

Income Tax in the United Kingdom: A Proposal for a New System



Taxation, and the laws by which it is governed, touches the lives of almost every individual in the civilised world. Arguably the most visible tax is taxation on income, levied directly upon anyone who earns over a certain threshold. Income tax in the United Kingdom is progressive; the more one earns the higher percentage one pays in tax. Progressive taxation is used to achieve various ends, most commonly wealth redistribution. This paper argues that both progressive taxation and the objective of redistribution are unjustified, breaching basic principles of liberty and equality. The paper continues to assert that not only would a proportionate tax on income would be more fair and just, but levied at a comparatively low rate it would actually result in increased government revenue. These claims are supported through an analysis of the leading jurisprudential debates between respected academics, and a comparative evaluation of economic data from countries around the world. The paper concludes with a proposal for a new flat rate income tax levied at 25%.

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Introduction

“...in this world nothing can be said to be certain, except death and taxes.”

- Benjamin Franklin

It is no overstatement to assert that taxation, and the laws by which it is governed, touches the lives of almost every individual in the civilised world. Certainly in the United Kingdom, from the wage one earns, to the goods and services one purchases, to the estate one bequeaths upon death, taxation is unavoidable. It is perhaps due to this fact that taxation is not merely a branch of law in its own right, but rather covers many aspects of legal study. Taxation may be a criminal matter when individuals engage in illegal tax evasion. It may be a constitutional matter; from what taxes a government may legally levy, to the very question of democratic representation. The specific rules governing taxation of companies and their produce, imports and exports, are obviously pertinent to commercial law. It is also a highly political subject, and as such there is much jurisprudence and political philosophy surrounding taxation and related topics, asking questions such as ‘what should be taxed?’, ‘how much should be taxed?’ and ‘for what purpose?’

There are four key reasons commonly identified as the main purposes behind, or outcomes of, taxation, often called the four ‘R’s’¹. The first, **Revenue**, describes tax as a means of meeting the government’s fiscal requirements. Despite alternatives such as borrowing or selling assets, taxation remains the primary method of raising capital. The tax system can also be used for **Redistribution**, the second ‘R’, whereby the government attempts to reduce inequality between citizens through the use of taxation. The predominant theory is that progressive taxation, where wealthier individuals pay a higher rate of tax than less wealthy individuals, is the best way of achieving redistribution. This is as opposed to proportionate taxation, which involves everybody paying the same rate of tax irrespective of their income. The third ‘R’ is **Re-pricing**, whereby taxes are levied on certain goods or services in order to make them more or less attractive to the public. The most obvious example of this is taxation

¹ Tax Justice Network, “Democracy, Tax and State-Building”, retrieved from http://www.taxjustice.net/cms/front_content.php?idcat=130 on 28/04/11.

on alcohol and tobacco, intended to reduce the nation's consumption of the aforementioned substances. Re-pricing also encompasses those taxes used to control inflation. Finally, **Representation** is the process through which the populous can hold the government to account by virtue of paying taxes. This stems from the colonial slogan '*no taxation without representation*' which was popular prior to the American Revolution.

Adam Smith, often regarded as the father of modern economics, described four maxims which he believed should set the minimum requirements for any tax levied by the government. Simplified, these are:

- Proportionality – everybody should pay tax in proportion to the revenue they enjoy under the protection of the state.
- Certainty – taxes should not be arbitrary, it should be certain how much has to be paid, at what time, and by what method.
- Convenience – taxes should be collected in a manner most convenient to the citizen.
- Efficiency – tax collection should be administered in the most efficient and cost-effective way.²

These criteria are as relevant today as when Adam Smith was writing in 1786, and so shall act as a guide whilst assessing the merits of various tax systems.

This paper shall focus specifically on levels of taxation – the tax rate. Just as sentencing constitutes one of the most significant aspects of the criminal legal system, rate of taxation is central to tax law itself. Representation through taxation shall thus not be considered, both because this constitutional matter would require an investigation of its own, and because the actual rate of taxation is not necessarily relevant to the question of representation once there is taxation at all. Re-pricing shall similarly not be considered. In 2008, Duties on alcohol and tobacco accounted for only 3.28% of total tax revenue³; furthermore there is almost universal consensus regarding the success of such duties in decreasing consumption. This paper shall instead concentrate on redistribution and revenue, identified by professors of law and philosophy Liam Murphy and Thomas Nagel as the two primary reasons behind taxation⁴. As such, the focus shall be on income tax, which is both the main source of government revenue,

