

PART

A

**INTRODUCTION
TO TAXATION AND
AUSTRALIA'S TAX
SYSTEM**

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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 the United States Supreme Court observed in *Dobson v Commissioner* (1943) 320 US 489 (at 494–495): ‘No other branch of law touches human activities at so many points’.

History vividly highlights that while taxation has brought great prosperity to nations, it has also fuelled bitter conflicts. Taxation can invoke passionate emotions in people about their rights and obligations and is a topic on which rational people often have diametrically opposed views. Ultimately, taxation is a powerful instrument that governments use to fund their activities and shape their economies. Without it, they would not be able to survive. While the features of taxation have evolved considerably over the years, taxation remains a fundamental characteristic of the modern nation state and an integral part of the overarching architecture that lies behind the economic systems of every developed country in the world. Its inescapable and pervasive nature was recognised long ago by Benjamin Franklin who famously wrote: ‘In this world nothing can be said to be 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 an entity'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 introduces 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. The aim of the book 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 Commonwealth taxes, particularly income tax, goods and services tax ('GST'), fringe benefits tax ('FBT') and a range of superannuation taxes. It also 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 13 parts, consisting of 41 chapters. 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. There is also a set of questions at the end of each chapter that test many of the key issues covered.

The book is supported by online resources, available on the Cambridge University Press Higher Education website at www.cambridge.org/highereducation/isbn/9781009458832/resources. Student resources are freely available and include a list of references to selected government reports, taxation rulings, books and articles for those interested in conducting further research. In addition, a set of over 1,000 PowerPoint slides that are directly cross-referenced to topics covered in the chapters are available to lecturers who use the book, along with answers and worked examples to all end-of-chapter questions.

Conceptual framework for studying taxation law

Before launching into a detailed examination of how Australia's tax system works, it is useful to first establish a conceptual framework for studying taxation law. In particular, it is important to recognise the historical setting in which taxes have operated and the kinds of taxes that have been levied by governments over the years. It is also important to understand the basic structural features of taxes as well as the jurisdictional constraints and international settings in which they operate. As taxation has wide-ranging social, political, economic and policy dimensions, these aspects also need to be considered in parallel with any legal analysis. This chapter canvasses some of these broader issues and lays the theoretical foundations for the detailed technical discussion contained in the rest of the book.

[1.2] 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 warns: 'You can have a Lord, you can have a King, but the man to fear is the tax collector'. The Bible also contains many notable references to taxation. The following passage from Paul's *Epistle to the Romans* (13:7–8) is a good example:

Pay to all what is owed to them: taxes to whom taxes are owed, revenue to whom revenue is owed, respect to whom respect is owed, honour to whom honour is owed.

While it is impossible to precisely determine when the first taxes commenced to be levied, it is clear that by the times of the ancient Egyptians, taxation was already well established in society. During the reign of the Pharaohs, taxes were collected by public officials, called *scribes*, on behalf of the Pharaoh's chief minister, known as the *vizier*. Taxes were paid in kind and levied on items such as grains from harvests, livestock and cooking oil. The ancient Egyptians also paid taxes with their own labour by working on construction projects like the pyramids and serving in the army.

In ancient Greece, the concept of benefaction was deeply rooted in society and the wealthy proudly made voluntary payments, known as *liturgies*, to fund public projects. In times of crisis, such as war, an additional wealth tax, known as *eisphorá*, was levied. The ancient Greeks also collected customs duties at their harbours and levied excise duties on products such as olive oil. They also paid taxes on their slaves and levied a per capita 'poll tax', known as *metoikion*, on foreigners.

The ancient Chinese also had their own unique tax system. Various kinds of agriculture, land and poll taxes were imposed during the Shang, Zhou, Qin and Han dynasties. It was usually the role of

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local magistrates, who were appointed by the imperial court, to collect taxes in their regions. Like the ancient Egyptians, the ancient Chinese also paid taxes with their labour by working on projects like the Great Wall and providing military service to their emperors.

During the Roman Empire, customs duties (*portoria*), sales taxes (*centesima rerum venalium*), land taxes (*tributum soli*) and poll taxes (*tributum capitis*) all featured prominently. In addition, there were also inheritance taxes (*vicesima hereditatum*) and taxes on owners who freed their slaves (*vicesima libertatis*). Taxation was largely decentralized and many early taxes were collected by *publicani* who were professional 'tax farmers' that bid at auctions for the right to collect taxes in the provinces and had the right to retain any excess for themselves.

In medieval England, the main taxes were property taxes, such as the *geld* and *tallage*, and death and inheritance taxes, such as the *heriot* and *relief*. These taxes were imposed alongside other peculiar feudal taxes, such as the *scutage* (which was payable by knights to commute military service owed to their lords) and the *merchet* (which was payable by serfs for a woman's right to marry). The famous *Domesday Book*, commissioned by William the Conqueror in 1086, was the first recorded survey of property holdings in England and was expressly undertaken for the purpose of assessing taxes.

