

TOPIC: CANONS OF TAXATION

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Canons of Taxation

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Canons of Taxation and Equity in Taxation:

1. Canons of Taxation:

Canons of taxation refer to the administrative aspects of a tax. They relate to the rate, amount, method of levy and collection of a tax.

In other words, the characteristics or qualities which a good tax should possess are described as canons of taxation. It must be noted that canons refer to the qualities of an isolated tax and not to the tax system as a whole. A good tax system should have a proper combination of all kinds of taxes having different canons.

According to Adam Smith, there are four canons or maxims of taxation on the administrative side of public finance which are still recognised as classic.

To him a good tax is one which contains:

1. Canon of equality or equity.
2. Canon of certainty.
3. Canon of economy.
4. Canon of convenience.

To these four canons, economists like Bastable have added a few more which are as under:

5. Canon of elasticity.
6. Canon of productivity.
7. Canon of simplicity.
8. Canon of diversity.
9. Canon of expediency

Different canons of taxation:

Canon of Equality:

Every fiscal economist, along with Adam Smith, stresses that taxation must ensure justice. The canon of equality or equity implies that the burden of taxation must be distributed equally or equitably in relation to the ability of the tax payers.

Equity or social justice demands that the rich people should bear a heavier burden of tax and the poor a lesser burden. Hence, a tax system should contain progressive tax rates based on the tax-payer's ability to pay and sacrifice.

Canon of Certainty:

Taxation must have an element of certainty. According to Adam Smith, "the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the amount to be paid ought to be clear and plain to the contributor and to every other person."

The certainty aspects of taxation are:

1. Certainty of effective incidence i.e., who shall bear the tax burden.
2. Certainty of liability as to how much shall be the tax amount payable in a particular period. This the tax payers as well as the exchequer should unambiguously know.
3. Certainty of revenue i.e., the government should be certain about the estimated collection of revenue from a given tax levied.

Canon of Economy:

This principle suggests that the cost of collecting a tax should not be exorbitant but be the minimum. Extravagant tax collection machinery is not justified. According to Adam Smith, "Every tax has to be contrived as both to take and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

Owing to the complex and ever-changing nature of taxation laws in India, government has to maintain elaborate tax collection machinery with a large staff of highly trained personnel involving high administrative costs and inordinate delay in assessment and collection of tax.

Canon of Convenience:

According to this canon, tax should be collected in a convenient manner from the tax payers. Adam Smith stresses: "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it." For example, it is convenient to pay a tax when it is deducted at source from the salaried classes at the time of paying salaries.

Canon of Elasticity:

Taxation should be elastic in nature in the sense that more revenue is automatically fetched when income of the people rises. This means that taxation must have built-in flexibility.

Canon of Productivity:

This implies that a tax must yield sufficient revenue and not adversely affect production in the economy.

Canon of Simplicity:

This norm suggests that tax rates and tax systems ought to be simple and comprehensible and not to be complex and beyond the understanding of the layman. This is what is rarely found in the Indian tax structure.

Canon of Diversity:

Canon of diversity implies that there should be a multiple tax system of diverse nature rather than having a single tax system. In the former case, the tax payer will not be burdened with a high incidence of tax in the aggregate.

Canon of Expediency:

This suggests that a tax should be determined on the ground of its economic, social and political expediency. For instance, a tax on agricultural income lacks social, political or administrative expediency in India and that is why the government of India had to discontinue it.

2. Equity in Taxation:

Equity in taxation refers to fairness or justice in the distribution of the tax burden. Since taxation implies a burden or sacrifice on the part of the tax payer, modern economists put great emphasis on justice in taxation and state that taxation should be based on the principle of equity so that direct money burden as well as real burden should be distributed in a just manner.

The concept of equity has two notions:

- (i) Horizontal equity and (ii) Vertical equity.

Horizontal equity suggests that in the matter of taxation, equal treatment should be meted out to people in equal economic circumstances, which means that they should pay equal amount of taxes. Vertical equity means that unequally placed persons should be treated unequally, thus, economically better placed people should pay more taxes than others.

However, any attempt to achieve vertical and horizontal equity simultaneously is not at all an easy task and can lead to ludicrous results.