Corporation Tax Or Income Tax: Which Is The Greatest Con?

transcript of a talk by
Professor Michael Mainelli, Executive Chairman, Z/Yen Group
at
Gresham College, Barnard's Inn Hall, Holborn, London EC1N 2HH
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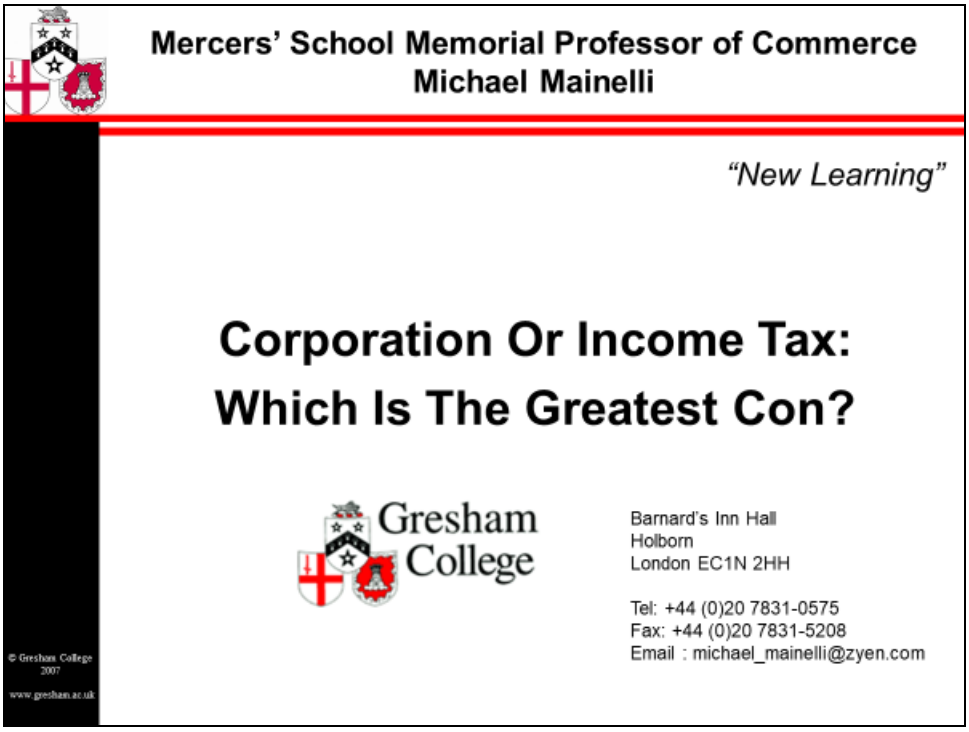
recording available at
https://www.gresham.ac.uk/lectures-and-events/corporation-tax-or-income-tax-which-is-the-greatest-con

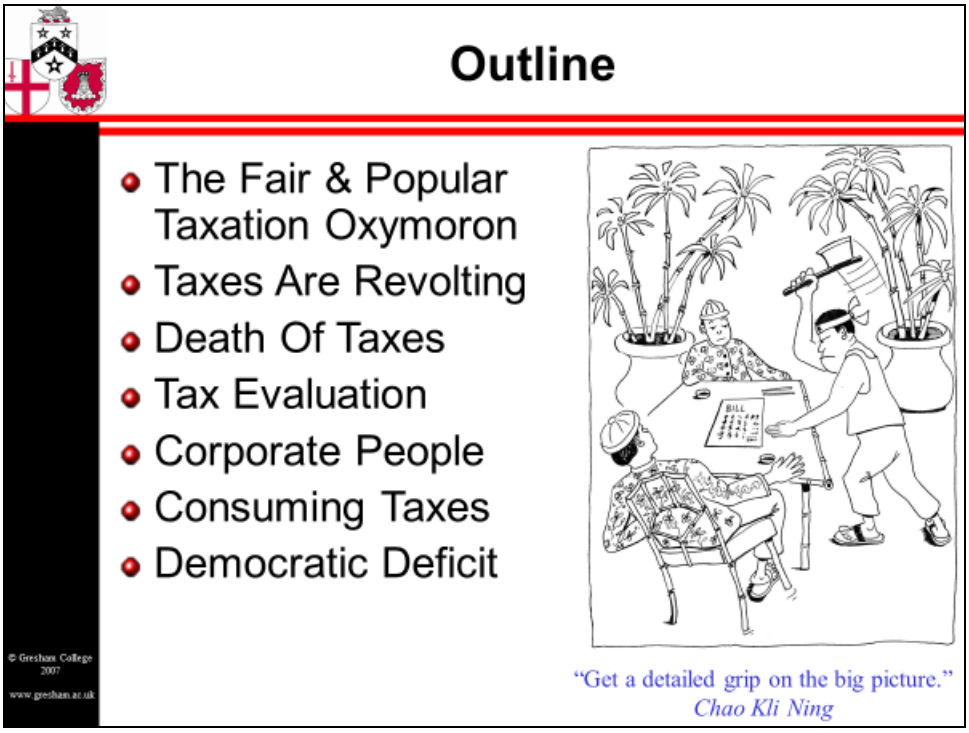


Good evening Ladies and Gentlemen. It's my privilege to welcome you to Gresham College tonight. I'm pleased so many of you found tonight's lecture topic interesting, especially as you could have spent this evening at home filling out your tax returns. Clearly I'm an optimist. You know an optimist? Someone who sets aside an hour to do their tax return. Of course the average figure in America is 27.4 hours. Not optimistic at all.

As you know, it wouldn't be a Commerce lecture without a commercial, so I'm glad to announce that the next Commerce lecture will continue our theme of better choice – "Too Unimportant To Fail? Innovation And Competitive Selection In Markets" - here at Barnard's Inn Hall on Monday, 26 February at 18:00.

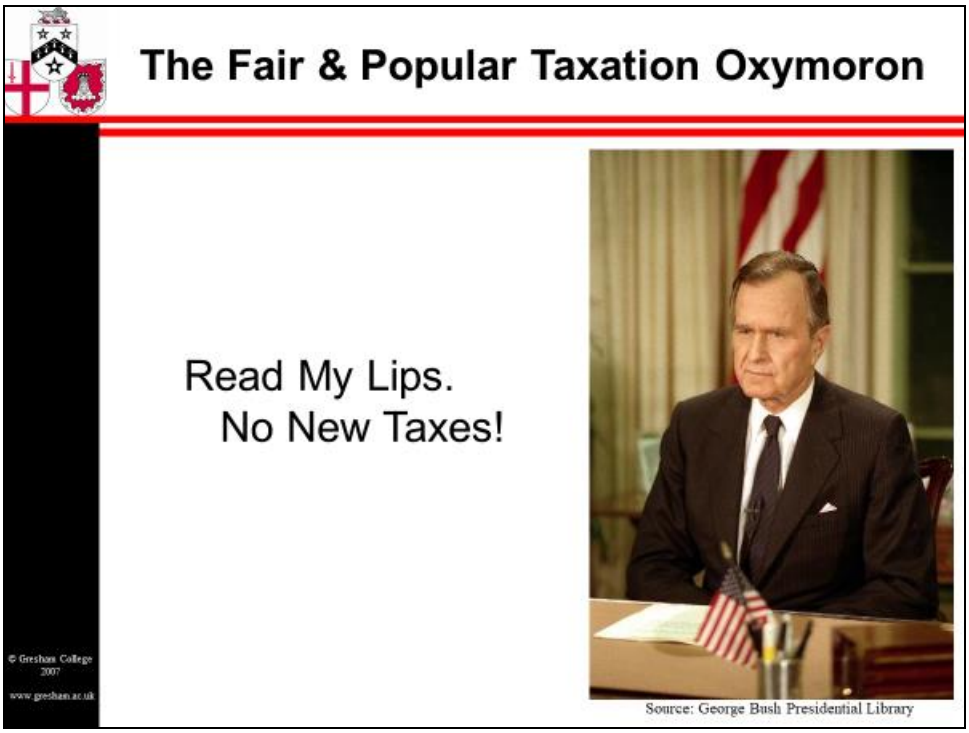
Gresham College is also pleased to announce that the Securities and Investment Institute and the Association of Chartered Certified Accountants have both put these Commerce lectures in the continuing professional development programmes. Would SII members

please be sure to see Geoff or Dawn at the end of the lecture to record their CPD points? Anyone else attending as part of another CPD programme can obtain a Certificate of Attendance afterwards from Gresham College on request.



Well, as we say in Commerce – "To Business".

The Fair and Popular Taxation Oxymoron



One of my displacement activities during the preparation of this lecture was to 'google' "sex". The word "sex" raised 448 million 'hits', but "tax" wasn't far behind at 382 million. "Jesus" scored 176 million, "Bible" 126 million and "football" 17 million. Given that tonight's billing noted that taxation is, arguably, the greatest intervention of government in the economy, this intense interest shouldn't be surprising.

You might find it surprising that providing a clear definition of tax is not straightforward. Webster's New World Dictionary defines "tax" for our purposes as "a compulsory payment, usually a percentage, levied on income, property value, sales price, etc. for the support of a government". At first glance, tax is simply money that the government takes from the economy, but the key point is that "… taxes are enforced exactions, not voluntary contributions" [Commissioner of Internal Revenue versus Newman, 159 F.2d 848, 850-51 (2d Cir. 1947)].

The "tax base" is the thing to which the tax applies, lands, goods, transactions or income, for example. Definitions of the tax base vary tremendously, especially when tax breaks are taken into account. The "tax rate" is the calculation applied to the tax base. A property tax might be so many currency units per hectare, while income tax might be quite complicated. We distinguish a "headline tax rate" or "marginal tax rate" from our "tax burden". The "tax burden" or "average tax" is the total tax paid in a period as a proportion of total income in that period. The "marginal tax rate" is the amount a person pays for their last tranche of tax. For example, I may start paying tax at 20% of my income but as my income rises I reach a marginal tax rate on additional income of 40%.