² Adam Smith, *An inquiry into the nature and causes of the wealth of nations*, (London: The Electric Book Company Ltd, 1998) pp. 1103-06

³ OECD (2010), *Revenue Statistics 2010 – Special Feature: Environmental Related Taxation*, OECD Publishing. http://dx.doi.org/10.1787/rev_stats-2010-ev-fr p. 211

⁴ Liam Murphy & Thomas Nagel, "Taxes, Redistribution and Public Provision", *Philosophy and Public Affairs*, Vol. 30 No. 1 (Winter:2001) pp.53-71

and the most progressive tax levied with the aim of reducing inequality. In part one, an analysis of the predominant literature on the matter of redistribution shall demonstrate that progressive taxation for this purpose is not only unjustified, but also ineffectual. Part two of this paper shall subsequently demonstrate how a lower proportionate rate of income tax in the United Kingdom could in fact return higher revenues. This assertion shall be considered in light of economic theories and a comparative and historical analysis of the tax systems employed by other OECD countries. The paper will conclude that a single proportionate income tax at a low rate is not only more justifiable than the current progressive system (described in Appendix A), but could also result in higher returns for the government. This conclusion shall be in the form of a proposed income tax system based on a 25% flat tax with a £15,000 pre-tax allowance.

Part One

Redistribution

What is Redistribution?

“That is not a just government... where the property which a man has... is violated by arbitrary seizures of one class of citizens for the service of the rest.”

- James Madison

Redistribution is not simply the case of one individual, or group thereof, becoming wealthier, and another poorer. If one man spends £10,000 on a holiday whilst another wins the same amount playing the lottery, a change in distributions has occurred. However, **redistribution** as a purposive economic activity requires that one man's loss intentionally facilitates another's gain. The difference is subtle, yet crucial. Changes in distribution occur all the time, as in the above example; however such changes are the natural result of individuals' decisions and luck. Redistribution, as a government policy or ideal, is purposive – it is the intentional result of particular government action. Furthermore, redistribution entails the removal of, or reduction in, wealth from one group in order for it to be distributed amongst another. This is most commonly achieved through an arrangement of progressive taxation and social welfare policy. Put simply, higher earning individuals pay a greater proportion of their income in wealth, which is subsequently spent on services and enterprises which are of most benefit to the poorer members of society.

This section of the paper will draw primarily from the work of Friedrich A. Hayek and Robert Nozick, analysing the strength of their respective arguments on redistribution against their major critics. The section will conclude that redistribution is both unjustifiable and ineffectual; however, pursuing a policy of changing distribution in order to better the position of the poorest in society is correct, so long as it is not facilitated by redistributive means, i.e. progressive taxation.

Nozick and Hayek

“You don’t make the poor richer by making the rich poorer.”

- Winston S. Churchill

Written in 1974, Robert Nozick’s *Anarchy, State, and Utopia*⁵ argues that “[t]he *minimal state is the most extensive state that can be justified.*”⁶ As a libertarian, he opines that anything beyond the minimal state inevitably violates the rights and liberties of individuals, and in Chapter Seven he addresses the topic of ‘distributive justice’ in light of this assertion.

Nozick opens with a discussion of ‘initial distribution’ – how private property and the initial distribution of resources can be justified – which is beyond the remit of this paper. Nonetheless, the beauty of Nozick’s primary argument against redistribution is its applicability to most concepts of distributive justice – it shall be referred to as ‘redistribution as against liberty’. Put simply, Nozick alleges that redistribution according to any patterned principle of justice necessitates violating people’s liberty. A patterned principle of justice is one which seeks to distribute resources according to a particular formula, which includes “[a]lmost every suggested principle of distributive justice...”⁷ Obvious examples would include purely equal distribution (egalitarian), distribution according to moral merit, need, use to society etc. Nozick’s argument is that in exercising their liberty, perhaps by simply purchasing goods or donating gifts to loved ones, such patterns are disturbed, and he offers the famous ‘Wilt Chamberlain’ allegory to exemplify the point⁸.

