

Taxation

Subject

Professor's name

Date

## TAXATION

Taxation affects everybody yet it remained elusive of common knowledge. It was constantly present in our everyday life: from the money we earn through gainful employment (whether as an employee of a business establishment or self-employed) to the clothes we buy, from the time we entertain ourselves say, watching a movie to a seemingly endless bills we pay. If we could just get away with it, we would not have second thoughts in doing so for the purpose of solely benefiting from our hard-earned money. If income is our means to stay alive however, taxation is the government's means to exist.

Taxation is one of the inherent powers of the state. The people need not confer it for without such power, the government cannot defray all the incidental expenses in serving the citizenry. Without an effective internal and external defense system, a country will be up for grabs to anybody who wants to conquer and rule, or without cemented roads and bridges, travel and transportation of goods would be cumbersome. The money to upgrade the armed forces and to construct the infrastructures comes from the coffers of the government, which in turn, sourced directly or indirectly from the pockets of each individual member of the society.

Taxation is a complex field of study. It is not only dynamic but tax laws are thoroughly reviewed to favor both the government and the taxpayers. However, it pays to know what comprises our taxable incomes and what are the items included and excluded from allowable deductions. Based on the problem given, it shows that Mr. Ben Brown is confused what to add and what to deduct in the final computation of his tax.

For one, Mr. Brown has the tendency to include personal expenses with that of his business. Based on the entity theory of accounting, a business is separate from its owner. This is to say that events affecting the business do not extend to the personal transactions of its owner as far as the law is concerned. This is the reason why the rental he derived from his son Jonathan is included as part of his income. Jonathan is paying the *business* and not the owner, per se.

The same principle goes for the deductibility of expenses. Personal expenses, such as the insurance premium paid by Mr. Brown for his son who is not working at all for him should be adjusted back to taxable income. Deducting Jonathan's salary from the Wages account is another application of excluding personal expenses. However, Mr. Brown's salary is viewed on a different plain.

Though it would not affect his overall networth, it would have a bearing in the computation of his income, thereby affecting income tax. It is properly included as Withdrawal because as owner, paying salary for himself is self-serving. It is like drawing money from the pocket with the left hand then transferring it to the other hand. The Withdrawal account embodies the taking away of a part of the business entity in favor of the *personal* purposes of the owner. The same applies to the cost of materials taken away from the stock. The stock is technically the business' resource, and building a loft extension is undoubtedly a personal endeavour.

In practice, what separates a business expense from that of personal is hard to determine. Take for example Ben's use of the car. There is no doubt he uses it both for business (of which the expenses should be included as a deduction) and personal purposes (the trip to the outskirts to visit his caravan). It is good if rational allocation

schemes (such as the breakdown of the car's mileage) are always present. What if it is not? Allowable deductions are highly subjective matters, and in spite of many tax regulations and guides issued, some part of business expenses remained a grey area.

**SOURCE:**

Chartered Institute of Taxation. (2004). "Tax Nothings – Schedule D." Retrieved April 05, 2005. Website: <<http://tax.org.uk/technical/main/ScedD.htm>>