TEST FOR PREVIOUS LEARNING MATERIALS UNDERSTANDING

Answer the questions about organizational structures of the enterprise:

1. Organizational structure determines how the roles, power and responsibilities are assigned, controlled, and coordinated, and how information flows between the different levels of management (TRUE/FALSE)
2. Organizational structures fall on a spectrum, with "mechanistic" at one end and "organic" at the other (TRUE/FALSE)
3. Bad organizational structure is not a problem for achieving the success of the enterprise (TRUE/FALSE)

In 5 minutes in one message write your name and answer to the test in Zoom chat personally to the teacher (NOT IN COMMON CHAT!!!), and your attendance would be assessed at 0,5 point

State tax system.

1. Public finance and state budget: the definitions, economic role and classifications.
2. Taxes as a tool of economic policy: the types, principles of calculation.

1. Public finance and state budget

- Finance is the study of how and under what conditions savings are allocated between lenders and borrowers
- Lifeblood of business
- Activating element in business

Public finance

- Expenditures have to be made to run the government organizations.
- Government has to raise funds
- Debts in case of unfavorable position
- Accounts regarding revenues and expenditures
- Public Finance deals with public revenues, public expenditures, public debt and their accounts.

Public finance

- **Public finance** is concerned with paying for governmental activities, and with the administration and design of those activities.
- The field is often divided into questions of what the government should do or is doing, and questions of how to pay for those activities.

Public finance

Definition by Harley Leist

- "Public finance deals with the provision, distribution and governance of resources which are required to perform the governmental functions".
- How the state collects revenue and makes expenditure to perform its various functions is called Public finance.

Scope of Public Finance

- Government Expenditures
- Government Revenues
- Public Debt
- Financial Management

Public finance

Public Expenditures

- The revenues raised by the government has to be spent on different items.

  Current expenditures:

  These are the day to day running expenses of the government e.g. salaries to the Govt employees.

  Development expenditures:

  This is the investment expenditures on new roads, buildings etc.

The Welfare State

Made up of 3 Components

Financial Services

Social Services

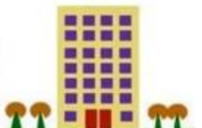
Education

Medical Care

Non-Cash Benefits

Medications

Housing



The State Undertakes to Protect Citizens' Well-Being and Health

Public Revenues

- Every government has to make a lot of expenditures. For this purpose it has to raise revenues.
- Sources of Raising Revenues:
  - Taxes
  - Fees
  - Penalties

Public finance

- A Tax is a compulsory contribution by the people to public treasury to meet the expenditure of the government.

- TAXATION:
- Taxation is the raising of money by the state from the general public

Direct Tax:

A tax where Impact and Incidence lies on one and the same person is known as direct tax. e.g. Income Tax

Indirect Tax:

A tax where impact lies on one person and incidence on another is called indirect tax.

e.g. General sales tax.

Fees and Fines:

A fee is a compulsory payment made by those who get any particular government service.

The examples are educational fee and license fee.

Fines are imposed as a penalty for violating the laws of the state.

Public finance

Public Debt

- If Revenues are lesser than Expenditures
- Goes for public debt
- Types of public debt available
- Rate of interest against such loans
- Repayment of debt?
- Spent on productive fields or non-productive fields

Public finance (PF)

Financial Management

- PF does not mean raising of public revenues, making of government expenditures and issuing of bonds to have public debt.
- Rather we study all the mechanism which helps in performing all these activities
- It means in PF we study Financial Management.

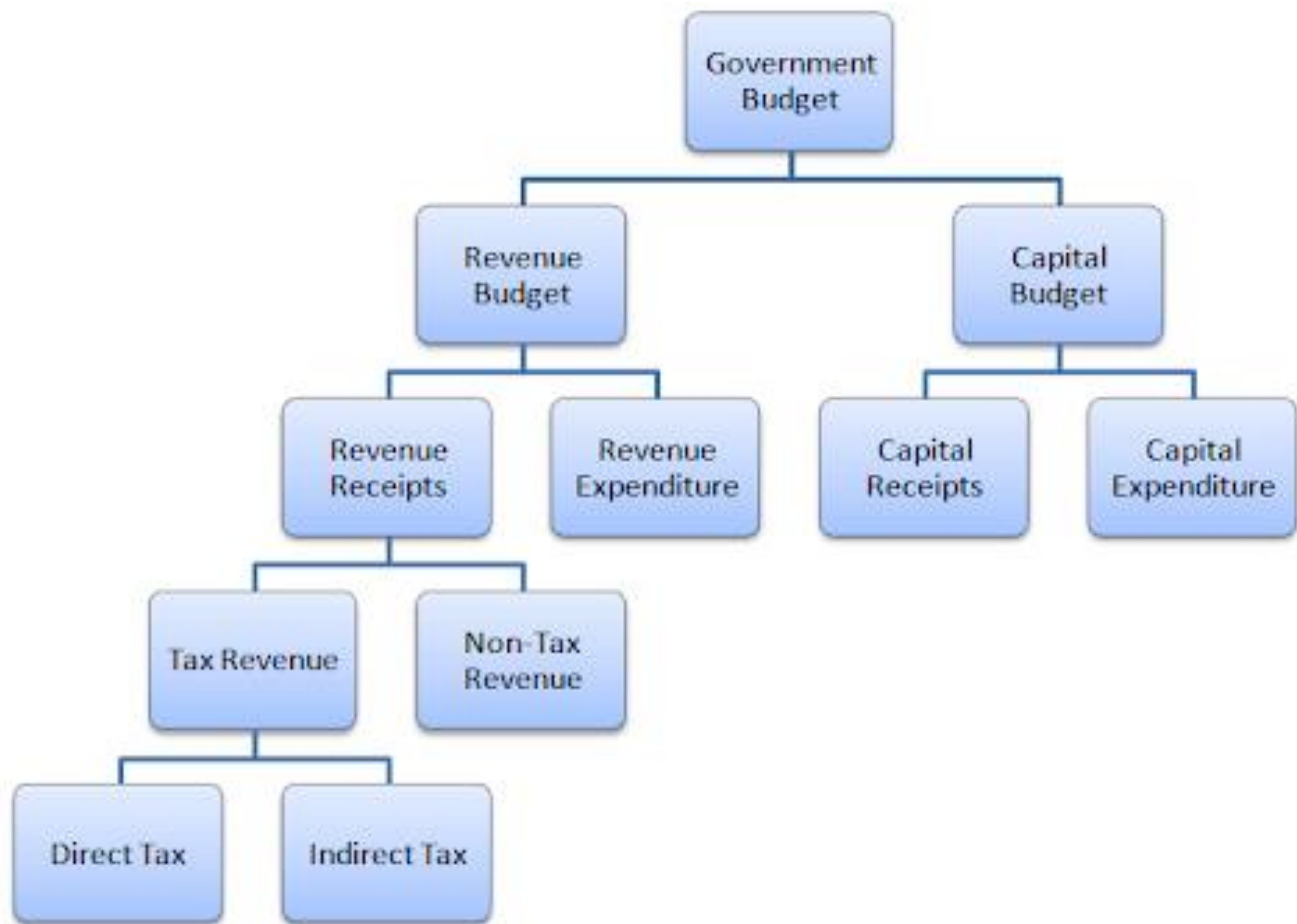
The state (government) budget: definitions, principles, problems

