

Title	PRICES AND INJUSTICE IN TAXATION
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Citation	Kyoto University Economic Review (1927), 2(2): 28-41
Issue Date	1927-12
URL	http://hdl.handle.net/2433/125165
Right	
Type	Departmental Bulletin Paper
Textversion	publisher

Kyoto University
Economic Review

MEMOIRS OF
THE DEPARTMENT OF ECONOMICS
IN
THE IMPERIAL UNIVERSITY OF KYOTO

VOLUME II 1927

PUBLISHED BY THE DEPARTMENT
OF ECONOMICS IN
THE IMPERIAL UNIVERSITY OF KYOTO

PRICES AND INJUSTICE IN TAXATION.

FOREWORD

The relations of prices and taxes are mutual: taxes affect prices (or the shifting of tax burdens) and prices affect taxes. The latter effects are also to be seen along two lines: prices affect taxes directly as well as indirectly. The indirect effects of prices upon taxes are of the following two kinds: variations of prices cause an increase or decrease in the amount of taxes by first affecting the amount of government expenditure; variations of prices cause an increase or decrease in the amount of taxes which cannot be covered by other revenues, by first affecting the amount of annual revenues other than from taxes (such as revenue from government enterprises or state property). The direct effects of prices upon taxes are also two: first, when variations of prices affect the amount of revenue; secondly, when variations or differences of prices affect justice in taxation, making the taxes unjust to a certain extent. It is the last mentioned case that I shall take up in this article.

I have decided to inquire into this problem because of the fact that, while it has been unduly neglected by scholars and statesmen, in actual practice it has been one of the greatest causes of injustice in taxation. It has been found that when prices are high following, let us say, an expansion of currency, the taxes which are ordinarily regarded as unjust approach justice; while those which are regarded as highly just in normal times become grotesquely unjust. Thus the question is full of interest.

I. LOCAL DIFFERENCE OF PRICES AND INJUSTICE IN TAXES

Prices affect taxes in terms not only of the changes of time but also of the difference of places. It often happens that a tax which is regarded as just at one time becomes unjust at some other time. Also the difference of prices in different parts of a country (which means that the real value of money is different in different localities) makes taxes to some extent unjust. The former case is the more important, but the latter is also quite important.

i. WHEN THE LOCAL DIFFERENCE OF PRICES DOES NOT VIOLATE JUSTICE IN TAXATION

Not that all differences of prices in different localities invariably violate justice in taxation. The following are such cases :

A. In the case of an *ad valorem* proportional rate

In this case a certain percentage of the tax basis of the object taxed is taken as tax. In our country such a rate is applied on the following tax bases: the value of land in the case of the land tax, the net revenue in the case of the business tax, the amount of interest in the case of the capital interest tax, the estimated value of mineral products in the case of the mineral tax, the gross revenue in the case of the tax on bourse business, the value of the objects taxed in some cases of the registration tax, the issue of banknotes in the case of the banknote tax, the amount of the contract in the case of the tax on sales in the bourse, and the values of objects taxed in the case of the textile tax. In these cases the propriety of tax objects and their bases becomes an issue. The *ad valorem* proportional rate, too, is open to some injustice. Especially in such a case as where the value of land, its basis, is fixed and therein is

found great dissatisfaction (particularly in view of the fact that the value is not that of the land at a given time but the cadastral value). However, aside from these considerations, the local difference of prices does not give rise to injustice in taxation, because there is a substantial proportion between the value of the object taxed and the amount of the tax.

B. Specific progressive rate and allowance in a certain percentage of the tax basis according to some object

The specific progressive rate is adopted in the case of our inheritance tax (the progression being according to the distance of relationship). In the case of the registration tax, the progression of the rate of the tax on the tenant's right is according to the length of the period. The allowance of a certain rate on the tax basis is made for earned income in our income tax. If the justice of these systems is assumed, it will be seen that the local difference of prices will not by any means add specially to the injustice of the taxes.

ii. WHEN THE LOCAL DIFFERENCE OF PRICES CAUSES AN INJUSTICE IN TAXATION

A. In the case of the fixed rate

This is when a fixed amount of money is imposed upon an object or in a certain case as tax. For example, a certain amount of tax is levied in such taxes as the registration tax, the stamp tax, or the card tax.

