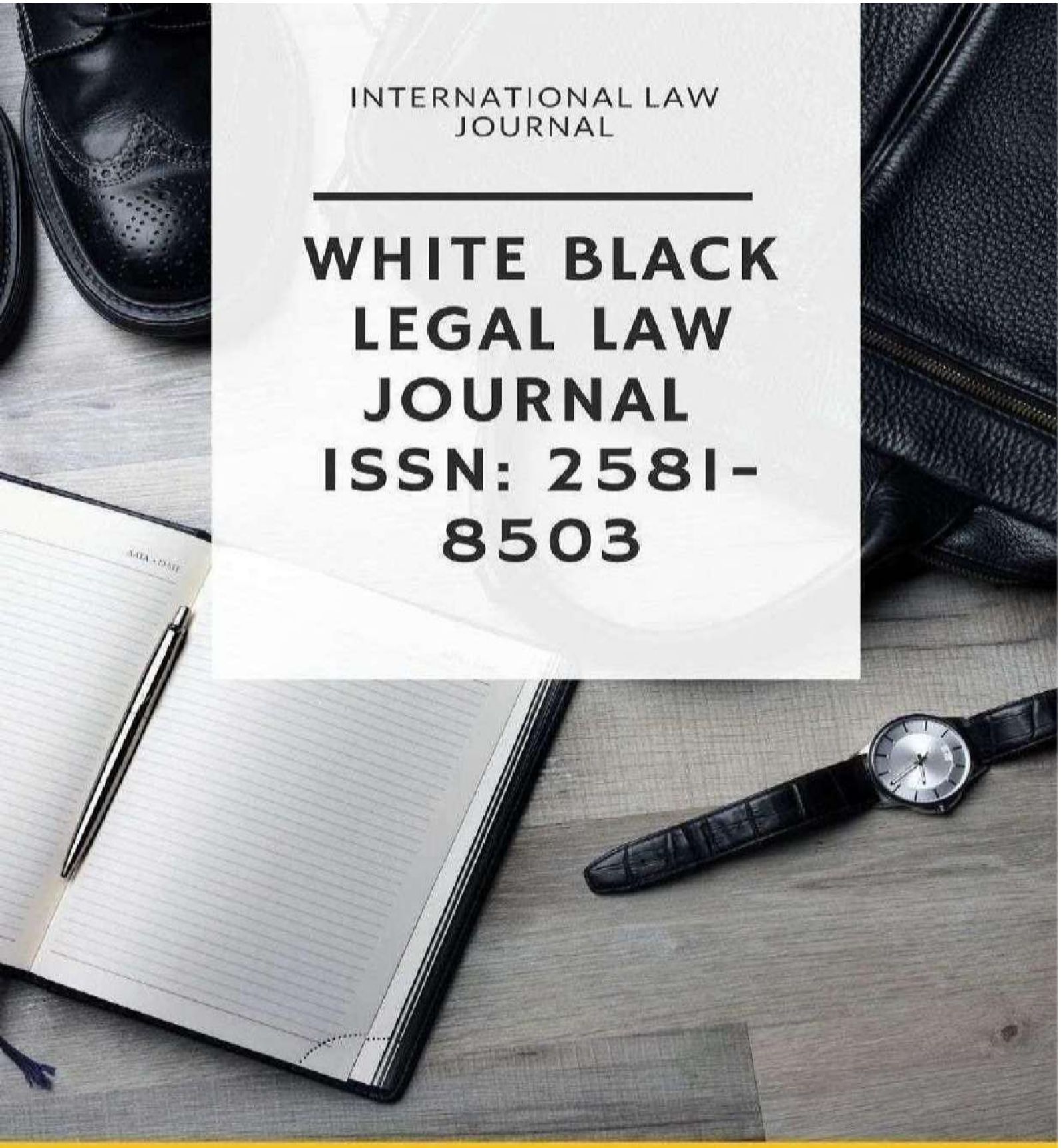

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BALANCING EQUITY AND EXPEDIENCY: A CRITICAL REVIEW OF TAXATION THEORIES

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INTRODUCTION

Taxation has been a fundamental pillar of organized society, evolving alongside the development of governments and legal institutions. It constitutes the primary means through which states mobilize resources for governance, public administration, and the provision of public goods and services. The obligation to pay taxes arises from the concept of sovereignty, whereby governments possess the legislative authority to impose compulsory financial charges on individuals and entities within their jurisdiction. The philosophy underlying this obligation has been the subject of rich academic and policy discourse, resulting in the emergence of various taxation theories that seek to rationalize how taxes should be levied and distributed among citizens.

