

Reasons for Reluctance of Tax Payers in Paying Tax: The Tax System Used in Mbeya City- Tanzania

Kaula Stephen^{1*}

¹Kaula Stephen, Kyela Polytechnic College-Department of Business Studies and Management, Tanzania.

***Corresponding author**

Kaula Stephen, Kyela Polytechnic College-Department of Business Studies and Management, Tanzania.

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Abstract

The study explores on the reasons why persons (individuals, corporations) avoid to pay tax and economic impacts of unfair tax system. Three objectives were formulated to reveal the reality which was to (i) examine the features of tax systems to be not complied voluntarily (ii) the factors for resistance towards paying tax and (iii) economic effects of unfair tax imposed. The facts from the above formulated objectives were obtained by employing a case study research design. The study was carried in Mbeya City in which tax payers and tax collectors were researched by applying simple random and judgmental sampling techniques. More over primary and secondary data collections were used to gather the facts. The collected facts were analyzed descriptively and by using Pearson's correlation coefficient and the results were most of tax systems are unfair, uneconomical, uncertain and non-convenient. Further results showed that persons resist paying tax voluntarily because of hurt (unfair) tax imposed and lack of frequent education provided on the importance of paying tax. Lastly it was found that unfair tax system lead into increase in cost of production, ceasing of business operations, less tax collection, illegal businesses, rampant tax evasion and avoidance.

Key Words: Tax systems, Education on tax payment system, Economic impacts of unfair tax system.

Introduction

Taxation is a main source of revenue to most of countries in the World [1]. It is about 80% of income sourced through taxation. The remaining 20% comprises of fines, penalty, profit from corporations, public Institutions [2]. Tax being a compulsory levy it is categorized into two types based on its burden that is direct tax and indirect tax. A direct tax such as pay as you earn (PAYE), corporate tax, property tax, capital input tax (investment taxes) business firm taxes its effects falls directly to the tax payer. Contrarily from indirect taxes such as VAT, custom duty, exercise duty its effects fall to the end consumer [3]. The PAYE for instance is the type of tax paid by employee directly to the government. A certain percent is deducted by the employer from the gross salary of the employee and being paid to the government. That means a PAYE-direct tax is the one in which the burden falls directly to the tax payer and consumer. Different from indirect tax in which the tax burden does not directly fall to the person (individual, trustee, and corporation) paying tax but to the consumer of the service or product. For instance a VAT tax paid by a business individual or company in which tax imposed on, because a business firm to raise price of that product to compensate for the VAT paid. Rise in price to compensate for the tax paid, is burden that is felt by the consumer of the product.

Through unfair tax charged explained in terms of tax system called tax incidence also affect sales of the firm or individual

if not lowering production. Thus apart from to whom a tax burdens fall but the effects of tax are issues to be considered when imposing it. The tax payment system may be progressive, proportional or regressive categorized into either horizontal equity or vertical equity (fair). A fair tax observes the two categories of tax systems. Equity in payment of fair tax states that as a person (individual or corporation) earn more it is when more tax is paid. This is what is with progressive tax system in as more income is earned from a business (trade) investment, the more tax is to be paid (showing taxable capacity). Proportional tax system is when the tax paid is proportionate to the revenue earned [4].

Regressive tax is the one in which less earning is subjected to high tax payment. Usually regressive tax system is supposed to be applied with regard to the vertical equity of taxation while progressive and proportional tax work better under horizontal tax system. Regressive tax system has reported to work better with higher income earners but this tax system has revealed to be the major source of the complains of the low income earners. Small business firms that the tax system in Tanzania is not fair as it is totally regressive. It was reported that while large business firms (higher income earners) has been paying less tax as compared to the low income earners. From the theory of tax theory it states that regressive tax is to be imposed to rich individuals as these are the major contributors of the National income and they are the major feeders of the Nation. More over large firms are

charged tax regressively as they are the major employers of other individuals large firms, investors, businesses are the source of employment while pile up a national output and individual economies. Regressive or high tax imposed to individuals or corporations in general is the source of multiplier effects towards increase in cost of production, less revenue collected because of involuntary tax compliance, tax evasion and avoidance, illegal or black economic activities [5].