(a). It is obvious that as the real value of the tax charged varies in different parts of a country due to the variations of prices, the tax which is just in places where prices are high, must be too high in places where prices are low. Of course, before such a tax is decided upon, the prices in different parts of a country are studied and the average price is adopted; and this certainly minimises the

injustice involved. But it is often very difficult to make such a study in prices in adopting taxes. The fact of the local difference of prices thus inevitably accompanies some measure of injustice in taxation.

(b). One method of remedying this injustice is to divide the whole country into three parts according to the rates of prices (for example, big cities, middle sized cities, and towns and villages), and to adopt a graded rate of tax for each group. The difficulty of such a method consists in the classification; and despite every effort it is practically impossible to obviate the injustice. Such a graded tax may be adopted in taxes such as the registration tax which is imposed at a respective place, but in such a tax as the stamp tax for cheques and bills which are moved from one place to another, it must be very difficult to regulate. Justice can not be assured in such a tax as the tax on playing cards, since it is impossible to forecast the place of sale of each individual pack. The fixed rate has an inherent injustice, but its unjust nature increases when one considers it in connection with the variation of prices. Nor is there any perfect remedy therefor.

B. In the case of the *ad valorem* classified rate

Classified rates of tax are imposed in accordance with the amount of money involved. This is adopted in some certificates in the case of the stamp tax. One rate is adopted for an amount, say, from A to B, and another rate for an amount from B to C, etc.

(a). This method also has the inherent defect of injustice, which is increased because of the local difference of prices. Where prices are high the high rate is adopted, while where they are low, the low rate is adopted, although the objects taxed are of the same net value. Furthermore, the difference between the two rates is not always proportionate to the difference of prices.

(b). The remedy for this injustice is to fix the tax rate

as in the previous case, but it also involves the same difficulty and injustice that the other system possesses.

C. Specific classified rate

This is a rate which is based upon things other than the amount of money, as, for instance, the hunting rate which is based upon whether the hunter pays an income tax or not.

(a). The difference in the real value of the rate in different parts of a country involves an injustice in taxation.

(b). The only remedy seems to be to divide the whole country into several zones according to the prices prevailing. This, however, is not free from objection.

D. Specific proportional rate

The following are examples of this rate: one *koku* is taken as the tax unit for *sake*, alcohol and alcoholic beverages, beer, and soft drinks; one hundred *kin* is taken as the unit for the tax on sugar; and so many square *tsubo* is taken as unit for the mineral zone rate.

(a). Injustice is involved also in this method because of the local difference of prices.

(b). It is obvious that the adoption of different rates for different local districts would not be just in the case of such consumption taxes as given above because productive districts do not always coincide with consuming districts. Nor is it possible to levy those rates upon consumers. The differentiation of areas would not mean anything in such a tax as the mineral zone tax as almost all mines are located in rural districts.

E. The *ad valorem* progressive rate

Progressive rates are levied for certain amounts of tax bases. For example, a per cent is levied for an amount ranging from A to B, and b per cent is levied on an amount

ranging from B to C, etc. This method is adopted in our country in the case of the income and inheritance taxes. There is a general belief that those taxes are justly imposed.

(a). However, the method involves injustice because of the fact that the real value of the amount of the tax bases varies in different places. Suppose that a class within the first group has the same real value as that in the second group, the same rate should be imposed upon both of them; but in actual practice different rates are levied on them.

