

Not the source, but the level of income matters - Klaus Schade

Benjamin Franklin reportedly said that there were only two things certain in life: death and taxes. Taxes have been with us for many thousand years dating back to ancient civilisations including in Africa. Taxes have been collected to finance public services ranging from safety and security (police, military) to health, education and other vital infrastructure, and have been used among other to redistribute wealth. Some see paying taxes as a responsibility of every citizen, such as the Tax Justice Network Africa that stated “Taxation is therefore needed to underpin the contemporary African version of Ubuntu as one of the fundamental responsibilities of every citizen”. Therefore, taxes are here to stay. The question that arises is who should pay taxes.

Adam Smith in his well-known book ‘The Wealth of Nations’ referred to four principles of taxation. One of the principles states that it should be “in proportion to the revenue which (the citizens) enjoy under the protection of the state”. This principle has been fine-tuned over time and is referred to as horizontal and vertical equity of taxation. While the latter refers to the taxation of different income levels at different tax rates, for instance through progressive taxes, the first refers to non-discrimination of taxpayers, meaning irrespective where the income is derived from or irrespective of how you buy goods the same tax rates should be applicable.

This brings us to the public debate whether the informal sector should be taxed. It will contravene the principle of vertical equity if someone who happens to be employed in the formal sector and earns for instance a salary of NAD60,000 per annum has to pay income tax, while the neighbour, who runs an informal business and makes a profit of NAD60,000 at the end of the year, does not need to pay income tax. Both ought to pay income tax on the amount that exceeds the tax threshold of currently NAD50,000 per annum, which would also level the playing field between formal and informal businesses. The tax threshold ensures that low-income earners whether they are employed or self-employed, whether they are involved in the formal or informal sector are protected from being taxed. As argued earlier¹, taking inflation into account, the tax threshold should be increased to at least NAD65,000.

However, collecting taxes from the informal sector will increase costs, since tax inspectors have to go out identify un-registered businesses and determine their profit. In the absence of any or at least incomplete records of turnover and input costs, this will be challenging. These challenges touch on another principle, namely the cost-effectiveness of tax collection. If cost-effective ways are found, everyone who earns an income or makes a profit that exceeds the tax threshold should contribute to Government coffers in order to finance public services.

Published in Business 7 – 1 August 2018

¹ Business 7 – 23 May 2018