Tax as it has noted is a major source of government revenue but to increase its collection then the good principles of taxation should be adhered that are equity (fair), economy, convenience, certainty and simple to understand and its formula should be known by tax payers. People are voluntarily to pay tax if they have that ability (evaluated taxable capacity) and they see to benefit from that tax. Thus tax collectors, policy makers should be considerate and make sure that the tax collected is allocated as it is (was) purported by avoiding misuses, allocating to unproductive expenditure. Either education is still needed to tax payers especially to small business owners on the importance of paying or why are they are paying tax to maximize the so-called voluntary tax compliance and ensure optimal (economical) tax collections.

Literature Review

Theoretical Literature review

This study was guided by three different relevant theories which were the benefit theory, service cost theory and the ability to pay tax theory as analyzed below:-(i) Benefit Theory According to this theory, the state should levy taxes on individuals according to the benefit conferred on them [2]. The more benefits a person derives from the activities of the state, the more he should pay to the government. This principle has been subjected to severe criticism on the following grounds (a) If the state maintains a certain connection between the benefits conferred and the benefits derived. It will be against the basic principle of the tax.

A tax, as we know, is compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefit. There is no direct *quid pro quo* in the case of a tax (b) most of the expenditure incurred by the state is for the general benefit of its citizens, It is not possible to estimate the benefit enjoyed by a particular individual every year (c) if we apply this principle in practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If we get more from the poor by way of taxes, it is against the principle of justice? (ii) The Cost of Service Theory Some economists were of the opinion that if the state charges actual cost of the service rendered from the people, it will satisfy the idea of equity or justice in taxation [1]. The cost of service principle can no doubt be applied to some extent in those cases where the services are rendered out of prices and are a bit easy to determine, e.g., postal, railway services, supply of electricity, etc., etc. But most of the expenditure incurred by the state cannot be fixed for each individual because it cannot be exactly determined. For instance, how can we measure the cost of service of the police, armed forces, judiciary, etc., to different individuals? Dalton has also rejected this theory on the ground

that there is no *quid pro quo* in a tax (iii) Ability to Pay Theory The most popular and commonly accepted principle of equity or justice in taxation is that citizens of a country should pay taxes to the government in accordance with their ability to pay [6]. It appears very reasonable and just that taxes should be levied on the basis of the taxable capacity of an individual. For instance, if the taxable capacity of a person A is greater than the person B, the former should be asked to pay more taxes than the latter. It seems that if the taxes are levied on this principle as stated above, then justice can be achieved. But our difficulties do not end here. The fact is that when we put this theory in practice, our difficulties actually begin. The trouble arises with the definition of ability to pay. The economists are not unanimous as to what should be the exact measure of a person's ability or faculty to pay. The main viewpoints advanced in this connection are as follows: (a) Ownership of Property: Some economists are of the opinion that ownership of the property is a very good basis of measuring one's ability to pay. This idea is out rightly rejected on the ground that if a person earns a large income but does not spend on buying any property, he will then escape taxation. On the other hand, another person earning income buys property; he will be subjected to taxation. Is this not absurd and unjustifiable that a person, earning large income is exempted from taxes and another person with small income is taxed? (b) Tax on the basis of Expenditure: It is also asserted by some economists that the ability or faculty to pay tax should be judged by the expenditure which a person incurs. The greater the expenditure, the higher should be the tax and vice versa. The viewpoint is unsound and unfair in every respect. A person having a large family to support has to spend more than a person having a small family. If we make expenditure as the test of one's ability to pay, the former person who is already burdened with many dependents will have to pay more taxes than the latter who has a small family. So this is unjustifiable (c) Income as the Basis: Most of the economists are of the opinion that income should be the basis of measuring a man's ability to pay. It appears very just and fair that if the income of a person is greater than that of another, the former should be asked to pay more towards the support of the government than the latter. That is why in the modern tax system of the countries of the world, income has been accepted as the best test for measuring the ability of a person to pay for.