(b). The remedy seems to divide the country into three zones according to prices. The district where the prices are highest must have a rate about one grade or two lower than the average. But such a division of districts is extremely difficult, and in any case, injustice will be found among the different groups. Moreover, in the case of the inheritance tax there will remain the question of where to impose the tax—the domicile of the legator or of the inheritor or the location of the tax object. As our tax is levied on the recipient of inheritance or the legatee, taxing at the domicile of the recipient seems to be proper. But suppose a recipient lives in a foreign country, there will be much difficulty. Thus, although the *ad valorem* progressive rate is regarded as just in principle, its unjust nature becomes apparent when prices and their effects are taken into consideration.

F. Exemption point, abatement and reduction of one or more grades

In Japan, an exemption point is adopted in some of the income, inheritance, land, business and stamp taxes. Abatement is adopted in some of the income and inheritance taxes; but reduction of one or more grades is not adopted.

(a). Those methods are adopted uniformly throughout the country without taking into consideration the fact that prices are different in different localities. This, obviously, is not just.

(b). The adoption of a local classification in accordance

with prices is desirable in the case of exemption point and of abatement, while reduction of grade should be made as a supplement to the progressive or classified rate. But local classification is extremely difficult and involves some measure of injustice.

II. TIME VARIATION OF PRICES AND INJUSTICE IN TAXATION

I have discussed how local difference of prices violate justice in taxation. I shall now consider the time variation of prices and its effect upon justice in taxation. It may be said that time variation of prices affects justice in taxation to a greater degree than the local difference of prices, although there are cases in which the former does not affect the justice in question.

i. WHEN TIME VARIATION DOES NOT AFFECT JUSTICE IN TAXATION

A. In the case of the *ad valorem* proportional rate

In this case justice in taxation is not affected because when money value or prices change, both tax bases and the amount of taxes also change. There is an automatic balance between prices and taxes. Thus the *ad valorem* proportional rate has great merits as compared with the progressive rate, although the former has some serious defects, because it is not affected either by the local difference of prices nor by the time variation of prices. It is well that the amount of the tax basis fluctuates, but when it is based, as in our land tax, upon the cadastral value, injustice results from the effect of the variation of prices upon the *ad valorem* rate. The remedy lies in the reform of the cadastral system. Furthermore, even when the amount of the tax basis fluctuates with the change of prices, it is sometimes extremely difficult to assess the tax basis

rightly, if prices are busily fluctuating, reducing the significance of the tax basis to a minimum. An *ad valorem* proportionate rate may be adopted in the case of transaction and consumption taxes to a greater extent than in any other taxes because of the fact that these two sets of taxes adapt themselves to price fluctuations more readily than do other taxes.

B. Specific progressive rate and allowance in a certain percentage of the tax basis according to some object

In these cases, the change of prices does not affect justice in the relations among taxpayers or tax-objects. Their relative position is unaffected by price variation, although the specific element and the object may be affected.

ii. WHEN TIME VARIATION AFFECTS JUSTICE IN TAXATION

A. In the case of the fixed rate

(a). If the amount of some taxes is fixed, the time variation of prices will inevitably affect justice in such taxation. If the amount is just, it will be too cheap in case prices go up, and too high in the reverse case.

(b). One remedy in a country with inconvertible paper money would be to require the payment of the tax in gold, but this is inconsistent with the fact that the paper money is legal tender. Moreover, the great majority of the people would be most seriously incommoded from the pecuniary standpoint since gold is not easily to be had; and for this reason it would be intolerably inconvenient for them to pay the tax in gold only. But something must be done to remedy the injustice arising from price variations. Another way is to adopt some price index and to levy an additional tax or make reductions in case prices go beyond that index or sink below it. This may add to the tax burden some

times, but such burden will be inevitable in securing justice in taxation. The second method is much better than the first one. However, there remains another perplexing question. The time of the price index constitutes a difficult question. The index of the preceding year may not always be desirable as great changes may be seen within one year. The beginning of the year may be less objectionable but the prices at that time are abnormal, hence injustice will persist in remaining. A much more desirable method is to fix the time of either assessment or of the payment of taxes (not actual time but legal time of payment of taxes) as the time for the price index number.