The debate surrounding taxation is deeply intertwined with issues of justice, equity, and efficiency. Over time, economists, political theorists, and legal scholars have proposed numerous frameworks to determine fair taxation systems, reflecting divergent perspectives on the role of the state, the rights and duties of citizens, and the socio-economic objectives of public finance. These theories attempt to answer essential questions such as: Who should pay taxes? How much should each individual contribute? Should taxation be based on what people receive from the government or on what they are capable of contributing?

Among the earliest and most influential are the Benefit Theory and the Ability to Pay Theory, which offer contrasting foundations for determining tax obligations. The Benefit Theory emphasizes a quid pro quo relationship, asserting that taxes should correspond to the benefits individuals receive from state services. In contrast, the Ability to Pay Theory centers on distributive justice, arguing that taxes should be imposed based on an individual's economic capacity, irrespective of the direct benefits enjoyed. Alongside these, other pragmatic and justice-oriented theories—such as the Expediency Theory and the Cost-of-Service Theory—further enrich the landscape of taxation thought, each offering unique insights and facing distinct criticisms.

The following sections provide a comprehensive overview of these prominent theories, examining their core principles, historical context, and practical implications. By understanding the philosophical underpinnings and operational challenges of each theory, one gains a more nuanced perspective on the complex interplay between taxation policy and socio-economic governance.

BENEFIT THEORY

Governments must secure money for their maintenance. The power to impose any compulsory taxes on its citizens for its support is inherent in the sovereignty of governments. Such power is legislative in nature as the legislature passes tax laws. It is probable that one of the earliest principles followed by the levying of taxes was that a tax was given as a payment for services which were received by the taxpayers from the government.

Benefit theory is a traditional theory of taxation that states that tax burdens should be allocated among taxpayers in accordance with the benefits they receive from the provision of public goods. The main feature of the Benefit Theory is that the relationship between taxpayers and government is one of exchange. In other words, this relation is seen in quid pro quo terms and tax payment becomes voluntary. The following statement from Cooley illustrates the concept of Benefit Theory:[1]

> *"If it were practicable to do, taxes levied by any government ought to be apportioned among the people according to the benefit which each receives from the protection the government affords him, but this is manifestly impossible. The values of life and liberty and of the social and family rights and privileges cannot be measured by any pecuniary standard; and by the general consent of civilized nations, income or the sources of income are almost universally made the basis upon which the ordinary taxes are estimated."*

Until the nineteenth century, the classical benefits theory predominated which treated contribution in proportion to benefits received from the state as the basic norm of tax fairness. Modern benefits theory, was developed in the late nineteenth and early twentieth centuries and it evaluated taxes in terms of the willingness to pay for public goods for each taxpayer, but does not necessarily require taxation in proportion to personal benefit.[2]

[1] Cooley, Taxation, 4th Ed. 1929, Collaghan& Co., Chicago, page 213, Illinois Central R. R. Co. v. Decatur, 147 U. S. 190
[2] R. Musgrave, The Theory of Public Finance: A Study in Public Economy (New York, McGraw-Hill, 1959) 66-69.

Classical Benefits Theory-

The classical benefit principle was defended by Grotius, Pufendorf, Sir William Petty, Hobbes, Turgot, Mirabeau, Montesquieu, Senior and Thiers, among others.[3] This approach was the leading approach to tax fairness from the beginning of modern period to the nineteenth century. American economist Henry Carter Adams described the benefits theory as "the idea….that, insomuch as individuals receive benefits from the state, a payment should be made on account of and in proportion to those benefits.'[4] Proponents of benefits taxation such as Thiers sometimes compared taxes to insurance premiums levied in proportion to the wealth that the taxpayer has under the state's protection.[5] The proponents of this classical theory were mainly concerned with apportioning tax burdens to finance basic public goods such as the military and the legal system.

