



## THE “ABILITY TO PAY” AS A FUNDAMENTAL RIGHT: RETHINKING THE FOUNDATIONS OF TAX LAW

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**ABSTRACT.** *This article starts by arguing that the ability to pay, as a tax law principle, has a meaning of its own, separate from political or economic considerations of vertical and horizontal tax equity. It then presents three different conceptual meanings of this principle. Each meaning has tremendous importance depending on context: whether it is in the law-making process, the administrative application of tax law, or the moment of judicial interpretation. The essay also summarizes the positions which are skeptical of treating the ability to pay principle as a fundamental right.*

**KEY WORDS:** *Tax equity, fundamental right, tax principle.*

**RESUMEN.** *El presente artículo comienza con los argumentos relativos a demostrar que el principio de capacidad económica tiene un significado propio, diverso a consideraciones políticas o económicas sobre equidad horizontal o vertical. Posteriormente se presentan tres acepciones de este principio. Cada acepción tiene gran importancia dependiendo del contexto: ya sea que estemos en el proceso de creación de normas, en la aplicación administrativa de las disposiciones fiscales, o en el momento de interpretación judicial. El ensayo también presenta las posiciones que resultan escépticas de la idea de que el principio de capacidad económica sea tratado como un derecho fundamental.*

**PALABRAS CLAVE:** *Equidad tributaria, derecho fundamental, principio tributario.*

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## I. INTRODUCTION

The “ability to pay” principle is what we might call a “classic topic” in tax law. Discussions about the meaning of this principle have been constant since the ancient science of public finances to modern-day tax law. Far from ending this discussion, current economic and political circumstances have presented new challenges.

The idea of people contributing to government expenses according to their ability to pay has not always been inherent to the concept of taxation or tax fairness. Adam Smith started modern debate about tax fairness by

including “equity” as one of his main principles,<sup>1</sup> but what is “equity”? Musgrave demonstrated how the Smithian approach to equity moves in two directions: that taxes should correspond to the benefits while also reflecting the ability to pay.<sup>2</sup>

The first legal formulation of the ability to pay principle came with the Declaration of the Rights of Man approved by the National Assembly of France (August 26, 1789). Article 13 states that all citizens should contribute in proportion to their means.<sup>3</sup> But the most difficult task does not lie in declaring the principle, but in applying it.

In the first part of this article, I show the importance of separating the meaning of this principle from economic or philosophical considerations of horizontal and vertical tax equity. Such considerations are an obstacle to understanding or defining a clear meaning of the ability to pay principle as a legal principle. The second part of the article shows how this tax principle has three perfectly valid and applicable meanings nowadays. These meanings do not exclude each other, but reveal the importance of the principle at different moments of applying the law. Overall, this article highlights the importance of the ability to pay principle as a fundamental right.

## II. SEPARATING THE LEGAL MEANING OF THE ABILITY TO PAY PRINCIPLE FROM ISSUES RELATED TO VERTICAL AND HORIZONTAL TAX EQUITY

Traditional doctrine has wrongly seen the principle of “ability to pay” as “the only principle of tax fairness.”<sup>4</sup> Tax fairness is an abstract ideal and requires adequate principles as well as specific conditions of application to be implemented in a certain society.<sup>5</sup> Some authors give the ability to pay

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<sup>1</sup> Adam Smith, *Sobre la naturaleza y causas de la riqueza de las naciones*, Vol. I OIKOS-TAU 852 (1988).

<sup>2</sup> Richard Abel Musgrave, *Una breve historia de la doctrina fiscal*, 115 HACIENDA PÚBLICA ESPAÑOLA 299, 331 (1990).

<sup>3</sup> “Article 13. A common contribution is essential for the maintenance of the public force and for the cost of administration. This should be equitably distributed among all citizens, in proportion to their means.”

<sup>4</sup> Carlos Palao Taboada, *Apogeo y crisis del principio de capacidad contributiva*, in 2 ESTUDIOS JURÍDICOS EN HOMENAJE AL PROFESOR FEDERICO DE CASTRO 418 (Tecnos, 1976). General explanations about the ability to pay principle, among others, in JOSÉ MANUEL GALLEGRO PERAGÓN, *LOS PRINCIPIOS MATERIALES DE JUSTICIA TRIBUTARIA* (Comares, 2003); Miguel Ángel Martínez Lago, *Una interpretación constitucional de la funcionalidad de la capacidad económica como principio informador del ordenamiento*, 55 REVISTA ESPAÑOLA DE DERECHO FINANCIERO (1987); Francesco Moschetti, *EL PRINCIPIO DE CAPACIDAD CONTRIBUTIVA* (1980); Emilio Albi Ibáñez, *Clásicos del enfoque de la capacidad de pago*, 39 HACIENDA PÚBLICA ESPAÑOLA (1976).

<sup>5</sup> LUCIEN MEHL, *ELEMENTOS DE CIENCIA FISCAL* 316 (Bosch, 1964).

principle the function of “covering a lie”<sup>6</sup> that is hidden in other ideologies. Although the ability to pay principle cannot remain separate from ideologies, it should not be mistaken for them. To confuse the ability to pay principle with the current ideology poses the risk of denying its specific content.

We can divide the present debates about economic equity into vertical and horizontal dimensions. The first has to do with equity among the different economic levels of society; the second is about finding a fair distribution of public expenses among the different sources of wealth.