B. In the case of an *ad valorem* classified rate

(a). When prices fluctuate and thus the value of money changes, the variation of the real value of the tax basis and that of the amount of the tax are not always proportionate. Suppose a tax of one *yen* is levied on an object of less than 200 *yen* value, and two *yen* on objects ranging from 200 *yen* and 400 *yen* in value. If the price of the former object goes up from 200 *yen* to 300 *yen*, those who used to pay one *yen* on that object will then have to pay two *yen* on the very same object, which has changed in no way at all except in price.

(b). An effective remedy for this is to convert the tax basis to the normal amount by means of the price index number, then to get the corresponding tax rate. As the system is highly complex, it will inevitably involve some mistakes in the payment of the tax as well as tax evasion. As to the time of conversion, in the case of the tax basis the time of assessment should be adopted; in the case of the tax amount, the time of the tax payment should be adopted. When the times of these two differ, injustice also becomes inevitable to some extent. But in such a case as the stamp tax on the certificate of the transfer of the ownership of immovables, both times are the same and so far do not involve injustice in taxation.

C. In the case of the classified rate based upon other than the amount of money

(a). As the real value of the tax changes with the fluctuation of prices, justice in taxation is violated. If the tax at the normal time is just, it becomes too low when prices rise and too burdensome when prices go down.

(b). As the remedy for this, the one which was proposed in the case of A may be adopted but it has the difficulty which we have already mentioned.

D. In the case of the specific proportional rate.

(a). The effects of price variations in this case are the same as in the previous case.

(b). The remedy considered in the case of A may be adopted but it also has its difficulty. If the time of assessment should be taken as the time for fixing the index of prices, the value of money will change by the time of the payment of the tax and thus injustice will result. If the payment is made in several instalments, the price variation in the different payments may cause injustice. It is highly desirable that the period between the times of assessment and of the payment of the tax should be shortened as much as possible. It is also desirable that the time for making out the index number of prices should be fixed at the time of the payment of the tax, and that those who fail to pay at the appointed time should be required to pay an additional charge, or that those who pay at the required time should get a certain discount. Such a measure as this will be very desirable in connection with the consumption taxes in our country, yet it will not be all plain sailing. For example, a measure of this kind may work quite smoothly with a consumption tax like the tax on manufactured articles shipped from a factory, but the tax on the manufacture of *sake* which is paid much later than other taxes will not work hand in hand with the measure under consideration.

E. In the case of the *ad valorem* progressive rate

(a). Supposing that a rise in prices resulted in an increase of business income,—it is evident that a higher grade in tax than before should be applied. However, from the standpoint of business men such an increase cannot always be justified, because they do not always profit by a rise in prices; they may be placed in a less economically advantageous position or remain in *statu quo ante*. For this reason, although the absolute amount of the tax may be increased in proportion to the lowering of the value of money, the percentage of the tax should remain the same as before. Certainly, the percentage of the tax should not be increased simply because prices have risen and income has increased. When prices rise extraordinarily as in the case of Germany after the World War, the workers of the lowest class are required to pay the highest percentage tax although in normal times they might pay the lowest percentage. There are those whose income does not increase although prices rise (salaried men and those deriving income from interest on capital). A rise in prices might even make some persons poorer than before and may reduce their incomes to a point where in ordinary times they might have claimed exemption from the income tax. A rise in prices is thus likely to result in an over-burden. On the other hand, the lowering of prices results in too great a lightening of the tax burden. At any rate, price variations result in some form of injustice in taxation.

