The word *ethics* is derived from the Greek word *ethos*, which means "character," and from the Latin word *mores*, which means "customs."

Aristotle was one of the first great philosophers to study ethics. To him, ethics was more than a moral, religious, or legal concept.

He believed that the most important element in ethical behaviour is knowledge that actions are accomplished for the betterment of the common good.

To determine what is ethically good for the individual and for society, Aristotle said, it is necessary to possess three virtues of practical wisdom: *temperance, courage, and justice.*
Ethics for Tax Legislators
Compliance with objectives

The tax legislators must keep in mind the objectives of taxation while making law:

- Revenue objectives
- Non-revenue objectives

[Covered in System of Taxation in Pakistan]
Ethics and Canon of Taxation

According to Hugh Dalton, "a tax is a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the taxpayer in return, and not imposed as penalty for any legal offence."

- Compulsory contribution
- Obligatory for a citizen living in that jurisdiction

However, the State's right to tax its people should be based upon some rational grounds. A good tax system is one which is designed on the basis of an appropriate set of principles (rules).

The tax system should strike a balance between the interest of the taxpayer and that of tax authorities.
Canons of Taxation

Adam Smith was the first economist to develop a list of canons of taxation. These canons are still regarded as characteristics or features of a good tax system.

In this book Adam Smith only gave four canons of taxation, which are now known as the "Original or Main Canons of Taxation". These are as follows:
I. Canon of Equity

The principle aims at providing economic and social justice to the people. According to this principle, every person should pay to the government depending upon his ability to pay. Rich people should pay higher taxes to the government, because without the protection of the government authorities (Police, Defence, etc.) they would not have earned and enjoyed their income. Adam Smith argued that the taxes should be proportional to income, i.e., citizens should pay taxes in proportion to the revenue which they respectively enjoy under protection of the State.
2. Canon of Certainty

According to Adam Smith, the tax which an individual has to pay should be certain, not arbitrary. The taxpayer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in what form the tax is to be paid to the government. In other words, every tax should satisfy the canon of certainty. At the same time a good tax system also ensures that the government is also certain about the amount that would be collected by way of tax.
3. Canon of Convenience

The mode and timing of tax payment should be, as far as possible, convenient to the taxpayers. For example, land revenue is collected at time of harvest and income tax is deducted at source. Convenient tax system encourages people to pay tax and increases tax revenue.
4. Canon of Economy

This principle states that there should be economy in tax administration. The cost of tax collection should be lower than the amount of tax collected. It may not serve any purpose, if the taxes imposed are widespread but are difficult to administer. Therefore, it would make no sense to impose certain taxes, if they are difficult to administer.
Additional Canons of Taxation

Activities and functions of the government have increased significantly since Adam Smith's time.

Governments are expected to maintain economic stability, full employment, reduce income inequality and promote growth and development.

Tax system should be such that it meets the requirements of growing state activities. Accordingly, modern economists gave following additional canons of taxation:
5. Canon of Productivity

It is also known as the canon of fiscal adequacy. According to this principle, the tax system should be able to yield enough revenue for the treasury and the government should have no need to resort to deficit financing. This is a good principle to follow in a developing economy.
According to this canon, every tax imposed by the government should be elastic in nature. In other words, the income from tax should be capable of increasing or decreasing according to the country’s requirement. For example, if the government needs more income at a time of crisis, the tax should be capable of yielding more income through increase in its rate.
7. Canon of Flexibility

It should be easily possible for the authorities to revise the tax structure both with respect to its coverage and rates, to suit the changing requirements of the economy. With changing time and conditions the tax system needs to be changed without much difficulty. The tax system must be flexible and not rigid.
8. Canon of Simplicity

The tax system should not be complicated. That makes it difficult to understand and administer and results in problems of interpretation and disputes. In Pakistan, efforts of the government in recent years have been to make the system simple.
9. Canon of Diversity

This principle states that the government should collect taxes from different sources rather than concentrating on a single source of tax. It is not advisable for the government to depend upon a single source of tax, it may result in inequity for a certain section of the society and uncertainty for the government to raise funds. If the tax revenue comes from diversified sources, then any reduction in tax revenue from one source for any reason is bound to be small.
Responsibilities of Tax legislator

The tax structure is a part of economic organisation of a society and therefore fits in its overall economic environment. No tax system that does not satisfy above canons of Taxation can be termed a good one.

Moreover, the state should pursue that the primary aim of tax should be to raise revenue for public services.

However, people should be asked to pay taxes according to their ability to pay and assessment of their taxable capacity should be made primarily on the basis of income and property.

Tax should not be discriminatory in any aspect, either between individuals or between various groups.
Ethics for Tax Administrators
Powers of FBR

Federal Board of Revenue is empowered under the law to monitor, assess, levy and collect taxes as provided in the tax statutes.