As to vertical equity, it is evident that when we refer to issues regarding distribution and redistribution of income, the conclusion reached will always depend on the concept of social justice in mind.<sup>7</sup> Should taxation be proportional for the rich and the poor? Should taxation be more than proportional (progressive) for the rich? Must taxation be less than proportional (regressive) for the rich? The answers to all these questions vary according to different ideologies.

- a) *Strict equality or capitation.* Capitation is positioned in the sphere of strict equality.<sup>8</sup> In recent times (from 1988 to 1993), the United Kingdom introduced the *Poll Tax* that set aside the ability to pay principle to go back to the benefit principle.<sup>9</sup> This “new tax” was a *per capita* contribution that all citizens over the age of 18 had to pay.<sup>10</sup> The Thatcher administration<sup>11</sup> wanted to “correct” the disparities among “those who vote, those who pay and those who receive the local benefits.”<sup>12</sup>

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<sup>6</sup> Concept used by Alexander Rustow, quoted in FRITZ NEUMARK, *PRINCIPIOS DE LA IMPOSICIÓN* 24 (2nd ed., 1994).

<sup>7</sup> Santiago Álvarez García & María Luisa Fernández de Soto Blas, *Principios de equidad y justicia distributiva en la imposición*, in *LA ÉTICA EN EL DISEÑO Y LA APLICACIÓN DE LOS SISTEMAS TRIBUTARIOS* 29 (Santiago Álvarez García & Pedro Manuel Herrera Molina coords., Instituto de Estudios Fiscales, 2004).

<sup>8</sup> The same equity that, as Anatole France said, prohibits rich and poor from sleeping under the bridges. “The law, in its majestic equality, forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread”. ANATOLE FRANCE, *THE RED LILY* (1894), chapter 7.

<sup>9</sup> It began with “...the existing local government finance system (making) it almost impossible for local electors to relate what they pay to the services provided.” In Green Paper, Department of Environment, 1986, quoted in ARTHUR MIDWINTER & CLAIRE MONAGHAN, *FROM RATES TO THE POLL TAX* 64 (Edinburgh University Press, 1993).

<sup>10</sup> *Id.*

<sup>11</sup> Following Friedrich August von Hayek, as quoted by Fritz Neumark in FRITZ NEUMARK, *PRINCIPIOS DE LA IMPOSICIÓN* 138 (2nd ed., Instituto de Estudios Fiscales, 1994). See also Friedman and Niskanen in MILTON FRIEDMAN, *CAPITALISMO Y LIBERTAD* (RIALP, 1966).

<sup>12</sup> The consequences for the Thatcher administration are well known. See more in: OLIVER MORRISEY ET AL., *POLL TAX PARADOXES AND THE ANALYSIS OF TAX REFORM* (University of Nottingham, 1990); TIMOTHY BESLEY ET AL., *FISCAL ANARCHY IN THE*

- b) *Proportionality*. This is a fairness criterion that takes into account the fact that each person must pay an equal percentage according to his ability to pay. According to the supporters of this idea, equality is synonymous with proportionality.<sup>13</sup> This criterion also starts from the idea that a tax system should be neutral. In other words, different economic levels should remain in the same circumstances after taxation and taxes should not be used as a tool for “redistribution.”<sup>14</sup>
- c) *Progressivity*. According to defenders of progressive taxation, the ability to pay is a principle of tax fairness needed to achieve “redistribution.”<sup>15</sup> Critics of this concept come mainly from the liberal school that considers progressivity a punishment to the competitive and a reward to the economically incapable.<sup>16</sup>

Several theories of “optimal taxation” combine the criteria of progressivity and proportionality.<sup>17</sup> Regardless of one’s particular opinion on these issues, choosing from the above possibilities does not have a direct effect on the ability to pay principle.<sup>18</sup> Respect for the ability to pay does not depend on the fact that a certain State accepts either progressivity or proportionality,<sup>19</sup> or even a “flat tax.”<sup>20</sup>

On the other hand, so-called horizontal equity seeks to find “generality” in taxation, not *stricto sensu* (for every single tax), but *lato sensu* (in the tax system as a whole). Therefore, it should not be confused with the ability to pay principle.<sup>21</sup> The principle of generality in taxation means the prohibition of any tax privilege.<sup>22</sup>

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UK (Instituto de Estudios Fiscales, 1993); Stephen James Bailey, *The Poll Tax in Scotland: The First Year*, 16 LOCAL GOVERNMENT STUDIES 57-80 (1990).

<sup>13</sup> HENRIK WILHEM KRUSE, DERECHO TRIBUTARIO. PARTE GENERAL 103 (Editorial de Derecho Financiero, 1978) (1973).

<sup>14</sup> See Musgrave, *supra* note 2, at 32; See also Emilio Albi Ibáñez, *Clásicos del enfoque de la capacidad de pago*, 39 HACIENDA PÚBLICA ESPAÑOLA 170 (1976).

<sup>15</sup> Neumark, *supra* note 6.

<sup>16</sup> *Id.* at 138. For Milton Friedman, progressive taxes are against individuals. MILTON FRIEDMAN, CAPITALISMO Y LIBERTAD 221 (RIALP, 1966).

<sup>17</sup> See John G. Head, *Tax Fairness Principles: A Conceptual, Historical and Practical Review*, 9 AUSTRALIAN TAX FORUM (1992).

<sup>18</sup> See JACINTO FAYA VIESCA, FINANZAS PÚBLICAS 86 (Porrúa, 1998).