Government budget is an annual financial statement presenting the revenues and spending for a financial year that is often passed by the legislature, approved by the chief executive or president and presented by the Finance Minister to the nation. The budget is also known as the Annual Financial Statement of the country. This document estimates the anticipated government revenues and government expenditures for the ensuing (current) financial year.

It includes 2 components:

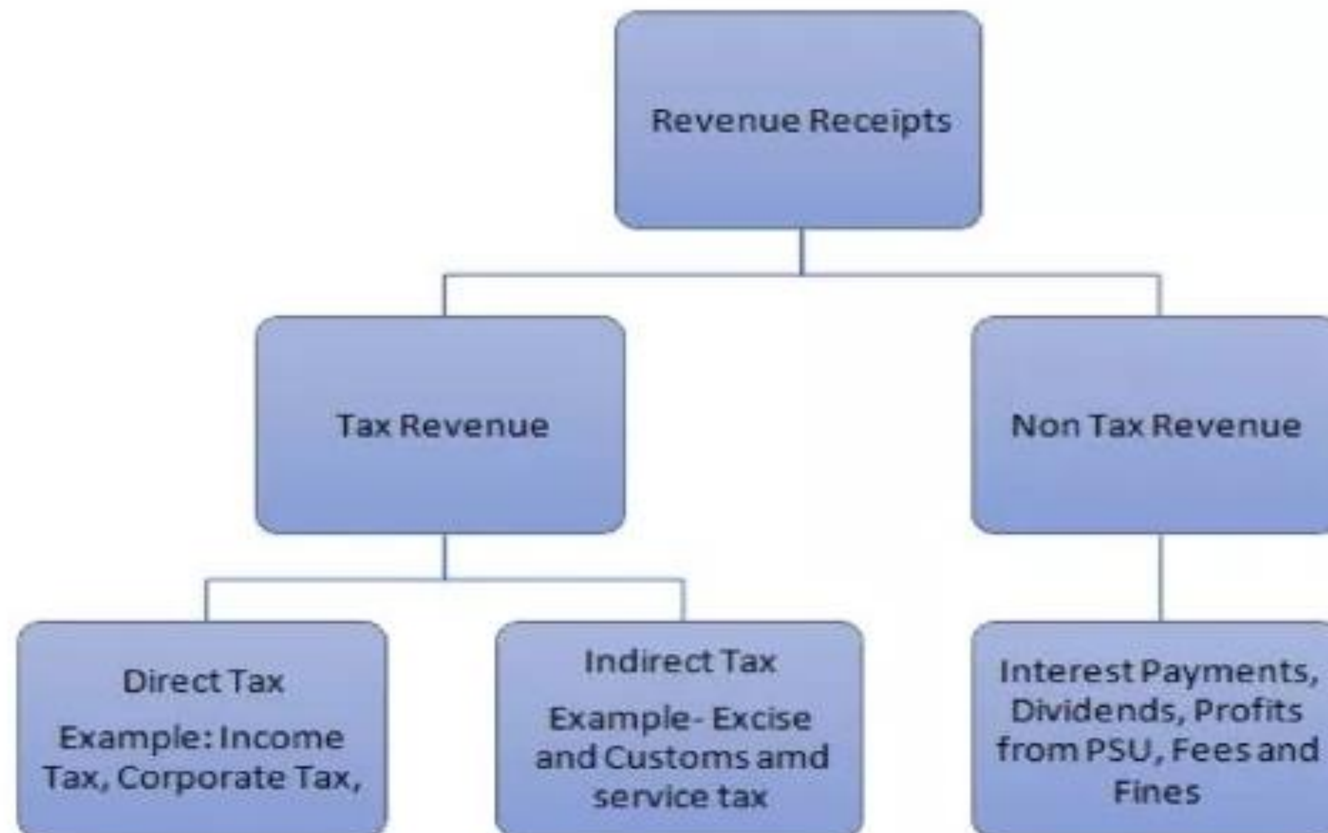
<u>Budget revenues</u>: all types of input payments which form the financial funds of government. In the case of the government, revenues are derived primarily from taxes.

<u>Budget spending (expenditures)</u>: all types of output payments made by the government in order to provide its functions. Government expenses include spending on current goods and services, which economists call government consumption; government investment expenditures such as infrastructure investment or research expenditure; and transfer payments like unemployment or retirement benefits.


Government Budget
Revenue Budget
Capital Budget
Revenue Receipts
Revenue Expenditure
Capital Receipts
Capital Expenditure
Tax Revenue
Non-Tax Revenue
Direct Tax
Indirect Tax