We frequently express the tax burden as a percentage of personal or national income. For example I may have a headline income tax rate of 40%, a marginal tax rate of 40%, but an average tax of 30% once allowances and deductions take effect. A government can both lower the tax rate and at the same time broaden the tax base, yet leave the tax burden unchanged.

I said that defining tax is not straightforward. If taxation is appropriation of resources by the state, there are numerous examples of quasi-taxation such as the sale of offices, confiscation of property, reneging on government debt, monopolies and devaluation. Let me give you two quick examples of definitional complexity. My first example is passports. You could argue that issuing passports is a basic right and should be free. But imagine a country that charges for services, such as issuing a passport. You could argue that only a minority of the population need a passport and this minority should pay for the cost of their passports. Surely, this is not a tax, just a charge for direct costs? You could equally argue that they should pay the marginal cost, i.e. as our country needs a passport office anyway, these people should only pay for the extra time and paperwork their specific demands create, but not for the totality of the passport service. But you could equally argue that people should pay more than the cost of the passport as we have to pay for defence and foreign offices, and if they can afford to travel through airports they can afford a bit more to help out with schools, hospitals and roads. Now passports are a tax on foreign travel. It's not easy to distinguish a tax from a payment for services. In order to make the distinction you have to have a tremendous faith in governmental cost calculations and allocations. The same argument applies to your local municipal swimming pool when it makes a profit or needs a subsidy.

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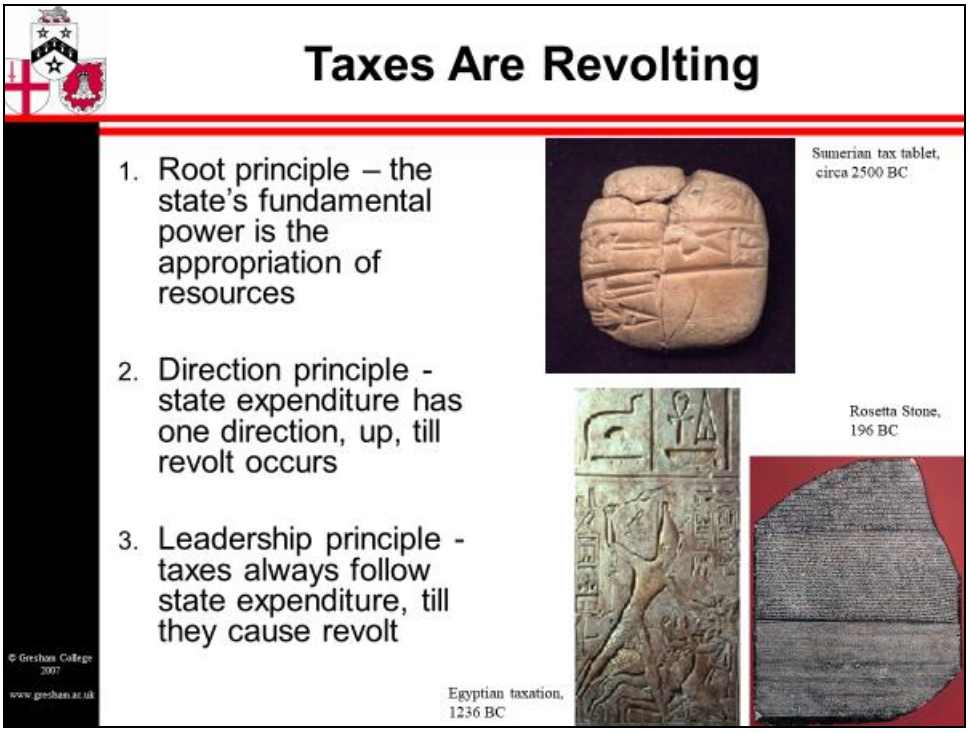
My second example is tariffs, subsidies and capital allowances. Imagine a country that levies a tariff on imports and provides subsidies to domestic businesses. A tariff is clearly a tax, but if it falls wholly on foreigners, who cares? Well, for a start, there are clear economic arguments that the tariff raises the costs of inputs for businesses and consumers. It is equally unclear what constitutes an import. What if goods are assembled and then re-exported? Turning to subsidies and capital allowances, how could they possibly be a tax? Well, subsidies and capital allowances are clearly a tax on businesses and consumers that don't receive them. The government has favoured businesses that receive subsidies by raising general taxation that would have been unnecessary without the subsidies. Of course, one would naturally exclude foreigners from subsidies and capital allowances. What's popular are unfair taxes on foreigners. Interestingly though, in 2006 a group of Ohio taxpayers took a case (DaimlerChrysler Corporation versus Cuno, 547 U.S. (2006)) to the US Supreme Court and argued that tax credits to attract investment by DaimlerChrysler injured them by diminishing the total funds available. The taxpayers lost on the basis they could not claim to have suffered any specific harm. Still, natives such as Arthur Godfrey whinge, "I'm proud to be paying taxes in the United States. The only thing is - I could be just as proud for half the money."

Taxes Are Revolting



The history of taxation is fascinating. The history of taxation is the history of peoples' relationships with their governments and each other. In an interesting contrast across two millennia, Marcus Tullius Cicero averred that "taxes are the sinews of the state", while Robert Orben joked that "Washington is a place where politicians don't know which way is up and taxes don't know which way is down." This leads me to introduce three of tonight's eight principles of taxation:

1. ***Root principle – the state's fundamental power is the appropriation of resources***

2. Direction principle – state expenditure has one direction, up, till revolt occurs

3. Leadership principle - taxes always follow state expenditure, till they cause revolt

No surprise then that, as counted by Google, the phrase "government expenditure upwards" is twice as common as "government expenditure downwards", while the phrase "tax rise" occurs 31 times more often the phrase "tax fall". Taxation is documented to at least 3,000 BC in Egypt. The early cuneiform tablets we have from Sumeria are mostly concerned with tax assessment and payment. The Rosetta Stone is an early tax amnesty document. Tax endures.

The history of taxation intertwines with that of expenditure. Many people welcome the benefits of taxation, regardless of the cost. Karl Marx noted that "Civil servants and priests, soldiers and ballet-dancers, schoolmasters and police constables, Greek museums and Gothic steeples, civil list and services list - the common seed within which all these fabulous beings slumber in embryo is taxation." The historian Publius Cornelius Tacitus emphasised the crucial role of force and tax in maintaining government, "The repose of nations cannot be secure without arms. Armies cannot be maintained without pay, nor can the pay be produced without taxes." The Egyptian, Chinese and Roman systems were constantly trying to balance expenditure with income, with varying degrees of success. Many ancient taxation abuses were due to annual collections enforced with capital punishment, rather than relying on longer cycles balancing expenditure and income.

In modern times we have seen numerous attempts to bring taxation into line with expenditure, and vice versa. While the debt markets allow governments of all types to borrow in frighteningly sophisticated ways, the electorate and the tax authorities are locked together in annual rituals. Despite the ability to borrow and invest over the economic cycle, taxpayers like the simplicity of annual balanced budgets. There are "balanced budget" regulations in American states and referenda to control tax levels such as California's renowned 1978 Proposition 13, the "People's Initiative to Limit Property Taxation." The annual tax cycle remains remorseless, as Ogden Nash quipped:

Indoors or out, no one relaxes
in March, that month of wind and taxes;
The wind will presently disappear,
the taxes last us all the year.

The Greeks, the Chinese and the Romans tried just about everything long before us. Payment has been made with salt, tea, wine, olive oil, slaves and shrunken heads. Greek and Roman citizens could be called on to serve as soldiers and to supply weapons. Tax farming (publicani) pre-dates the Romans as Egyptians and Greeks auctioned off tax collection. Modern European taxation emerges from medieval subjects paying money to their feudal lords in lieu of military service. Early taxes tended to be on land, harvests and orchards. An equitable tax ranged from 10% to 20% in most ancient cultures. In Babylonian and biblical terms a "fair tax" was the tithe, i.e. 1/10th. Confucius supported a 10% tax rate, while Mencius in the 4th century BC extolled the Chinese well-field system dating back to the 9th century BC that came out as 1/9th tax, i.e. an 11% tax rate. In modern times, many, perhaps most notably Andrew Mellon, wished to control government expenditure by choking it at a fixed percentage, often the tithe.