<sup>19</sup> See the opinion of Klaus Tipke, quoted in Carlos Palao Taboada, *Nueva visita al principio de capacidad contributiva*, 124 REVISTA ESPAÑOLA DE DERECHO FINANCIERO 772 (2004); See also Reinhold Beiser, *Das Leistungsfähigkeitsprinzip – Irrweg oder Richtschnur?*, ÖSTZ (Österreichische Steuerzeitung), No. 16 (2000).

<sup>20</sup> See Arie Rijkers, *Ability to Pay Principle and Privileges*, 5 STUW (2005).

<sup>21</sup> See JOSÉ JUAN FERREIRO LAPATZA, CURSO DE DERECHO FINANCIERO 327 (16th ed., Marcial Pons, 1994).

<sup>22</sup> “Pertenece a la esencia del impuesto el que su emisión se produzca según la regla general. En otro caso no sería más un impuesto, sino una extorsión.” [“Part of the essence

The main questions that arise regarding horizontal fairness are: Does equal ability to pay among taxpayers mean an identical taxation? Or is it fair for two people with the same “wealth” to pay different amounts of taxes due to the origin of the resources (personal work, commercial activity, capital gains, etc.)? It is useless to defend the preeminence of a source of wealth: income, patrimony, consumption.<sup>23</sup> These three manifestations of ability to pay are (could or should be) considered in a tax system in order to achieve horizontal justice.

We need to maintain a healthy conceptual distance between the legal concept of the ability to pay principle and the aspects of horizontal and vertical equity. Those elements pursue an ideal state of equity while the ability to pay principle, as a legal instrument, only helps substantiate the principle of equality in tax law. The ability to pay principle is part of what is called “tax fairness,” but it is not tax fairness in itself.

### III. THREE CONTEMPORARY INTERPRETATIONS OF THE ABILITY TO PAY PRINCIPLE

Tax doctrine has developed several ideas on the meaning of the ability to pay principle.<sup>24</sup> Some scholars have even sustained the supposed *emptiness*<sup>25</sup>

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of tax is that its emission is produced according to the general rule. Otherwise, it is no more a tax, but extortion.”] Kruse, *supra* note 13, at 103.

<sup>23</sup> See VITTORIO LUIGI BERLIRI, *EL IMPUESTO JUSTO* 222 (Instituto de Estudios Fiscales, 1986).

<sup>24</sup> José Luis Pérez de Ayala, *Las cargas públicas: principios para su distribución*, 59 HACIENDA PÚBLICA ESPAÑOLA (1979) makes a classification that I synthesize as follows:

1) Positivists who deny any relevance of the principle as a criterion of equity, for whom there is no other source of justice than the law.

2) Those in search of ethical criteria and tax justice that are a cut above the law, but who do not see the ability to pay principle as a real solution.

a) Those who see a glimmer of the already defeated utilitarian philosophy in the ability to pay principle and, therefore, it should also be eliminated.

b) Those who see a guiding criterion or focus built inductively on this principle to resolve problems of tax equity.

3) Those who see this principle as an imprecise, undetermined concept and try to substitute it with more specific ideas.

4) Those who think that the ability to pay principle derives from the concept of justice that has prevailed in Europe.

5) Lastly, his personal idea of the ability to pay principle. For him, it is not an autonomous principle of tax justice, but a common or necessary ground upon which the principles of tax fairness, to use the correct term, stand: progressiveness, equality and non-confiscatoriness.

I do not adhere to any of these ideas and I think there are other ideas on this.

<sup>25</sup> See Wolfgang Gassner & Michael Lang, who conclude that this principle lacks importance from a tax law science point of view. Wolfgang Gassner & Michael Lang, *Das*

or “non-juridical”<sup>26</sup> nature of this concept. I do not share these ideas, nor do I agree with those that remove the ethical elements of this principle.<sup>27</sup> I believe the ability to pay principle has three perfectly valid meanings that do not necessarily exclude each other, but have to do with the specific way the principle is applied.<sup>28</sup>

### 1. *The Ability to Pay as a Premise, a Limit and a Parameter of Taxation*

The ability to pay principle is a precept that justifies and legitimates all taxes,<sup>29</sup> which is why I consider it a premise of taxation. The ability to pay principle also serves as a limit in the law-making process of any tax because legislators cannot ignore this principle by taxing acts or businesses without any economic content. Since all taxes must be based on a clear manifestation of wealth,<sup>30</sup> we can also say that this fact applies to the tax system as a

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*Leistungsfähigkeitsprinzip in Einkommen- und Körperschaftssteuerrecht*, 14 ÖJT Band III/1, Manz-scher Verlag, 121 (2000), as well as sufficient grounds in certain States; *Die mangelnde Leistungsfähigkeit des Leistungsfähigkeitsprinzips*, ÖSTZ (*Österreichischer Juristentag*), No. 22 (2000).

<sup>26</sup> See Emilio Giardina & Antonio Berliri who thought this principle as “parajurídico” [parajudicial] quoted by Palao Taboada, *supra* note 4, at 383. Fernando Sainz de Bujanda argued against this idea: “La ciencia económica suministrará criterios aptos para gravar las rentas, atendiendo su origen o su altura, con arreglo, por ejemplo, a un criterio de igualdad; pero ese criterio, en sí mismo considerado, no es un criterio económico sino jurídico. Es el principio de justicia adoptado el que mueve los resortes técnicos del reparto.” [“Economic science will supply criteria that are fitting for taxing income, considering its origin or its aggregate, adhering, for example, to a criterion of equality; but that criterion in itself is not an economic criterion, but a legal one. The principle of fairness adopted is the one that moves the technical strings of distribution.”] FERNANDO SAINZ DE BUJANDA, *HACIENDA Y DERECHO* III 183 (1963).

