Time for a Change
The need for a new system of taxation

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INTRODUCTION

Successive British governments have been trying to kill of the UKs own off-shore services industry for many years now. Legislation has been passed changing long held common law positions to reflect this new wave of anti-tax avoidance measures. No longer can it be said that British common law permits every Englishman to arrange his affairs so as to minimise his exposure to taxation. Such a proposition, formerly the accepted law of the land, is now not merely frowned upon but is considered heretical, immoral and unethical in these sorry times.

Draft legislation has already been proposed by a "conservative" government to criminalise the professional adviser for providing tax mitigating advice to any client in the UK.

This paper seeks to summarise some of the reasons why the tax avoidance industry is required and to suggest some macro alternatives to this status quo.

Effective Rates of Taxation

As a recent article published in the Daily Mail[1] explained, the headline rates of UK taxation are very different from the effective rates of taxation. This disparity actively impoverishes the working man in

[1] Daily Mail, 15th November 2017 – "Tax traps . . . and how the HMRC can take 88% . . ." by Tony Hazell

Britain today and is, in large part, caused by the convoluted layers of tax legislation that adds cumulatively to the tax burden.

"You may think [your tax rate is] 20 per cent or 40 per cent but the convoluted mess created by successive Chancellors means you may be taking home as little as 12p in every pound . . . of your income."[2]

The effective rate of tax is a whopping 88 per cent. In an extreme example, as explained by Deloitte, in consequence of the compounded muddled thinking of successive Chancellors, a family with eight children could see a marginal tax rate of 101.33 per cent.

With excessive real levels of tax, is it any wonder that there is a demand for off-shoring?

Destroying the UKs Offshore industry

What do you suppose is the result of legislation designed to kill off Britain's legal offshore industry?

The answer is that market forces will continue to flow, ebb and weave around all obstacles placed in its way, as Milton Friedman once explained in one of his many lecture series.

The current industry comprising tax professionals, wealth managers, wealth advisors, professional trustees, lawyers and accountants derive much of their work from the demand of UK residents (including non-Doms) to create tax shelters so that they can keep more of what they have worked for, legitimately.

All those professionals raise invoices for their services and advice. Their clients pay, and then tax is paid to the government on those invoices through VAT, and again, by the professionals by way of income tax (if the professional acts as an individual), or through a mixture of corporation tax, if the services are provided through an incorporated entity, and income tax if dividends are paid by the corporation to its shareholders.

The tax on this earned income is a valuable source of revenue for the government.

Now, when the government manages to kill off this entire industry, specialist advisers will either leave the country to ply their trade elsewhere, or lose their jobs. Either way, this change would represent a huge loss of revenue to the government's coffers, and hence to the country.

Does the government truly believe that in shutting down the UK offshore industry, they will in any meaningful way impact people's nature, behaviour and needs? The answer, if history has shown us anything, is a categoric no. People will not change their behaviour, rather they will come up with more ingenious solutions to the problems that their government has created.

[2] ibid

In the best-case scenario, people will take their wealth offshore and live off smaller increments of their own income, and seek advisers and professionals in offshore jurisdictions. In the worst-case scenario, people will fall in to the hands of non-professional advisers or worse still, criminals.

Think of the behaviour of the average US citizen in the days of US "prohibition". The fact that the law was puritanical, did not stop non-puritanical Americans from enjoying their nightly tipple . . . or three! Instead, an entire underclass of criminals was allowed to develop in order to provide the beverages that law abiding citizens used to buy (and on which today they pay sales duty). When prohibition ended, many of those criminals were, through market forces, but notably not through the coercive forces of government, left without a market in which to ply their trade. Accordingly, these criminals effectively disappeared, and millions of dollars in tax revenue found their way to the American treasury.

This is an example of the positive effects of free-market capitalism in stark contrast to the negative impact of (the usually short-sighted) coercive force of government.

In other words, it is, and always will be, the market forces which successfully dictate human behaviour not the coercive force of government.

Lower the Rates and Increase the Take

It may sound counterintuitive, however when one looks at the history of lower versus higher rates of taxation the results are incontestable.