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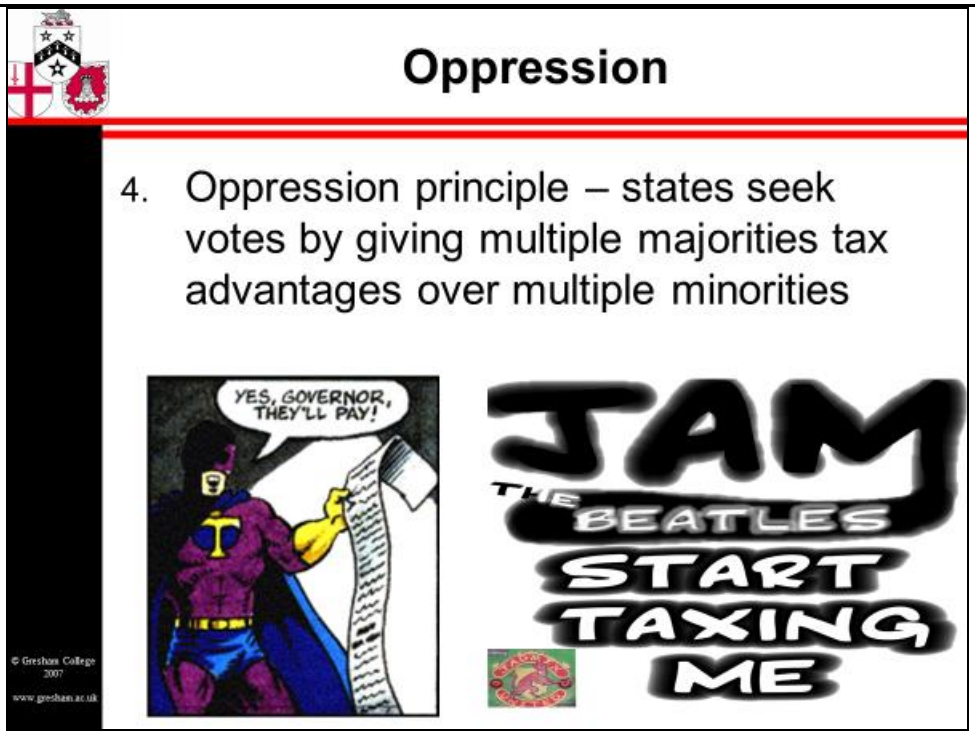

4. Oppression principle – states seek votes by giving multiple majorities tax advantages over multiple minorities.

Yesterday's votes bought today's taxes. Today's 10p is really yesterday's pound with all the taxes deducted. Trade taxes, tolls and customs duties are popular with governments and citizens because they appear to be paid by foreigners. Earl Wilson quipped, "There's only one kind of tax that would please everybody - one that nobody but the other guy has to pay." Governments also like taxing the easy-to-measure and hard-to-hide. For this reason, early taxes focused on property, physical goods, commodities and ships. Governments have tried to tax other easy-to-measure and hard-to-hide things such as the number of windows or fireplaces. King William III levied a glass and window tax in 1696 that was a primitive form of income tax. The greater the wealth, the bigger the house, the more the windows, the higher the tax. Some of the richest deliberately commissioned homes that ostentatiously showed their ability to pay for lots of windows, while other families bricked-in existing windows to reduce tax. In London today you can still see 17th and 18th century houses with bricked-in windows, some are just by Smithfield market. The tax was finally repealed in 1851 and replaced with early council taxes.

Taxation affects culture. Tax inspires – take the Beatle's hit "Taxman" that disagreed with tax rates of 95% in the 1960's, "Let me tell you how it will be; There's one for you, nineteen for me." Tax figures heavily in the Bible. An excise tax on articles was termed "belo" in Hebrew, a road toll or customs tax was "halakh", forced labour was "mas", burden was "massa" and tribute was "middah". Equally important English terms betray the association of taxation with domination, the Danegeld, scutage and tallage. Not only was the disciple Matthew a revenue man, so was Zacchaeus, Brian Boru, Etienne de Silhouette, Lavoisier and, quite importantly this close to 25 January, Robbie Burns, while Robin Hood was rather the opposite. Over a far longer period, from Boudica's revolt to Lady Godiva's protest, to Wat Tyler's poll tax rebellion, the UK has seen tax figure (sic) in how the people

express their satisfaction with government, through bread tax riots or gin tax riots right up to poll tax riots in 1990 and fuel tax protests in 2000.

Democracy erupts from tax. The United States of America resulted from taxation vexation with the Sugar Act, the Stamp Act and other taxes. Strangely, the Boston Tea Party of 1773 enforced a boycott of the British East India Company as local merchants destroyed unfair tea that had ***not*** paid normal taxes. Of course almost immediately after independence, the Whiskey Rebellion of 1791 erupts and a new Constitution is required to restructure taxes. The Magna Carta and the Declaration of Independence both document tax rebellions where the taxpayer won. One delightful bit of *Schadenfreude* on the net goes, "if Patrick Henry thought taxation without representation was bad, he should see how it is with representation."

Tax avoidance and evasion are as old as taxation itself. We call something "tax efficient" when, from the point of view of the taxpayer, the activity results in the lowest, legitimate tax bill. Tax avoidance is structuring things to get as close to tax efficient as possible. The US Judge, Learned Hand, reasoned in Helvering versus Gregory (1934), that "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes…" Amusingly, despite this taxpayer-friendly quote, in this case Judge Hand dismissed the taxpayer's convoluted argument and gave impetus to the substance over form doctrine, which leads us to tax evasion.

Tax evasion is paying less tax than you are legally obliged to. Denis Healey, a former chancellor, once clarified the definitions by stating that, "The difference between tax avoidance and tax evasion is the thickness of a prison wall." Of course tax evasion is best done in a country with no taxes, secretive banks, good beaches and palm trees. In Europe, politicians seem increasingly to get away with saying that tax avoidance is tax evasion – politicians insist that we have moral obligations to meet their exactions.

People often say death and taxes are the same, but this is wrong. Death is a taxable event, but taxes never die without a hard struggle. Economists see tax avoidance as tax competition, and economists almost always welcome competition. Charles Tiebout argued in a 1956 article, "A Pure Theory of Local Expenditures", that variation in tax rates among different countries is beneficial because it puts pressure on governments to be efficient. Taxpayers will choose the appropriate combination of government services and tax rates. Measures to harmonise taxes restrict competition. This competition assumes reasonable taxpayer mobility. Professor Ian Angell of LSE, and many others, point out that intense tax competition may make it almost impossible to redistribute from rich to poor if the rich 'barbarians' move to tax havens and leave the immobile poor behind. France's well-kept-secret, the rock star Johnny Hallyday, created a recent election controversy by moving to Switzerland to avoid punitive French taxes.

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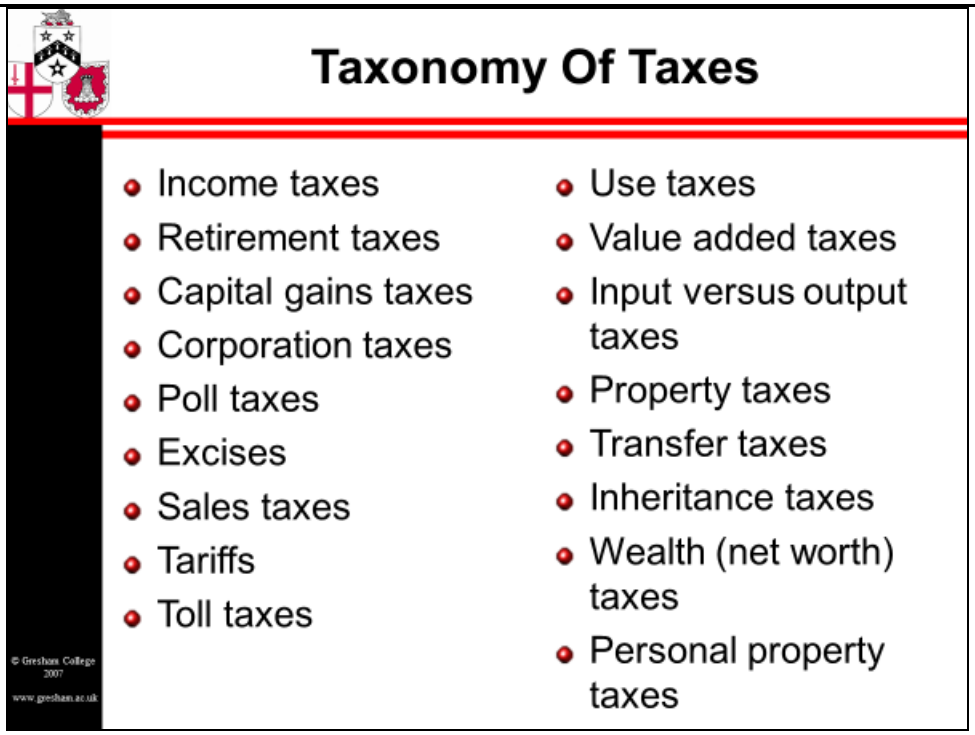


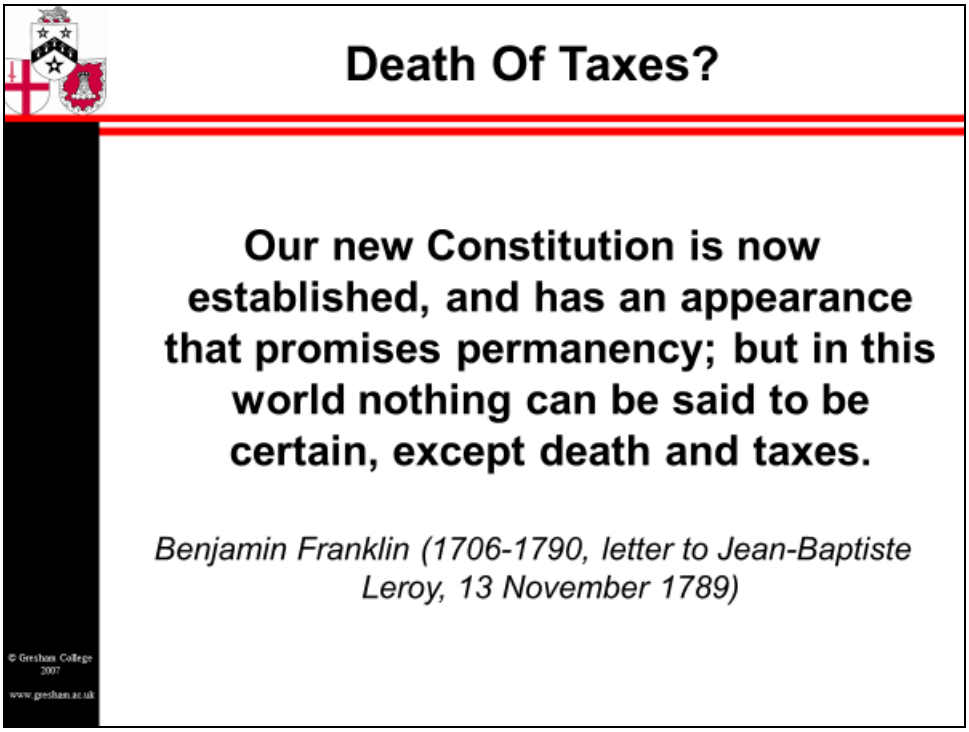
Hypothecation is one attempt to control taxes. The word derives from "hypothetical dedication", a dedicated tax for a specific purpose. US Social Security and UK National Insurance Contributions and the BBC licence fee are all attempts at hypothecation. Hypothecation emerges either from taxpayer frustration or from political sales techniques. Taxpayers want to make sure that new taxes are used for a purpose or politicians think that a new tax is better wrapped up as a service fee. There are several problems with hypothecation, principally what do we do when we have too much or too little. Imagine a hypothecated road tax for road safety based on fuel prices. If it raises too much money do we overspend on road safety? If it raises too little money, will we let people die? There are other problems, principally to do with timing and allocation, but if you can hypothecate a tax, it frequently argues that there is some potential privatisation therein, e.g. road tolls or television channels. Hypothecation is inevitably doomed to go to general revenues, or to become a cosy imposition arranged in concert and spent freely. As Lord Bramwell noted in the 19th century, "Like mothers, taxes are often misunderstood, but seldom forgotten.''

