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PROPOSAL FOR ADVOCATING TAXATION METHODS THAT  
WILL MEET THE TESTS OF BOTH THE ABILITY-TO-PAY  
AND BENEFIT PRINCIPLES OF TAXATION

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The Government of Canada in 1962 appointed a Royal Commission on Taxation to enquire into and report on the incidence and effect of taxation, and in particular to consider how a sufficient flow of revenues could best be raised for purposes of the federal government. A six-volume report was released by the Commission four years later in 1966 and was followed in 1969 by a government White Paper outlining proposals for tax reform based on the Commission's recommendations. In 1971 the government introduced a broad programme of tax reform which reflected such recommendations, with certain modifications.

Now, more than a decade later, it is clear that Canada's tax reforms were ineffective for the tax system is in an even greater need of reform than before the appointment of the Royal Commission in 1962.

The government stated at the time it issued its White Paper that its tax proposals were the result of a careful study of tax principles and practices. However, the Royal Commission appointed by the government failed to make a careful study of tax principles. It merely noted that there were two streams of thought as to how to apportion taxes in an equitable manner, and it referred to them as the benefit approach and the ability-to-pay approach. It concluded that the benefit approach

has very serious practical and theoretical deficiencies and as a result it very strongly favoured the ability-to-pay approach. Its studies and the tax proposals that followed were based wholly on its interpretation of ability-to-pay.

It is unfortunate in the field of taxation as in other important fields of knowledge that it has been possible for otherwise responsible persons to embark on elaborate studies without giving sufficient consideration to simple fundamental principles. In choosing its course, Canada's Royal Commission employed a syllogistic form of logic, a deductive method, based on a major premise that there are two quite separate approaches to taxation, the benefit and the ability-to-pay approaches, on a minor premise that the benefit approach was deficient, and a conclusion that tax reform in Canada must therefore be based on the ability-to-pay approach. No consideration was given to the fact that these concepts represented principles of taxation rather than approaches and that a sound tax system is one that should conform to both the benefit and ability-to-pay principles.

Over two hundred years ago Adam Smith in The Wealth of Nations presented four maxims relating to taxes in general. They were as follows:

1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion of their respective abilities; that is, in proportion to the revenues which they respectively enjoy under the protection of the state.

2. 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 quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.
3. 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.
4. Every tax ought be to so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above which it brings into the public treasury of the state.

With respect to the first maxim, Adam Smith qualified a person's abilities to pay taxes to those that were in proportion to the revenues enjoyed, or in other words, in proportion to the benefits received under the protection of the state. It would appear that Adam Smith did not look upon ability-to-pay and benefits as two separate and mutually exclusive approaches to taxation but rather as two principles that should determine a sound tax system. His three remaining maxims that deal with the certainty of a tax, its convenience, and the cost of its collection are more likely to apply in the case of a tax that conforms to the concept of ability-to-pay in proportion to benefits received. There are many examples among tax systems in the world today that will give evidence of the uncertainty, the inconvenience and the high costs of taxing on the basis of unrestricted and liberal interpretations of ability-to-pay.

This brief paper is not intended to introduce new ideas or thoughts with a view to revolutionizing thinking in the field of taxation but merely to draw attention to the fact that the polarization of thinking

has resulted in much wasteful effort being directed towards tax reform. Also, it is suggested that the time is now ripe to examine all major forms of taxation on the basis of a Georgeist analysis with a view to ensuring that progress made in promoting tax reform generally will assist in the promotion of reform in each of the major tax areas including land-value taxation.

In days of Henry George it would probably have been feasible to finance the costs of all government services through the taxation of land values alone. Most of the population in those days lived in rural communities on or close to the land, and most government services were related more closely to assisting in production of wealth rather than its distribution and consumption. Today the bulk of our population in the more advanced countries lives in urban communities and many are involved in service occupations that are related to the consumption of wealth. It is essential therefore that there be additional sources of tax revenues to pay for such services. However, all taxes should be levied in the same manner and in accordance with the same logical principles as those that underlie George's land value taxation.

One of the purposes of this paper is to outline briefly an overall system comprising of three levels of taxation, each conforming to the benefit and the ability-to-pay principles, and each applicable in such a way as to safeguard the property rights of individuals and business enterprises and thus ensure the continuance of a free enterprise

system. They would permit individuals and business enterprises, through the operation of the marketplace, to play a major role in maximizing the production of wealth and in equitably distributing the wealth produced.

As individuals, business enterprises and property owners all benefit from the provision of various government services, it is reasonable that they should pay their fair share of the costs of such services. Thus there is justification for taxes to be levied on persons, business enterprises and property owners. However, in each case, the taxes should be levied on the basis of sound principles of taxation in accordance with Adam Smith's four maxims, and on the basis of that concept of ability-to-pay that is proportionate to the benefits received in the form of government services.

There is no need to invent taxes of this nature for they already exist, at least in theory if not in general application. There is a need however to draw attention to them and to promote their acceptance and application. They will be discussed below briefly under the following headings:

1. The proportional personal income tax,
2. The net costs business tax, and
3. Site-value taxation for property owners.

### The Proportional Personal Income Tax

In the field of personal income taxes, a sound argument can be made for a flat rate or proportional tax rather than the commonly employed progressive personal income tax. Studies undertaken in Canada, the United States and the United Kingdom have all indicated that by applying a flat rate of about 16% to 17½% on personal incomes above stated personal exemptions, the governments would be able to obtain at least the same volume of revenues presently obtained through the progressive tax, and at considerably lower cost.