If one chooses their favourite form of distribution, be it utilitarian, egalitarian, or any other form of patterned principle, let this be called *d1*. Next suppose that the famous basketball player Wilt Chamberlain, who is in popular demand, charges \$1 to every spectator wishing to view him play. After one year, and one million spectators, Wilt Chamberlain is \$1m wealthier than everybody else – this new distribution is *d2*. This second distribution is obviously going to be different to the original, *d1*. In fact, the only way to maintain *d1* is to

⁵ Robert Nozick, *Anarchy, State, and Utopia*, (New York: Basic Books Inc, 1974)

⁶ Ibid., p. 149

⁷ Ibid., p. 156

⁸ Ibid., p. 161

infringe on people's liberty, either before the fact by stopping people paying \$1 to see Wilt Chamberlain, or after the fact by redistributing the player's newly earned wealth. As Nozick states,

*"To maintain a pattern one must either continually interfere to stop people from transferring resources as they wish to, or continually interfere to take from some persons resources that others for some reason chose to transfer to them."*⁹

This obviously constitutes an infringement upon people's basic liberties. If one is to safeguard liberty by accepting the initial distribution of resources (*d1*) as just and then allowing individuals to transfer their assets, *d1* must be sacrificed and *d2* accepted as just.

Nozick's second argument against redistribution follows from the first – it shall be referred to as 'taxation as slavery'. Assuming one's desire is to sustain the initial, just distribution of resources, *d1*, Nozick concludes that redistribution is inevitable. However, not only does this violate people's basic liberty in transferring resources to one another, Nozick argues that redistribution by way of "[t]axation of earnings from labour is on par with forced labour."¹⁰ He sees little difference between forcing an individual to work for five extra hours to help the needy, and taxing someone five hours' worth of wages. One response might state that under a system which taxes only above a certain threshold, individuals can simply choose to work less in order to pay less tax. In response, Nozick compares two hypothetical individuals¹¹. Both perform equal work, however in their free time one takes enjoyment from certain goods or services, and another prefers spending his time doing leisure activities, such as hill walking. The first man must work longer to earn above his basic needs so that he might spend the extra money on certain goods – not forgetting that he is also taxed on anything he earns above the basic limit. The second man spends the extra hours hill walking. Presuming one would find it objectionable for a tax system to seize one's free time to help the needy, Nozick asks why it is more justified in seizing a man's goods instead. One might assert that the first man **chooses** to work extra hours, and thus ought to pay the extra tax. This would constitute a very simplistic interpretation of what it is to make a choice. If the first man wishes to engage in those 'materialistic' activities which please him, he has **no** choice but to work extra hours. If he does not work longer, his only alternative is to earn up to the basic minimum and consequently forgo any of his (more expensive) leisure activities. Forcing someone to work

⁹ Robert Nozick, op. cit., p. 163

¹⁰ Ibid., p. 169

¹¹ Ibid., pp. 170-1

extra hours for free and taxing the earnings of someone who works the extra hours of his own accord are both essentially a tax on leisure, the only difference being one man's leisure costs money, and the other's costs time. Nozick goes further, suggesting that it is paradoxical that the first man, who is working extra hours to the benefit of a third party who employs him, should be taxed **on top** of the extra hours he is working, whilst the second man is not. A further point to note is that the first man, even if he weren't being taxed, is still benefitting the community as a whole more than the second man through working extra hours and thus further stimulating the economy. It should be noted that Nozick accepts some degree of tax for raising revenue as a necessary evil. 'Taxation as slavery' is presented to demonstrate why such taxation should be as minimal a burden on the taxpayer as possible.

Hayek's arguments against progressive taxation are proposed to demonstrate that progressive taxation simply does not work as a means of wealth redistribution. These two arguments shall be explicated before examining Hayek's assertion that progressive taxation is ineffectual. The first – 'progressive taxation as arbitrary' – follows.

Hayek begins with the suggestion that the justice of progressive taxation is nothing more than a presumed justice; progressive taxation is "*no more than a rejection of proportionality in favour of a discrimination against the wealthy...*"¹² Hayek quotes the Royal Commission on Taxation of Profits and Income as confirming that progressive taxation as a theory does not suggest any ideal rate of progression¹³, but rather, "*there is no reason why 'a little more than before' should not always be represented as just and reasonable.*"¹⁴ The arbitrary nature of progressive taxation clearly violates Adam Smith's principle of all taxes being certain (see page 5), however Hayek's objection continues further. He claims that the principle 'adopted' under progressive taxation is one of discrimination by a majority (literally, the majority of citizens) against a more affluent minority (the wealthy). Despite any argument that may exist regarding the ability of, and therefore equity in, the rich paying higher taxes, Hayek states that for a majority to impose upon a minority a rule which it does not apply to itself is contrary to a principle "*more fundamental than democracy itself...*"¹⁵, namely equality before the law. It is rejected that taxing one man 20% of his income and another 50% could ever be

¹² Friedrich Hayek, *The Constitution of Liberty*, (Chicago: The University of Chicago Press, 1960), p. 313

¹³ Inland Revenue, *The Royal Commission on Taxation of Profits and Income – Second Report*, Cmd. 9105 (London: HMSO 1954) s. 142

¹⁴ Friedrich Hayek, op. cit., p. 314

¹⁵ Ibid.

considered equal¹⁶ - progressivity shifts the tax burden from those who determine the rate (the voting majority) to those paying.