There are numerous types of taxes. The OECD works hard to compare taxation rates among developed countries. The OECD taxonomies of tax divide taxes into income taxes, retirement taxes, capital gains taxes, corporation taxes, poll taxes, excises, sales taxes, tariffs, toll taxes, use taxes, value added taxes, input versus output taxes, property taxes, transfer taxes, inheritance taxes, wealth (net worth) taxes and personal property taxes.

Most economists favour neutral tax systems that do not favour one economic activity over another – the market should decide. Others favour directing markets using tax, and tax breaks, to guide economic activity in ways they favour, such as increasing the attractiveness of employing people rather than capital. Taxes can also be categorised by their purpose, for instance taxes that penalise socially undesirable activities, such as smoking, drinking or gambling, can be called "Pigovian taxes" after the British economist Arthur Pigou, and are also described as "sin taxes". Pigou felt that taxes could correct negative externalities and saw externality-balancing taxes as preferable to regulation. Of course the rub in Pigovian

taxes lies in calculating what level of tax will counterbalance the negative externality. Sin taxes have hit mobile phones in the UK, luxuries in many countries and air travel everywhere. Frankly, Pigovian responses to tax approximate Pavlovian responses to problems. The recent rage has been for "green taxes" that penalise environmentally-harmful activities, but without the bother of accurately calculating the balance with negative externalities. Of course, the paradox is that if Pigovian taxes are effective at penalising negative externalities, the taxes become less effective at raising revenue.

Death of Taxes?



Any talk on taxation must include two essential quotations. The first, of course, is the cynical, yet accurate, from Benjamin Franklin:

> *Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes.*
>
> [Benjamin Franklin, 1706-1790, Letter to Jean-Baptiste Leroy, 13 November 1789]

Difficult as it is to accept, there are two 'too big' ideas about taxes that would render Franklin's comment moot. To look at the first 'too big' idea, I need your help. How many people here pay tax? Hands up, please. Now keep all your hands up, except for those of you who deliberately pay more tax than you know you are required to – you may lower your hands. I'm talking directly to those of you who voluntarily donate money to the government. Intriguingly, we support philanthropy, but rarely see the state as a valid recipient. Not a lot of trust there.

That may have seemed an odd question with little insight into human nature, but to the ancient Greeks it wasn't. In Athens, and other cities, leading citizens were called upon to

help finance buildings, bridges, roads and festivals with voluntary contributions to their city-state. The voluntary contributions were called liturgies. "Liturgy" means "work for the people". In Athens, any man who had been assigned a liturgy while a richer man had none could challenge the richer man either to undertake the liturgy or to exchange property with him. As a Latin author quipped a few centuries later, "Qui vult dare parva non debet magna rogare", "He who wishes to give little shouldn't ask for much." So the first 'too big' idea would be to develop a society where people donated their taxes due to societal norms and pressures. This might sound like extortion, but then again it might be hard to distinguish from current norms.

The second 'too big' idea is to expand one rarely-recognised form of taxation, namely inflation. Governments that mint their own currency can mint as much as they like, though they must recognise that inflation will result. In a world with free exchange of currencies, this would result in a very simple form of taxation, no HM Revenue & Customs, no annual forms, no tax investigations. There would even be market control over government efficiency and effectiveness. If the foreign exchange markets lost confidence in the government there would be immediate repercussions in a currency fall and an inflationary rise. If foreign exchange markets gained confidence in a government, then the currency would rise and inflation would fall. Obviously, just minting money wouldn't work for the EU countries in the Euro; likewise it wouldn't work for a local council in the UK, unless we accept Portsmouth Pounds or Liverpool Livres. There are some other flaws with this otherwise simple scheme, but it is interesting to contemplate the idea of eliminating tax altogether while still having government expenditure. No less an authority that Milton Friedman concurred, "Inflation is one form of taxation that can be imposed without legislation."

Tax Evaluation

There are two other, not-quite-so-big ideas. Tax is big business. I quote from a statement by David Varney, Chairman of HM Revenue & Customs, describing his department:

> *"HM Revenue and Customs employs about 100,000 staff (or 20% of the whole civil service); we work from 300 locations occupying 900 offices; we utilise 250 major computer systems; we collect some £370 billion pounds per annum and disburse £12 billion at a cost of £4.6 billion."*

Many citizens are concerned at the new powers of HM Revenue & Customs [Baron, 2006] So, the first idea is to introduce competition into tax collection processes. Why can't we have HM Revenue & Customs A and HM Revenue & Customs B? It would probably be easier to say IRA and IRB in the USA, but the basic idea is that citizens could choose with which organisation they preferred to deal. At least there would be competition for customer service and reduced bureaucracy, even though the tax collected would be the same.

Another idea is the tax equivalent of freeing the Bank of England while setting inflation targets. The government could free the relevant parts of HM Treasury and HM Revenue & Customs with specific targets to balance the budget with tax. A discussion on targets might include a taxpayer to non-taxpayer ratio or a future commitment index. This new "tax target" entity would make balanced budgets more rigorous, but gains in clarity and confidence might be offset by a government still able to issue debt and make long-term contracts such as those in PFI and PPP schemes.

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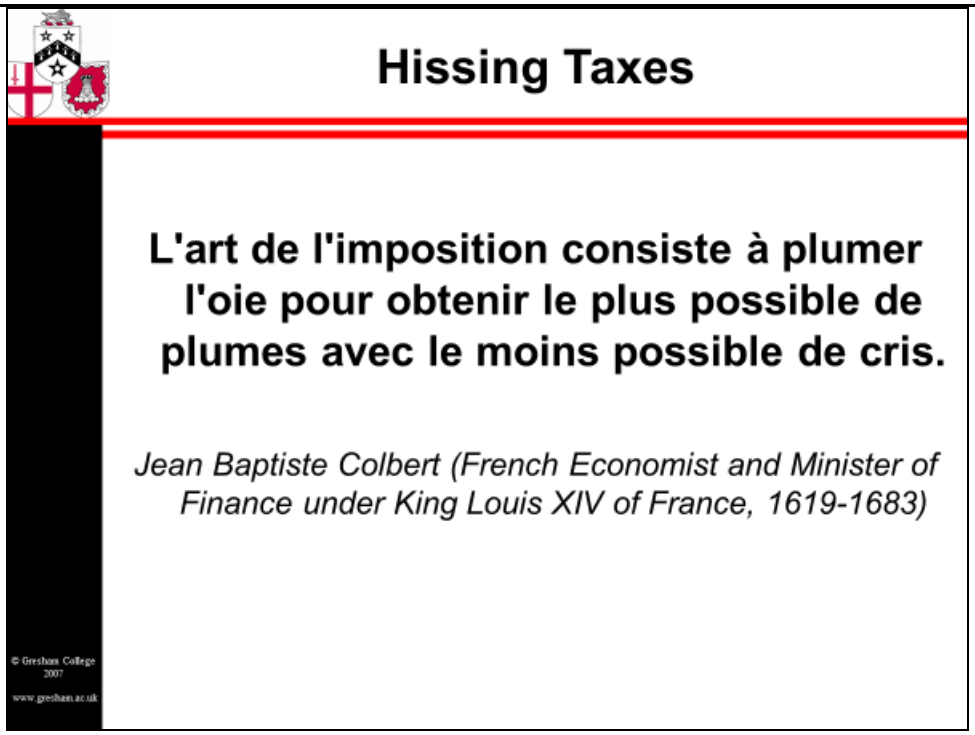
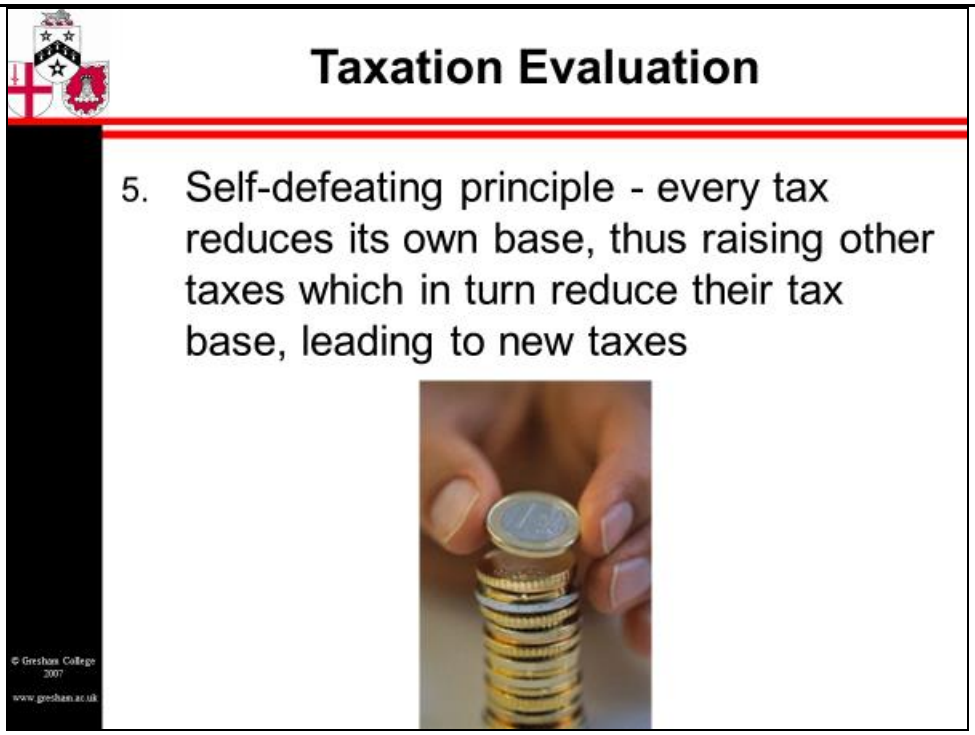


