

## The Characterization of the Taxation Process in Terms of Tax Culture, as an Element of Novelty

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### Abstract

*This research does not aim to achieve the optimal taxation, because this is theoretically plausible, but in practice, is an amalgam of principles, roles and objectives, which could not be achieved at the same time, so that the taxation process works in -an ideal way, without negative effects on the economic and social life of societies. Thus, the main purpose of this study is to study the characteristics that give taxation optimal elements, so that the fulfillment of as many of them can lead to a good tax system, in any economy, whether it is a developed or a developing economy. To achieve this goal, the research methodology is based on theoretical research of the opinions and visions held by theorists in the economic world. The research results are based on the fact that, although the principles and roles of taxation are interpreted differently over time, their essence is the same, and the development of a tax culture is a novelty, addressed in the literature in recent years.*

**Key words:** optimal taxation, taxation principles, fiscal system, tax culture

**J.E.L. classification:** H20, H21, H30

### 1. Introduction

Over time, many characteristics and criteria have been addressed in the literature, which can give taxation the appellative of "optimal", "ideal" or "perfect" (Ungureanu et al 2017, Pițu et al, 2018; Vodă et al, 2020). In this paper, the aim is not to achieve the fiscal optimum, because this is theoretically plausible, but in practice, the elements and criteria of the optimum, studied by many authors, cannot be met at the same time, because tax systems are designed by the decisions factors, depending on the fiscal objectives with higher priority, and this means that the fulfillment of some principles will be chosen, to the detriment of others.

In the present research, in the first phase, the elements that give the taxation optimal characteristics and that help to build a good tax system were studied. Based on the principles of Adam Smith, we believe that the tax system must be built in such a way as to be fair, which means that the distribution of the tax burden must not be burdensome for different social groups of the population, to be transparent, inexpensive and simple to understand, both for taxpayers and for tax administrations, but also effective in the sense that fiscal policy, through taxation, must facilitate long-term economic and social development. In addition to the principles of taxation, the study of the roles played by the taxation process can provide considerable information in characterizing the tax system.

As a preliminary step in characterizing the tax system, it is important to address what elements give the characteristic of "optimal" to the tax system. The performance of the fiscal mechanism as well as of the fiscal apparatus depends very much on the successful implementation, in practice, of

the taxation principles. In a context where most states have to deal with declining revenues, rising expenditures and resulting tax constraints, rising revenues remain the most important function of taxes, serving as the primary means of financing public goods. Assuming that income levels need to be raised, there are a number of broad fiscal policy considerations that have guided the development of taxation systems over time. In economic practice, states and their tax systems are divided into developed and developing economies, and therefore, in the literature, *the principles and roles of taxation are approached, which even if they are interpreted differently, their essence is the same.*

## 2. Research methodology

Regarding the research methodology of this study, to achieve the main purpose of this research, namely the characterization of a good tax system, it was necessary to study the literature, to understand the concepts and opinions held by theorists, on the optimal elements of tax system. Thus, the approach of the objective through the prism of a qualitative research, aims to provide advantages in knowledge, within the specialized literature, from a theoretical point of view.

This study is divided into five sections, namely: the introductory part, which briefly presents the importance of this research; the methodological part; the theoretical section, in which the main principles and roles of the taxation process are presented, from the perspective of the visions held by the great economists and researchers, over the years; the fourth section, in which the main results obtained are presented, through the study of the specialized literature and the conferment of some own perceptions on the studied elements; and, the last section is represented by the part in which the main conclusions of the present study are presented.

## 3. Theoretical foundations regarding the principles and roles of taxation

The objective of this sub-point of the research is to address the elements that can give the tax system the optimal characteristics, and, to achieve this goal, we will start with the presentation of the established "tax canons", pronounced as maxims, by Adam Smith in 1776, in the work "The Wealth of Nations". They are the cornerstone in shaping the principles of taxation, on the basis of which many authors have made improvements, in order to give the state, the power to design at a higher level the tax system, both as a means of achieving public revenue and as a lever of influence, at the economic level.

Adam Smith's intention was to provide the necessary features to the tax system so that it meets the balance between the interest of the taxpayer and that of the tax authorities, which will directly lead to the general welfare of the nation. In Popescu's opinion (2019, pp. 13-18) the tax canons can be summarized as follows:

a) The maximum of tax justice (the principle of fiscal equity), which stated that the subjects of each state must participate in the coverage of government expenditures, depending on the possibilities, respectively directly proportional to the revenues obtained within the state.