Empirical Literature review

The study by Apps on the family taxation: An unfair and Inefficient System presents an analysis of the 2005-2006 family tax system compromising the personal income tax, the medicare levy, family tax benefits parts A and B and tax offsets [5]. The study also finds that families face a marginal rate schedule that is no longer progressive but tends to have an inverted U-shaped profile-working family in the middle of the distribution face the highest marginal rates. As a consequence, the income of second earners in low and average wage families are taxed effectively at the highest average rates in the economy. The study explains why the system is unfair and seriously damaging for the economy in its effects on female labor supply in ageing population.

The study by Steinmo on the evolution of policy ideas: tax policy in the 20th century, revealed that elite ideas about tax policy

have changed dramatically over the past century and that these ideas have had enormous consequences for the development of the Modern state [7]. This article argues that there is an iterative, interdependent and dynamic relationship between policy makers ideas, political institutions and public policy outcomes.

The study by Peter commented that citizens usually do not like to pay tax and thus policy makers try a level best to have a tax system which strikes a balance between the maximum revenue to be attained and the reactions (resistance) from citizens [8]. Thus a fair, certain, and convenient tax system is to be used and much forces used by the government tax authorities which may make it uneconomical.

The study on “enforced versus voluntary tax compliance The “slippery slope” framework by Kirchler, Hoelzl and Wahl suggested that a framework for tax compliance comprising both the power of tax authorities and trust in the tax authorities are relevant dimensions for understanding enforced and voluntary compliance [9]. Dynamic interactions between power and trust are considered. Using the framework as a conceptual tool, factors studied in previous research, such as fines, audit probabilities, tax rate, knowledge attitudes, norms and fairness were reviewed and discussed with reference to the power and trust dimensions. Using the framework as an operational tool, approaches of responsive regulation to the increase tax compliance were emphasized.

The statutory rate and effective tax rate to be imposed on corporation income provide for fair and productive tax system which further stimulate investments Thus to rise a national output (GDP) effective corporate tax is an important issue a country through tax authorities should consider towards achieving optimal (economical) tax system [10].

Different from the criterion location as a basis of differentiating the study under examination and the other past research studies analyzed above but also this study has revealed on the reasons why people resist to pay tax, the features of unfair tax system being the major cause of resistance towards paying tax; and the

economic effects of unfair, uncertain , uneconomical and inconvenient tax system what has not explicitly addressed by other studies analyzed above thus the discrepancy which has therefore fulfilled by this study.

Methodology

The study employed a case study design. The study was conducted in Mbeya City in which the facts about the “nature and impacts of tax systems used” were collected from business firms, Micro Small and Medium enterprises (MSMEs) (from Mwanjelwa area), investors (Mbeya Spring drinking Water Company Ltd), individuals, service providers, manufactures (e.g. SIDO) and TRA (tax collectors). The simple random and judgmental sampling techniques were used to obtain a sample of 97 respondents. Moreover the structured interview, questionnaires and reviewing secondary documentaries were data collection methods used. Finally the processed and edited data were analyzed descriptively and inferentially (through the use of Pearsons’ correlation coefficient)

Results and Discussion

Pearson’s Correlation

Tax evasion is an illegal practice in which tax payers do i) report less than the actual receipts ii) high cost of production showing that a firm or individual, business does not make profit iii) more cost of operation or transaction. By reporting less than what is earned means being subjected to less tax payment in which by reporting that large profit is made meaning that more tax is to be paid. Tax avoidance occurs when a tax is paid as deferred amount. With tax evasion more over some organization has been trying to employ labor force at causal basis despite of being able to employ them permanently and award a permanent contract. This is the special form of tax avoidance/ evasion as by awarding permanent contract say for five years means more PAYE tax is deducted from employee gross salary in which the gross salary need to be higher for employee to be sustained with the net pay. More salaries to be paid reduce profit earned by corporation or individual called rise in operation expenses. Thus more (hurt) tax to be imposed is positively related to tax avoidance and evasion, more results shown in Table 1 below

