**A brief definition of Ability to pay theory of Tax**

The ability-to-pay principle requires that the total tax burden will be distributed among individuals according to their capacity to bear it, taking into account all of the relevant personal characteristics. The most suitable taxes from this standpoint are personal levies (income, net worth, consumption, and inheritance taxes). Historically there was common agreement that income is the best indicator of ability to pay. There have, however, been important dissenters from this view, including the 17th-century English philosophers [John Locke](http://www.britannica.com/EBchecked/topic/345753/John-Locke) and [Thomas Hobbes](http://www.britannica.com/EBchecked/topic/268448/Thomas-Hobbes) and a number of present-day tax specialists. The early dissenters believed that equity should be measured by what is spent (i.e., consumption) rather than by what is earned (i.e., income); modern advocates of consumption-based taxation emphasize the neutrality of consumption-based taxes toward [saving](http://www.britannica.com/EBchecked/topic/525766/saving) (income taxes discriminate against saving), the simplicity of consumption-based taxes, and the superiority of consumption as a measure of an individual’s ability to pay over a lifetime. Some theorists believe that wealth provides a good measure of ability to pay because assets imply some degree of satisfaction (power) and tax capacity, even if (as in the case of an art collection) they generate no tangible income.

The ability-to-pay principle also is commonly interpreted as requiring that direct personal taxes have a progressive rate structure, although there is no way of demonstrating that any particular degree of progressivity is the right one. Because a considerable part of the population does not pay certain direct taxes—such as income or inheritance taxes—some tax theorists believe that a satisfactory redistribution can only be achieved when such taxes are supplemented by direct income transfers or [negative income taxes](http://www.britannica.com/EBchecked/topic/284849/income-tax/71951/The-negative-income-tax) (or refundable credits). Others argue that income transfers and negative income tax create negative incentives; instead, they favour public expenditures (for example, on health or education) targeted toward low-income families as a better means of reaching distributional objectives.

Indirect taxes such as VAT, excise, sales, or turnover taxes can be adapted to the ability-to-pay criterion, but only to a limited extent—for example, by exempting necessities such as food or by differentiating tax rates according to “urgency of need.” Such policies are generally not very effective; moreover, they distort consumer [purchasing](http://www.britannica.com/EBchecked/topic/483815/purchasing) patterns, and their complexity often makes them difficult to institute.

Throughout much of the 20th century, prevailing opinion held that the distribution of the tax burden among individuals should reduce the income disparities that naturally result from the market economy; this view was the complete contrary of the 19th-century liberal view that the distribution of income ought to be left alone. By the end of the 20th century, however, many governments recognized that attempts to [use tax](http://www.britannica.com/EBchecked/topic/620277/use-tax) policy to reduce inequity can create costly distortions, prompting a partial return to the view that taxes should not be used for redistributive purposes.

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