Revenue Account

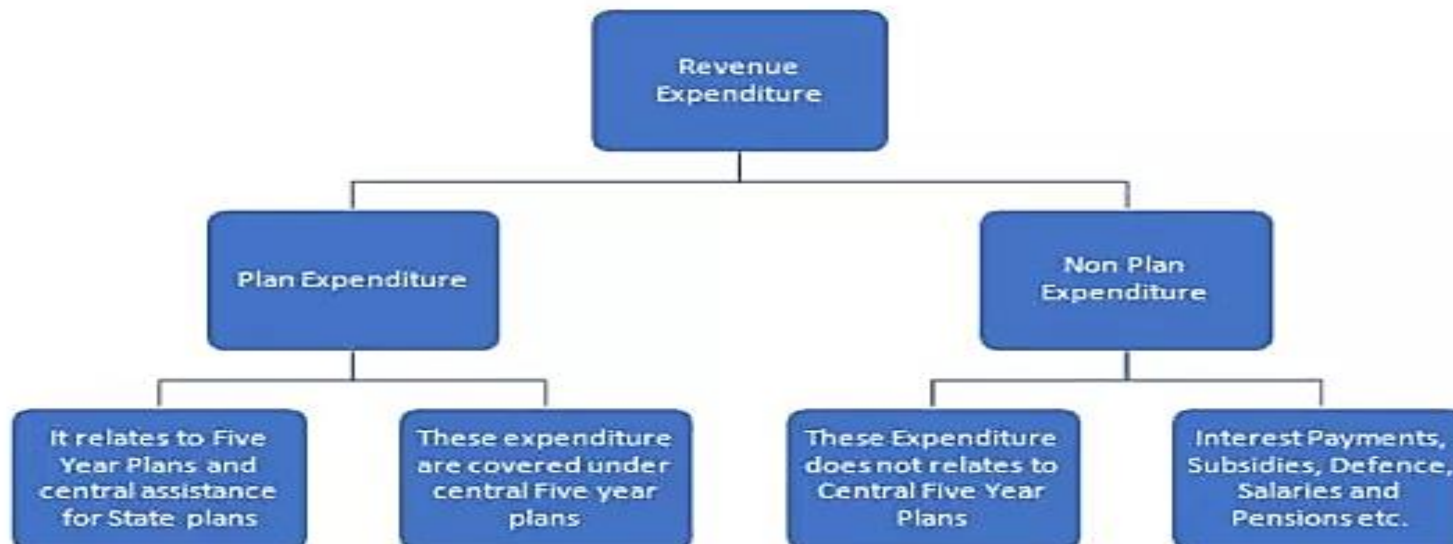
- The revenue account shows the current receipts of the government and the expenditure that can be met from these receipts.
- Revenue Receipts: RR are receipts of the government incomes which cannot be reclaimed back by the citizens from the government.



Revenue Expenditure

- The expenditure incurred by thegovernment that neither creates any physical/financial asset nor reduces the liability of the government. The Revenue expenditure relates to thedaytoday functioning of the government.
- Revenue expenditure is expenditure for normal running of the government department and various services, interest charges on debt incurred by government, subsidies and so on.
- Example: Salaries of employees, Interest payments on past debts, grants given to state governments etc.

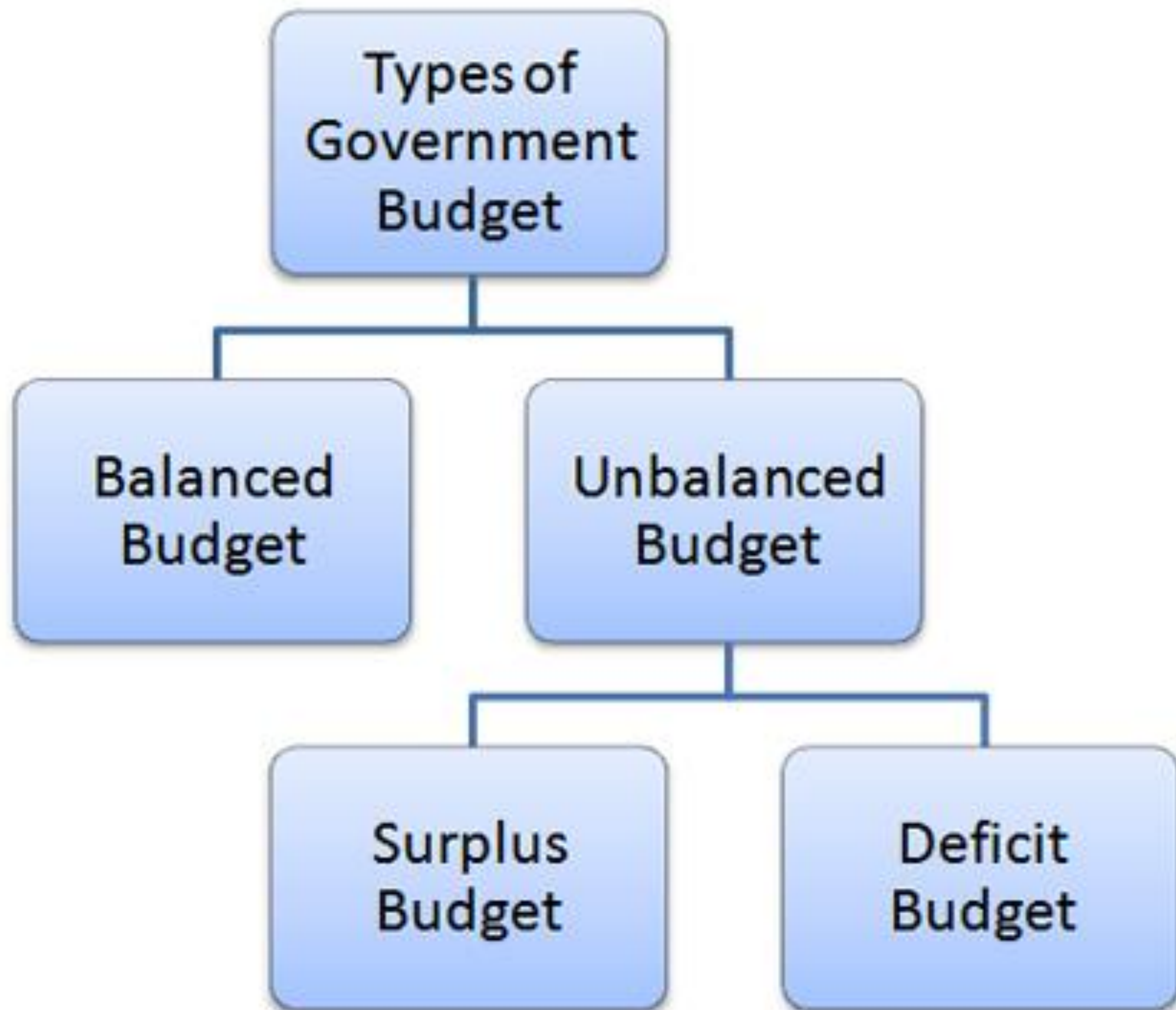
The Expenditure under Budget is divided into two subheads.



Government budgets are of the following types:

- Union Budget : the budget prepared by the central government for the country as a whole.
- State (or regional) Budget: In countries like USA, Russia, India, there is a federal system of government thus every state / region prepares its own budget.
- Local Budgets: the budget prepared by local government of the city, town or rural settlement for satisfying local needs.
- Plan Budget: It is a document showing the budgetary provisions for important projects, programs and schemes included in the central plan of the country. It also shows the central assistance to states and union territories.
- Performance Budget: The central ministries and departments dealing with development activities prepare performance budgets, which are circulated to members of parliament. These performance budgets present the main projects, programs and activities of the government to achieve the specific objectives (for example, the program to support national automobile industry).
- Supplementary Budget: This budget forecasts the budget of the coming year with regards to revenue and expenditure.
- Zero-Based Budget: This is defined as the budgetary process which requires each ministry/department to justify its entire budget in detail. It is a system of budget in which all government expenditures must be justified for each new period.

