Taxable Capacity:Meaning, Types, Factors affecting taxable capacity

Meaning:

The purpose of finding out the taxable capacity of any country or people is to know the limit of taxation to which it could be subjected for raising public revenue. This has to be done without creating higher adverse conditions in the economy which might defeat the very object of taxation.

Taxable Capacity refers to the maximum capacity that a country can contribute by the way of taxation both in ordinary and extra ordinary circumstances. In other words, it refers to the maximum capacity of the people of a country to bear the burden of taxation without much hardship. It is nothing but the maximum limit that a government can tax the people. If the government exceeds this red signal, namely the maximum limit, it will result in over-taxation.

Types:

The term taxable capacity is used in two senses which are as follows:

1. **Absolute Taxable Capacity:** Absolute taxable capacity refers to whatever could be taken away by the State after allowing for the barest of subsistence to the citizens. The indicator of absolute taxable capacity is that if it does not increase the revenue of the State, it then indicates that the absolute taxable capacity of the people has already been reached.

2. **Relative Taxable Capacity:** Relative Taxable Capacity refers to the respective contribution made by two communities for the common expenditure of the government. In other words, it is the capacity of one community to some common expenditure in relation to the capacities of other communities. For example, there are two communities, namely the rich and the poor communities. The rich-people can be made to contribute more to a common expenditure than the poor people. The rich people have the ability to pay in view of their higher income.

Factors Affecting Taxable Capacity:

As the prosperity of nation progresses, the taxable capacity of the people also increases under the influence of many economic and non-economic factors. Therefore, the concept of taxable capacity is not very rigid rather it is dynamic. The taxable capacity of the people of a country is affected by several factors which are as follows:

1. Psychology of tax payers: If the people are prepared to make greater sacrifices, then taxable capacity is said to have increased. In times of war, the people are made to pay more taxes. People are generally optimistic during the period of prosperity and they are prepared to pay more taxes.

2. Distribution of Wealth: If it is distributed equally, the taxable capacity becomes limited. If it is concentrated with few people, then they can be made to shoulder heavy burden of paying taxes.

3. Nature of taxation: If the tax system is scientifically framed, the taxable capacity increases. If the tax system produces adverse effects on the productive capacity of the people, this will reduce the taxable capacity.

4. Purpose of taxation: If the purpose of taxation is to raise resources and to bring about economic development [on agricultural, industrial and infrastructural development], people of the country are willing to pay taxes. In contrast, if it is used for spending on ammunition and war overheads, this will inevitably reduce the taxable capacity of the people.

5. Level of economic development: The taxable capacity of the people is determined by level of economic development of the country. Highly developed countries have greater taxable capacity than the poor countries.

6. Political conditions: It depends on political stability and internal prosperity. If there is peace inside and outside country, there will be encouraging atmosphere for expanded economic activity, which will in turn increase the taxable capacity.

7. Population: It depends on the size and rate of growth of population. If population increases at a faster rate than the national income rate, the taxable capacity becomes poorer.

8. Size of National Income: The taxable capacity of any community will depend upon the size of national income which itself will depend upon such factors as the volume of natural and other resources, the degree of utilization of resources, the state of technology, and so on. The richer a community, the higher is its capacity to pay taxes.

Thus, all these factors taken together determine the upper limit of taxation. As the economy goes on achieving prosperity and affluence, the taxable capacity also increases. Taxable capacity varies from country to country and from time to time in the same country. But there is no mathematical formula to measure taxable capacity.