# Public Revenue

The public revenue can be broadly classified into two:

**(a) Tax Revenue:** It is the most important and major source of public revenue. Government may require the members of the community to contribute to the support of governmental functions through the payment of taxes. An individual has no right to directly demand social services in return to his payment of tax nor has he any other choice except to pay the tax when it is levied on him.

Taxes, in general, serve both functions of a revenue system:

**(i)** they provide funds, and
**(ii)** they reduce private consumption and investment.

**(b) Non-Tax Revenue:** Non-tax revenue is derived from public undertakings called 'Prices' and other miscellaneous receipts. It also raises loans, short-term and long-term, to augment its revenues. Other minor revenue sources are fees, special assessment, fines, forfeitures and escheats, tributes and indemnities, gifts and grants.

***Adam Smith's Canon of Taxation***

Adam Smith's contribution to this part of economic theory is still regarded as classic. His presented theory on taxation is still considered as the foundation of all discussions on the principles of taxation. There are four essentials of his theory of taxation, i.e., equality, certainty, convenience and economy. The first canon is ethical and other three are administrative in character:

**1. Canon of Equality:** means the principle of justice, i.e., in accordance to 'ability to pay'. This is the most important canon of taxation. It lays the moral foundation of the tax system. The cannon of equality does not mean that every taxpayer should pay at the same sum. That would be manifestly unjust. Nor does it means that they should pay at the same rate, which means proportional taxation, for a proportional tax is also not a very just tax. What this canon really means is the equality of sacrifice. The amount of the tax paid is to be in proportion to the respective abilities of the taxpayers. This clearly points to progressive taxation, i.e., taxing higher incomes at higher rates.

**2. Canon of Certainty:** means 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 to be clear and simple to the taxpayer. According to Adam Smith, uncertainty in taxation encourages insolence or corruption.

**3. Canon of Convenience:** Every tax, according to Adam Smith, ought to be levied at the time or in the manner in which it is most convenient for the taxpayers to pay their dues. The canon of certainty says that the time and the manner of payment should be certain. But the canon of convenience states that the time of payment and the manner of payment should be convenient. For example, if a tax on land or house is collected at a time when

rent is expected to be received, it satisfies the canon of convenience. If the tax can be paid through cheque, or credit card, or internet, the manner is convenient, but not so if it is to be paid personally to the taxing authority. In the latter case there will be a lot of inconvenience and harassment.

**4. Canon of Economy:** The tax will be economical if the cost of collection is very small. If, on the other hand, the salaries of the officers engaged in collecting the tax eat up a big portion of the tax revenue, the tax is certainly uneconomical. Similarly, such other huge and unnecessary administrative costs will make the tax collection an extravagant task. If there is corruption or oppression involved in the frequent visits to the income tax office and the odious examination by the taxing officer the canon of economy is not satisfied.

In broader sense, the canon of economy means a tax must not obstruct in any manner the ultimate prosperity of the country. It would infringe the canon of economy if it retards the development of trade and industry in any manner. If incomes are subjected to a very heavy tax, saving may be discouraged, capital will not accumulate and the productive capacity of the community will be seriously impaired.

***Other Canons of Taxation***

**1. Fiscal Adequacy or Productivity:** The State should be able to function with the revenue raised from the people by means of taxes. The government should be free from financial embarrassments. It will be necessary, therefore, that the tax proceeds should adequately cover the government expenditure and the government does not run into a deficit. But at the same time, the government should also not err on the side of excess. In their zeal to raise more revenue, they should not cripple, in any manner, the productive capacity of the community.

**2. Canon of Elasticity:** The canon of elasticity is closely connected with that of 'fiscal adequacy'. As the needs of the State increase, the revenue should also increase otherwise they will cease to be adequate. To meet an emergency or a period of stress and strain, the government should be in a position to augment its financial resources. Income tax is considered to be an elastic tax, as it can be considerably increased when needed.