Types of Government Budgets



A Balanced Budget

A Balanced Budget is a situation in which estimated revenue of the government during the year is equal to its anticipated expenditure.

Government's estimated revenue = Governments proposed expenditure.

For individuals and families it is always advisable to have a balanced budget.

Most of the classical economists advocated balanced budget which was based on the policy of "live within means". According to them, government's revenue should not fall short of expenditure.

They also favored balanced budget because they believed that the government should not interfere in the economic activities and should just concentrate on the maintenance of internal and external security and provision of basic economic and social overheads. To achieve the government has to have enough fiscal discipline so that its expenditures are equal to revenue.

Thus till 1930, generally accepted norm was that of "sound finance" which implied that a public authority should balance its budget. But the great depression of 1930s proved that balanced budget was not a guarantee of stability and full employment. It was realized that the government can play an effective role in the recovery of the economy. This is because if the government's expenditure exceeds its revenue, it will generate additional demand which will accelerate the pace of economic growth.

B. Unbalanced Budget

The budget in which income and expenditure are not equal to each other is known as an unbalanced budget.

Unbalanced Budget is of two types

- Surplus budget
- Deficit budget

Surplus budget

A surplus budget is a situation in which estimated revenues of the government during the year is greater than its anticipated expenditure.

Governments expected revenue > Governments proposed expenditure.

OR

Governments proposed expenditure < Government's expected revenue

Surplus budget shows the financial soundness of the government. When there is an inflation, the government can adopt the policy of surplus budget as it will reduce aggregate demand.

Increase in revenue by levying taxes on people reduces their disposable income, which otherwise would have been spent on consumption or saved and devoted to capital formation. This in turn reduces the demand for goods and services, thereby bringing down the prices.

Since government spending will be less than its income. Aggregate demand will decrease and help to reduce the price level.

Deficit budget

A deficit budget is a situation in which estimated expenditure of the government during the year is greater than its expected revenue.

Government's estimated expenditure > Governments expected revenue.

OR

Governments expected revenue < Government's estimated expenditure

According to Prof Hugh Dalton, "If over a period of time expenditure exceeds revenue, the budget is said to be unbalanced".

During depression, the government can adopt the policy of deficit budget as it will reduce aggregate demand. In this case the government incurs excess expenditure which increases the level of employment. This leads to increase in the demand for goods and services, thereby leading to revival of the economy.

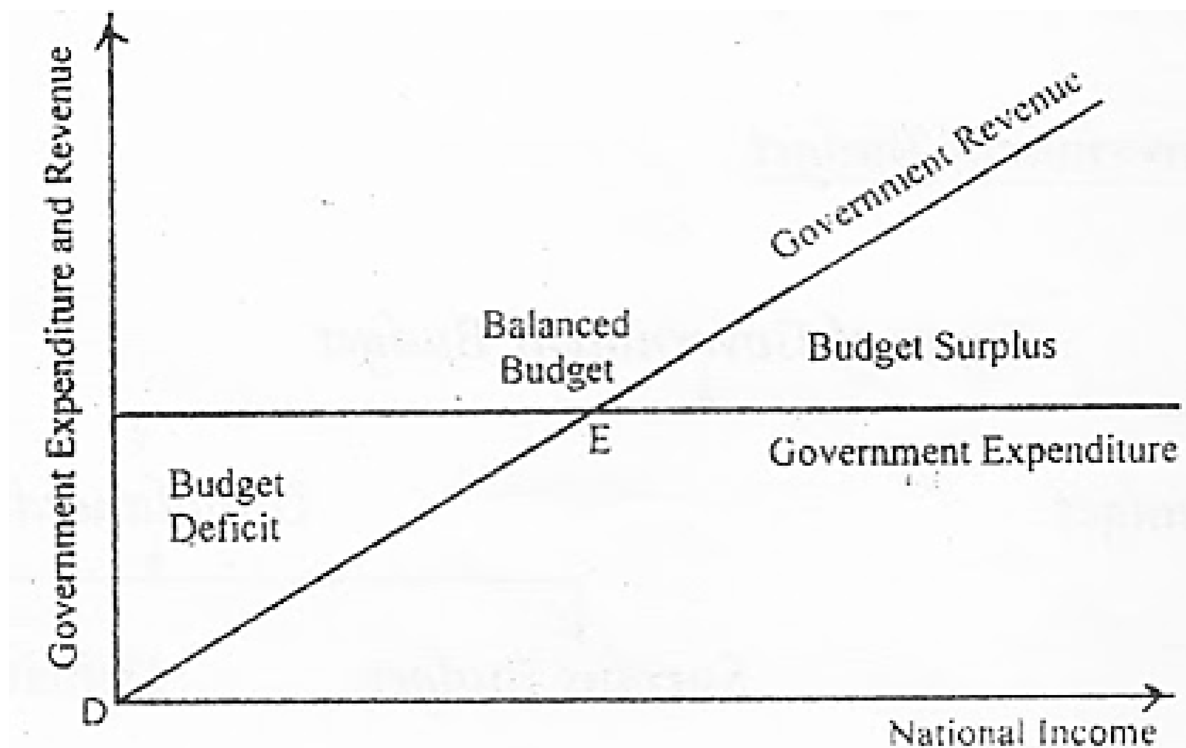
When the government incurs a budget deficit it is financed by borrowing. The government borrows from the public by issuing government bonds. This gives rise to government or public debt.

Such deficit amount is generally covered through public borrowings or withdrawing resources from the accumulated reserve surplus. In a way a deficit budget is a liability of the government as it creates a "burden of debt" or it reduces the stock of reserves of the government.

In developing countries like India, where huge resources are needed for the purpose of economic growth and development it is not possible to raise such resources through taxation, deficit budget is the only option.

In general, budget deficit is very common.Today almost all countries of the world follow the norm of deficit budget instead of surplus or balanced budget.

Developing countries use it as a means to finance planned development.