Table 1: Hurt tax as a source of tax avoidance and evasion

			Tax avoidance and evasion
Hurt tax	Pearson correlation	0.640	
	Sig.	0.035	
	N	97	
Source: Field data (2018)			

The possibility of tax avoidance and evasion being committed by tax payers indicated by $r = 0.640$, $p = 0.035$ is a function of hurt tax imposed given that the acceptable threshold level is $0 \leq r \leq 1$ and the significance level is $p < 0.01$ for 2-tailed. This was also proved by one of the service firm owner who said “tax collectors are frequently attending the place where business operation take place even more than one month while deducting tax”. This therefore indicates that that a double tax system is exercised for service providers to stop operation.

Tax deducted base on the benefits obtained

Usually adhering to the principle of good taxation, a tax to be charged should be fair and certain by reflecting the amount of sales income earned or profit maximized and then tax deducted from that profit figure. For instance with business firms a standard VAT in Tanzania is 18 percent, corporate tax= 30 percent , PAYE = 11 percent of the taxable amount .But it has revealed that tax collector has sometimes deducting from the capital amount or simply the taxable pay is not obtained from the benefits conferred. The same results were shown in the Table 2 below

Table 2: Tax deducted reflect the revenue earned

Sub-construct	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Tax deducted reflect the benefits derived	5%	10%	0%	57%	28%
Source: Field data (2018)					

The results from Table 2 above of 5 percent for strongly agree statement, 10 percent agreed, 57 percent being disagree statement and 28 percent holding strongly disagree indicate that tax imposed is not certain and convenient to encourage voluntary tax compliance. Rather increase in illegal businesses, tax avoiders and evaders. These results are consistent with that of Apps (2006) on his study “Family taxation: An Unfair and Inefficient System”

Tax and education

Education on the taxation is very important as to reveal the im-

portance of why paying a tax, how tax is to be paid and what is the model (formula) used in delivering to taxable pay. Education is also an important tool to reduce misconceptions, misperception, tax avoidance and evasion experienced and thus increasing the voluntary payment of tax. Education on taxation makes taxation system economical and fair for more collection to be attained. Education to tax payers in Tanzania is not effective and not conducted frequently as it was expected shown in Table 3 below

Table 3: Tax payment and education

Sub-construct	Strongly agree (SA)	Agree (A)	Neutral (N)	Disagree (D)	Strongly disagree(SD)
Frequent education is provided on why tax is to be paid	25%	15%	0%	45%	15%
Source: Field data (2018)					

With 40 percent (25 percent-SA; 15 percent-A) positive response and 60 percent(45 percent-D ; 15 percent-SD) negative response shows that education on taxation theory is not frequently provided and thus it is effective to convince tax payers become honest to pay for it .Majority of tax payers, said that they are paying tax because it is something compulsory. Specifically one of businessman at Mwanjelwa market said “I am paying tax because of laws and regulations requirement and thus because of fearing to be sent to court”. This therefore shows the tax payment is more involuntary complied and not that tax is paid to raise government revenue which in turn used to foster for the non-revenue expenditures(such as paying wages, rent) to administrators , sustaining education, healthy, social services

projects and more other capital(development) expenditure such as agriculture , mining, natural gas exploration.

Use of EFDs

Introduction and use of Electronic Fiscal Devices (EFDs) has being an accurate tool towards attaining reliable tax to be paid. EFDs apply fairness, certainty and convenience in taxation system. But this applies only if these machines are effectively and appropriately used. Having EFDs while not producing receipts for every sales transaction effected still does not hold water as the actual earning cannot be examined for reliable tax to be deducted. More results are shown in Table 4 below

Table 4: Perception of tax payer on the use of EFDs

Sub-construct	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
A good method of increasing tax collection	20%	10%	20%	40%	28%
Certainty of the earnings is ascertained	45%	5%	0%	0%	0%
Disrupt business, investment	45%	35%	0%	15%	5
Source: Field data (2018)					