<sup>27</sup> This interpretation of the ability to pay principle implies making jokes, such as “a taxpayer has taxable capacity when he can sell his wife and his children as slaves to pay taxes.” Barry Bracewell-Millnes, *Economic Taxable Capacity*, Vol. 29 No. 4 *INTERTAX* 114 (2001). Also: “Nothing of value —not life itself— could go on without taxation” or, even more radically “If it moves, tax it!” GEORGE KATEB, *THE INNER OCEAN: INDIVIDUALISM AND DEMOCRATIC CULTURE* (1992), quoted by Hans Gribnau, *General Introduction, in THE PRINCIPLE OF EQUALITY IN EUROPEAN TAXATION* 1 (Gerard T. K. Meussen ed., 1999).

<sup>28</sup> With this explanation of the ability to pay principle as having “different meanings,” I do not imply that the principle is vague or undetermined. On the contrary, I am well aware of its different scopes of application.

<sup>29</sup> For Tulio Rosembuj, it is “the only precept...” TULLIO ROSEMBUJ, *ELEMENTOS DE DERECHO TRIBUTARIO* 28 (PPU, 1988), and the “north star” of tax legislators. MATÍAS CORTÉS DOMÍNGUEZ, *ORDENAMIENTO TRIBUTARIO ESPAÑOL* 28 (Tecnos, 1968).

<sup>30</sup> See José Luis Pérez de Ayala, *Las cargas públicas: principios para su distribución*, 59 *HACIENDA PÚBLICA ESPAÑOLA* 90 (1979); and Miguel Ángel Martínez Lago, *Una interpretación constitucional de la funcionalidad de la capacidad económica como principio informador del ordenamiento financiero*, 55 *REVISTA ESPAÑOLA DE DERECHO FINANCIERO* 396 (1987).

whole.<sup>31</sup> In other words, legislators must abstain from taxing acts that do not constitute a manifestation of wealth.<sup>32</sup> Even if those acts have economic content,<sup>33</sup> legislators must openly observe reality and become familiar with economic realities to determine whether the act to be taxed is a true indicator of the ability to pay.

Once legislators are certain that the act intended to be taxed is a clear manifestation of wealth, they must devise the taxes in such a way as to avoid the possibility of exceeding the tax threshold and adapt the taxes to each taxpayer's personal and professional circumstances.

## 2. *The Ability to Pay as an Interpretation Criterion in the Application of Taxes*

The legally defined indicator of the ability to pay is the compelling force behind the application of any tax.<sup>34</sup> This assertion brings us to a new aspect

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<sup>31</sup> FRANCESCO MOSCHETTI, *EL PRINCIPIO DE CAPACIDAD CONTRIBUTIVA* 395 (Instituto de Estudios Fiscales, 1980).

<sup>32</sup> See Álvaro Rodríguez Bereijo, *Los principios de la imposición en la jurisprudencia constitucional española*, 100 R.E.D.F. 613 (1998). See also CÉSAR ALBIÑANA GARCÍA-QUINTANA, *DERECHO FINANCIERO Y TRIBUTARIO* 315 (1979). The Spanish Constitutional Court decision can be interpreted along the same lines: “[C]apacidad económica a efectos de contribuir a los gastos públicos, tanto significa como la incorporación de una exigencia lógica que obliga a buscar riqueza allí donde la riqueza se encuentre” ([F]inancial capacity for the purpose of contributing to public spending is as important as developing a logical demand that requires searching for wealth there, where there is wealth).

<sup>33</sup> Gulliver's Travels comically shows several forms of taxation lacking of economic contents in a discussion among professors from the *Grand Academy of Lagado*: “I heard a very warm debate between two professors, about the most commodious and effectual ways and means of raising money, without grieving the subject. The first affirmed, ‘the justest method would be, to lay a certain tax upon vices and folly; and the sum fixed upon every man to be rated, after the fairest manner, by a jury of his neighbours.’ The second was of an opinion directly contrary; ‘to tax those qualities of body and mind, for which men chiefly value themselves; the rate to be more or less, according to the degrees of excelling; the decision whereof should be left entirely to their own breast.’ The highest tax was upon men who are the greatest favourites of the other sex, and the assessments, according to the number and nature of the favours they have received; for which, they are allowed to be their own vouchers. Wit, valour, and politeness, were likewise proposed to be largely taxed, and collected in the same manner, by every person's giving his own word for the quantum of what he possessed. But as to honour, justice, wisdom, and learning, they should not be taxed at all; because they are qualifications of so singular a kind, that no man will either allow them in his neighbour or value them in himself... The women were proposed to be taxed according to their beauty and skill in dressing, wherein they had the same privilege with the men, to be determined by their own judgment. But constancy, chastity, good sense, and good nature, were not rated, because they would not bear the charge of collecting.” See also KLAUS TIPKE, *MORAL TRIBUTARIA DEL ESTADO Y DE LOS CONTRIBUYENTES* 24 (Pedro M. Herrera trans., 2002).

<sup>34</sup> TULLIO ROSEMBUJ, *DERECHO FISCAL INTERNACIONAL* 22 (El Fisco, 2001).



of the ability to pay principle, which involves activities pertaining to tax administration and the administration of justice.