Here are three real world historical examples of the impact that slashing higher rates of taxation has on the Gross Domestic Product of a nation state as well as upon the tax revenues received:

(i) President Coolidge slashed the top rate of taxation in the US from 70% to 25%. The result on the amount of tax paid to the IRS was a massive increase of 35% over the amount received when the tax rate was at the higher rate of 70%. The amount of money received by the federal government rose from $1.8billion in 1923 to $2.43billion in 1929. As for GDP growth, the 5 year annual GDP growth before the tax cuts were made, was only 0.8%; however, following the implementation of these tax cuts, the GDP growth rate massively increased to 4.8%

(ii) President Johnson implemented the tax cuts proposed by JF Kennedy, reducing the tax rates from 90% to 70%. Tax revenues rose by 75% between 1964 and 1969 (or from $77.7billion to $136billion). The 5 year annual GDP growth rate before the tax reductions were implemented was 3.5%; following the tax cuts the GDP growth rate increased to 4.9%

(iii) Perhaps more famously, President Reagan slashed the tax rate from 70% to 28% and that saw an increase in tax revenues of 70% (or an increase from $437billion to $672billion) between 1983 and 1986. The 5 years average annual GDP growth before the tax cuts was a paltry 1.8% however following the tax cuts, US GDP grew to a rate of 4.4%

It is clear from these three examples spanning the 20th century in the US that cutting the rate of taxation is hugely beneficial for the economy as well as for the tax revenues received by the government.

It is equally true, therefore, that raising rates of taxation has the effect of reducing the amount of the tax take for the government. This historically verified reality was summed up eloquently by professor Laffer in the (now famous) Laffer-Curve, depicting how the higher rates of taxation lead to lower levels of tax revenues for the government and that lower rates of taxation leads to higher tax revenues for the government.

If the UK successfully exits from the constraints of EU rules and regulations, it will be free to modernise its tax laws without concern for EU objections, (the reader will recall the manner in which the EU sought to interfere with Ireland's corporation tax rate). The UK will also be free to invite foreign investments that will lead to greater investment in-flows into the country and its commercial enterprises. When its commercial enterprises are set free to trade in an open free market capitalist economy, the unemployed will be more able to find remunerative work and those living on the or below the poverty line will be more capable of improving their position as well.

Market Driven Solution

Since it is free market capitalism that is best suited to instigate and guide policy, what free-market solution could there be to more sensibly resolve the problem that successive governments have been trying to coercively resolve?

To answer this question, one must first be clear about what the problem is and able to correctly define it.

The demand for tax sheltering is not the problem. Tax sheltering is not a cause but a consequence. The cause is the excessive effective rates of taxation combined with the enormous complexities and burdens of this draconian system.

Since we now know the cause, the solution should readily present itself.

The free-market solution to moving people away from their desire for tax-sheltering, is to make tax less of a burden, both in terms of effective rates of taxation and in terms of complexity. It follows that genuinely lower rates and a simplified system would result in a dramatic lessening of the need to utilise various methods and vehicles applied when seeking to mitigate the impact of tax.

Concluding Remarks

A complete overhaul of our current draconian taxation system is recommended (currently, our tax laws run to some 17,000 pages of complex – and often unintelligible – provisions) to produce a simplified system. The flat tax system would provide precisely such benefits and solutions.

The flat tax system would work in a way that boosts the governments tax revenues whilst simultaneously could quieten the banshee-like cri de-coeur "the wealthy must pay their fair share" (a horrible socialist statement based on ignorance, stirred by jealousy and spread with mendacity). Here is how the proposed flat-tax could work.

It is understood that a flat tax would require every member of society to contribute the same percentage of their income to the government. So, for example, Mr. X earning £35,000 per annum would, under a flat

tax system of (say) 12.5% pay the government £4,375.00, whereas Mr. Y earning £250,000 per annum would pay the same rate of 12.5% but that would cost him £31,250 and Mr. Z who earns £1million a year would, under this system pay £125,000.

In this fashion, each member of society is actually paying their "fair share".

However, to help the government both in terms of reducing current levels of indebtedness as well as to sell this radical proposal to the country, the flat tax system could become two-tiered, with all members of society earning up-to (say) £250,000 paying a 12.5% rate of income tax whilst a top tier of flat-tax on earners over £250,000 would pay a flat tax rate of (say) 20%.

In this way, Mr. X and Mr. Y would still pay 12.5% but Mr. Z would pay 12.5% on his first £250,000, but thereafter Mr. Z would pay 20% on any excess (in this example, £1million) being a total of £31,250 (i.e. 12.5% of £250,000) + £150,000 (i.e 20% of £750,001) = £181,250.

It is suggested by the authors that this simplified taxation system should have the following direct consequences:-

(i) Less money being spent on off-shoring

(ii) More money remaining in the UK and being attracted into the UK from foreign investors

(iii) More tax revenues for the British government

(iv) A lowering of unemployment

(v) A lowering of public debt

(vi) An end to confusing and draconian policies of taxation

(vii) An incentive for people to earn more money

(viii) An easily understood and straightforward system of direct taxation

The above direct consequences have themselves the real potential to cause the following:-

(a) The abolition of all capital based taxation

(b) The abolition of the pernicious and immoral inheritance taxes

(c) The abolition of the anti-employment NI and related taxation systems

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