This maxim reveals that the taxation *in fixed rates* is not efficient, because it does not take into account the size of the income held by the taxpayer, while the taxation *in progressive rates* respects the principle of equity, the subjects paying in relation to the income held.

b) The maximum of certainty (the principle of fiscal certainty) referred to the condition that the amount of taxes owed by taxpayers to be precise, not arbitrary.

This means that taxpayers need to be aware of each type of tax, and the legislative framework is intended to be clear and contain in advance all information regarding the size of the tax liability, the terms and methods of collection of taxes, and the situations when the tax authorities may apply sanctions, in case of non-compliance.

This maxim also refers to the feature of transparency of taxes, respectively taxpayers and control bodies must know of their existence, and this principle is often violated, because some taxes are invisible, being difficult to decipher, as in the case of excise duties, where the tax is introduced in the final consumer price. The choice to use and increase invisible taxes, which consumers do not notice, is often used by governments, when the size of tax revenues is not at the forecast level.

c) The maximum of convenience (the principle of convenience of tax collection), meant that each tax was levied at the time or in the most convenient way for taxpayers;

d) The maximum of minimizing costs and fiscal efficiency (the principle of fiscal efficiency), meant that the imposition of the lowest taxes and ensuring their collection with a minimum of expenses from the state, for the following four reasons:

- the collection of taxes requires a large number of officers, whose salaries will consume most of the income obtained from taxes;
- high taxes can affect people's industry, as they can diminish the financial resources held or destroy those branches of industry that provide jobs, which would mean paying more taxes and obtaining higher incomes by the state;
- the higher the tax, the greater the temptation to circumvent it, and the penalties should be proportionate to the illegality committed;
- the more frequent the unnecessary controls of the authorities, the higher the expenditure of the state, and, in this way, the taxes can be more burdensome for the people, than the benefits brought to the state, by collecting them.

Smith (2015) finds that the principle of fiscal efficiency, outlined by Adam Smith, can also be approached in terms of tax costs, which must be taken into account when designing the tax system, namely:

- operating costs of the fiscal apparatus, which need to be found at minimum levels;
- economic costs imposed by taxation, through its impact on the taxpayer's behavior, which means that it can affect its consumption and production decision;
- the costs of the activities within the fiscal administration, which are necessary to prevent evasion;
- compliance costs, borne by the taxpayers themselves in their contact with the tax system, respectively the payment of mandatory levies.

Next, the two overriding principles of taxation, namely tax efficiency and fairness, are presented in more detail, so as to understand that optimal taxation involves some trade-offs between the two, as the design of the taxation system needs to be appropriate to the economic situation, and the two principles must not be mutually exclusive.

A. **Fiscal efficiency** can mean many things, and in our case, in addition to the characteristics set out in Adam Smith's canons, we can also refer to the state's ability to undertake activities necessary *to build and develop a national fiscal culture*, both at the taxpayer level, as well as at the level of tax authorities. This can improve the state-citizen relationship through active participation, but also by increasing trust in society, and the decision to comply with the payment can directly bring payments in tax revenues.

#### B. **Fiscal equity**

A key issue, which stems from the promotion of the principle of equity in the tax system, is the equitable distribution of tax burdens among taxpayers. In this direction, over time, two theories have developed, namely: *the theory of benefits received*, according to which taxpayers who are in the same conditions and obtain the same benefits from public activity, it is necessary to have a similar tax treatment and *the theory of ability to pay*, according to which taxpayers will not pay according to the benefits received, but according to their ability to participate in taxes.

We believe that in designing the tax system it is necessary to take into account, in addition to the fundamental principles of taxation, the taxation methods which derive from the two theories stated, because managed together, are meant to bring improvements to the tax system. The literature talks about two types of equity, namely:

- horizontal equity, in which persons with the same characteristics have a similar tax treatment (fixed taxation method, in which the amount of tax is fixed, regardless of the value of the tax base);
- vertical equity, which involves the application of taxation directly proportional to income or wealth, respectively, the higher the income, the higher the taxes.