Part of the attributes and responsibilities of tax administration is interpreting legislation and classifying acts to determine what should be taxed. When interpreting the law, the tax administration must consider the ability to pay principle, and in doing so, assess whether the law abides by the principle. If this is not the case, the tax administration can and should correct legislative mistakes. However, in interpreting the law, the tax administration may not overstep its authority.

If we hold that the legislative branch must ensure that, among other things, the tax threshold is complied with, there is no need to release the tax administration from that obligation, especially when it prevents certain interpretations of the law from imposing confiscatory effects on taxpayers. Therefore, the tax administration can use the ability to pay principle as a means to evaluate the law.

### 3. *The Ability to Pay as a Fundamental Right of Citizens*

The ability to pay principle can also be seen as a fundamental right of citizens: the right to contribute according to one’s means. Fundamental rights act as a way to reach substantial equality (an essential aspect of a fair tax system).<sup>35</sup> Underlying the obligation of contributing to public spending, there are unalienable rights: legality, generality, etc., as well as considerations on the ability to pay. I understand fundamental rights as ethical realities that need positive law to fulfill their purpose, or a legal reality that requires ethics of dignity, equality and freedom to be fully satisfied.<sup>36</sup>

Human rights scholars have not taken seriously the study of the fundamental right of contributing according to one’s ability to pay.<sup>37</sup> It is easy to

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<sup>35</sup> Andrea Amatucci states that the first paragraph of Article 31 of the Spanish Constitution gives a modern and complete vision of the financial phenomenon within the scope of fundamental freedoms. Andrea Amatucci, *La intervención de la norma financiera en la economía: perfiles constitucionales*, in SEIS ESTUDIOS SOBRE DERECHO CONSTITUCIONAL E INTERNACIONAL TRIBUTARIO 23 (Editorial de Derecho Financiero, 1980).

<sup>36</sup> I follow an eclectic position that takes into consideration both ethical aspects (from natural law) and legal aspects (from positivism) that have a bearing on fundamental rights. See, e.g., GREGORIO PECES-BARBA MARTÍNEZ ET AL., CURSO DE DERECHOS FUNDAMENTALES. TEORÍA GENERAL (Universidad Carlos III de Madrid-Boletín Oficial del Estado, 1999).

<sup>37</sup> See *Id.* Nonetheless, this author considers taxation according the ability to pay to derive from the principle of equality, *id.* at 286; See generally ANTONIO ENRIQUE PÉREZ LUÑO, LOS DERECHOS FUNDAMENTALES (Tecnos, 1984); DIEGO LÓPEZ GARRIDO, LIBERTADES ECONÓMICAS Y DERECHOS FUNDAMENTALES EN EL SISTEMA COMUNITARIO EUROPEO (Tecnos, 1986); PATRICK WACHSMANN, LE DROITS DE L’HOMME (Daloz, 2002); REMEDIO SÁNCHEZ FERRIZ, ESTUDIO SOBRE LAS LIBERTADES (Tirant lo Blanch, 1989);

see that this right has all the elements of a “traditional” fundamental right: a legal framework, generalization and internationalization.<sup>38</sup> Any shortcomings found in these elements do not necessarily imply that the right does not exist.<sup>39</sup> The right to contribute according to one’s ability to pay constitutes a real limit to public power.<sup>40</sup> It is important to note that this right is not “new,” “exotic” or a fourth or fifth generation fundamental right, even if it has not historically been included in the “list” of fundamental rights.

#### IV. THE ABILITY TO PAY AS A FUNDAMENTAL RIGHT

##### 1. *The Legal Basis of the Right to Contribute According to One’s Ability to Pay*

###### A. *Equality*

This right is primarily based on the general principle of equality. The right to equal application of the law translates into as the right to contribute according to one’s ability to pay in tax law. Since the ability to pay is the measure of equality in tax law,<sup>41</sup> the right to contribute should therefore be based on that measure of equality. The ability to pay is undoubtedly a significant differentiating feature of taxation, and no argument can be put forward to claim that taxation based on the ability to pay contravenes formal equality.<sup>42</sup>

The equality principle is a good example of what have been called “historically open principles” that have been perfected at the same rate as societies have evolved.<sup>43</sup> Equality before the law is clearly not the same today as it was yesterday, nor as it will be tomorrow.<sup>44</sup>

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LUIS PRIETO SANCHÍS, ESTUDIO SOBRE DERECHOS FUNDAMENTALES (Debate, 1990); LUIS LÓPEZ GUERRA ET AL., DERECHO CONSTITUCIONAL (Tirant lo Blanch, 1992).

<sup>38</sup> RAFAEL DE ASÍS ROIG, LAS PARADOJAS DE LOS DERECHOS FUNDAMENTALES COMO LÍMITES AL PODER (Dikinson, 2000).

<sup>39</sup> Regarding the international application of the ability to pay principle, see Hick Schamburg, *Steuerrechtliche Leistungsfähigkeit und europäische Grundfreiheiten im internationalen Steuerrecht*, STUW, No. 4 (2005) and Reinhold Beiser, *Das Leistungsfähigkeitsprinzip im Licht des Gemeinschaftsrechtes*, STUW, No. 4 (2005).

<sup>40</sup> See PERFECTO YEBRA MARTUL-ORTEGA, EL PODER FINANCIERO 160 (EDERSA, 1977).

<sup>41</sup> PEDRO MANUEL HERRERA MOLINA, CAPACIDAD ECONÓMICA Y SISTEMA FISCAL 84 (Marcial Pons, 1998).