(b). The remedy for this is to raise or lower the tax rate over or below the index number of prices. When prices rise to a certain degree, the rate should be lowered; and when they go down to a certain degree, the rate should be raised. But there is the difficulty of fixing the time of making up the index numbers. In the case of the income tax, the amount of one's income in the preceding year may be computed into this year's, and the rise or fall of this

year's income by taking the index number of the year before. But in the case of some forms of our income tax it is very difficult, because it is assessed on the estimate of a given year's income. But even in the case under consideration, there will be price variations between the time of the index number and that of the actual payment of the tax. Moreover, as the income tax is paid in several instalments, there is a difference in the real value of money between any two different payments. And, in this case, if prices are rising, the government loses financially, and the levying of an additional charge or a discounting will be necessary. Of course this payment of the tax in instalment will help the taxpayers financially when the value of money is on a downward trend.

**F. Exemption point, abatement and reduction
of one or more grades**

(a). In all of these cases, price variations would result in injustice in taxation. An exemption point fixed at a particular time will become too low when prices go up, and too high when prices go down. The same thing will happen in the case of abatement of a fixed amount. Reduction of grade also becomes an issue in the case of a classified or progressive rate, and since both the classified and progressive rates are affected by price variations, it is only natural that reduction of grade should also be similarly affected.

(b). Exemption point and abatement should be made dependent upon the index number of prices, while reduction of grade should be made a supplement to the remedial measures of the main tax rate.

**G. Sales income and increasing value as the
tax object and tax basis**

(a). These cases will also suffer injustice in taxation as the result of price variations especially when prices go

up. It often happens that increased income is only apparent and in reality there is no real increase.

(b). The remedy is to decide on the real profit by means of an index number and those who have really secured profits should be taxed. But this calculation is difficult indeed.

H. The duration between the times of tax assessment and of payment and the duration between the legal time and the actual time of tax payment

(a). The longer the duration under consideration, the greater will be the effects of price variations upon the justice in the taxation. The state treasury will suffer a great loss if the duration is long.

(b). The remedy is found in shortening the duration as much as possible, and to levy an additional charge on delinquencies and making a discount for those who pay by the appointed hour.

I. Money as a convenient means of payment

(a). Fundamentally speaking, it may be said that the injustice in taxation mentioned in the foregoing discussion is due to the fact that money is used as a convenient means of payment.

(b). Payment in articles other than money may largely do away with the injustice but will involve a fresh difficulty of great magnitude. Nor can it be adopted without reconstructing the whole financial system, nor without causing inconvenience to taxpayers. We must be contented with those remedies previously suggested. Of course, as has already been discussed in a previous article, the adoption of actual objects as a supplement to money in the payment of taxes would eliminate the evils to some extent.

CONCLUSION

In short, the fluctuation of prices both in terms of time and place greatly affects justice in taxation. Only the

following are free from the undesirable effects of price variations. The *ad valorem* proportional rate, the specific progressive rate, and the allowance by a certain rate of the tax bases. But second and third are rather supplementary measures to a certain main tax, and therefore have no independent value, so that the *ad valorem* proportional rate is the only desirable tax rate. This, however, cannot be adopted in all cases (In some of the registration and stamp taxes, for instance, it cannot be applied). Even in the case where this rate can be adopted (for instance, in the income tax), it cannot be carried out without some injustice. It is indeed regrettable that the various tax rates which are adopted in order to remove injustice in taxation cannot escape that injustice to some extent, due to the fluctuation of prices. This is particularly true of the progressive rate which in principle is superior to any other and which for this reason should be maintained together with proper guards against its short comings. Nor can payment in articles other than money be adopted with a few exceptions, as it will result in much trouble for the taxpayers. It is evident that attempts should be made for the purpose of excluding price fluctuations or of tempering their effects upon justice in taxation. It is difficult to exclude the local difference of prices, but much can be done by way of excluding the time difference of prices, if the authorities would properly direct their efforts towards this object. Prices in our country today are much higher than those at the time the taxes were adopted, especially since the Great War. The Government is disregarding this fact. Justice in taxation, in my opinion, depends on the stability of prices. The old taxes are good taxes is a truth, but then the stability of prices is assumed; they are not good taxes when prices are unstable. Most taxes are bad taxes at a time when prices are unstable.

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