Gashenko et al (2019) consider that vertical equity brings new features to the taxation process, by classifying taxation methods into:

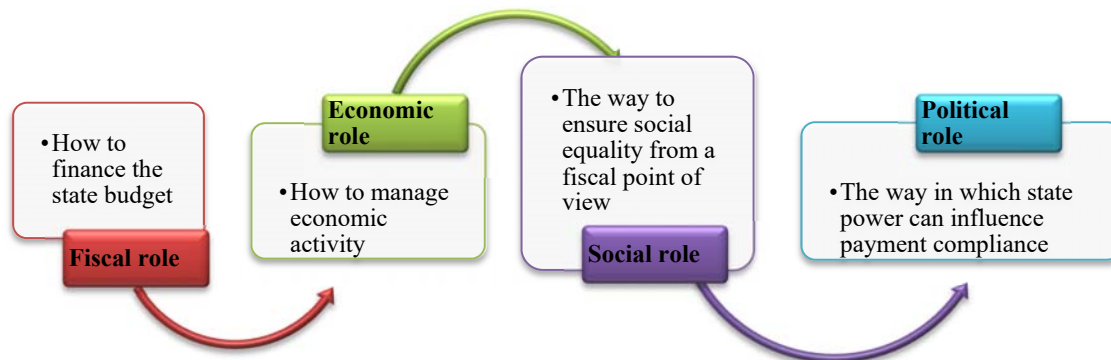
- a. Regressive taxation, which involves a decrease in the tax rate with the increase of the tax base, so that those with low incomes pay a higher share of tax revenues than those with higher incomes. Almost any tax on necessities is regressive, because people with lower incomes end up consuming a larger share of their income.

- b. Proportional or fixed taxation implies the same tax rate, regardless of the value of the tax base. A tax is proportional if its value increases with the value of the tax base and all taxpayers pay the same tax rate.
- c. Progressive taxation implies the increase of the tax rate with the increase of the tax base. A progressive tax requires people with higher incomes to pay a higher share of their tax revenues.

It can thus be seen that, in addition to the principles of taxation, taxation methods provide options in choosing elements that give the tax system optimal elements. Thus, taxation methods are selected individually for each type of tax, depending on the particularities and priorities of the development of the social and economic system, but also according to the fiscal pressure, assessed by the extent and structure of tax revenues in the economy and correlated with taxpayers' incomes. However, there is a general agreement among economists that the tax system, in order to aim for perfection, should *be at least proportionate* so that it is about the same percentage of everyone's income, and there is a consensus that it should *be even moderately progressive*, taking a larger share of the income of richer households (Limberg, 2020; Barrios et al, 2020).

By systematizing the scientific interpretations of the essence of taxes, it was deduced that in contemporary research the role of taxes on the financial, economic and social level is recognized. Figure 1 shows a new approach, namely the role of taxes on the political level.

Figure no.1 The role of taxes in financial, economic, social and political terms



Data source: made by the authors based on the study of the literature

**Financially**, the main role of taxation is the fiscal one, through which, according to contemporary authors, the state budget is financed (Miller et al., 2016; Stiglitz et al., 2020), a budget without which the existence of a state is inconceivable. This consists of using taxes to raise budget revenues, thus allowing states to maintain the quality of public services as well as to cover government expenditures.

**Economically**, the way in which the state can regulate economic activities so that they comply with national priorities highlights the economic function of the taxation process. Contemporary representatives of the economic or regulatory approach (Sineviciene, 2016; Musaye and Musayeva, 2018) consider that the role of taxes on the economic level is manifested by promoting privileges or fiscal barriers, so that certain economic activities are encouraged or restricted.

At the **social level**, the role played by the taxation process is manifested in several directions. For example, it envisages correcting imbalances, ensuring social protection and equality from a fiscal point of view, which can be achieved through reductions, facilities or tax exemptions of some socio-professional categories. However, this social function can also be applied by overtaxing some destructive products / services on the taxpayer. The state can also intervene in correcting the distribution of income, by applying fiscal means to support disadvantaged groups and by its possibility to implement at national level policies for redistribution of part of the gross domestic product in favor of the least advantaged (Oh, 2017).

A recent approach, directly related to the social role of taxation, refers to social justice on taxation (Peters, 2020) and how to promote the role played by tax legislation and establish a similar tax treatment for those with the same income can help, encourage and influence taxpayers, so that, socially, all this leads to the fight against poverty and the existence of societies in which equality prevails.

We believe that, at the **political level**, the role of taxation is materialized by the way in which the state powers can influence the payment compliance of citizens, stimulating the increase of their involvement in the democratic control of taxation.