<sup>42</sup> See EMILIO GIARDINA, LE BASI TEORICHE DEL PRINCIPIO DELLA CAPACITÀ CONTRIBUTIVA (Giuffrè, 1961), IGNAZIO MANZONI, IL PRINCIPIO DELLA CAPACITÀ CONTRIBUTIVA NELL’ORDINAMENTO COSTITUZIONALE (Giappichelli, 1965), quoted by JOSÉ MANUEL GALLEGO PERAGÓN, LOS PRINCIPIOS MATERIALES DE JUSTICIA TRIBUTARIA (Comares, 2003).

<sup>43</sup> Francisco Laporta, *El principio de igualdad: introducción a su análisis*, 67 SISTEMA (1985).

<sup>44</sup> An example of this situation is equality in political rights. In the 18th century, Kant

### B. *Solidarity*

Solidarity is a relationship among people united toward a common goal.<sup>45</sup> Unlike other values, solidarity is indirectly based on rights, that is, it is achieved by means of obligations.<sup>46</sup> In terms of the right to contribute according to one’s ability to pay, the obligation is clear.

Originally, proposing solidarity as the basis for the ability to pay principle was a way to justify progressive taxation. However, if solidarity is understood as people’s responsibility to collaborate for the further development of legal entities, there is nothing that says it must necessarily be higher than a proportional rate for those with more resources.

As fundamental rights scholars have pointed out, the proper use of the value of “solidarity” leads to positive behaviors on behalf of public institutions in terms of removing obstacles against freedom and equality.<sup>47</sup>

### C. *A Decent Standard of Living*

Another foundation for the right to contribute according the ability to pay is comprised of certain rights classified as “economic rights:” the right to own property, the right to work, and in general, the right to a decent standard of living.

While it is true that certain rights that form part of these grounds may not be completely regulated, it is also true that legislators cannot create a tax system that directly contradicts these principles or values. For example, one fundamental right is the right to health. Taxing expenses made to satisfy this basic need would go against the ability to pay principle. A person who spends money to restore his health does not show an ability to pay taxes and should therefore not be obligated to be taxed for those services.

#### 2. *The Central Points of the Right to Contribute According to the Ability to Pay*

The central points of the right to contribute according to the ability to pay can be divided into three basic stages: determining the objective ability to pay (objective net principle), ascertaining the subjective ability to pay (subjective net principle), and establishing the intensity of taxation (prohibition of confiscatory taxes).<sup>48</sup>

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considered that the “equals” able to vote were only proprietors. IMMANUEL KANT, *TEORÍA Y PRAXIS* 34-35 (Tecnos, 1986).

<sup>45</sup> See A. CORTINA, quoted in Peces-Barba Martínez *et al.*, *supra* note 36, at 277.

<sup>46</sup> Peces-Barba Martínez *et al.*, *supra* note 36, at 280.

<sup>47</sup> *Id.* at 282.

<sup>48</sup> Herrera Molina, *supra* note 41, at 116.

### A. *Objective Ability to Pay*

Objective ability to pay means that taxation must be based on net and real gains.<sup>49</sup> Net yield is the total income minus the basic expenses needed to earn that income. Every activity requires a certain investment and expenses. These expenses do not show any ability to contribute to public expenditure, but only reflect the ability to generate income by operating a business or carrying out an activity.

The techniques each State uses to enforce this principle may vary. In terms of the quantitative aspect, the ability to pay requires taxing real gains and not only the expected or nominal assets.<sup>50</sup> At the same time, fictions of law<sup>51</sup>—which are very useful when it is impossible to know the real ability—should be established on practical criteria to avoid claims of wealth that are clearly not based on reality.

### B. *Subjective Ability to Pay*

Subjective ability to pay comes into play only after the taxpayer's basic personal needs have been met. Abiding by a tax threshold involves two facets: the tax aspect and participation in public expenditure. A tax threshold in tax law refers to a set of measures set forth in the tax code that prevent taxing people in a way that would affect their having a decent standard of living. It would be incongruous for taxation not to respect citizens' minimum needs for survival, and for governments to attempt to compensate the lack through State aid. It also would be "illogical to demand a sacrifice for the sake of the common good when people do not have the minimum needed for their own survival."<sup>52</sup>

Subjective ability to pay tends to rank on par with the minimum subsistence level,<sup>53</sup> but it goes beyond that and extends to different elements that constitute a decent standard of living. A decent standard of living satisfies the most basic needs, but it also includes all those elements that allow a per-

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<sup>49</sup> *Id.* at 118.

<sup>50</sup> *Id.* at 117.

<sup>51</sup> A classical work on this topic is JOSÉ LUIS PÉREZ DE AYALA, *LAS FICCIONES EN EL DERECHO TRIBUTARIO* (Editorial de Derecho Financiero, 1970). *See also* Victor Thuronyi, *Presumptive Taxation*, in *TAX LAW DESIGN AND DRAFTING* (Kluwer Law International, 2000).

<sup>52</sup> Herrera Molina, *supra* note 41, at 121.

<sup>53</sup> Some authors have seen the ability to pay principle as "susceptible of working" in "extremes." *See generally* María Pilar Alguacil Marí, *La capacidad económica como parámetro de enjuiciamiento*, Vol. XLIX, No. 253 *REVISTA DE DERECHO FINANCIERO Y DE HACIENDA PÚBLICA* 656 (1999).

son to fully develop himself and his potential, such as freedom, a decent place to live, a good environment, a decent job with wages that cover the taxpayer’s typical needs and those of his dependents (food, dress, transportation, education, rent, culture, sports, entertainment, etc.).