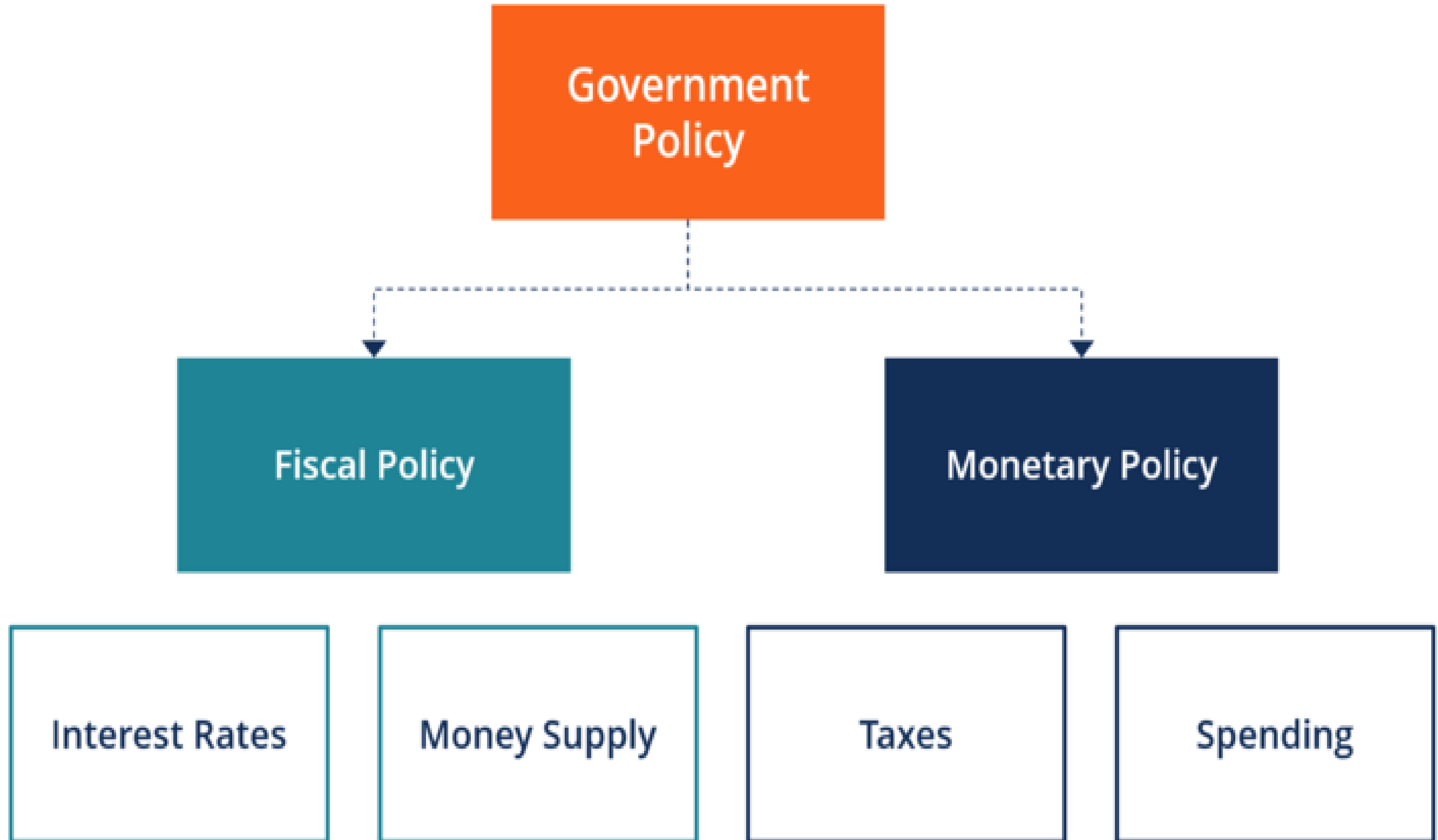


At the point "E" the budget is balanced. To the left of point "E" the government budget is in deficit and to the right of point "E" the budget is in surplus.

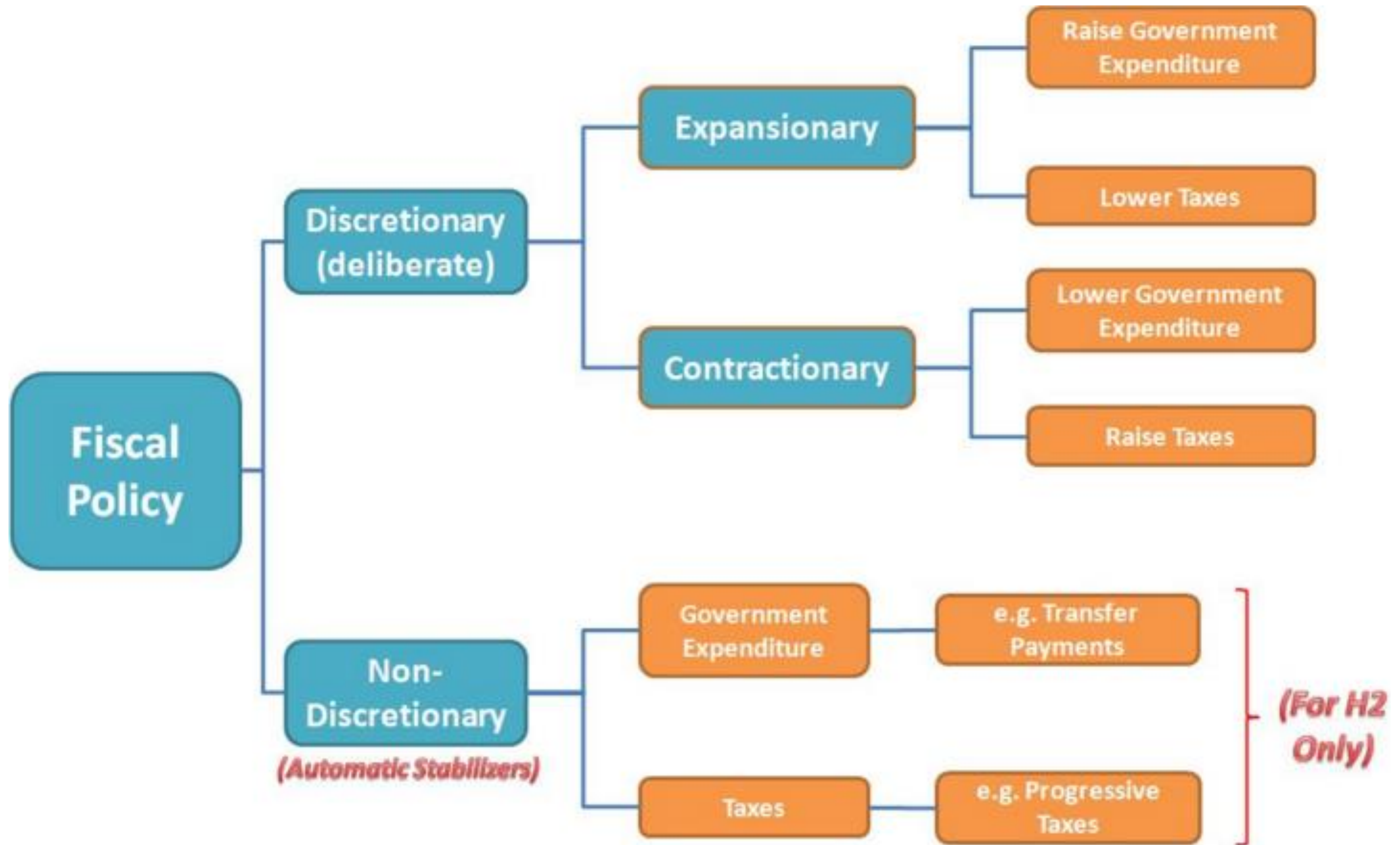
II. Significance of different measures of deficit

