

The Ethics of Taxation

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It would be wonderful if the authorities in today's world paid more attention to the well-known chapter on taxation in Adam Smith's WEALTH OF NATIONS, the canons of ability, equity, certainty, economy and convenience. We in India have reason to be happy that the new central government has promised to rationalize our notorious and inadequate system of taxing and public finance. In India, only a micro-minority pay income tax because the rest are too poor. Yet even here, there is scope for rationalizing. It could be made more conducive to promote productive efficiency and economic growth just to take a random example.

Adam Smith spelt out these 'canons' of taxation in the last quarter of the eighteenth century, when England had made what W. W. Rostow would describe as the pre-conditions for 'take off' into self sustained economic development and growth. The seeds of the industrial revolution had been sown and having fallen on fertile ground had started sprouting. An important aspect of this process was that the age of commerce had gained precedence over the age of knight-errantry and chivalry. We in India could describe this change as the vysya era of civilization' taking over from the Kshatriya era. This was a paradigm shift. Royal despotism was no more. People had rights and in England the Parliament was supreme. While imposing taxes on the people, certain ethical considerations had to be kept in mind. Canons

are basically ethical rules. Society is the result of a social contract and all parties to the contract have to act ethically vis a vis one another. In the canons of taxation as described by Adam Smith the people are privileged over the tax collecting authorities. In the canon of convenience for instance, it is the convenience of the tax payer that is to be taken into account and not that of the government in collecting it. This canon namely that of convenience is so brazenly flouted sometimes in India. It happens when the government imposes a "retrospective" tax on the profits of an enterprising firm. It also flouts the canon of "certainty" because the prospective payer can never be sure of what his costs in terms of dues to the government would be. Thus important economic decisions will be that much harder to take. Therefore we can conclude that a retrospective tax definitely hurts productive effort and efficiency. It has to go!

Moreover, let us consider the canon of Economy. According to this canon, the cost of collecting a tax should never be more than the amount of the tax itself. If a retrospective tax is imposed on a trans national company which has the means to resist it, it will go to any length to avoid it. If the government is dragged to an international court of arbitration it is bound to be very expensive. Even if the case is won, it would be an expensive victory. Probably it would have cost more in financial terms than the total tax amount in question. As

mentioned earlier, we are in the Vysya era of civilization. All developed countries are happy to update their economies to this reality. They are business friendly and investor friendly. They expect host countries which invite capital investments to play according to the rules as they conceive it themselves. They expect ethical tax systems which mean observing all the cannons of taxation which are well known and have been around for more than two hundred years now. Any transgression will cost not only a lot of goodwill but an avoidable delay in economic development.

It is a very important consideration while imposing taxes that it does not lead to a fall in productive effort and efficiency. In this regard radical changes are required in India. This is not merely a financial or economic matter but one of ethics. It goes without saying that it is unethical to allow employment opportunities to fall when it is avoidable. Taking an example from the airlines industry a recent news item which from The Times Of India, illustrates the point that a change is required in our indirect tax structure urgently. The headline ran “49000 crore Rupee losses put aviation sector on the verge of collapse.” It goes on to say that the prime minister was informed by the aviation minister at a review meeting that ‘poor returns from airports, burgeoning costs

and a tax infra structure that hurt maintenance, repair and overhaul was burying the sector under debt. The ministry stressed on the potential of the MRO industry generating large revenue and enhancing employment if service tax and VAT structure were made more attractive. The current rates make India a 35 percent more expensive destination for MRO operations than countries like Singapore. Tweaking tax rates can give employment to skilled hands and bring business to India..” The improvements in the tax structure should include an end to the inordinate delay of goods traffic at check points at inter state borders. This will not only facilitate commercial activity but also stop possibilities of corruption. A recent study shows that in some countries such a move would result in a quick increase in the countries gross domestic product. An increase in commercial activity has been acknowledged as the main causative factor of an increase in prosperity. Ever since Adam Smith, it has been shown that an enlightened government can make commercial activity the key to increase the wealth of the nation. All other systems have failed to deliver. Commerce itself depends on the removal of the barriers of space, time and lack of information. It also depends on an enlightened tax system. It is time that we in India take serious cognizance of these matters.



ECONOMICS AND MORALITY

“The economics is untrue which ignores or disregards moral values. An economics that inculcates Mammon worship and enables the strong to amass wealth at the expense of the weak, is a false and dismal science. It spells death. True economics, on the other had, stands for social justice; it promotes the good of all equally, including the weakest and is indispensable for decent life.”

– Mahatma Gandhi