So many ideas for reform require us to have a means of evaluating a good tax from a bad tax, and that leads to the second essential quotation from Jean-Baptiste Colbert:

> *«L'art de l'imposition consiste à plumer l'oie pour obtenir le plus possible de plumes avec le moins possible de cris.»*
>
> *"The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing."*
>
> [Jean Baptiste Colbert, French Economist and Minister of Finance under King Louis XIV of France, 1619-1683]

But the idea predates Colbert, recurring in many ancient texts. Tiberius supposedly said that his governors should "have my sheep shorn, not skinned alive." [Adams, 1999, page 104, quoting Suetonius, The Lives of the Caesars, Book III, Chapter XXXII, Volume 1, translated by John Rolfe, Loeb Classics, 1979, page 341] Colbert refers to the art of taxation from the point of view of impositional comfort. But what does make a good tax?



Edmund Burke claimed "there is no such thing as a good tax" and, possibly, all taxes will be bad taxes, or 'least bad', but public goods and welfare must be financed. Most economists agree that the best taxes have as little impact as possible on people's choices to undertake a productive economic activity. Unfortunately:

5. Self-defeating principle - every tax reduces its own base, thus raising other taxes which in turn reduce their tax base, leading to new taxes.

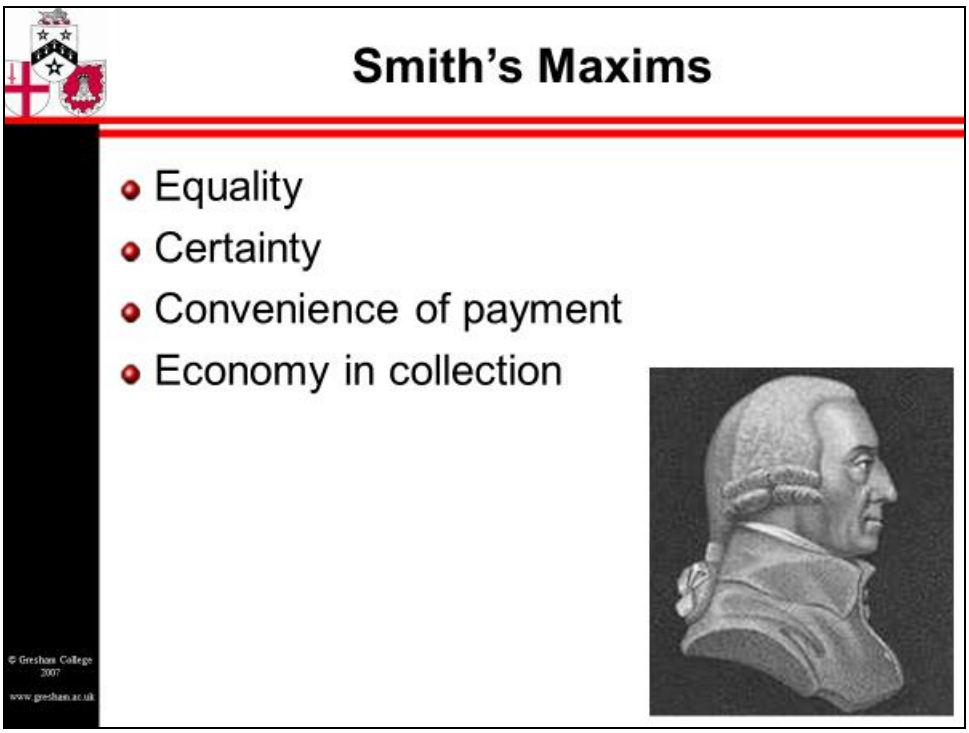
Thus, capital taxes discourage investment. Labour taxes discourage labour. James Tobin, a Nobel laureate, proposed a tax on foreign exchange transactions specifically to reduce rapid foreign investment. Even death taxes result in fewer deaths, well recorded ones anyway.

The reverse of this self-defeating principle of taxation finds its expression in the Laffer curve where lower taxes increase tax revenue, but it was also recognised by Mencius in the fourth century BC explaining to a ruler that:

> *"If, in the market-place of his capital, he levy a ground-rent on the shops but do not tax the goods, or enforce the proper regulations without levying a ground-rent; then all the traders of the kingdom will be pleased, and wish to store their goods in his market-place. If, at his frontier-passes, there be an inspection of persons, but no taxes charged on goods or other articles, then all the travellers of the kingdom will be pleased, and wish to make their tours on his roads."*
>
> [Mencius (Mèng Zǐ, circa 372-289BC), The Works of Mencius, Book II, Part I, Chapter V, verses 2-3 - http://nothingistic.org/library/mencius/toc.html]

More recently, William Cobbett, writing as Peter Porcupine in the 18th century, said, "The tendency of taxation is to create a class of persons who do not labor, to take from those who do labor the produce of that labor, and to give it to those who do not labor." Nozick equates

taxation of earnings with forced labour, and thus tax is a tax of time. He points out that we disadvantage people who need goods to be happy against those who value leisure. If we tax people in proportion to their ability to pay, then perhaps we should follows his argument through to "forcing unemployed hippies to work for the benefit of the needy" [Nozick, 1974, page 169] rather than time-poor working folk.



Adam Smith stated four maxims for good taxation [Smith, 1042-1046]:

- equality – all subjects should contribute, and in proportion to their respective abilities;
- certainty – tax calculations, timing and demands are not arbitrary;
- convenience of payment - in line with cashflow and payment systems;
- economy in collection – few officers, few inspections, few evaders and few economic distortions.

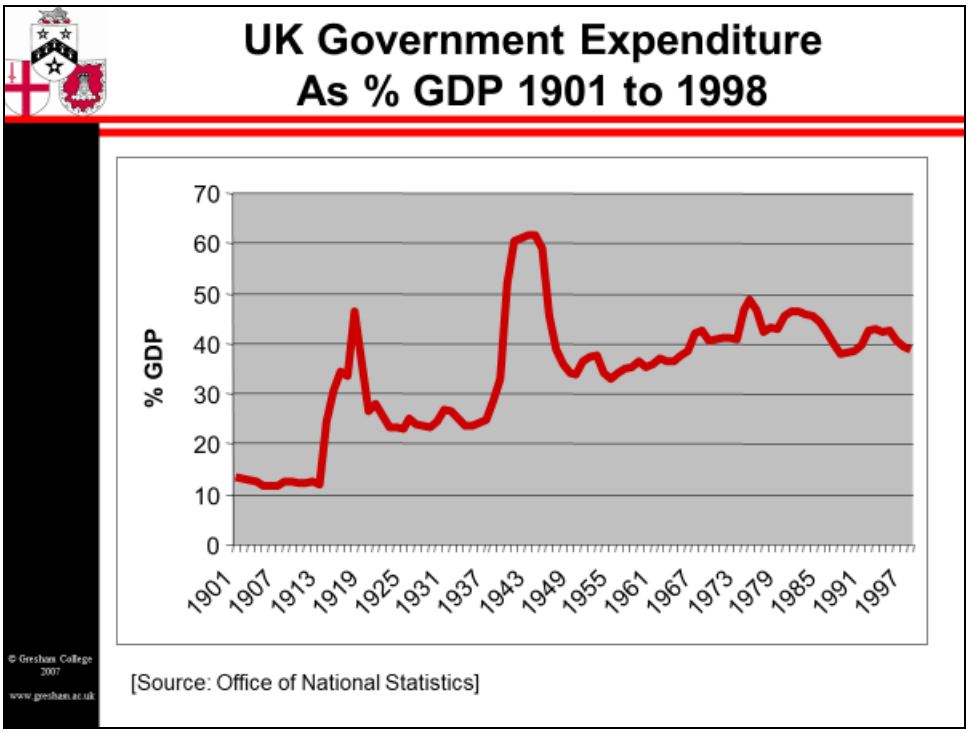
The modern view is not much different:

> *"The primary purpose of tax is to raise revenue to fund necessary government expenditure. It should do so without, as far as possible, damaging wealth creation and individual freedom of choice. Four principles should be adopted to achieve this:*
> - *Economic efficiency. Tax should be as low as possible, should not distort business decisions and should discourage neither economic growth nor individual enterprise and effort.*
> - *Fairness. The least well-off should pay a smaller proportion of tax. People in similar circumstances should be treated equally.*
> - *Simplicity and transparency. Tax should, as far as possible, be clear, easy to understand, of certain application, easy to calculate and easy to collect.*
> - *Stability and predictability. Once the above principles have been adopted, changes to tax law should be kept to a minimum."*

[The Tax Reform Commission, October 2006 - http://www.taxreformcommission.com/report.php]

So what's wrong with today's taxes. The Tax Reform Commission, after intensive research, affirms what we all know. The tax burden in the UK is high in both historic and international terms; the UK system is too complex, too unfair, too unstable; the tax system is exacerbated by problems with legislative process; high taxes and complexity damage growth - the tax system is undermining UK competitiveness and precipitating relative economic decline. While acknowledging Andrew Jackson's (7th President of the USA) comment that "The wisdom of man never yet contrived a system of taxation that would operate with perfect equality", the Tax Reform Commission concluded last year that reform has worked extremely well in Australia, New Zealand, the Netherlands, and Ireland.