S.No	Deficit Measure	Significance
1	Fiscal Deficit	Widely used as a summary indicator of the macroeconomic impact of the budget in several industrialized countries. This measure has been adopted by the IMF as the principal policy target in their programmes. In India, the government began to report the fiscal deficit only after 1991.
		Since the shortfall in receipts over expenditure must be covered through borrowing, therefore, Gross Fiscal Deficit, gives the overall borrowing requirements of the government over a given financial year. And thus shows the net addition to the level of public debt during a financial year.
2	Budget Deficit	In the presence of the system of automatic monetization of deficits through issuance of ad-hoc treasury bills, this measure of deficit, becomes an important target to keep in check. However, in the year 1997, the government discontinued the issuance of ad-hoc and tap treasury bills. As a result of this, now, the concept of budget deficit in the traditional sense has lost its significance in public finance and is now not reported in the Budget documents of the Government of India.
3	Monetized Deficits	Monetization of deficits, which increases the money supply, is inflationary if the rate of growth of money supply is greater than the rate of increase of the demand for cash balances arising from the growth of the economy. Thus, monetized deficits are an important indicator of the inflationary impact of the increase in government's budgetary deficits.
4	Primary Deficits	It excludes the burden of the past debt and shows the net increase in the government's indebtedness due to the current year's fiscal operations. A reduction in primary deficit is reflective of government's efforts at bridging the fiscal gap during a financial year.
5	Revenue Deficit	A positive revenue deficit implies that the government is resorting to borrowing to finance current consumption.

Budgetary policy



Budgetary policy = Fiscal policy + Monetary policy + Government spending structure optimization



2. Taxes & fiscal system

Tax is a **compulsory**, financial levy on the income, resources or goods of natural or legal persons. It is used to finance public expenditure.

There are several types and classes of taxation, for which the rates can vary depending on the legal form of the company.

A tax is validly constituted when the four following elements are present:

- **taxable item**: this is the **item** on which the tax is paid (income, capital, good or service). We also refer to this as the tax **base**;
- **taxable person (=taxpayer)**: this is the person **liable** for tax, meaning the person who must assume the fiscal cost;
- **taxable event**: this is the **event** triggering a tax charge (e.g. the possession of wealth on a certain date, the sale of a building...);
- **due date**: this is the **time** when the taxable person must pay the tax.

2. Taxes & fiscal system

Tax deduction is a reduction of income that is able to be taxed and is commonly a result of expenses, particularly those incurred to produce additional income.

Tax exemption is the reduction or removal of a liability to make a compulsory payment that would otherwise be imposed by a ruling power upon persons, property, income, or transactions. Tax-exempt status may provide complete relief from taxes, reduced rates, or tax on only a portion of items. Examples include exemption of charitable organizations from property taxes and income taxes, veterans, and certain cross-border or multi-jurisdictional scenarios.

Tax credit is an amount of money that taxpayers are permitted to subtract, dollar for dollar, from the income taxes that they owe. Tax credits are more favorable than tax deductions or exemptions because they actually reduce the tax due, not just the amount of taxable income.

The difference between deductions, exemptions and credits is that deductions and exemptions **both reduce taxable income**, while credits reduce **tax**.

TAXES: DEFINITIONS

There are several very common types of taxes:

Income Tax —a percentage of individual earnings filed to the federal government

Corporate Tax —a percentage of corporate profits taken as tax by the government to fund federal programs.

Sales Tax — taxes levied on certain goods and services

Property Tax — based on the value of land and property assets

Tariff — taxes on imported goods imposed in the aim of strengthening internal businesses

Estate tax — rate applied to the fair market value of property in a person's estate at the time of death

Income tax is a tax that governments impose on income generated by businesses and individuals within their jurisdiction. By law, taxpayers must file an income tax return annually to determine their tax obligations.

Individual income tax is also referred to as personal income tax and is levied on wages, salaries, and other types of income. This tax is usually a tax the state imposes. Because of exemptions, deductions, and credits, most individuals do not pay taxes on all of their income. For example, if a taxpayer earns $100,000 in income and qualifies for $20,000 in deductions, the taxable income reduces to $80,000 ($100,000 - $20,000). Tax credits are used to reduce the taxpayer's tax obligation or amount owed. To illustrate, if an individual owes $20,000 in taxes but qualifies for $4,500 in credits, his tax obligation reduces to $15,500 ($20,000 - $4,500).

Businesses pay income taxes on their earnings; the IRS taxes income from corporations, partnerships, self-employed contractors, and small businesses. Depending on the business structure, either the corporation, its owners, or shareholders report their business income and then deduct their operating and capital expenses. The difference is their taxable business income.

Corporate tax is a levy placed on a firm's profit by the government. The money collected from corporate taxes is used for a nation's source of income. A firm's operating earnings are calculated by deducting expenses including the cost of goods sold (COGS) and depreciation from revenues. Then, tax rates are applied to generate a legal obligation the business owes the government. Rules surrounding corporate taxation vary greatly worldwide, but they must be voted upon and approved by a country's government to be enacted. Some areas are considered tax heavens, like Jersey, and are heavily prized by corporations.

Corporations **are permitted** to reduce taxable income by certain necessary and ordinary business expenditures. All current expenses required for the operation of the business are fully tax-deductible. Investments and real estate purchased for the intent of generating income for the business are also deductible. **A corporation can deduct** employee salaries, health benefits, tuition reimbursement, and bonuses. In addition, **a corporation can reduce** its taxable income by deducting insurance premiums, travel expenses, bad debts, interest payments, sales taxes, fuel taxes, and excise taxes. Tax preparation fees, legal services, bookkeeping, and advertising costs are also used to reduce business income.