Hayek's second argument shall be referred to as 'progressive taxation as disincentive'. It follows that progressive taxation renders remuneration for work done dependent upon other earnings over a certain period of time, namely the tax year.

“[P]rogressive taxation necessarily offends against what is probably the only universally recognised principle of economic justice, that of ‘equal pay for equal work’.”¹⁷

Hayek uses the example of two lawyers working on identical cases. One may be in high demand and thus has worked many other cases throughout the year, subsequently earning a higher income. The other is less talented and has thus earned less over the year. Under progressive taxation, the first lawyer would earn less than the second for work conducted on an identical case, purely because of his other work throughout the year – the two men do not receive equal pay for equal work done on an identical case.¹⁸ This analogy can extend to a comparison of any two individuals performing equal work, where 'equal work' is defined by any measure, i.e. equal standard, equal number of hours etc. What each comparator earns after progressive tax is entirely dependent upon the amount and value of work conducted over a given time period – remuneration is not equal. Hayek argues that this reality has an effect on incentive, as *“the more consumers value a man's services, the less worthwhile will it be for him to exert himself further.”¹⁹* Such a disincentive can have repercussions in many areas. For example, people are less likely to make certain investments – particularly those with higher risk – if a great deal of return on such investments is to be paid in tax. As higher risk investments are typically those which provide a greater return, such economy-stimulating activities as starting new businesses or investing in emerging markets are hindered by a progressive tax system. Not only does this affect the economic growth in any given country, but it means that a progressive tax system favours existing companies, reducing competition and increasing the potential for monopoly. People also have a disincentive to save money, as higher savings accrue a larger tax liability under a progressive system. The benefits of saving cannot be stressed enough, particularly after the largest recession in 70 years.

¹⁶ Ibid., p. 315

¹⁷ Ibid., p. 316-17

¹⁸ Friedrich Hayek, op. cit., p. 317

¹⁹ Ibid.

In presenting his arguments against progressive taxation, Hayek also attempts to explain why such a system gained and sustained popularity throughout the 20th century. He hypothesizes that the populous regards income *“not as related to value of the services rendered but as conferring what is regarded as an appropriate status in society.”*²⁰ Thus, he suggests, people hold a prejudice, or envy over, those with high incomes because they do not believe such high earners should command such a high status in society. This reasoning ignores what service or work an individual may have done to merit a high income. Considering that Hayek was writing in 1960, his view may still have merit today. Findings of the National Centre for Social Research reveal that in 2009 over one third of people believed in the government pursuing a policy of wealth redistribution, and that the chairman of a large national corporation should not earn more than six times that of an unskilled factory worker.²¹ Taken together, these statistics do not necessarily indicate social envy, however they are certainly indicative of Hayek’s assertion that people do not regard high incomes as a related to the value of services rendered. To further validate his hypothesis, Hayek doubts whether *“a society consisting mainly of ‘self-employed’ individuals would ever... have thought of taxing the earnings from a certain service according to the rate at which they accrued over time.”*²²

Whatever the reasons for its successful inception, Hayek concludes that progressive taxation is arbitrary, offending democratic principles such as equality before the law and equal pay for equal work, and that it acts as a disincentive to working harder, investment, and saving. It is for these reasons, he concludes, that progressive taxation does not actually work as a redistributive measure. His claim can be corroborated to some degree by looking at the available data on inequality.