This idea of a decent standard of living falls under the economic principle of “needs are unlimited and resources are scarce.” But it is also true that resources vary at a certain time or place. Thus, some expenses might be considered a luxury in one place, but necessary in another.<sup>54</sup> Therefore, constant observation of the social reality is required.

We can conclude that expenses that originate from a compensatory situation and those that allow the taxpayer a decent standard of living should be set aside from tax payments. Some States have regulated “a tax threshold” as a guideline to follow this principle.<sup>55</sup> A State can adopt various types of measures and can even combine them. Here are some examples:<sup>56</sup>

- 1) Based on economic studies, an amount can be established for the concept of minimum personal or family subsistence.
- 2) The minimum subsistence can be the same as the official minimal wage or to the amount of State aid allocated to the needy.
- 3) Legislators can establish minimum and maximum limits on deducting certain expenses that are considered necessary, and even require certain conditions to ensure that said expenses are not superfluous.
- 4) Exceptions and reductions to the tax base can be established for basic items. Regardless of its name, its importance lies in examining which concepts are left out of taxable concepts for being considered necessary. As to indirect taxes, the ideal procedure would be to exempt certain goods or services that are considered necessary (allowing credit for the taxes paid).

Each type of tax requires an in-depth analysis on how to observe the minimum subsistence level and the most suitable way of reaching it. For example, exceptions are not the best way to acknowledge a minimum subsistence level in taxes like V.A.T.

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<sup>54</sup> As Ángeles García Frías states, these terms have been used by German authorities. Ángeles García Frías, *Balance de la jurisprudencia del Tribunal Constitucional alemán sobre el impuesto sobre la renta*, 122 REVISTA ESPAÑOLA DE DERECHO FINANCIERO (2004).

<sup>55</sup> See an in-depth analysis of the family and personal minimums in Javier Martín Fernández, *Regulación en España*, and Pedro Herrera Molina, *Derecho comparado: especial análisis del caso alemán*, quoted in *EL MÍNIMO PERSONAL Y FAMILIAR EN EL IMPUESTO SOBRE LA RENTA DE LAS PERSONAS FÍSICAS* (Pedro Herrera Molina ed., IEF-Marcial Pons, 2000).

<sup>56</sup> Herrera Molina explains some techniques that can take the personal and family minimum into account with regard to income taxes. *Fundamento y configuración del mínimo personal y familiar*, in Herrera Molina, *supra* note 55, at 10.

### C. *The Intensity of Taxation*

The last factor to be considered in the ability to pay principle is that the tax rate should not be confiscatory. The general principle of non-confiscation can refer to the entire tax system, including expenditures made by the public sector.<sup>57</sup> Public spending should be assigned to guaranteeing the basic needs of the poor and improving the living conditions and competitiveness of the rest of the population, but not for compensating any instability caused by the tax system itself.<sup>58</sup> A tax becomes confiscatory when it takes the resources the taxpayer needs to maintain his same level of productive economic capacity. A tax can also become confiscatory when it leads to situations in which the economic yield after taxes does not compensate the cost, the risk or the effort involved.<sup>59</sup>

The prohibition of confiscatory taxes clearly limits the progressive nature of a tax system, but this principle does not only affect progressive taxes. A tax system that seeks proportionality can also be confiscatory when legislators create a vast number of taxes and their total exceeds the amount taxpayers need to carry out their productive activities. Furthermore, a proportional tax by itself can be confiscatory when it completely inhibits certain activities or the production of certain goods.

There are five different circumstances in which confiscatory taxes might occur:

- 1) When the payment of a single tax in due time and form is excessive or steep;
- 2) When the payment of all the taxes in due time and form does not compensate the cost, the risk and the effort involved in the economic activity;<sup>60</sup>
- 3) When payment is not made in due time, there are two distinctions:
  - a) If the non-compliance does not violate a law and it only violates an administrative procedure, taxes would be confiscatory if the total amount of interests, fines and other fees are ruinous;

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<sup>57</sup> Scholars have stated that the principle of non-confiscatory taxation includes three elements: 1) observing the level of the minimum exempt, 2) fulfilling the principle of justice in expenditures and 3) limiting tax rates; *See* MARÍA DEL CARMEN BOLLO ARCENA, LA PROHIBICIÓN DE CONFISCATORIEDAD COMO LÍMITE CONSTITUCIONAL A LA TRIBUTACIÓN 174 (1989).

<sup>58</sup> On the different concepts of the principle of non-confiscatory taxation, see FRANCISCO GARCÍA DORADO, PROHIBICIÓN CONSTITUCIONAL DE CONFISCATORIEDAD Y DEBER DE TRIBUTACIÓN 93 (Dickinson, 2002).

<sup>59</sup> See the opinion of José Luis Pérez Ayala in Bollo Arcena, *supra* note 57, at 394.

<sup>60</sup> See Herrera Molina, *supra* note 41, at 133.

