Taxes

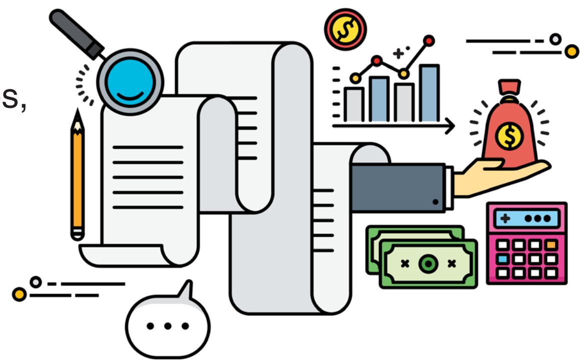
"Every person has limited specific income (salary, private business profits, property revenue) and on the other hand there are expenses and obligations (food, housing, education, entertainment). If our expenses exceed our revenues, we will begin to search for solutions to increase our revenues with all possible ways".

What about governments, how does the government fund its expenditures and how to increase its revenues?

The government finances its expenditures through several methods, the most important of which are "Taxes"

What is the definition of Tax?

Tax is a monetary amount (obligatory fees) imposed by the government on individuals and companies, in order to finance the government's expenses and commitments such as providing social services and subsidized commodities, paying the government entities employees' salaries, and developing the state's infrastructure.



The importance of Taxes is as follow:

- Covering the government various expenses through one of the most important sources of revenues for the government "Taxes"
- Having a significant impact on demand and supply in the economy especially during periods of inflation.
- Protecting the society from undesirable or harmful products and industries by imposing high taxes on them (e.g. cigarette).
- Supporting the domestic industry and protecting it from foreign competition by imposing taxes on international trade (Customs). At the same time, taxes encourage the export of goods and services by reducing or eliminating taxes on exported goods in order to enhance their competitiveness in the global market.

- Achieving greater equity in the distribution of wealth and income; the government may impose a progressive tax on income and wealth, then use the revenue collected to provide social services to the most marginalized groups of the society.

Despite the taxes importance in the economy, many citizens may view taxes as a major burden. Therefore, the distinction between different types of taxes and the determination of tax rates are very crucial in maintaining the country’s economic balance and stability.

Taxes are classified as direct and indirect taxes:

• Direct Taxes:

Taxes that are directly levied on income or money, and are taxed directly by the taxpayer. The direct tax is imposed on the income of individuals, on commercial and industrial profits of companies and on real estate assets and property. In this case, the individual or the company shall bear the full burden. This type of tax is based on the ability to pay, since those with more and higher resources are subject to higher taxes.

There are two types of direct taxes: 1- direct taxes on income: A tax paid by individuals and institutions on their income, for example: the salary you receive from your employer is a net salary after the deduction of taxes and other fees 2- direct taxes on capital/wealth: The tax imposed on the property or capital owned by the taxpayer, for example the tax imposed on real estate property.

• Indirect taxes:

This type of taxes is not directly paid by individuals and companies and, it is imposed by the government on consumption and expenditure through its imposition on the production and sales of goods and services. This type of taxes is imposed on goods and services consumed by rich and poor similarly and it is not based on the principle of the ability to pay.

Examples of indirect taxes:

(1) Sales Tax: Sales taxes are paid by consumers when purchasing different goods. It is imposed on different types of goods at variable rates, for example, the percentage of the tax on clothing is different from tax rates on cars. This tax is not payable on intermediate goods in production like vehicle's tier, but on final commodities.

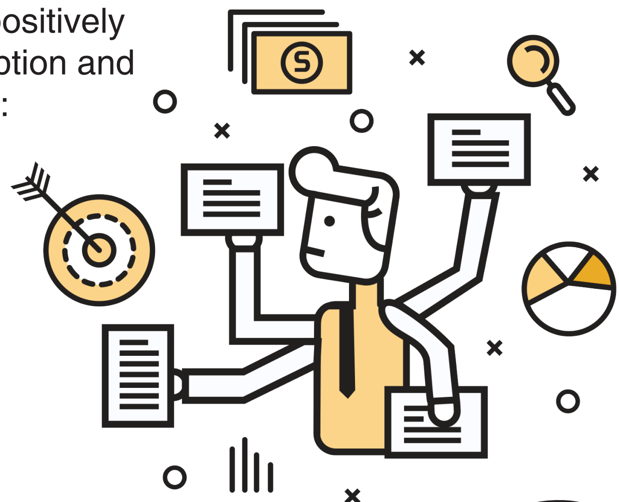
(2) Value Added Taxes (VAT): These taxes differ from the sales tax as it is paid on all production's stages. For example, in case of the automobile industry, the tire manufacturer sells the tire at a price to which the tax rate is added. The owner of the factory sells the car to the owners of the car showrooms after calculating the tax rate. Finally, the owner sells the cars

with the addition of VAT to the sales bill paid by the final consumer.

(3) Customs duties levied on imports: The taxes imposed by the state on imported goods from abroad and charged while crossing the country's borders. Although these fees serve the interests of local producers, they directly affect the purchasing power of consumers and reduce their chances of consumption, which may negatively affect the welfare and the standard of living of the community.

Impact of Tax Policies on Economic Activity:

The government may follow an expansionary economic policy aimed at stimulating economic activity by raising production and consumption rates. To achieve this, the government reduces the rates of direct and indirect taxes, which affect positively the rates of consumption and investment as follow:



(1) Raising Consumption Rates: The reduction of direct taxes such as income tax will increase the remaining amount of salary and thus increase the income of individuals and enhance their consumption ability. Additionally, reducing indirect taxes will decrease the prices of goods and services, making them accessible to a larger number of consumers and thus increasing demand and consumption.

(2) Raising Production and Investment Rates: The reduction of the tax rate on the company's final profit is reflected positively on its performance (final profit = sales - cost - tax), which strengthens the company's ability to increase production and expand investment.

As for indirect taxes such as Value Added Taxes (VAT), their reduction will decrease the cost of raw materials on the product and may reduce the price of the final product to the consumer.

Conversely, the government can adopt a deflationary economic policy, and raises direct taxes on individuals' income, which reduce the demand on consumption. The increase of indirect taxes on goods will also lead to higher prices, therefore lower demand, and reduce consumption.

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