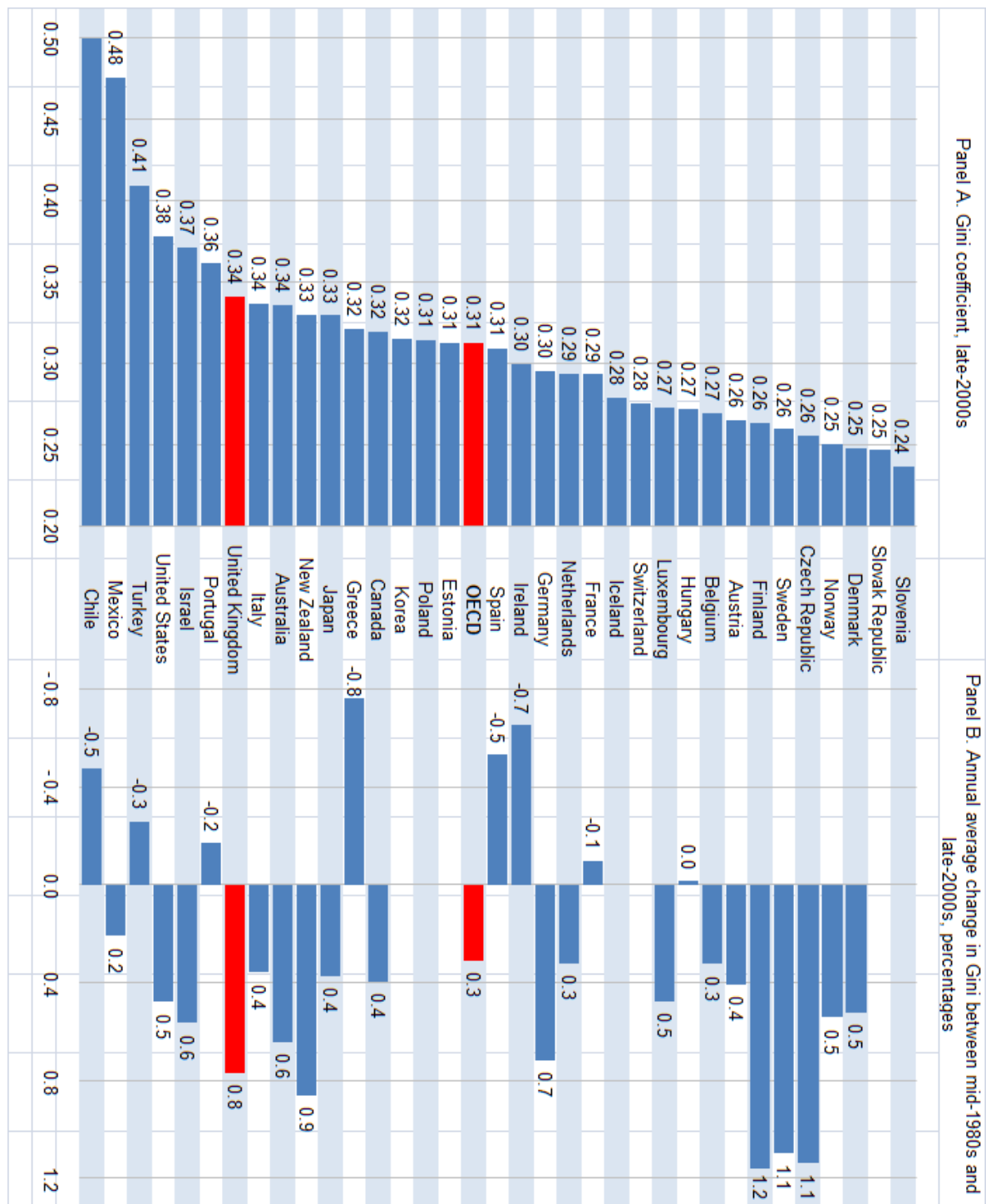
The Gini coefficient (mathematical explanation in Appendix B), named after Italian statistician Corrado Gini, is commonly used as a measure of inequality of a distribution, in our case wealth, with a score of ‘0’ signifying complete equality, and ‘1’ inequality. Figure 1 Panel A below demonstrates how the United Kingdom has one of the highest levels of inequality for member state of the Organisation for Economic Cooperation and Development, and is higher than the OECD average. Panel B of the same table shows that inequality in the UK has grown by an average of 0.8% per annum between the mid-1980s and late-2000s.