**3. Canon of Flexibility:** There is a difference between flexibility and elasticity. Flexibility means that there should be no rigidity in the tax system so that it can be quickly adjusted to new conditions; and elasticity means that the revenues can be increased. The presence of flexibility is a condition of elasticity. A tax system cannot be altered without bringing about a revolution or without much flexibility in the tax system.

**4. Canon of Simplicity:** According to Armitage Smith, a system of taxation should be simple, plain and intelligible to the common understanding. This canon is essential if corruption or oppression is to be avoided.

**5. Canon of Diversity:** Another important principle of taxation – diversity. A single tax or only a few taxes will not do. There should be a variety of taxes so that all the citizens, who can afford to contribute to the State revenue, should be made to do so. They should

be approached in a variety of ways. There should be a wise admixture of direct and indirect taxes. But too great multiplicity will be bad and uneconomical.

**6. Social and Economic Objectives:** In modern times, economists emphasised that the tax system should be based on the principle that the effects of taxation should be compatible with the economic and social objectives and preferences of the community. The social and economic objectives of a standard tax system are:

**(i) Reduction of inequalities in the distribution of income and wealth:** For this purpose, progressive taxes must be levied instead of proportional taxes.

**(ii) Accelerating economic growth:** For this purpose, the tax system must be so designed as to raise the rates of saving and investment. This is a very important objective for less developed countries (LDCs), where there is a deficiency of savings and investments.

**(iii)Price stability:** to ensure stable economic growth. When LDCs launch economic development programme they have to face inflation or soaring prices. An integrated tax policy would solve this problem.

***Objectives of Taxation in Developing Economies***

**(a) Ability to contribute to economic development:** Each person should be made to contribute to economic development, according to his ability to do so. All his unused capacity must be utilised, through appropriate tax measures, for purposes of economic development. Suppose a person is making a large saving but he lets it lie idle. Such saving must be mobilised and channelised into investment.

**(b) Mobilisation of economic surplus:** In all backward countries, a significant portion of national output goes to the big landlords and other idle rich people. A large portion of their income is spent on conspicuous consumption, e.g., building of palaces, etc. This is unproductive expenditure and a waste from the point of national development. Economic growth can be accelerated if an appreciable portion of this 'surplus' income is mobilised and made available for productive investment.

**(c) Increasing the incremental saving ratio:** As economic development proceeds apace, incomes rise. But there is a danger that propensity to consume may also increase so that extra incomes generated in the economy are utilised in consumption rather then invested in production. This has to be prevented. In other words, the consumption is not allowed to increase in proportion to increase in income. For this purpose commodity taxes are quite effective.

**(d) Income elasticity of taxation:** In backward economies, the share of taxation out of the national income is less than 10%. This share must be progressively raised as national income increases as a result of economic development. This needs built-in flexibility in the tax system. Progressive taxation of income provides this flexibility.

Taxation of goods having a high income-elasticity of demand also imparts to the tax system much needed flexibility.

**(e) Equity:** The canon of equity demands that the burden of economic development must be distributed among the different sections of the community equitably. That is why the richer classes are prevented from increasing their consumption in proportion to the rise in their incomes. This is how they make a sacrifice for the economic development of their country. The poor people also make a sacrifice because rising prices curtail their consumption. In this manner, sacrifices in consumption are shared by all sections of the society. Thus, the burden of economic development is equitably distributed among all. This is also known as *'horizontal equity'*.

***Characteristics of A Good Tax System***

**(a) Simple, financially adequate and elastic:** The tax system should be simple, financially adequate and elastic. In other words, the system should be easily intelligible; it should be sufficiently productive of revenue; and the tax structure should be adaptable to meet the changing requirements of the economy.

**(b) Broad based:** The tax system should be as much broad-based as possible. It should be multiple tax system. There should be diversity in the system. But too great multiplicity in tax system should be avoided.

**(c) Administratively efficient:** The tax system should be efficient from the administrative point of view. It should be simple to administer. There should be little scope for evasion or accumulation of arrears. It should be foolproof and knave-proof. Chances of corruption should be minimised.