Difference in sample in which tax collectors being 37 and tax payers being 67 percent was the major source of the shown in Table 4 above in which the question asked on the advantages of introducing and using of EFDs, in which 30 percent positive response against 50 percent negative responsive and 20 percent showing no standings in which simply it can be evaluated that majority indicate that introduction of EFDs has created worse towards decrease in tax collection but in actual facts it is not. The major source of the discrepancy with the 2 percent of undecided response shows the difference in understanding (perceiving) over the new technology (use of EFDs) between the tax

payers (60) and tax collectors and administrators (30).But in actual fact use of EFDs has played a lot towards increasing tax collection, the same what was reported by Tanzania Revenue Authority TRA ,2014) in which it was reported that the collection has doubled and more three times. Use of EFDs display the actual earnings from which reliable tax is charged upon, the same results shown under the sub construct that use of EFDs considers certainty , 45 percent showed strongly agree and 55 percent- indicated agree responses. While tax revealed to pile up operation expenses and more over disrupting business and investment as it was shown by 45 percent (strongly agree and 35 percent –agree

statements and little 20 percent showing disagreements shows the discrepancy originate because of difference in sample size between the tax payers (60) and tax collectors/ tax law enforcers (37) but the truth is that introduction and use of EFDs has come as a new technology. Normally to most of people try to resist to change even without adopting to the advantages. And a negative response of 45 percent and 35 percent (with disagree statements) revealed to be imposed by tax payers as to them tax is an expense (tax tend to increase cost of operation/transaction or production) but the 15 percent and 5 percent (disagree statements) shows to be imposed by tax collectors as to them tax is a revenue.

That means results from Table 4 under sub-construct 3 two forces between a tax payers and tax collectors were acting against each but the large 80 percent versus less 20 percent is just because of the difference in sample size. It is therefore expected that if say a stratified sampling technique could be used, then the agree responses could balance with disagree statements. But it holds true if tax imposed could be hard. Reliable tax to be charged depend

on the actual amount earned which can only be attained through the use of EFDs and not manual receipt as it was before. What is important to emphasize is that for every transaction to be made a seller has to provide a receipt and a buyer has to take a receipt which then need effective follow up, administration and sometimes use of laws and regulations for tax payers to be adapted to the use of new technology.

Characteristics of unfair tax

Unfair tax system is more distorting the income of individuals and National output at large. Increasing tax collection is when tax imposed is fair. From the use of tax buoyancy equation $T = a + bY$; in which increase in income (or as individual or firm earn more) is when more tax will be paid and thus more collection. Thus tax to be charged should be certain and convenient by focusing on how much is received. More other features of fair tax are i) economical ii) simple iii) progressive and proportional in nature. More results are shown in the Table 5 below on characteristics of unfair tax

Table 5: Features of unfair tax system

S/N	Sub-construct	Responses (%)
1	Follow voluntary tax compliance principle	20
2	Economical	10
3	Formula of computing for taxable pay is known by tax payers	30
4	Tax payers are reminded on the due date	20
5	Stiff laws, rules and government forces are used	70
6	Uncertain	65
7	Progressive in nature	35
	Total	250
Source: Field data (2018)		

With voluntary tax compliance principle =20 percent shows insignificance the same as sub construct, economical =10 percent; formula of computing for taxable pay to be known to tax payers = 30 percent; and tax payers to be reminded on the due payment date = 20 percent .But stiff laws, rules, government use of forces (70 percent) and uncertainty of tax system (65 percent) has shown to be a typical features of unfair tax. Finally for a tax system to progressive in nature = 35 percent less than 50 percent shows negative association between the two variables. Thus these results are contrarily from what was reported by Kirchler, Hoelzl and Wahl (2008) on study the “Enforced Versus Voluntary tax Compliance: The Slippery Slope framework”