Sales tax (in many countries = value added tax) is a consumption tax imposed by the government on the sale of goods and services. A conventional sales tax is levied at the point of sale, collected by the retailer, and passed on to the government. A business is liable for sales taxes in a given jurisdiction if it has a nexus there, which can be a brick-and-mortar location, an employee, an affiliate, or some other presence, depending on the laws in that jurisdiction.

Understanding Sales Tax

Conventional or retail sales taxes are only charged to the end user of a good or service. Because the majority of goods in modern economies pass through a number of stages of manufacturing, often handled by different entities, a significant amount of documentation is necessary to prove who is ultimately liable for sales tax. For example, say a sheep farmer sells wool to a company that manufactures yarn. To avoid paying the sales tax, the yarn maker must obtain a resale certificate from the government saying that it is not the end user. The yarn maker then sells its product on to a garment maker, which must also obtain a resale certificate. Finally, the garment maker sells fuzzy socks to a retail store, which will charge the customer sales tax along with the price of said socks.

Value-added tax (VAT) is an indirect tax which is charged at the time of consumption of goods and services and is levied when a value has been added over various stages of production/ distribution right from the purchase of raw materials till the final products are sold to the retail consumers.

VAT is levied on the cost of the products at each stage and its full burden is borne only by the final consumer since the producer of the product or supply chain distribution members can take the credit of VAT paid by them. (i.e.) until the purchaser is not the end-user, the goods procured is the cost to the business, and the tax paid on those purchases can be reduced from the tax they charge on their customers.

It is levied based according to the consumption of goods and rather than the income of the consumers.

- **Output VAT** = It is a tax charged on the sale of goods. It is charged on the selling price of the goods.
- **Input VAT** = It is the tax paid on the purchase of goods. It is paid at the cost price of the goods.

You may look the video about VAT mechanism in Saudi Arabia at https://www.youtube.com/watch?v=meolk4pYic8

The following example shows how a VAT would apply to the production and sale of a chair:

- First, a supplier sells raw materials (for example, wood) to a manufacturer for use in producing the chair. If the raw materials are sold for $40, the materials supplier pays tax on the whole $40. A 5 percent tax rate on the $40 of value added equals a $2 tax.
- Second, the manufacturer builds the chair and sells it to a wholesaler for $140. The manufacturer pays a VAT only on the value it has added to the chair. Since the manufacturer has taken raw materials worth $40 and made a chair worth $140, the manufacturer's value added is $100. A 5 percent tax on the $100 value added is $5.
- Third, the wholesaler sells the chair to a retailer for $200. The wholesaler bought the chair for $140 and sells it for $200, so the wholesaler's value added is $60. The 5 percent tax is $3.
- And finally, the retailer sells the chair for $300. Since the retailer bought the chair for $200 and sold it for $300, the retailer's value added is $100.
- At the end of this process, the outcome from the consumer's perspective is just the same as if the state had imposed a retail sales tax on the $300 sales price. The main difference is that the VAT is collected a little bit at a time at each stage of the production process, rather than being collected in one lump sum at the time of the final retail sale.

Excise Taxes

In general, sales taxes take a percentage of the price of goods sold. For example, a state might have a 4% sales tax, a county 2%, and a city 1.5%, so that residents of that city pay 7.5% total. Often, however, certain items are exempt, such as food, or exempt below a certain threshold, such as clothing purchases of less than $200. At the same time, some products carry special taxes, known as excise taxes. "Sin taxes" are a form of excise tax, such as the local excise tax of $1.50 New York City charges per pack of 20 cigarettes on top of the State excise tax of $4.35 per pack of 20 cigarettes.

Property tax is a tax paid on property owned by an individual or other legal entity, such as a corporation. Most commonly, property tax is a real estate ad-valorem tax, which can be considered a regressive tax. It is calculated by a local government where the property is located and paid by the owner of the property. The tax is usually based on the value of the owned property, including land. However, many jurisdictions also tax tangible personal property, such as cars and boats.

The local governing body will use the assessed taxes to fund water and sewer improvements, and provide law enforcement, fire protection, education, road and highway construction, libraries, and other services that benefit the community.

Tariffs are used to restrict imports by increasing the price of goods and services purchased from another country, making them less attractive to domestic consumers. There are two types of tariffs: A specific tariff is levied as a fixed fee based on the type of item, such as a $1,000 tariff on a car. An ad-valorem tariff is levied based on the item's value, such as 10% of the value of the vehicle.

- Governments impose tariffs to raise revenue, protect domestic industries, or exert political leverage over another country.
- Tariffs often result in unwanted side effects, such as higher consumer prices.
- Tariffs have a long and contentious history, and the debate over whether they represent good or bad policy rages on to this day.

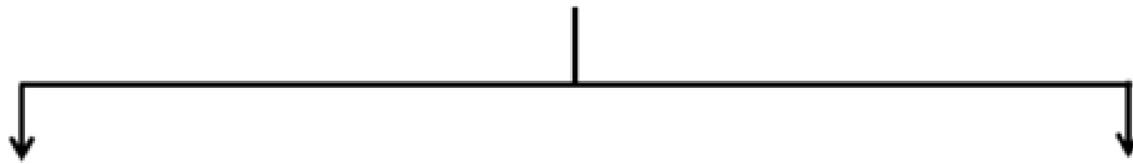
Fiscal system – a system of permanent or periodic payments to the government by all economic agents operating in the national economy

Taxes are classified

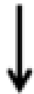
1. By the type of budget: federal, regional, local
2. By the taxable person: direct (income taxes for individuals and for firms, property taxes, environmental taxes, etc.) and indirect (paid for taxable event, mainly for good sold/service provided, such as sales or value added taxes and ad valorem tax)
3. By the date of payment (spot and periodical)
4. By the income ratio dependence (proportional, progressive, regressive)
5. By the ratio calculation (specific and ad-valorem).

Tax

teachoo.com



Direct Tax



Person pays tax from own pocket

Example

Income Tax

Indirect Tax

Person collects Tax from Customer Pays to Government

Example

Vat. Service Tax, Excise, Customs etc.