Since the benefits received by taxpayers cannot be measured directly, some kind of proxy must be used for benefits to determine tax obligations. Potential proxies could be consumption, property holdings and income. Thomas Hobbes favored a consumption tax on the grounds that subjects should contribute taxes in proportion to the benefits they receive from the state and that these benefits are roughly proportional to their expenses.[6] Persons who save rather than consume their income leave resources to be enjoyed by other citizens and thus should be taxed only on that increment of income which they consume. Thiers, by contrast, appealed to the benefits principle to argue that income from both labour and property should be taxed, since both property owners and workers benefited from the protection of the state.[7]

However, classical benefits theory was rejected by leading figures such as John Stuart Mill and Adolph Wagner and thus the theory went into decline by the late nineteenth century. The reasons for their decline were-

1. It is difficult to ascertain prices for public goods as there is no market as such for national defence or the legal system. Asking about the value of services from the tax-payers would be a futile exercise.

[3] E. Seligman, 'Progressive Taxation in Theory and Practice' (1908) 9(1/2) American Economic Association Quarterly, 158-80
[4]H Adams, The Science of Finance (New York, Henry Holt, 1899) 299.
[5] A Thiers, The Rights of Property: A Refutation of Communism and Socialism (London R. Groombridge, 1848) 229.
[6] T Hobbes, Leviathan (Cambridge, Hackett Publishing, 1994, Ch 30 [17] 227-28.
[7] A Thiers, The Rights of Property: A Refutation of Communism and Socialism (London R. Groombridge, 1848) 229-30.

2. Classical benefits principle might be thought to have undesirable distributive consequences. To the extent that the state protects persons as well as property, this might suggest that taxes should combine a per capital charge with a tax proportionate to property holdings, which would yield a quite regressive overall rate structure.[8]
3. This theory was based on a very limited conception of the nature of government. The range of projects which are taken up by modern states makes the classical theory seem somehow inadequate.

MODERN BENEFITS THEORY

Just as the Classical Benefits Theory started collapsing, innovations in economic analysis provided a new approach to benefits taxation. The modern benefits principle holds that a tax is fair if the benefits received from the state adequately compensate the tax-payer for the burdens of taxation. Modern Benefits theory can be traced to the work of Knut Wicksell and it was further developed by Erik Lindahl.[9]

Wicksell's basic insight was that there should be a unanimous consent rule for each project which requires funds that are taken by the people as taxes. This way the problem of measuring the value of public goods can be done away with and also there will be a guarantee that each tax-payer is receiving public services which they value and have no problem in paying taxes for them.

The modern approach differs significantly from the classical approach. The classical benefits principle states that tax obligations should be assigned in proportion to the benefits the taxpayer has received from the government. Whereas, the modern benefits principle requires that every taxpayer should receive benefits from the state that they value more than the income that they sacrifice in tax. In short, the classical principle looks to total benefit, whereas the modern principle looks to marginal benefit. Classical principle requires a particular relation between the taxes paid by each taxpayer whereas modern principle is consistent with taxpayers who receive similar benefits owing substantially different amounts of tax so long as each taxpayer is adequately compensated by a package of public services that they value more than the

[8]J S Mill, Principles of Political Economy (London, Longman, Green & Co, 1909, reprinted Fairfield, Augustus M Kelley, 1976) Book V, Ch II § 2, 804
[9]K Wicksell, 'A New Principle of Just Taxation' in Musgrave and Peacock, 72-118; E Lindahl, 'Just Taxation-A Positive Solution' in Musgrave and Peacock.

foregone revenue.

Owing to the several limitations of the implementation of the Benefit Principle, an alternative principle has been suggested which is commonly known as the “Ability to Pay Principle”.