Reasons for resistance to pay tax

Though tax is a compulsory levy most of tax payers resist to pay and this is the reason why involuntary tax compliance is imposed. That means not always that a voluntary compliance is applied though it is insisted that inventory tax compliance should not be promoted. Resistance to pay is fostered by several reasons such as unfair tax, limited education on the importance of paying tax, inconvenient tax system, double taxation. More results are shown in Table 6 below

Table 6: Factors that cause people avoid to paying tax

S/N	Sub-construct	Responses (%)
1	Unfair tax imposed	13
2	Limited education on the importance of paying tax	12
3	Inconvenient tax system	12
4	Double taxation (More types of duties (taxes) imposed	12
5	Uncertain tax system	12
6	Benefits of paying tax not realized at their business (investment) area	12
7	Less taxable capacity	12
8	The nature of people being resistant to new technology	12
	Total	97

Unfair tax imposed (13); limited education on the importance of paying tax (12); inconvenient tax system (12); double taxation (12); uncertain tax system (12); benefits of paying tax (duties) not realized (12); less table capacity (12); and nature of people being resistant (12) to a new technology show a significance of why persons (individuals, firms) resist to pay tax.

Effects of unfair tax system

Unfair tax system has impacts to economy thus to be rectified to

be attained to fair tax system. The revealed economic impacts of unfair tax system include i) increase in cost of production ii) increase in transaction cost iii) less collection during inelastic demand iv) ceasing or closing of the business, firms, investments v) people cannot work hard vi) tax evasion and avoidance vii) illegal businesses and increase in informal economic sectors. Descriptively the results are shown in the Table below:

Table 7: Impacts of unfair tax system

S/N	Sub-construct	Responses (%)	Cases (%)
1	Increase in cost of production	16	58
2	Transaction cost increase	14	45
3	Less collection during inelastic demand	15	48
4	Ceasing/Closing of business/ firms, investments People cannot work hard	15	69
5	Tax evasion and avoidance	14	43
6	Illegal businesses and increase in informal	14	64
7	economic sectors	12	50
	Total	100	337
Source: Field data (2018)			

It is from the responses and cases that have reported shown in Table 7 above such as increase in cost of production (16 percent/ 58 percent); increase in transaction cost (14 percent/45 percent); closing of business, firms, investment (15 percent/69 percent) and more effects as indicated in the Table 7 above shows a positive relationship that exist between variables.

Conclusion

Tax is compulsory levy imposed by the government. Being the major source of government revenue to foster both recurrent and capital expenditures for about 80% then every citizen with ability to pay tax (The ability to pay tax theory by Kendrick (1939) is reliable to pay tax. Heath, education, defense and security and other development projects and investments cannot beattained if tax to be collected less than normal Deficit budget of the Nation implies less tax collection (T) than spending (G)Thus everyone has to be insisted to pay tax to increase tax revenue to sustain the expenditures. But what is the discrepancy prevailing is what kind of tax and type of tax system is to be used. To increase tax

collection then a tax system should observe the good taxation principles (Wanjialin, 2004), education should be provided to tax payers on the importance of paying tax. Tax laws and regulations should also be put into action. Opposite to what has noted above as rectifiers towards effective tax system then effects will be less tax collections. More forces (involuntary tax compliance) used cost a lot as compared to voluntary tax compliance. Furthermore unfair tax lead into increasingly illegal business emergences, excessive tax evasion and avoidance, little supply (production), low investments and ceasing of business operations.

Recommendations

The Following Is Recommended to Be Attained to Optimal Tax System

- i) A tax system should observe the canons of taxation
- ii) Education is to be provided on why an individual or corporation has to pay tax
- iii) Promotion of voluntary tax compliances
- iv) Use of electronic means of tax collection such as use of EFDs

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- v) The tax collected should be realized beneficial to tax payers
 - vi) Tax charging should observe taxable capacity and progressive tax should be promoted
 - vii) Firms or individuals with taxable turnover threshold level right for them to pay tax
 - viii) Rules, laws and regulations should be in acted or put into action for tax avoiders and evaders
 - ix) The tax bases, taxable capacity and tax yield are the issues to be considered to increase tax collection.

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