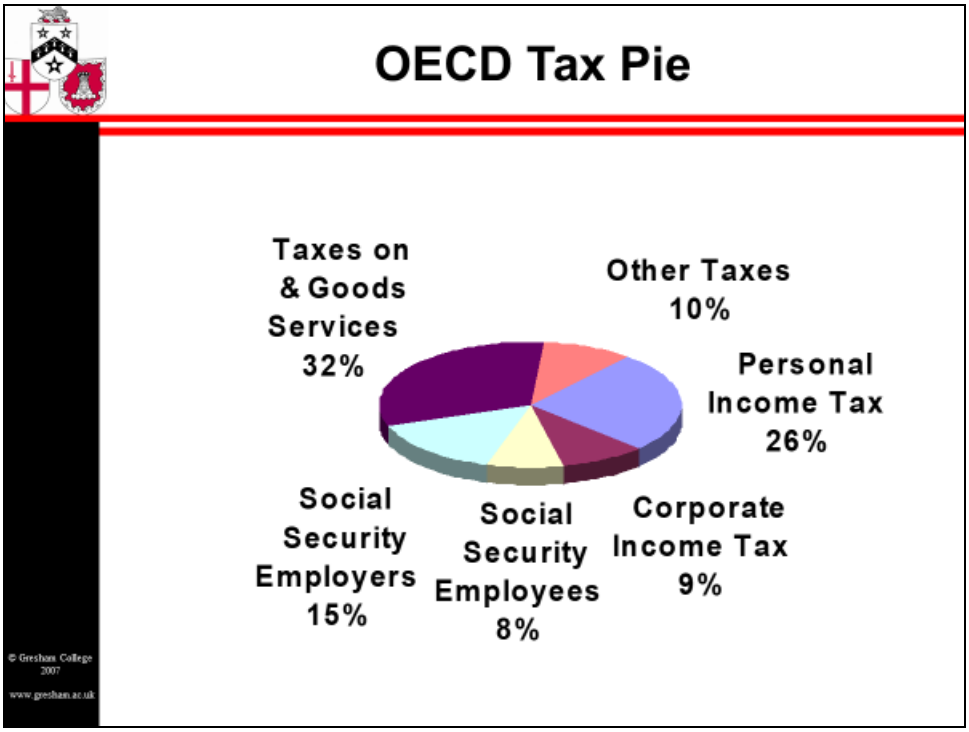
Corporate People



Tonight we certainly do not have time to examine the many categories of tax and their interactions, nor to explore the wider issues of government budgeting, expenditure and finance, let alone elucidate the many moral, ethical, and social ramifications of tax that put it at the heart of politics. Instead, I intend to focus on two taxes, income tax and corporation tax.

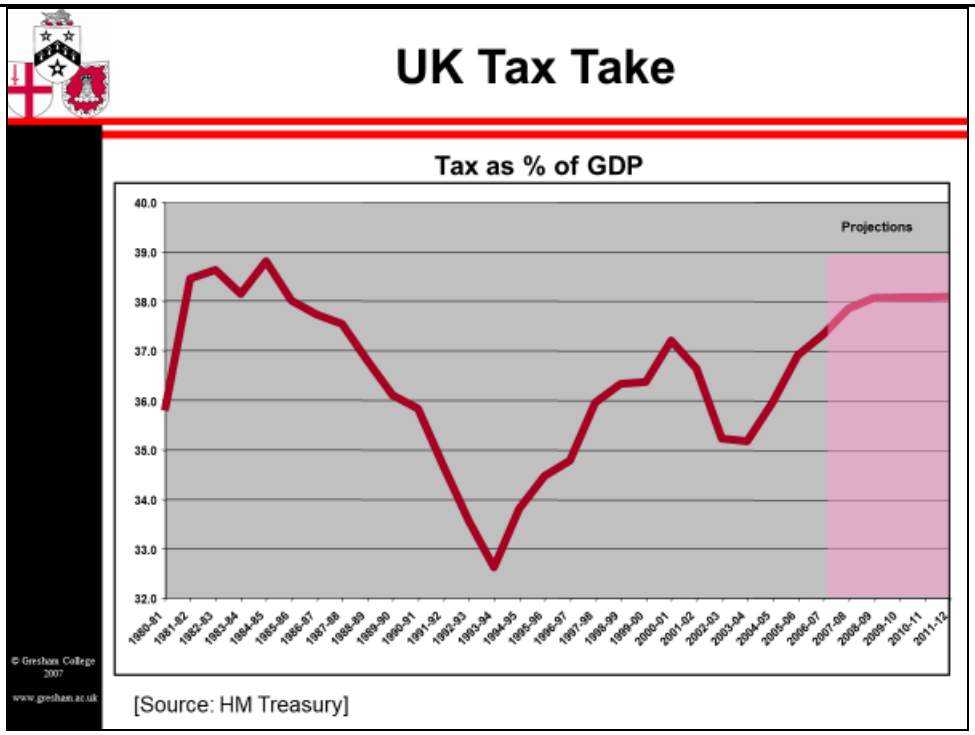
During the second half of the 20th century, governments everywhere increased their take of national income, mainly to pay for modern welfare states and larger bureaucracies to enforce increased regulation. In 2005, the OECD average of tax receipts as a percentage of GDP was 36.3%. The UK was almost exactly average at 36% against an EU average of 41%, while the USA and Japan were rather low at 26% and Sweden topped the rankings at 50%. There remain many other differences, e.g. how taxes are collected, how the tax base is defined, how rates are set, how states handle regional and local budgets and taxes, how

transparent the budgetary process is or how the Black Economy is handled. But two trends are clear. First, tax rates over five decades have increased. Second, because direct taxation on employment and wealth is increasingly resented, governments increasingly rely on indirect taxation of consumption, e.g. VAT.

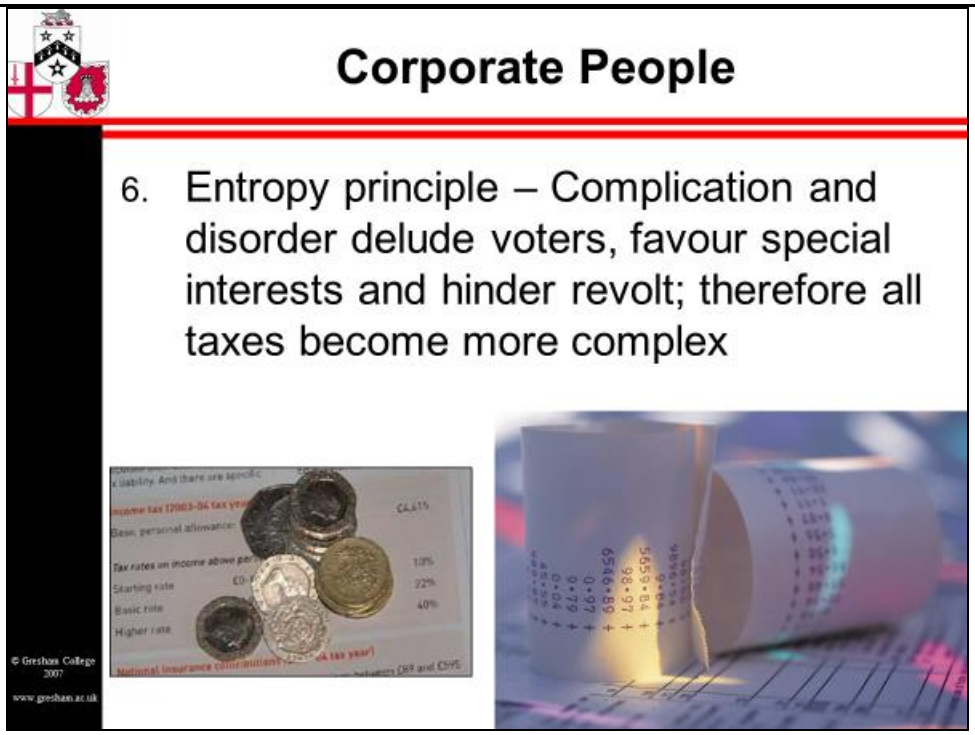


Income tax and employment taxes together are the biggest source of revenue in most countries, 49% across the OECD. Income tax is a comparatively recent invention, because annual income is a recent idea, the modern equivalent of assessing a harvest. Income tax systems require a monetised economy and common understanding of accounts, valuations, records, receipts, expenses and profits. Income taxes require a stable, ordered society. As with the introduction of almost all taxes, income tax was originally a temporary measure. Income tax was first implemented in Britain by William Pitt the Younger in December 1798 to pay for the Napoleonic wars. Pitt hoped that the new income tax would raise £10 million but actual receipts for 1799 totalled just over £6 million. Henry Addington abolished Pitt's income tax three years later after the Peace of Amiens, but reintroduced it in 1803 when hostilities recommenced. Income tax was re-abolished in 1816, one year after the Battle of Waterloo, but, like a cockroach, was reintroduced by Sir Robert Peel in the Income Tax Act 1842.