**(d) Balanced and harmonious:** Another important characteristic of a good tax system is that it should be a harmonious whole. It should have a balanced structure. It should be truly a system and not a mere collection of isolated taxes. Every tax should fit in properly in the system as a whole so that it is a part of a connected system. Each tax should occupy a definite and due place in the financial structure.

**(e) Ensuring the reduction of economic inequalities:** A good tax is that it should be an instrument for the reduction of economic inequalities. The purpose of public finance is not merely to raise revenues for the State but to raise the revenue in such a manner as to reduce the economic inequalities. In this manner, the State may also be able to divert idle resources in bank balances or lockers to more productive areas.

**(f) Ensuring economic stability:** From the point of view of ensuring economic stability, it is necessary that the tax system must be progressive in relation to changes in the national income. This means that when national income rises, an increasing part of rise in income should automatically accrue to the tax authorities and when national income falls, as in a depression, the tax revenue should fall faster than the fall in national income.

**(g) Ensuring that national income is increasing:** The tax system should ensure that the national income is increasing during boom periods. Similarly, in depression, tax revenues should fall faster than income so that the purchasing power of people does not fall as fast as their pre-tax income. Thus, an overall progressive tax system is an important factor in ensuring stability.

**(h) An instrument of economic growth:** For developing economies, the tax system has to serve as an instrument of economic growth. Economic development rather than economic stability is the objective of under-developed countries. Their tax system must be so shaped as to accelerate economic development. For this purpose, it must mobilise the required resources and channelise them into investment. It must, in short step up savings and investment and raise the level of income and employment in the economy.

**(i) Socially advantageous:** The tax system should be socially advantageous and promote general economic welfare. From this point of view, taxes on goods of mass consumption should be avoided. The burden of tax on basic items should not be excessive.

**(j) Optimum allocation of resources:** The tax system should be so framed as to ensure that the productive resources of the economy are optimally allocated and utilised. For this purpose, it is essential that the tax system should be economically neutral. In other words, it should interfere as little as possible with the consumers' choices for consumption goods and the producers' choices regarding the use of factors.

***Classification of Tax***

Some classifications of taxes are as follows:

**1. Proportional & Progressive Tax:** A proportional tax is one in which, whatever the size of income, same rate or percentage is charged.

On the contrary, progressive tax refers to the tax system in which the rate of tax increases with the increase in table income. It is based on the principle 'higher the income, higher the tax'.

**2. Regressive & Digressive Tax:** A tax is said to be regressive when its burden falls more heavily on low-income earners / poor than the high-income earners / rich. It is opposite of progressive tax.

A tax is called digressive when the higher income does not make a due sacrifice, or when the burden imposed on them is relatively less. This tax may be progressive up to a certain limit beyond which a uniform rate is charged.

**3. Specific & Advolarem Tax:** A specific tax is according to the weight of the commodity. An advolarem tax is according to the value of a commodity.

**4. Direct & Indirect Tax:** Direct tax is one which is paid by the person on which it is charged. The examples of direct taxes are income tax, wealth tax, etc.

On the contrary, the indirect tax's is paid by one person and its burden is fall on other, generally the consumer. The examples of indirect taxes are sales tax, central excise duty, custom duty, recreational tax, etc.

***Sources of Tax Revenue / Major Types of Tax***

**1. Income Tax:** It is a form of direct tax which is levied on individual's total earnings. It is the most effective tax vehicle for attaining equity, particularly if it is progressive tax. Following are the requirements for an optimal income tax system:

- **(a)** All incomes should be treated uniformly and all rupees of income should be accorded equal tax treatment regardless of the source.
- **(b)** Just as 'equals' should be treated 'equally', 'unequals' should be treated 'unequally'.
- **(c)** The tax structure should be sensitive to changes in economic activity in order to dampen the changes
- **(d)** The tax structure should be designed in such a fashion as to facilitate compliance and in enforcement, consistent with the attainment of the other objectives.