A proportional tax on personal incomes would ensure that each person would pay his or her fair share of the costs of the services provided or available in the form of government services. It would thus conform to ability-to-pay in accordance with Adam Smith's first maxim "as nearly as possible, in proportion to the revenues which they enjoy under the protection of the state."

To the extent that the progressive personal income tax takes more than the costs of government services, it is confiscatory and in violation of property rights. It was advocated for this reason by Karl Marx and Friedrich Engels in "The Communist Manifesto" as a method for converting private property to public ownership.

It is interesting to note that when personal income taxes were first introduced they were levied on a proportional rather than a progressive basis. According to the Encyclopedia Americana, the economists of the 19th century generally argued that equality in

taxation should be interpreted in terms of benefits derived from the state. Since these benefits were thought to be proportional to income, it followed that the appropriate basis for taxation should be proportionality.

#### The Net Costs Business Tax

As business enterprises also benefit to a considerable extent from the availability of government services, it is reasonable that they should pay their fair share of the costs of such services. It is also reasonable that such taxes should be considered a cost of doing business and should be added to all other business costs. It is unfair to tax businesses on their profits for this has the effect of penalizing the most efficient businesses and subsidizing the least efficient businesses. A more equitable way to prorate the costs of government services to businesses is in relation to their costs of production rather than to their profits. However, in determining the amount of taxes payable, only those costs of production that are related to the value added by any business enterprise should be considered. Thus a business enterprise might be taxed on its total costs after deducting the costs of goods and services the enterprise has purchased from other businesses where a tax has already been paid. It is proposed that business enterprises should pay a tax based on their cost of value added.

Such a tax, which might be as low as 10%, would provide for all businesses to pay their fair share of the costs of government services, but no more than their share. The imposition of such a tax would provide an important incentive to increase profits, for these would no longer be taxed, and to reduce costs for this would have the effect of reducing taxes. The role of profits not only as an incentive to produce but also as a measure of business efficiency would be considerably enhanced. (1)

#### Site-Value Taxation for Property Owners

It is hardly necessary at a conference of the International Union for Land-Value Taxation and Free Trade to enter into a discussion of the advantages of taxing property owners on the basis of land value rather than the combined values of land and improvements. However, it is astonishing, to say the least, in spite of many years of research and the large number of studies that have been carried out to indicate the merits of land value taxation, that considerably more progress has not been made in extending the application of this form of taxation.

Of the three areas of taxation discussed in this paper, it is site-value taxation that provides the best example of a tax that meets the tests of both the ability-to-pay and benefit principles of taxation. This fact has been stated or implied by numerous writers on the subject.

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(1) A detailed study of the net costs tax was produced by the Ottawa Board of Trade (185 Sparks Street, Ottawa, Canada) in 1976 entitled "Creating a More Productive Economy Through Positive Taxation".



The idea was well expressed in a Research Monograph entitled "Property Taxation and Urban Development" written in 1961 by Mary Rawson, a Canadian economist and town planner, for the Urban Land Institute in Washington, D.C. The following is an extract from that paper:

"The services provided by public improvements and the size and wealth of the community are directly reflected in land values. Whether or not the land owner takes advantage of the benefits conferred upon his property by availability of services, by access to the community at large, or by unique natural advantages, is not the point at issue. Benefits are conferred upon different sites in various degrees and these benefits are measured in land values. A corner lot in the business district may be occupied by a department store or a car parking lot. The same public services are available to it, the same advantages accrue to it, whether or not it is well used.

"On the principle of benefit-received then, it is fairer to tax on the value of the site alone rather than the value of the improvement and the site together; that is, to tax on the potential use of the land not on its actual use.

"To look at it from another point of view, a site's ability-to-pay is related to its ability to earn. Land value is an indication of the earning power of the site. A lot cannot be lazy if the tax is based on its ability-to-pay.

"The principles of ability-to-pay and benefit-received are not necessarily in conflict and, in the case of land-value tax, they can be said to coincide."

The relationship between the ability-to-pay and the benefits principles in relation to site-value taxation was also well expressed in an article in the January 1977 issue of The American Journal of Economics and Sociology on "Broader Policy Issues in Property Tax Reform", by P. I. Prentice:

"A tax on unimproved urban location values is the only tax for which the ability to pay is actually created by the taxing community through the enormous community investment need to make land in that location richly saleable. . . . And to the extent that the land tax falls on a value created by the community rather than by the owner it conforms closely to the principle of taxation in proportion to benefits received."

### Summary

The tendency to consider the two main principles of taxation as being two different approaches has resulted in most tax systems being based almost entirely on the ability-to-pay concept. This concept not only seems intuitively to be fair, just and equitable and therefore appeals to the social conscience, but it also appeals to most governing bodies. To these latter it provides a theoretical basis for greater and sometimes unlimited control of a nation's wealth and justification for intervening, even with the best of intentions, in the workings of the market economy.

Tax systems based on the ability-to-pay concept have been in practice anything but fair, just and equitable, mainly because the concept has resulted in a lack of respect for and the violation of property rights.

A general recognition that the principles of ability-to-pay should complement rather than be in conflict with the benefits principle, and that a sound tax system should be based, as nearly as possible, on both principles, would permit the development of tax systems that not only would respect property rights but also would meet more closely the requirement of being fair, just and equitable.

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