Although taxes are nowadays usually paid in money, this has not always been the case, especially before the wide use of currency as a medium of exchange. In the Middle Ages, for example, it was common for peasants to pay taxes by contributing a percentage of their crops and agricultural produce to their landlords. This often left the poor with little to live off and even led to uprisings like the English Peasants Revolt of 1381. It also contributed to the creation of legendary stories, such as that of Robin Hood who, with his Merry Men from Sherwood Forest, stole back taxes collected by the Sheriff of Nottingham so that they could be returned to the poor. Another well-known tale is that of Lady Godiva who rode naked on horseback through the centre of town to persuade her husband, Leofric, the Earl of Mercia, to lower taxes on the people of Coventry.

During the Middle Ages, taxes were also levied by religious orders. The ancient *tithe*, which can trace its origins back to biblical times, is an example of such a tax. This tax derives its name from the old English word for 'one-tenth', as it originally involved a contribution of one-tenth of a person's earnings (usually taken from the produce from their land). People who did not pay the *tithe* to the Catholic Church were at risk of excommunication. While nowadays it is usually only governments that raise taxes, it is interesting to note that religious taxes still exist in some places. An example is the *Kirchenbeitrag* levied by the Catholic Church on its members in Austria.

Over the years, almost 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 bizarre taxes such as the urine tax (*vectigal urinae*), which was first imposed by the Roman emperor Nero, and later his successor Vespasian, in the first century AD. Urine was a valuable commodity as it contained ammonia and could be used in a number of chemical processes, including cleaning garments, tanning leather and fertilizing crops. The tax was payable on the purchase of urine collected from public sewers. Vespasian's son, Titus, allegedly criticised his father for imposing such a disgusting tax, to which his father famously responded by holding up a gold coin and remarking '*pecunia non olet*' (money does not stink!).

Another colourful illustration of an unusual tax is the beard tax levied in Russia during the time of Peter the Great. The tax required men to pay for the right to have a beard and was part of the Tsar's efforts in modernising Russian society to fit more into line with Western Europe. A token was issued to those who paid the tax (which could be as high as 100 rubles for wealthy merchants). Those who refused to pay the tax or produce a token could be forcibly shaved in public.

The English window tax levied between 1696 and 1851 is yet another peculiar tax. 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. Earlier on, between 1662 and 1689, a hearth tax (also known as a ‘chimney tax’) was levied in England at the rate of two shillings for every hearth or stove in a dwelling. The origins of the hearth tax date back to the Byzantine Empire where a similar tax, known as *kapnikon*, was levied on households.

History contains many examples that demonstrate the effects taxation can have on behaviour. A good illustration is the Dutch property tax levied during the 16th and 17th centuries, which was calculated according to the width of buildings. Not surprisingly, this led to the construction of many narrow multi-storey houses that are characteristic of the ones still seen today alongside the canals in Amsterdam.

It is fascinating to note that there have even been great archaeological discoveries related to taxation. The most notable example is the famous Rosetta Stone discovered by a French soldier serving under Napoleon near the Nile. The Rosetta Stone, which has been prominently displayed at the British Museum since the early 1800s, contains inscriptions in Egyptian hieroglyphics, Demotic script and ancient Greek. 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.’

[1.3] Kinds of taxes

Income tax

The most important and widely imposed modern tax is income tax. As its name suggests, income tax is a tax on income (ie earnings). Income tax was first introduced in Great Britain in 1799 by 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 continued to be levied in the United Kingdom ever since.

The introduction of income tax 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 and is, subject to certain limitations, generally 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

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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' [8.4]. 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 set off against each other. For historical and constitutional reasons, Australia's income tax laws are not all contained in one Act. Instead, there are several distinct pieces of income tax legislation, including the *Income Tax Assessment Act 1997* ('ITAA97') and the *Income Tax Assessment Act 1936* ('ITAA36'), which determine how a taxpayer's taxable income is calculated, and the *Income Tax Act 1986* ('ITA') and the *Income Tax Rates Act 1986* ('ITRA'), which impose income tax and set out the rates of tax payable [8.2].

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 [17.1].

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% (reduced rates are allowed for certain supplies).

Australia began to levy its own version of VAT, known as goods and services tax ('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 (which include most entities that carry on business) 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 (ie 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. The tax was levied at the last point of wholesale sale of goods (eg 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 wide range of other kinds of taxes are 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 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 bank deposits and withdrawals), bed taxes (on accommodation provided in hotels) and road taxes (on the use of highways).

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 [5.6]. At the same time, it also introduced a carbon tax on large greenhouse gas emitters to combat climate change [5.6]. The Abbott Liberal–National Coalition Government, however, abolished both the MRRT and carbon tax in 2014.

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.

[1.4] 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 said 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 goods 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' [1.5] to encourage particular kinds of investment, such as private retirement savings under the superannuation regime [19.1]. 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 [8.8]. 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 microeconomic 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 under the World Trade Organization's General Agreement on Tariffs and Trade).

Governments also often use taxation as a macroeconomic device to speed up or slow down their countries' economies. Higher taxation usually leads to less spending as taxpayers have less