- b) If the non-compliance arises from breaking a law, the confiscatory effects might be justified since a considerable part of such a taxpayer’s wealth was obtained by criminal means;
- 4) When inefficient tax administration allows high levels of tax evasion and only a few taxpayers (the honest ones or those who cannot avoid paying taxes) support the entire tax burden, and;
- 5) When inefficient public administration does not allow taxpayers partake in the benefits that legitimately correspond to them.<sup>61</sup>

The German Constitutional Court has stated that the right to own property and the ability to pay principle prevent the total tax burden from exceeding a limit of close to 50% of a taxpayer’s income since property serves both public and private interests.<sup>62</sup> The Argentinean Court has also set a limit of 33% as the highest possible tax rate.<sup>63</sup> These limits, however, are quite arbitrary and oversimplify the connection between ability to pay and the right to own property. I think it is more important to ensure a coherent tax system than to establish limits in terms of percentages (a 60% tax might be fine if the population so desires and if government-provided services were good while a 20% tax might be excessive if the government were extremely inefficient).<sup>64</sup>

### 3. *A Critical Perspective on the Idea of the Ability to Pay Principle as a Fundamental Right*

Carlos Palao Taboada has presented several different ideas on the ability to pay principle, as well as his own, with remarkable clarity.<sup>65</sup> Although my idea of the ability to pay principle as a fundamental right might seem contrary to his, we hold several points in common.

We coincide in that the ability to pay principle influences tax fairness less than what many scholars have suggested. By itself, the principle does not aim at “ideal justice.”<sup>66</sup> I also agree with his criticism of those who see this principle as the only criteria of tax fairness. The ability to pay principle alone is not enough to achieve tax justice.

<sup>61</sup> It seems as if the solution to this kind of problem is more political than it is legal.

<sup>62</sup> BverfGE 93, 121, 138, cited by Herrera Molina, *supra* note 41, at 67.

<sup>63</sup> Gustavo Naviera, *La prohibición de confiscatoriedad por la vía tributaria en el derecho judicial argentino*, IV DIRITTO E PRATICA TRIBUTARIA INTERNAZIONALE (2002).

<sup>64</sup> I am not proposing any of these percentages, but I am simply showing how accurate taxation is related to the ideal of state that both citizens and governments want.

<sup>65</sup> Carlos Palao Taboada, *Apogeo y crisis del principio de capacidad contributiva*, in ESTUDIOS JURÍDICOS EN HOMENAJE AL PROFESOR FEDERICO DE CASTRO, Vol. II (Tecnos, 1976). See also Palao Taboada, *supra* note 19.

<sup>66</sup> Palao Taboada, *supra* note 65, at 418 and Palao Taboada, *supra* note 19, at 769.

Along this line, I have explained and demonstrated that the aspects related to horizontal and vertical equity (which pertain to politics or economic sciences) should not be mixed with the strictly legal content of the principle.<sup>67</sup> A logical formulation of the ability to pay principle at the core of the tax law might give a certain coherence to tax systems and even bring in ethical criteria in tax law that cannot logically be drawn from other tax principles.

Palao Taboada strongly criticizes the fact that what he calls “positive theories” always fail because it is impossible to formulate a principle like this in purely logical terms. Therefore, these theories usually include elements that are foreign to positive law and more related to the concept of arbitrariness.<sup>68</sup> I have taken care not to include elements that belong to non-legal areas in my proposal. For this reason, I have carefully demonstrated that the elements of the ability to pay principle have a logical basis that does not involve elements outside positive law.

Coming to know an individual’s ability to pay taxes requires identifying genuine manifestations of the ability to pay. I am not straying from basic logic by omitting the part of the taxpayer’s assets that guarantee his economic and personal growth. Nor do I include non-legal aspects in stating that the tax rates are applied without having ruinous effects. The three “sub-principles” of the ability to pay principle (objective ability to pay, subjective ability to pay and intensity of rates) do not defy basic logic by using a term that is initially abstract.

Finally, as Palao Taboada has said, the ability to pay principle has been used to justify diverse tax initiatives.<sup>69</sup> Nonetheless, the fact that the use of this principle has been “abused” (using it only as rhetorical justification) from time to time does not mean it should be paid no attention. Unfortunately, many important values of society (like democracy, social justice, freedom, etc.) are also used to justify illegitimate and illegal political projects (even wars), and that does not mean they should not be defended.

## V. CONCLUSIONS

- 1) This article proposes a healthy conceptual distance between the ability to pay principle and the ideas of horizontal and vertical tax fairness as explained here. The ability to pay principle is part of what is called “tax fairness,” but it is not tax fairness in itself.

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<sup>67</sup> I think mixing general ideas of equity with a strictly legal concept of the ability to pay (or substantiation of the principle of equality) results in discussions such as the one Joachim Lang and Wolfgang Gassner had in JOACHIM LANG & WOLFGANG GASSNER, *THE NOTION OF INCOME FROM CAPITAL* (IBFD, 2005).

<sup>68</sup> Palao Taboada, *supra* note 19, at 799.

<sup>69</sup> *Id.* at 769.



- 2) The ability to pay principle has three perfectly valid meanings that do not exclude each other. They center on the specific moment of applying the principle: the ability to pay principle as a premise, a limit and a parameter of taxation; an interpretation criterion in the application of taxes; and as a fundamental right.
- 3) The legal basis of the right to contribute according to one's ability to pay is found in the principles of equality, solidarity and dignity of life in general. These last two also point toward the central elements of the principle. In tax law, the general principle of equality means contributing according to one's ability to pay, which is in turn a measure of equality.

The central points of the fundamental right to contribute according to one's ability to pay consist of three logical elements: determining the objective ability to pay (objective net principle), the subjective ability to pay (subjective net principle), and the intensity of taxation (prohibition of confiscatory taxes).