"Factors determining Taxable Capacity"

For 6th Semester
Economics (Major)
Paper – 6.1

Aparna Sengupta
Associate Professor
HOD, Department of Economics

Factors determining or influencing Taxable Capacity :—

There is no specific level of taxation applicable to all Countries, or at all times to any Particular Country, which may be referred to as Constituting the limit of taxable Capacity. It is a flexible Concept. As the Prosperity of nation increases, the taxable Capacity of the People also increases. So, while analysing the factors limiting a Country's taxable Capacity, both economic and political matters will have to be Considered.

1) Size of national Income :—

The taxable Capacity of any Community will depend upon the size of national income which itself will depend upon such factors as the volume of natural and other resources, the degree of utilization of these resources, the State of technology and so on. The richer a

Community the higher is its Capacity to Pay taxes.

2) Distribution of national income:—

The distribution of national income between People plays an important role in influencing the taxable capacity of the People. Since a richer Community Can Pay a higher Percentage of taxation, So also a System of distribution Which leads to Concentration of Wealth in the hands of a few may yield a higher volume of tax revenue than the one Which brings about more or less equal distribution of income. This is because of the observation that the ability to Save and Pay taxes is greater in the Case of the few rich than in the Case of the many moderately Well to do men.

3) Size and rate of growth of Population:—

Taxable Capacity depends on the Size of the Country's Population as well as the rate of growth of Population taken together with the increase of national income. Given the volume of national income of a Community, the taxable Capacity will directly depend upon the size of the Country's Population — the larger the Population, the lower will be the taxable Capacity. Again, taxable Capacity will depend upon the Comparative rise in Population and national income. It will be obvious that if Population rises at a greater rate than increase in national income, the Country will become Poorer and its Capacity to bear tax burdens will be reduced.

4) Pattern of taxation :—

A very important factor which influences taxable Capacity is the Pattern of taxation. If the tax Structure have adverse effects on the Production of national income i.e on the Productive Capacity of the People, this will reduce the taxable Capacity. While some taxes are elastic and highly Productive others may prove to be less so. The taxable Capacity of a Community Can be raised Provided the tax Structure is very Carefully designed so that the irksomeness of taxation is reduced to the minimum.

5) Nature and extent of Public expenditure:—

Public expenditure affects the size of national income — for, the larger the public expenditure, the higher will be money income of the public. With the rise in income, the taxable capacity of the community can also be expected to rise. Moreover, in expanding economies like India much of the tax revenue is devoted to financing of projects which aim at raising the volume of national income in the country. It may be stated in a general way that all those forms of public expenditure which promote capital formation and accelerate economic growth and development raise taxable capacity while all other forms of public expenditure which lead to the construction and maintenance of unproductive projects and which may result in the reduction of national income have the tendency to reduce taxable capacity.

6) Level of economic development:—

The taxable capacity of the people is determined by level of economic development of the country. Highly developed countries have greater taxable capacity than the less developed or poor countries.

7) Political Conditions:—

The nature of the Governmental machinery and administration has considerable influence on the willingness of people to bear taxes. If there is peace inside and outside the country, there will be encouraging atmosphere for expanded economic activity, which will in turn increase the taxable capacity. Similarly, in times of war or emergencies, if the people are prepared to make greater sacrifices, then taxable capacity is said to have increased. Thus, patriotism, emergencies, nature of the Govt. (e.g a democratic Govt. based on popular represantation as compared to a dictatorship) will all have considerable infuence upon the willingness of people to contribute to the expenses of the public authorities. Psychological Consideration exert important influence on taxable Capacity.

Thus, all these factors taken together determine the upper limit of taxation. There is no mathematical formula to measure taxable capacity. However, the Well-known economist Colin Clark has laid down 25 Percent of the national income as a Safe upper limit for taxation. But this is applicable to developed Countries only.