²⁰ Ibid., p. 318

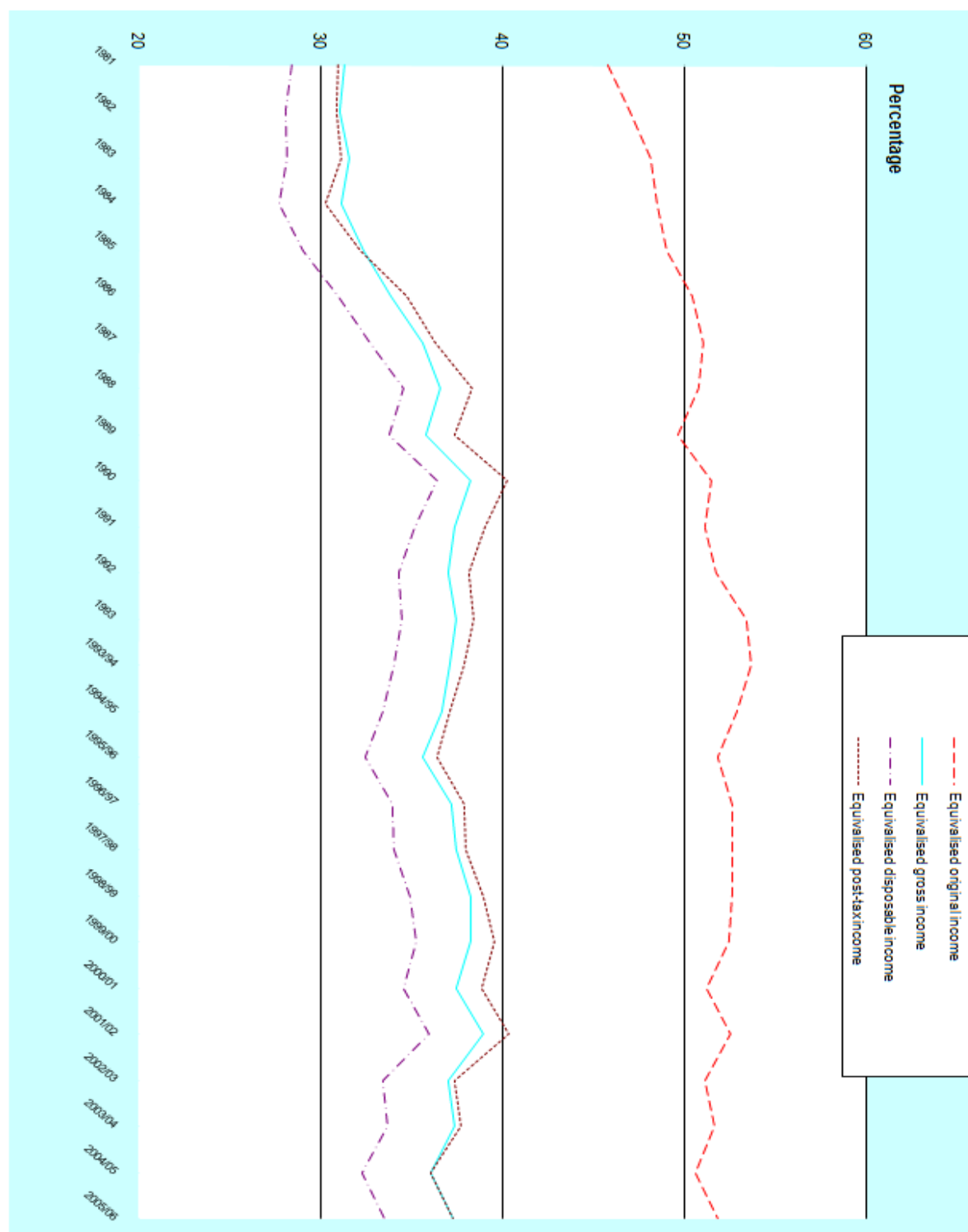
²¹ National Centre for Social Research, *British Social Attitudes – 27th Report*, available at <https://spreadsheets.google.com/cc?key=0AonYZs4MzIZbdFNNRzNGR3VzUTh3VWlaa2duOHBKNVE&hl=en#gid=0> on 08/05/11

²² Friedrich Hayek, op. cit., p. 319

Naturally, any number of factors could be contributing to rising inequality, not the tax system alone. However in Figure 2, displaying the changes in inequality of income in the UK since 1981 to 2005/6, it is shown that since 1985 income inequality has been consistently higher **after** tax. In 2001, inequality after tax was 1.4% higher than before tax. This shows that the progressive tax system in the UK is not only failing to address income inequality, it is in fact exacerbating it. Progressive tax is failing to redistribute wealth and income in the United Kingdom.

Figure 1²³

²³ OECD, *Society at a Glance 2011: OECD Social Indicators*, (OECD Publishing, 2011) p. 71

Figure 2²⁴

²⁴ Office for National Statistics, *Gini coefficients, 1981 to 2005/06 (per cent): The effects of taxes and benefits on household income*, available at <http://www.statistics.gov.uk/statbase/ssdataset.asp?vlnk=9604&More=Y> on 08/05/11

Objections to Nozick and Hayek

“Collecting more taxes than is absolutely necessary is legalized robbery.”

- Calvin Coolidge

Neither Nozick nor Hayek are without their opponents, and it would be impossible to address the arguments of all those writing against the principles outlined above. Therefore, this section shall seek to examine some of the main opposing arguments from a range of political and philosophical viewpoints, measuring the validity of such contention against the principles discussed above, namely ‘redistribution as against liberty’, ‘taxation as slavery’, ‘progressive taxation as arbitrary’, and finally ‘progressive taxation as disincentive’.