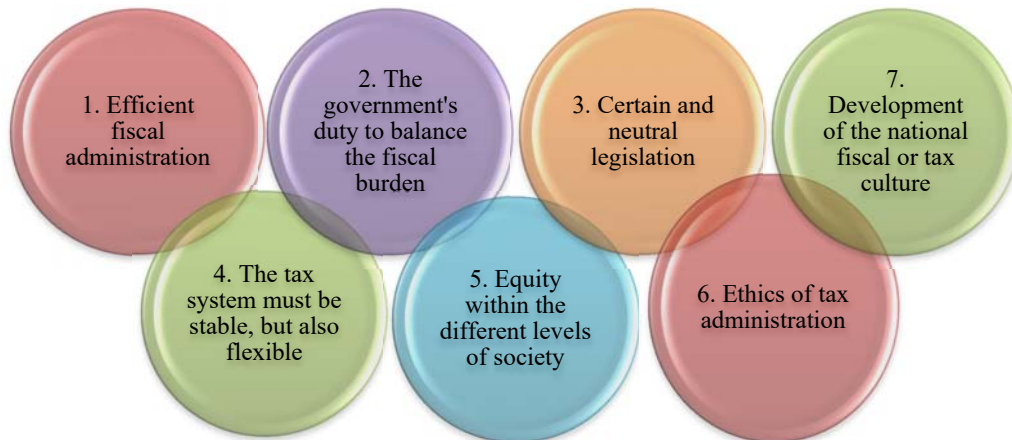
Based on the study of the visions of economic theorists, the principles of taxation, taxation methods, but also the roles of taxation, offers options for fiscal policy, choosing the right features, so that a good tax system can be built, because it is found that their essence remains the same, even if opinions tend to be approached from different points of view.

#### 4. Research results

Regarding the results of the research, based on the previous sections, we note that over the years, the principles of taxation have been developed and supplemented in order to achieve a common an global model of design of tax systems, reaching a multitude of criteria, meant to give the taxation process the characteristic of optimal.

Du-Preez (2018) conducted a historical study of the formulations regarding the principles of taxation and found that, over time, characteristics such as: equity, certainty, efficiency, convenience (Adam's "golden principles") were addressed, plus simplicity, neutrality, transparency, flexibility, acceptability, stability and growth. His conclusion is that in the modern era it is necessary for the taxation to meet the criteria presented in figure no. 2, to which we consider opportune the addition of the characteristic with number 7, respectively the social characteristic of development the national fiscal culture, or tax culture.

Figure no. 2 Principles of taxation in the contemporary period



Source: made by authors based on Du-Preez (2018) and Bringselius (2018)

If we study better the contemporary principles presented above, we can see that most of them are in fact readjustments of Smith's canons: principle 1 refers to maximum efficiency, principle 3 to maximum certainty, principle 4 to convenience, and principles 2 and 5 to Smith's maximum equity. In addition to the initial canons, the principle of ethics in the tax system is intensely debated in the literature. We believe that it can bring a number of benefits, including strengthening internal relations between tax administrations and strengthening relations with citizens, by supporting the public interest, and last but not least, *ethics can influence the need for the last principle, namely forming and developing the fiscal or tax culture from the lowest level, namely the taxpayer, to the higher level, namely the decision makers.*

Thus, we consider that the theory of taxation principles is limited to the reinterpretation according to the need of the tax system, of the "golden principles", to which are added the principle of ethics and the social principle of development of tax culture, and other derivatives.

Regarding the establishment of the Romanian tax system, it is designed based on European principles, through the Fiscal Code and the Fiscal Procedure Code, referring to five fundamental principles, namely: fiscal neutrality, tax certainty, fiscal equity, tax efficiency and predictability taxation. At EU level, according to the European Commission, several "key features" are taken into

account, which are analyzed in assessing the fairness and efficiency of a fiscal system, emphasizing that it is very important for fiscal policy to promote economic growth through the use of taxes and incentives that encourage investment, innovation and economic efficiency. We consider that the structuring of the tax system must be designed in such a way as to minimize distortions in the economy, to develop an employment-friendly environment, not to discriminate against social classes, not to restrict access to public goods and, last but not least, it needs to be designed in a way that addresses the lack of transparency, corruption and tax evasion in the economy.

From the perspective of modern economic analysis, it is considered that fiscal policy is usually viewed in terms of "efficiency" and "equity" and "fairness", the rest of the attributes being only related results. Efficiency and equity are two basic principles of fiscal policy, as well as the design of the tax system, which are also objectives to be achieved in terms of taxation. However, their implementation is often in conflict, as high efficiency usually accompanies the sacrifice of equity, while achieving state revenues at full capacity is often detrimental to efficiency.