There are a number of occasions whereby they possess any of the following powers:

- Assess taxes (including best judgment);
- Collect Revenue;
- Seize Property;
- Attach bank accounts;
- Commence legal (criminal/civil) proceedings against taxpayer
Implications of FBR Powers

Such powers may be **misused and can become abusive powers** as exercise of that power can result in the following against the taxpayer:

- Loss of property and income;
- Imprisonment

So, these powers can result in the loss of some of the **fundamental human rights** of the taxpayer.

Ethics tend to bring these powers within the principles of goodness and morality.
Illustration 1

Mr. Zahid is running a textile unit and tax amounting to Rs. 5M is assessed against him. His bank accounts balance is Rs. 10M. However, he has to fulfil his exports orders. In case he fails to fulfil his orders, he would lose his customers and that orders. Considering his present critical financial position, Zahid believes that tax recovery proceedings by recovery from bank account (Attachment of bank account) would entail an irreparable loss to his organisation. So he files a request to FBR for allowing him to pay the tax dues in installments

*FBR staff has the power to allow him relief or recover this tax directly from his bank account.*

*Justice and equity demands that his request should be entertained so that his continuation and prosperity of business would eventually result in payment of better taxes in future whereas recovery of tax could jeopardise his business operations.*
Illustration 2

Income Tax Ordinance, Sales Tax Law, Federal Excise law empower tax authorities to select cases for audit. This power can be misused by selecting some cases while leaving many unaudited. Thus, despite the fact that law provides unfettered powers, these should be exercised on some ethical and rational basis.
Pillars of Tax administration

In order to safeguard the interest of taxpayers and avoid abuse of powers by the tax administration, following four pillars of Tax administration are defined:
1. Fairness

Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social or economic circumstances.
2. Transparency

All Proceedings must be transparent and must be seen as transparent.
3. Equity

Similar taxpayers should be taxed in the same way by tax authorities.

Salaries class should not be taxed more than business class.

Administrators should not achieve their objectives of revenue in an irrational way.
4. Accountability

There must be a strong system of accountability for wrong doers which should curb corruption, nepotism and maladministration.
Ethical Issues faced by Tax Administrators

Under the four pillars, some of the ethical issues facing tax administration are:

- Acceptance of gifts
- Conflict of Interest
- Selective application of the law/ or inconsistency in applying the law
- Political influence
- Confidentiality/secrecy
- Discretion
- Corruption
- Lack of Autonomy
7 Principles for structuring discretion

In order to avoid pitfalls of the abusive use of discretion, seven principles for structuring discretion are defined which are as under:

- Open plans
- Open policy statements
- Open rules
- Open findings
- Open reasons
- Open precedents
- Fair informal procedure
Responsibilities of Tax Implementing Authorities

A concise code which can enlist responsibilities of Tax Administrators can be as under:

1. Obey all laws relating to taxation and grant no exemptions, credit or advantage to any taxpayer that is not provided by the law;

2. Be dedicated to the highest ideals of honesty and integrity in all matters in order to maintain the respect and confidence of the government and taxpayers;

3. Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social status or economic circumstances;

4. Provide prompt, efficient and quality service to all stakeholders in an effort to exceed their expectations;

5. Refrain from actively participating in partisan political activities;
6. Accurately record proceedings and maintain taxpayer information in the strictest confidence and highest level of security;
7. Refrain from soliciting gifts for actions and non-actions;
8. Make reasonable effort to collect the proper amount of tax revenue due at the lowest possible cost to the state, and in a manner that warrants the highest degree of confidence in our integrity, efficiency, effectiveness and fairness;
9. Respond to valid taxpayer refund claims with the same diligence as employed in collection of taxes;
10. Educate taxpayers on their rights and responsibilities to ensure the highest possible levels of voluntary compliance to the laws.
Ethics for Tax Practitioners

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Moral and Ethical principles governing tax practitioners

**Integrity**
Tax Practitioners should be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness.

**Objectivity**
Tax practitioners should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments.

**Professional competence and due care**
Tax Practitioners have a duty to maintain their professional knowledge and skill at such a level that a client or employer receives competent service, based on current developments in practice, legislation and techniques. Tax practitioners should act diligently and in accordance with applicable technical and professional standards.
Confidentiality
Tax Practitioners should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without authority or unless there is a legal or professional right or duty to disclose.

Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of tax practitioners or third parties.

Professional behaviour
Tax practitioners should comply with relevant laws and regulations and should avoid any action which discredits the profession. They should behave with courtesy and consideration towards all with whom they come into contact in their professional capacity.
Whistle blower

Whistle blower means a person who reports concealment or evasion of income tax leading to detection or collection of taxes, fraud, corruption or misconduct, to the competent authority having power to take action against the person or an income tax authority committing fraud, corruption, misconduct, or involved in concealment or evasion of taxes.
Ethics for Taxpayers
Morality behind tax compliance

There are three approaches to ethics for tax compliance which are as under:

**Utilitarianism**, which tells us to aim for the greatest total happiness across the population. In the economic sphere, we can interpret ‘happiness’ as the satisfaction of our desires; and so utilitarianism as aiming for maximum satisfaction of desires.