Indirect Tax

teachoo.com

On Goods Sold

By Dealer

Within State
Vat

Outside State
CST

Outside Country
Customs

By Manufacturer

Within State
Excise + Vat

Outside State
Excise + CST

Outside Country
Excise + Customs

On Service Provided

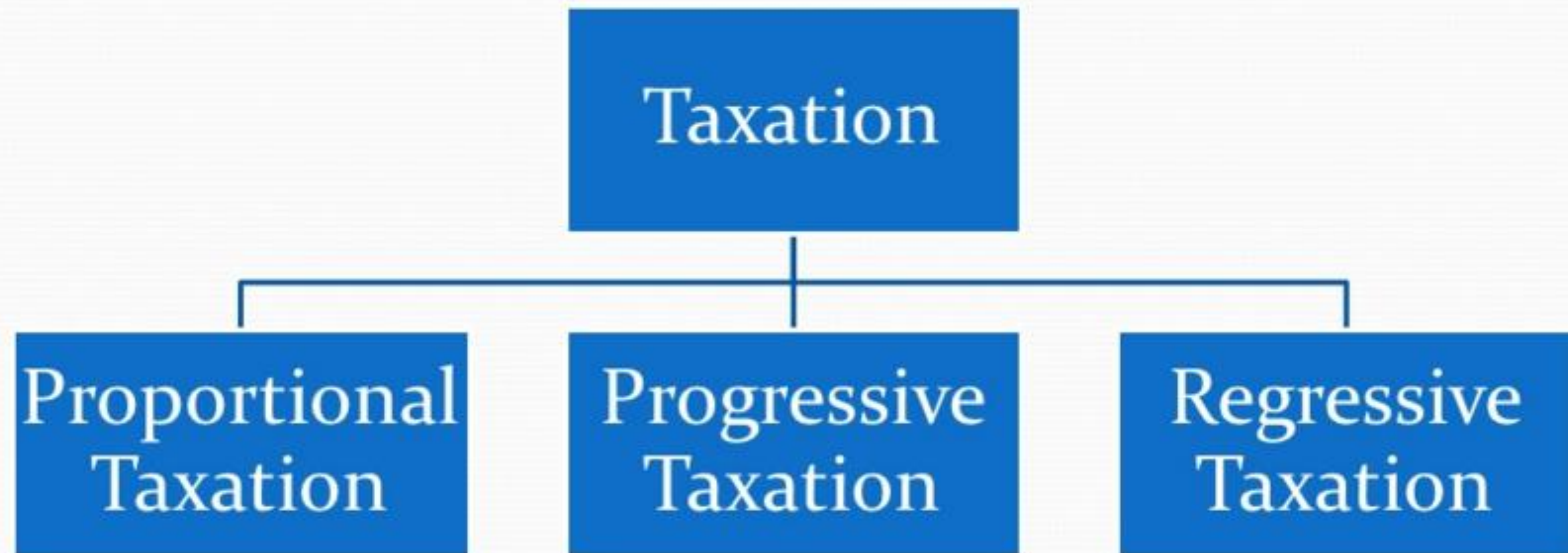
By Service Provider

Within State
Service Tax

Outside State
Service Tax

Outside Country
Service Tax

Classification Of Taxation



Proportional Taxation

- Percentage remains proportional

Size of the base	Tax Rate	Tax Amount
Rs. 10000	10%	1000
Rs. 100,000	10%	10000

Progressive Taxation

- Tax rate increases with the increase in size of tax base.
- Helps ensure economic equality in the society.

Size of the base	Tax Rate	Tax Amount
Rs. 10000	**10%**	1000
Rs. 100,000	**20%**	20000

Regressive Taxation

- Tax rate decreases with the increase in tax base.

Size of the base	Tax Rate	Tax Amount
Rs. 10000	**10%**	1000
Rs. 100,000	**5%**	5000

Fiscal policy is how government and elected officials influence the economy using spending and taxation. It is used in conjunction with the monetary policy implemented by central bank. It influences the economy using the money supply and interest rates.

The objective of fiscal policy is to create healthy economic growth. Ideally, the economy should grow between 2 to 3 percent a year. Unemployment will be at its natural rate of between 4.7 and 5.8 percent. Inflation will be at its target rate of 2 percent. The business cycle will be in the expansion phase.

Types

There are two types of fiscal policy.

The most widely-used is **expansionary**. It stimulates economic growth. Congress uses it to end the contraction phase of the business cycle. That's when voters are clamoring for relief from a recession.

The government either spends more, cuts taxes, or both. The idea is to put more money into consumers' hands, so they spend more. The increased demand forces businesses to add jobs to increase supply.

Politicians debate about which works better. Advocates of supply-side economics prefer tax cuts. They say it frees up businesses to hire more workers to pursue business ventures. Advocates of demand-side economics say additional spending is more effective than tax cuts. Examples include public works projects, unemployment benefits, and food stamps. The money goes into the pockets of consumers, who go right out and buy the things businesses produce.

Types

The second type of fiscal policy is **contractionary fiscal policy**. It's rarely used. Its goal is to slow economic growth. Why would you ever want to do that? One reason only. That's to stamp out inflation. The long-term impact of inflation can damage the standard of living as much as a recession.

The tools of contractionary fiscal policy are used in reverse. Taxes are increased, and spending is cut. You can imagine how wildly unpopular this is among voters. Only lame duck politicians could afford to implement contractionary policy.

Tools

The first tool is taxation. That includes income, capital gains from investments, property, and sales. Taxes provide the income that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend on themselves. As a result, taxes are unpopular.

The second tool is government spending. That includes subsidies, transfer payments including welfare programs, public works projects, and government salaries. Whoever receives the funds has more money to spend. That increases demand and economic growth.

The federal government is losing its ability to use discretionary fiscal policy. Each year, more of the budget must go to mandated programs. As the population ages, the costs of Medicare, Medicaid, and Social Security are rising.

- Changing the mandatory budget requires an Act of Legislatives and that takes a long time. One exception was the American Recovery and Economic Stimulus Act. Congress passed it quickly to stop the Great Recession.

Monetary policy is the process by which a nation changes the money supply. The country's monetary authority increases it with expansionary monetary policy and decreases it with contractionary monetary policy. It has many tools it can use, but it primarily relies on raising or lowering the fed funds rate. This benchmark rates then guides all others.

Monetary policy works faster than fiscal policy. The Central bank raises or lowers rates. It may take about six months for the impact of the rate cut to percolate throughout the economy.

Lawmakers should coordinate fiscal policy with monetary policy. They don't. Why? Their fiscal policy reflects the priorities of individual lawmakers. They focus on the needs of their constituencies. These local needs often overrule national economic priorities. As a result, often fiscal policy runs counter to what the economy needs. Central banks are forced to use monetary policy to offset poorly planned fiscal policy.