**2. Corporate Tax:** The following are the primary tax consequences of the existence of the corporation:

- **(a)** The corporation's earnings are accumulated as reserves giving rise to capital gains.
- **(b)** The division between initial earning of the income and subsequent payment of dividends encourages government to tax both the corporation and the dividend earners.
- **(c)** The division between ownership and top management in a large corporation may cause the reactions to the tax to be different from the personal income tax.

Under perfectly competitive markets the corporate tax shifted to reduce the real income of stockholders. Under imperfectly competitive markets the firms use mark-up price for shifting the tax burden on consumers.

**3. Wealth Tax:** A wealth tax is a levy upon individuals not corporations, on the basis of their net wealth. Corporate property is reached via securities outstanding in the hands of the owners and creditors. The wealth tax can take form of either progressive or proportional tax. Wealth tax is not a major source of revenue and in most countries they form 1 to 2% of the total tax revenue.

**4. Sales Tax:** Sales tax is applied to all or a wide range of commodities and services. It is collected from vendors rather than individual consumers. The sales tax is finally borne by consumers. The sales tax is often refer to regressive tax relative to income.

**5. Excise Duty:** It is actually imposed on the manufacturers but the consumers have to pay it. It is a form of indirect tax imposed on widely used commodities often regarded as non-essential such as cigarettes, liquor, tobacco, etc.

**6. Custom Duty:** Custom duties are of two types:

**(i)** specific, and
**(ii)** advolarem.

Specific custom duty is fixed per physical units of goods, e.g., television, CD players, computers, etc. The advolarem custom duty is according to the value of a good and charged at a certain rate.

As industrial and commercial development continues the increased use of custom duties lessens the revenue potential.

**7. State Duties:** There are several other duties imposed by the government broadly classified as 'state duty'. These include the tax on the earnings of commercial deposits and on sales and purchase of properties. These are some what different types of tax as:

**(a)** the taxes imposed by the federal government and used by itself,
**(b)** the taxes imposed by the federal government and distributed among provinces, and
**(c)** the taxes imposed by the provincial governments and used by themselves.

**8. Other Sources:**

**(i) Fee:** It is also a compulsory payment but made only by those who obtain a definite service in return from the government. The fee covers the part of the cost of service provided to the consumer / client. The licence fee, however, is much more than the cost of service and there is not much of a positive service in return.

**(ii) Price:** A price is the payment of a service of business character, for example, charges for travelling on railway. The price is different from fee. The fee is for public interest. You can escape a price by not purchasing the said service / commodity.

**(iii)Special Assessment:** According to Professor Seligman, special assessment is a compulsory contribution, levied in proportion to the special benefit derived, to defray the cost of a specific improvement to property undertaken in the public interest. Suppose the government build a road or bridge or provide mass transport system or makes suitable sewerage and water supply arrangements, all the property will appreciate in value. The State has the right to levy a special tax on the owners of land or property known as 'special assessment'.

**(iv)Rates:** Rates are levied by the local bodies, municipalities and district boards for local purposes. They are generally levied on immovable property of the residents, but not necessarily for any special improvements effected or special benefits conferred.

***Sources from Non-Tax Revenues***

In Pakistan, following are the sources of non-tax revenue available for Federal Government:

**1. Income from Property & Enterprise:** The Government receives income from the owned lands, forests, mines, canal water and various public enterprises.

**2. Profit from Post Office and TNT:** The Government also receives income from its Post and Telegraph departments.

**3. Trading Profits:** The Government of Pakistan earns trading profits from exports of rice, cotton and edible oil.

**4. Interest Receipts:** It is the most important head in the NTR source. The interest and the return from investment received from various autonomous bodies, and central bank and state-owned banks come under this head.

**5. Surcharges:** The difference between the sales price and the production cost / import price of petroleum products, gas and fertilisers represents the surplus profit or the surcharge, which is used to iron out the fluctuations in the prices of these essential commodities.

**6. Other Sources of Non-Tax Revenue:** The other minor heads of non-tax revenue are:

(i) Dividends and returns
(ii) Receipts from civil administration and other functions
(iii) Miscellaneous sources, which includes passport, CNIC (Computerised National Identity Card), copyright fees and other receipts.