For Taxpayers following utilitarian approach, the most important economic goals are to ensure that goods and services are available to allow everyone to have a decent life, and to ensure that these resources are distributed widely enough for all or most people to enjoy them. Motivating citizens to pay taxes even at the highest rate.
Deontology, which bases ethics on the idea of duty.

Taxpayers preferring the deontologist ethical approach lay down absolute duties. Such duty includes respect for other people’s property rights. This could be interpreted to mean that **there should be no tax at all**, because tax is the forcible transfer of property from taxpayers. On the other hand, the duty to respect property rights could be used to argue that **any social resources one uses should be paid for**, even if one did not ask for those resources to be provided. Thus in order not to be a thief, anyone who uses a public hospital, or even a public road, should make sure that he or she pays tax to cover their use. So this approach envisages that taxes are paid as a matter of obligation by the taxpayer for use of public facilities.
Virtue ethics, which focus on the virtues we should have, and on what constitutes a virtuous life. A broad conception of the virtues must be used here, encompassing not only virtues such as honesty, but also virtues such as using one’s talents and leading a fulfilled life.

One should use one’s talents to the full. Financial incentives can encourage people to use their talents, but very high taxation dampens those incentives by reducing take-home pay.

Another virtue is charity, either in the form of cash or time. The more take-home cash people have, the more likely it is that they would be able to afford charitable donations; and also find time from paid employment to perform charity work or other forms of civic service, as school trustees for example.

A third virtue is independence. It is good to earn what one needs rather than to depend on subsidies from others. Lower rates of taxation make independence more easily achievable.
Purpose and response of ethicist

Providing law and order, health care and education to public
- **Utilitarian**: Will approve tax because more goods and services will be available resulting in an increase in happiness among people.
- **Deontology**: If there is no duty, why to pay?
- **Virtue ethics**: Will approve tax because this will enable people to lead prosperous lives and utilise their talents to full.

Helping the needy and poor with tax money
- **Utilitarian**: Will approve tax because it will lead to an equal distribution of wealth and happiness among society.
- **Deontology**: Will approve because it is our duty to take care of poor.
- **Virtue ethics**: Will approve because taking care of less fortunate is itself a virtue.
The Conduct of Taxpayer

Most people pay their taxes, without a doubt not all are willing to part with their money. So lastly let’s look at whether other forms of behaviour can be ethically acceptable:

- tax evasion
- tax avoidance.
Tax Avoidance

Tax avoidance is generally the legal exploitation of the tax regime to one's own advantage, to attempt to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities.

Examples of tax avoidance involve using tax deductions, changing one's business structure through incorporation or establishing an offshore company in a tax haven.
Tax Evasion

By contrast tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means.

Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as under declaring income, profits or gains; or overstating deductions).
Illustration

- Mr. A earned Turnover of Rs. 10 M. However, he kept it as cash in his bank locker and hid it from tax authorities. He paid all related expenses from this cash. [*Tax evasion, Criminal Act, he cannot buy any asset or settle liabilities unless he declares this income and also pays tax due on it*]

- Mr. B earned income of Rs. 10 M. However, he declared only so much of income which is verifiable from the banks i.e. 6M, remaining amount he has hidden in a separate bank account [*This too is tax evasion, a understatement is also an offence*]

- Mr. C earned Rs. 10 M. However, he recorded 7M expenses employing legal tactics to reduce his net income and offering the remaining income of Rs. 3 Million for Taxes. [*Tax avoidance, which is legally permissible.*]
Response of Ethicist

A utilitarian, concerned with aggregate welfare, might be quite relaxed about tax avoidance. After all, when tax is avoided, wealth is not destroyed: it is merely kept in the private sector instead of being transferred to the public sector.

The main utilitarian concern would probably be that it would result in an unintended distribution of the tax burden, as some of the burden would be shifted from the rich onto people with modest incomes who cannot afford clever tax lawyers. That would reduce their satisfaction more than it would increase the satisfaction of the better-off people who have succeeded in reducing their tax burdens.

A virtue ethicist would perhaps dislike tax avoidance. It is, after all, hardly virtuous to exploit rules knowing that one is exploiting them in unintended ways to redistribute the disadvantage away from oneself.

A deontologist would not positively favour tax avoidance, but might not condemn it either. Deontologists can easily argue for a duty to obey the law: yet obeying the law is something the tax planner takes care to do, in his own peculiar way.
Question & Answers