ABILITY TO PAY THEORY

Ability to pay theory is a dominant theory of taxation. It is usually interpreted in terms of sacrifice of the tax-payers. It is the most generally accepted theory. This approach considers the tax liability as a compulsory payment to the state without any quid pro quo. Like Benefit Theory, this theory does not assume that there is any commercial or semi-commercial relationship between the state and the citizens.

This theory is based on the principle of equity and justice and so is supported by socialist thinkers. The basic tenet of this theory is that burden of taxation should be shared by the members of the society on the principle of justice and equity. And these principles emphasize that the tax burden is apportioned according to their relative ability to pay.

The ability to pay is measured by two ways-

1. Objective Indices
2. Subjective Indices

An objective index may be measured on the basis of wealth, property, consumption, expenditure or income of the tax payers whereas a subjective index is based on some measure of sacrifice of utility by the tax payers.

Objective Indices of the ability to pay-

(i) Property:

Property is one of the indices, though it is an insufficient index. It has the demerit of adversely effect on will to work, save and invest and its consequent effects on the growth and capital accumulation in the economy.

(ii) Consumption:

Choices of this index assume that people with greater consumption expenditure have more ability and derive smaller marginal utility from their expenditure. The criteria suffers from the fact that people with more income may spend less and divert

income towards saving and investment. Thus, increase in inequality in distribution of income and wealth.

(iii) Income:

Income is one of the most accepted indices of ability to pay, though it is usually supplemented by other tax indices also. A citizen receiving a larger income is made to pay a larger state bill and vice-versa.

Subjective indices of ability to pay-

Subjective approach is based on the assumption that a tax payer sacrifices some utility by paying the tax. This approach is based on equity principle. Equity approach implies that the aggregate sacrifice of all the tax-payers should be the minimum possible amount.

The development of theory of ability to pay can be traced back to an essay by Guicciardinii and a case for proportional taxation was made by Bodin. This principle was then amended and developed by Bodin, Rousseau, Sismondi, Mill, Wagner and Franklin Roosevelt.

Ability to pay theory is held to justify progressive taxation under any one of the three possible interpretations of sacrifice: the equal, equal-proportional, and least-sacrifice theories. These theories rest on three assumptions: the declining marginal utility of money with an increase in its supply, the existence of sacrifice arising from the payment of taxes, and the quantitative expression of that sacrifice. Analysis discloses each of these supports to be defective and thereby breaks down the theory of ability to pay. Progressive taxation may, however be justified on other grounds. These grounds should be founded on the broad realities of the economic system. Taxes have economic effects and these effects entail social consequences. The choice of the taxes to be laid and rates at which they are to be applied expresses a preference for one set of economic effects, and hence of social consequences, to another. The theory of taxation, progressive or other, should correspond to these facts. The thin nebula of hedonism in reverse is no longer adequate.

The three interpretations of Ability to Pay are as follows-

(a) Equal Absolute Sacrifice-

Each tax-payer is made to sacrifice the same amount of utility so that the difference between the aggregate utility from income before tax and utility of income after tax is the same for each tax-payer.

Symbolically, U(Y)- U(Y-T)= U(T) should be the same for all where

U is the total utility;

T is amount of tax;

Y is the income before tax;

And Y-T is the income after tax.

If this doctrine is applied, each member of the society will pay some tax atleast. None of them will enjoy complete tax exemption.

(b) Equal Proportional Sacrifice-

According to this approach, no one will be exempted from sharing the tax burden. Each tax payer is supposed to sacrifice the same percentage of the total satisfaction which he would have derived from his income.

Symbolically, it would mean that tax liability of each individual is determined in a manner that for their income Y,

[U(Y)-U(Y-T)]/U(Y), or U(T)/U(Y)

Is same for everyone.

(c) Equal Marginal Sacrifice-

According to this interpretation, the tax burden should be apportioned in such a way that the marginal utility of post-tax income with any tax payer would be the same.

Symbolically, for each tax payer U(Y-T) should be the same.