Rawls

No discussion of Nozick’s work could be complete without also considering that of John Rawls. Nozick himself wrote about *A Theory of Justice*²⁵, “[p]olitical philosophers now must either work within Rawls’ theory or explain why not.”²⁶ Considering the degree of conflict between the theories of justice proposed by both writers, it is surprising that with regards to the matter of tax, in particular for the purpose of redistribution, there is great consensus.

The inalienable keystones of Rawls’ theory are two so-called principles of justice. The first principle, which takes priority over the second, is that all individuals have an “*equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all.*”²⁷ Included under this principle are basic political freedoms, freedom of speech and thought, freedom from physical and psychological oppression etc. The second principle dictates that social and economic inequalities must be arranged for the greatest benefit of the least advantaged, and attached to offices and positions which are available to all under the

²⁵ John Rawls, *A Theory of Justice*, rev. ed. (Cambridge: Harvard University Press, 1971)

²⁶ Robert Nozick, op. cit., p. 183

²⁷ John Rawls, op. cit., p. 266

principle of equality of opportunity²⁸ – this is the difference principle. Although Rawls wrote comparatively little on the matter of taxation, numerous academics have extrapolated various ‘Rawlsian’ views on the subject. Robert Ehman interprets Rawls’ first principle, regarding liberty, as forbidding market intervention through taxation without the unanimous consent of those affected²⁹, a view shared with David Hasen³⁰. The parallel can be drawn between this conclusion and Nozick’s ‘taxation as slavery’, which similarly views compulsory taxation as a violation of liberty. Both Rawls and Nozick would presumably accept taxation with the consent of those being taxed, as in Rawls’ case liberty is being surrendered willingly, and under Nozick’s argument slavery clearly isn’t so if the ‘slave’ consents.

Rawls does concede that some scheme of taxation may be necessary in order to raise the revenues required to maintain justice. He advocates for an expenditure tax, arguing that it is more just, being levied only according to the resources an individual consumes. Furthermore, he supports the expenditure tax being proportionate, again drawing from his first principle of justice in so far as a progressive tax would be contrary to equality, and only justified if it was necessary to “*preserve the justice of the basic structure with respect to the first principle of justice and fair equality of opportunity...*”³¹ As a cursory note, Rawls indicates Hayek’s ‘progressive taxation as disincentive’ argument as being a further reason to prefer a proportionate tax. This proportionate expenditure tax thus satisfies Rawls’ first principle – liberty – in that individuals have choice in what they purchase; none are forced to pay tax as under an income-based system. Furthermore, as Linda Sugin confirms³², a proportionate expenditure tax does not conflict with the difference principle if the revenue is spent in such a manner that benefits the least-advantaged of society. This would constitute a policy of changing distributions in making the least-advantaged wealthier, as opposed to redistribution, as all citizens are taxed proportionately.

In terms of taxation, then, Rawls and Nozick reach a significant level of agreement in their beliefs that taxation acts contrary to individual liberty. Furthermore, Rawls’ difference principle has the effect of changing distributions, however it is not actively redistributive, and thus does not conflict with Nozick’s ‘redistribution as against liberty’. The reason for this is

²⁸ John Rawls, op. cit., p. 266

²⁹ Robert Ehman, “Rawls and Nozick; Justice Without Well-Being”, in *Equality and Liberty – Analysing Rawls and Nozick*, edited by J. Angelo Corlett (New York: St. Martin’s Press, 1991) p. 322

³⁰ David Hasen, “Liberalism and Ability Taxation”, *Texas Law Review*, Vol. 85 No. 5 (April:2007) p. 1068

³¹ John Rawls, op. cit., p. 246

³² Linda Sugin, “Theories of distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems”, *Fordham Law Review*, Vol. 72 (2004) p. 1994-96

thus. The difference principle allows for only those inequalities which better the position of the least advantaged; it does not facilitate the improving of the least advantageous position through the lowering of a more advantageous one. An able man might perform a task which makes him ten times richer, whilst making the less able man only twice as rich. Distributions have changed and inequality has increased, yet this is permitted under the difference principle. Alternatively, the able man might perform a task which only makes him twice as rich, but makes the less able man ten times wealthier. Again, distribution has changed, only this time inequality has reduced. The significance is that the difference principle does not dictate that those who are better off must worsen their position to the benefit of those who are least well off; it is not redistributive, it simply maintains that any change in distributions is always to the benefit of the least well off.

