

## **TAXABLE CAPACITY - III**

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## **EFFECTS OF TAXATION**

➤ There are two views on the effects of taxation: Classical & Modern.

### **A. Classical View**

✓ “Taxation should not have any effect on the economy.”

✓ Therefore, the socio-economic welfare of the citizens before levying the tax & after levying the tax should be exactly equal.

### **B. Modern View**

- “Taxation should produce some desired effects and avoid undesirable effects.”
- Therefore, taxation should be deliberately designed to produce certain socio-economic effects on the economy.

Based on the second view:

### 1. Effects on Production

- On the ability to work, save & invest
- On the willingness to work, save & invest
- On the composition of output

### 2. Effects On Distribution (we need)

Reduction in inequalities of income & wealth

Reduction in fluctuations of income between different periods

This depends on:

1. Taxbase: (i) direct (ii) indirect

2. Taxrate: (i) proportionate (ii) progressive (iii) regressive

### 3. Effects on Saving

$Y = C + S \quad \therefore S = Y - C$  but,  $Y = y - T$

Disposable Income = Total Income – tax

### 4. Effects on Prices

Depends on the demand & supply of goods & also the volume of money in the economy.

a) Inflation

b) Deflation

## **Canons of Taxation**

### **Adam Smith's Canons of Taxation**

- Canon of Equity
- Canon of Certainty
- Canon of Convenience
- Canon of Economy

**Modern Canons** (Economists, like Bastable, have added to Smith's canons)

- Canon of Productivity
- Canon of Elasticity
- Canon of Diversity
- Canon of Simplicity
- Canon of Expediency
- Canon of Co-ordination