We believe that depending on how the principles of taxation are implemented, the impact of the tax system can be felt on:

- economic growth, depending on how tax rates affect taxpayers' decisions to work, save or invest;
- fairness and redistributive effects of taxation;
- sustainability, depending on the ability to obtain sufficient tax revenue;
- social welfare, depending on the capacity of nations to implement measures to create a tax culture at the national level, which will lead to decreases among evasion phenomena, increases in awareness of tax obligations, and strengthening the state-citizen relationship.

Regarding the financial role played by the taxation process, we consider that, given that the existence of the tax function comes from the nature of the tax system and occurs in each case where taxation takes place, it is the most popular, but also the oldest, and the other functions are of secondary importance, and their approval at the level of the specialized literature is not unanimous. Depending on the additions to the state budget, made with the help of the taxation process, also depends the standard of living of all citizens, which materializes in the current state economy.

Regarding the economic role of taxation, we consider that depending on how the tax system is conducted within a state, through taxation can stimulate or stop the interest of citizens to carry out an economic activity, to consume certain goods and / or services, but trade relations with the outside world can also be influenced. The role of taxation in economic terms can be viewed from two different points of view, namely: state incentives and disposable income. The two are in a relationship of mutual dependence.

Through their role, taxes can contribute to job creation, can lead to reductions in inflation and unemployment, but can also have a negative role, which discourages economic behavior. However, this depends on the tax rate and the elasticity of the economic agent to the tax. It can be said that the lack of tax benefits to encourage the increase in the number of investments, consumption of goods and services, employment, but also additional taxation, made even for the purpose of increasing tax revenues, have ultimately discouraging effects.

In terms of political role, the existing literature shows that democracy and fiscal transparency have positive effects on compliance, and that the participation, consultation and involvement of civil society in tax issues can lead to easier policy acceptance and tax law, on the part of citizens (Riccuti et al, 2019). Thus, it is not desirable for the tax system within the state to be perceived as unfair, because this feeling can encourage evasionist phenomena at national level (Cristea et al, 2020). Therefore, the political legitimacy of the tax is essential and can lead to the creation of a tax culture at the level of society.

## **5. Conclusions**

It is surprising how much the four tax canons of Adam Smith are folded and how consistent are with the approach of modern fiscal policy. The concepts of modern economic theory of "equity" and "efficiency" are embodied in the first and fourth canons, while the second and third canons can be points of thought for the practical functioning of tax systems. This can be translated into the fact that taxation is based on clear rules, so that a limited space is left for the abuse of power by the control

body, which gives practical importance to the collection of taxes in a way that is convenient for the taxpayer.

As for the differentiation of Smith's canons from the contemporary economy, it is their lack of clear guidance on how to balance and achieve the various considerations, and in particular they do not take into account the state intervention in society through fiscal policy. They are focusing more on the taxpayer- legislation - fiscal apparatus triad.

We consider that the theory of taxation principles is mainly based on the reinterpretation of the "golden principles", depending on the need of the tax system of states, to which are added other derivatives, including the principle of ethics and the social principle of development of tax culture. Ethics can influence the need for the formation and development of the tax culture from the lowest level - the taxpayer to the level of the decision makers.

And regarding the four roles highlighted above, we can bring more knowledge in the literature by defining the taxation process, through its roles. Thus, it represents the way to ensure the state budget, to regulate economic activities, respecting national priorities, to redistribute revenues in order to ensure social justice, social protection and equality from a fiscal point of view, as well as to ensure a tax culture, way in which the state policy can influence the payment compliance, but also the improvement of the fiscal apparatus.

Thus, we conclude that it is necessary for the fiscal policy to focus on the implementation of a tax system in which the "optimal" elements presented in this research, and especially the principles of efficiency and equity, to represent its basic characteristics. The efficiency and fairness of fiscal policy measures depend on their ability to lead to the formation and development of the national fiscal and tax culture, in which legislative interventions are at a minimum and invasive level, respecting the criteria of transparency, consistency and certainty. The formation and development of a tax culture at national level aims for the tax system to reach the criterion of stability, so that it can cope with economic changes, but also the efficient management of budget expenditures, in which taxpayers are aware of the importance of paying taxes, so that tax evasion to be reduced, and the fiscal apparatus to encourage taxpayers to continue lawful activities and without traces of legislative illegality.

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