In the USA income tax was also a temporary measure, first imposed during the Civil War. Income taxes came and went until 1894 when questions about their constitutional legality prevented them being imposed without an amendment to the Constitution. Naturally an amendment came swiftly. After the 16th Amendment (of only 27 in the US Constitution) was ratified in 1913, the USA equally swiftly expanded income tax.

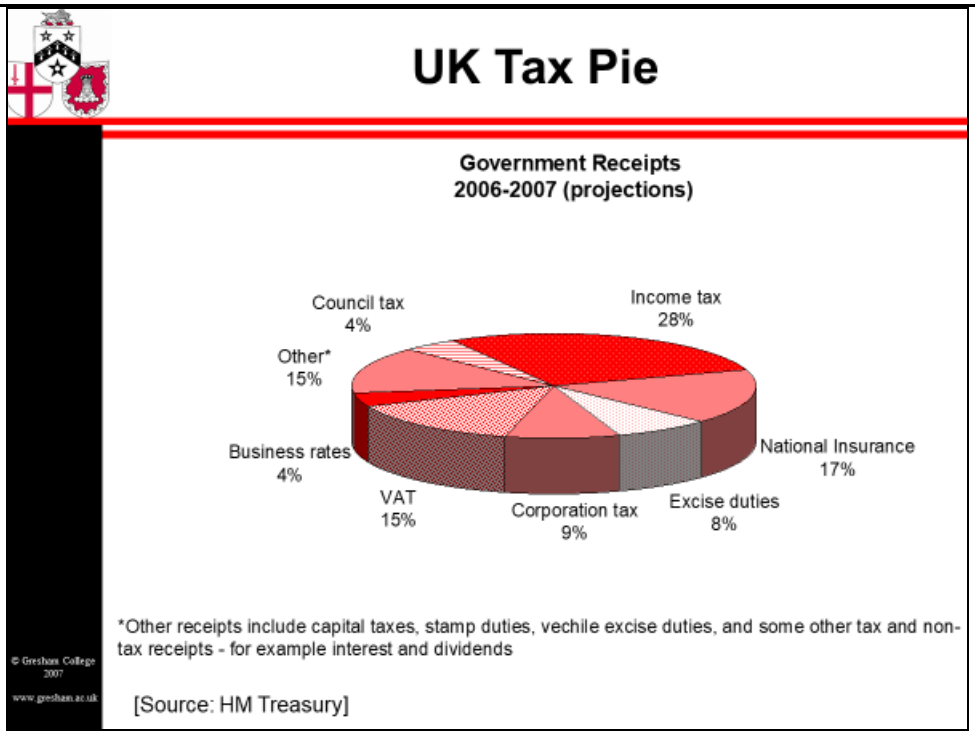


Corporate or corporation taxes evolved from personal income tax systems. If society treats a corporation as a legal entity distinct from its shareholders created by charter, with transferability of shares, identification as a person under law for many purposes (sometimes as a citizen), perpetual existence, limited shareholder liability, and management elected by the shareholders [Mann and Roberts, 2004], then it might seem reasonable to tax the corporation in a similar way to individuals. On the other hand, if it is so simple, why do we have so many problems with corporation tax calculations? There are similar problems with income tax, but corporation tax is a labyrinth of calculations and contradictions about accounting profit, income/capital distinctions, pooling of losses, capital allowances, interest deductibility and accelerated depreciation. The more Byzantine the tax structure, the more it suits politicians trying to obscure the tax take from the populace.



6. Entropy principle – Complication and disorder delude voters, favour special interests and hinder revolt; therefore all taxes become more complex.

The title of this talk is "Corporation Tax Or Income Tax: Which Is The Greatest Con?", con in the sense of "confidence game" or swindle. The direct answer is fairly clear – corporation tax. Taxes on companies are always paid by people, be they workers, customers or shareholders. Corporations are owned by real people, either directly through shares or indirectly through investment vehicles such as pensions. When we permit politicians to single out corporations and say that they should pay more tax, we are only appropriating those monies from people, in many cases ourselves. Corporation tax is a lie for children. It allows politicians to lie to us as parents lie to children over mythical gift-bearing creatures. After a lifetime seeking gradual improvement, Peter Wyman, former President of the Institute of Chartered Accountants of England & Wales and former partner of PricewaterhouseCoopers, went over to the 'dark side' of radical tax reform, supporting the abolition of corporation tax, the elimination of capital gains tax, and the amalgamation of income tax and national insurance.



If corporation tax were abolished, other taxes would go up, and more accurately reveal the true level of the tax take. This tax rise would be mitigated by the rise in receipts from dividends and capital distributions to shareholders. Corporate investment would rise. A study by Hassett and Mathur reported in The Economist links a 1% decrease in the corporate tax rate with a nearly 1% increase in wages across 72 countries over the past 22 years. At the same time, in the spirit of tax competition, corporations would seek to locate in the UK, not just because 0% is a lower tax take than most (you may be forgetting subsidies such as industrial development agencies), but also because the costs of "no corporation tax" are zero. No accountants, no tax lawyers, no investigations. Moreover, we would instantly free almost a percentage point of GDP taken up by accountants, lawyers, tax inspectors and the tax departments of many corporations. As John Maynard Keynes wryly remarked, "The avoidance of taxes is the only intellectual pursuit that still carries any reward." We would free some of the trickiest, if not the brightest, minds in the country for better purposes.

Consuming Taxes

Income tax is more complex. The current debate revolves around progressive, regressive and flat taxes. Progressive taxes take more from those that have, e.g. higher income tax at higher wages. Regressive taxes comparatively disadvantage those who earn less because they pay the same as those who can afford more, e.g. poll taxes. A simple but powerful economic estimate is that distortion from a tax is proportional to the square of the tax rate. A 20% tax rate causes four times the deadweight loss of a 10% rate. This implies that a low uniform rate on a broad tax base will be more economically efficient than a mixture of high and low rates on smaller tax bases. This leads us to flat tax. Flat taxes are supposedly neutral in the progressive-regressive debate, but with the addition of an exemption rate, they actually become partially progressive, i.e. the poor don't pay until they reach a particular income. Years ago, when nobility and clergy paid lower or nil taxes, flat taxes were seen as progressive! During the 19th century, most European income taxes started as flat taxes.

Despite much support for a return to flat taxes by many reformers and a US presidential candidate, Steve Forbes, it is fair to say that many reformers watched recent implementations of flat taxes in eastern Europe with some trepidation. Ten countries starting with Estonia in 1994 and ending recently with Macedonia this year have adopted flat taxes. Had these flat taxes fallen flat, a pet theory would have been quashed.

So far, the experiments show that flat taxes can work, but reformers find themselves fighting the entropy principle and the bleating of special interests requires special vigilance to keep the reform volume up:

7. Volume principle - losers scream and winners mumble, thus quiet means more people are taking advantage of fewer, until they leave or revolt.

David Boaz of the Cato Institute contends that "The fundamental class division in any society is not between rich and poor, or between farmers and city dwellers, but between tax payers and tax consumers." Flat taxes pretty much include everyone. The classic developed world argument against flat tax is that nobody is really screaming for reform and that flat taxes are inequitable. However relative inequality matters in society as it both determines the type of society we have and even affects the health of the less well-off. Menzies Campbell pointed out (6 July 2006) that, "The UK tax system is not as progressive as is often claimed, with the bottom fifth of households paying a higher proportion of their gross income in tax than the top fifth." Leona Helmsley might have agreed, "We don't pay taxes. Only the little people pay taxes." And Peter De Vries would have concurred, "The rich aren't like us; they pay less taxes".

A flat tax with no exceptions and a reasonable exemption level would be more progressive, but another argument goes that, at least in establishing flat taxes, eastern Europe had it easy, and that leads to our final principle:

8. Revolutionary principle - tax reform is impossible without revolt.

Governments last as long as the undertaxed can defend themselves from the overtaxed, so real revolution would begin with a flat consumption tax instead of a flat income tax, freeing the earners from the consumers. Given our principles, a consumption tax would reduce consumption, increase savings and simplify the tax system. Instead of "taxing efficiency, added value, sheer hard work, and saving", as Matthew Leitch points out, we should let people keep money until they choose to spend it. Alan Greenspan supports a consumption tax, though he recognizes that "getting from the current tax system to a consumption tax raises a challenging set of transition issues." [FoxNews, 3 March 2005] In practice a flat consumption tax would work mechanistically like income tax. Expenditure would be calculated as income less the amount in approved savings. Taxpayers would then declare the amount of expenditure and be taxed on it. The system would be much simpler because instead of needing complicated exemptions for pension savings, share dealings or property investments where the complexity emerges from permissions and timing, the income from these would only be taxed when spent. Our current system taxes the wrong item, income, and then generates all its complexity trying to remove this distortion. In the extreme, we could eliminate VAT as redundant. But then we would have to face the truth, tax rates for most earners exceeding 50%, unclouded by excise taxes, VAT, television licence charges or fuel levies.

One twist might be to introduce a guaranteed minimum level of income. Below the minimum level we get paid by our fellow citizens through the state. Once we start to work above the exemption level we pay the flat tax. This could do away with welfare benefits and their attendant complexity. Our tax discussions will be clearer. Walking along together, we pass a beggar in the street. You think he needs more money – we discuss the level of exemption. You claim taxation is too high, we can almost immediately calculate the effect on government expenditure of lowering the flat tax rate. There would be far fewer lies for children.