THE EXPEDIENCY THEORY

This theory asserts that every tax proposal must pass the test of practicability. It must be the only thing that must be taken into consideration by the authorities while choosing a tax proposal. Economic and social objectives of the state as also the effects of a tax system should be treated as irrelevant. This proposition has a truth in it, since it is useless to have a tax which cannot be levied and collected efficiently. There are pressures from economic, social and political groups. Every group tries to protect and promote its own interests and the authorities are often forced to reshape tax structure to accommodate these pressures. In addition, the administrative set up may not be efficient enough to collect the tax at a reasonable cost of collection. However, as we can easily see, to build up an entire tax system solely on the considerations of expediency is also full of pitfalls. Taxation provides a powerful set of policy tools to the authorities and should be effectively used for remedying economic and social ills of the society such as income inequalities, regional disparities, unemployment, cyclical

fluctuations and so on. Practicability is an essential consideration in every tax proposal. If a tax cannot be collected, it is ridiculous to impose it. But given the set of different practicable taxes, and different practicability rates, a choice has to be made with reference to their possible effects on the working of the economy. By itself, this approach is not at all able to help the authorities in deciding as between different practicable taxes. And ofcourse those who are going to suffer by the imposition of a new tax or by a change in any existing tax are bound to advocate that the tax under consideration is not practicable.

COST-OF-SERVICE THEORY

In a democratic country, the government policies should be based on the principle of justice otherwise the people will protest against the unjust policies of the Government. Taxation policies of the Government should be based on justice and equity. Among the number of theories proposed by different economists explaining how justice in taxation can be achieved, Cost of Service Theory of Taxation is an important theory.

This theory implies that the Government should tax the citizens according to the cost of the service furnished by it. The Government renders certain services to citizens and the cost of such services should be collectively met by the citizens. Thus, the tax, an individual should pay must be equal to the cost of the benefit he receives. This means that the cost which is incurred by the government in providing public goods to satisfy social wants should be regarded as the basis of taxation.

Thus, tax is payable as per the cost of public goods enjoyed by the citizens. This implies that the state is just a producer of social goods and taxes are the prices that are paid for the same. This theory comes with some shortcomings and they are:

1. It is not easy to ascertain the cost of government service or social goods which are made available to each individual tax payer. Therefore, the question of distribution of total cost among tax payers is not easy to solve.
2. If the total cost of services can be presumed, the next issue will be how to divide the costs of these services among individuals.
3. If this theory is followed in the modern welfare state, the poorer will have to pay more taxes because they enjoy more benefits. Hence, this will be in derogation to the principle of justice.

4. It is not in conformity with the definition of tax. A tax is not a price. Tax has no quid pro quo.
5. Lastly, the cost of the services rendered depends very much on the efficiency of the administrator. If the administrator is efficient, the cost would be lower and if the administrator is inefficient, the cost of the benefit would be higher.

CONCLUSION

Theories of taxation form the intellectual and philosophical backbone of fiscal policy in any nation. Each theory—whether it be the **Benefit Theory, Ability to Pay Theory, Expediency Theory,** or **Cost-of-Service Theory**—reflects a different conception of justice, governance, and the citizen-state relationship. While the Benefit Theory focuses on a reciprocal exchange between the government and taxpayers, the Ability to Pay Theory prioritizes equity and redistribution. The Expediency Theory, on the other hand, underscores the practical feasibility of tax implementation, and the Cost-of-Service Theory attempts to align taxes with the actual cost of services consumed by individuals.

None of these theories is without limitations. Practical implementation challenges, socio-political dynamics, and economic inequalities often complicate the application of any single theory in its pure form. As a result, modern tax systems tend to incorporate elements from multiple theories, seeking a balance between fairness, efficiency, simplicity, and administrative feasibility.

Ultimately, the choice and design of a taxation framework must align with the broader objectives of the state—whether they be economic development, social equity, or administrative efficiency. A nuanced understanding of these foundational theories not only aids in constructing rational tax policies but also enhances transparency and public trust in the fiscal machinery of the state.