

Theories of Distribution of Tax Burden

Ability to Pay Theory of Taxation

Part 2

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(B) Subjective indices of ability to pay

- Subjective approach to ability to pay is based on the assumption that a tax payer sacrifice some utility by paying the tax.
- Based on equity principle
- Equity approach implies that the aggregate sacrifice of all the tax-payer should be minimum possible.

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- The term equal sacrifice may be interpreted in three alternative ways, viz.; equal absolute sacrifice, equal proportional sacrifice and equal marginal sacrifice. Problems arise to choose the right type of meaning of equity.
- **Three Interpretations of Ability to Pay**
 - (i) Equal absolute sacrifice
 - (ii) Equal Proportional sacrifice
 - (iii) Equal Marginal sacrifice

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I. Equal Absolute Sacrifice

- This means that 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.

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- 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 members of the society will pay some tax at least. None will enjoy complete tax exemption.

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II. Equal Proportional Sacrifice

- According to this approach, no one is exempt 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.

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

$$[U(Y)-U(Y-T)]/U(Y), \text{ or}$$

$$U(T)/U(Y)$$

is same for every one.

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III. Equal marginal sacrifice

- According to this interpretation of equity, the tax burden should be apportioned in such a way that the marginal utility of post tax income (income left after tax) with any tax payer would be the same.
- Symbolically, for each tax payer $U(Y-T)$ or post tax disposal income should be the same.

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THANK YOU