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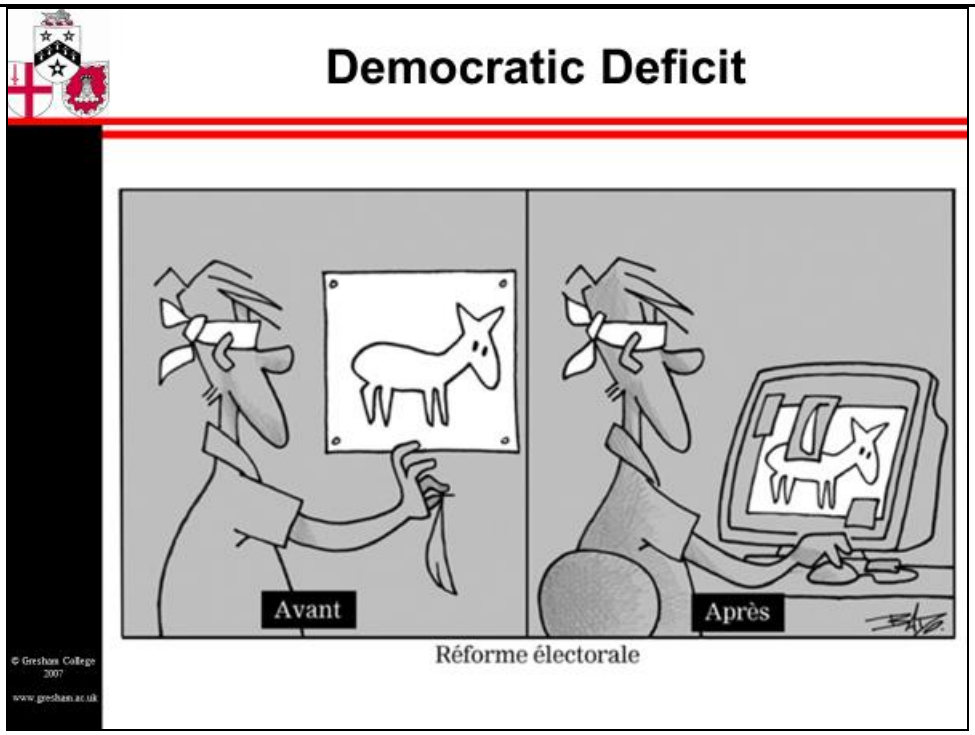


For a final reform, while strict hypothecation may be wrong, personal hypothecation of taxes might make sense. We spend enough time filling in forms stating what we owe. Perhaps a few moments should be spent to gather our views on where our taxes should go. This would make spending departments more open and accountable to the taxpayer. Whether we allocated our taxes by amount, or more likely by percentage votes, taxpayers could induce competition in government departments by allocating a percentage of their overall tax take to specific departments. This would induce competition among departments. Failing departments would ultimately have to merge with the successful, or close. Successful departments would expand, advertising their success and comparing themselves with other departments. We could put in trigger mechanisms, e.g. no department could have its budget cut by more than 5% by taxpayers, but might remorselessly shrink over a decade if it failed to reform. Imagine that University Department has a scandal and has to merge with Schools, or that popular admiration of the Navy encourages the Navy to split from an unpopular Ministry of Defence that failed to sell itself.

If this smacks too much of selling a vote, perhaps it's really just too evidently modern democracy and capitalism.

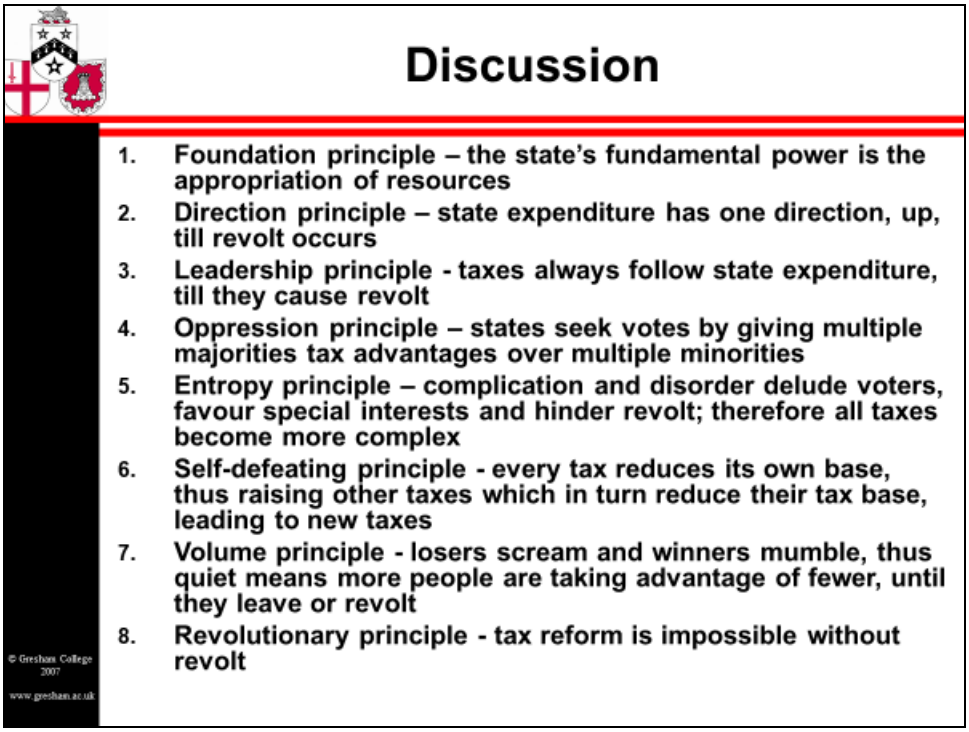
Democratic Deficit

So why isn't there more push for a flat consumption tax that simplifies the tax system, reduces the top rates of tax, stimulates growth and increases compliance? Well, that's politics. With a personal allowance of £10,000 and a flat rate of 30% the tax would raise as much revenue as the present system. Unfortunately, the mass of voters who earn between £20,000 and £50,000 would be worse off.

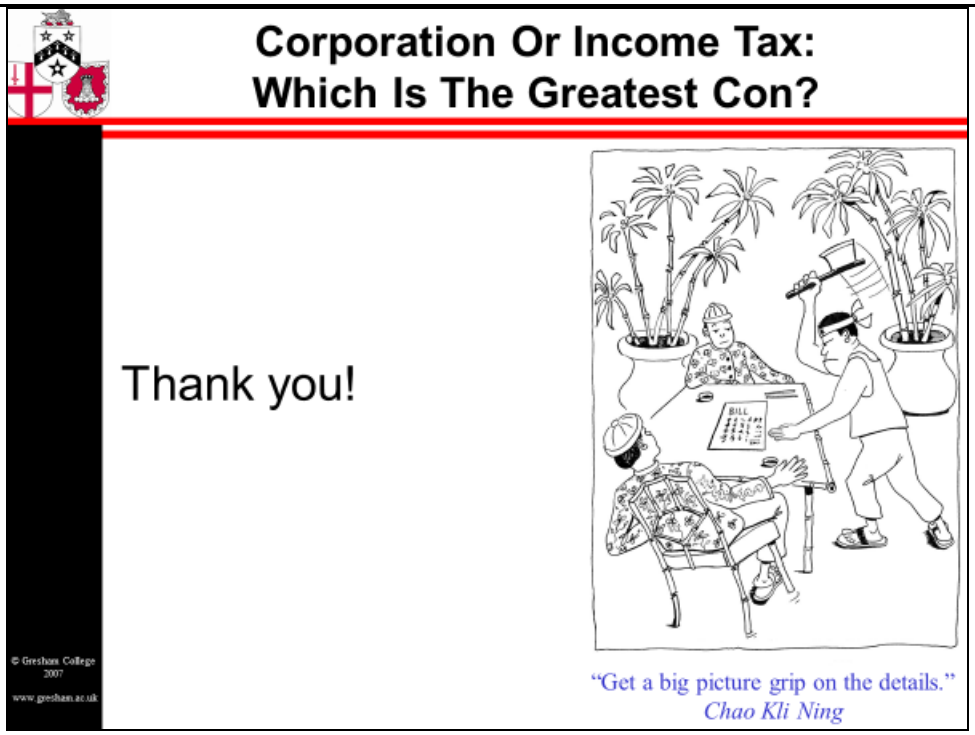
The long-term challenge is not merely tax reform, but full-scale and integrated reform of the tax and benefits systems together with government funding. Arguably, government funding

should be subordinate to fixed levels of equitable taxation. "Tithes that Bind" rather than "Expenditure that Expands". Optimal government and optimal taxation go hand in hand. Churchill contended that "… for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."

The author Walt Streightiff concluded that "the chief deduction most people make from their income tax is that government costs too darned much." But in the UK the clear, and classic, debate between large and small government has disappeared. Fraser Nelson notes, "there are three parties, each centre-ground fundamentalists, who agree that the UK should give up 42% of its national wealth to the government. It is a strange time for such consensus." [Nelson, 2006] We don't seem to want to face the awful truth of how much we want government to spend.



A con is a con, whether it's self-perpetuated self-deception or lies for children. Perhaps it's time we clearly stated to politicians that we care about tax, that we want to abolish the distortions of corporation tax, have a proper debate about moving to a flat consumption tax and have a more direct say in expenditure. Or we need a revolution.



Thank you.

Further Discussion

1. Foundation principle – the state's fundamental power is the appropriation of resources.
2. Direction principle – state expenditure has one direction, up, till revolt occurs.
3. Leadership principle - taxes always follow state expenditure, till they cause revolt.
4. Oppression principle – states seek votes by giving multiple majorities tax advantages over multiple minorities.
5. Entropy principle – complication and disorder delude voters, favour special interests and hinder revolt; therefore all taxes become more complex.
6. Self-defeating principle - every tax reduces its own base, thus raising other taxes which in turn reduce their tax base, leading to new taxes.
7. Volume principle - losers scream and winners mumble, thus quiet means more people are taking advantage of fewer, until they leave or revolt.
8. Revolutionary principle - tax reform is impossible without revolt.

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Thanks

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