**Taxation’s social and political functions**

It is important to understand that taxation is a powerful political engineering device that governments can use as either a ‘carrot’ or a ‘stick’ to promote their objectives. For instance, in Australia, the Federal Government provides a range of tax concessions under various ‘tax expenditure programs’ [¶1.4] to encourage particular kinds of investment, such as private retirement savings under the superannuation regime [¶20.1]. On the other hand, it imposes excise duties on cigarettes, not only to raise revenue, but also to discourage smoking and thereby reduce the nation’s health costs. Similarly, it imposes the MLS on high-income earners who do not have private health insurance, to encourage them to take out appropriate cover in order to lessen the burden on the publicly funded health system [¶8.7]. The benefit of a concession or the burden of taxation can thus be a useful tool in sculpting social behaviour.

**Taxation’s economic functions**

Taxation also has important micro-economic ramifications. For instance, taxing particular goods adds to their cost, making them more expensive than similar kinds of untaxed goods. Taxation can therefore be used to modify consumer behaviour by encouraging spending on one product rather than another. Governments around the world have frequently used taxation to protect their domestic industries by taxing imported goods more heavily than locally produced goods. This provides the local goods with a competitive advantage over the imported goods which, in turn, encourages spending on local products. A government’s ability to tax goods will, of course, be subject to its obligations under any international agreements it has entered into (eg with the World Trade Organization).

Governments also often use taxation as a macroeconomic device to speed up or slow down the economy. Higher taxation usually leads to less spending as taxpayers have less disposable income. This typically has a deflationary effect on the economy. Lower taxation, on the other hand, usually results in increased spending as taxpayers have more disposable income. This, in turn, can have an inflationary effect on the economy.