To summarise, there would appear to be consensus between Rawls and Nozick that taxation, certainly on income and wealth, is contrary to personal liberty. If Rawls' theory of justice does require taxation, he advocates a proportionate expenditure tax. This continues to be compatible with personal liberty, and the proportionality element is also in accord with Hayek's two arguments, because it treats consumers of resources equally ('progressive taxation as arbitrary') and it does not act as a disincentive to work, invest or save ('progressive taxation as disincentive').

Marxism

Cheyney C. Ryan, Professor of Philosophy and Law at the University of Oregon, has developed his own counter-arguments against Nozick's theory, in particular against the principle of 'redistribution as against liberty'. He exemplifies much of his argument by applying Marxism as the initial distribution, *d1*, in Nozick's own demonstration of his argument; it will thus be convenient to use this section not only to comment upon Ryan's own assertions, but also any arguments in favour of redistributive progressive taxation arising from Marxism (and for our purposes, Communism and Socialism).

The core of Ryan's argument lies in an objection to Nozick's assessment of patterned principles of distribution upsetting liberty; he accuses Nozick of simply presuming that individuals have ownership of whatever 'holding' is being distributed according to a pattern.

“[F]or any set of holding, sustaining a pattern implies coercive restrictions (restrictions on personal liberty) only if the ‘holdings’ are private property – holders have full rights of ownership in them.”³³

He continues, stating that restriction on the exchange of holdings which aren’t private property does not amount to an infringement upon one’s liberty, as without the element of private property there are no rights being subverted³⁴. He exemplifies the point with Marxism, under which private property rights only extend to personal items; most other holdings such as *“means of production”*³⁵ and *“natural resources”*³⁶ belong to the community as a whole, with no one individual being able to claim any ownership rights. If Marxism is thus deemed to be the theory of justice guiding the initial distribution (*d1*) of natural resources, for example, then either individuals do not possess unlimited rights to deal with their share of holdings (they can only use them as Marxism dictates), or alternatively, should the distribution change to *d2*, redistribution can occur without the violation of liberty (again, because individuals never had full rights in their holdings).

Nozick’s response is to argue that an individual under Marxism could work overtime in order to accrue more personal items, which he could then trade with other workers in return for their labour. Nozick’s reasoning is that the individual would take ownership of the products of others’ labour, whom he is paying with personal items. If Marxism forbade this activity, or acted to redistribute the said products, then this would constitute a violation of liberty. However, Ryan asks again why the entrepreneurial individual takes ownership of said products, as opposed to simply being in possession of them; *“[T]he mere fact that one has come to possess a good does not imply that one has acquired the rights of ownership in it.”³⁷* A more appropriate response to Ryan’s objection would refer back to an individual’s most basic right – ownership of himself. If a man owns himself – an assertion which no credible theory of justice denies, least of all Marxism – and he uses his spare time to accumulate extra natural resources, then the initial distribution of natural resources changes from *d1* to *d2*. If redistribution consequently occurs, it is an effective taxation on the worker’s time. The extra natural resources are the fruits of the man’s labour; however he need not have any proprietary

³³ Cheyney C. Ryan, “Yours, Mine, and Ours: Property Rights and Individual Liberty”, in *Equality and Liberty – Analysing Rawls and Nozick*, edited by J. Angelo Corlett (New York: St. Martin’s Press, 1991) p. 330

³⁴ Ibid., p. 331

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid., p. 333

rights in the extra resources for their confiscation and redistribution to constitute a breach of the man's liberty. Redistribution of the remuneration, whatever rights he may or may not have in that remuneration, results in the man having worked for the community for no return. As Nozick writes, "*taking the earnings of n hours labour is like taking n hours from the person.*"³⁸ Thus, Ryan's objection only holds true if one's preferred theory of justice does not allow for a man to have ownership of himself.

The above reasoning also demonstrates why Marxism, and its derivatives, Socialism and Communism, cannot justify redistribution. At the core of such theories is the principle that the workers, the proletariat, are entitled to the full fruits of their labour, all men are equal, and every man owns himself. If Marxism, Communism or Socialism prevent an individual from working extra time for extra remuneration, whatever that remuneration might be, then his liberty is offended as he is not able to exercise his self ownership. Alternatively, if the fruits of his extra labour are confiscated to be redistributed amongst the entire community, then it is an effective tax on the individual's time, again, offending his liberty of self ownership. Under Marxism and similar theories, either the initial d_1 distribution is allowed to change to d_2 , in which case the principles of Marxism are no longer in operation, or redistribution occurs, offending the core principle of Marxism, namely the proletariat's self ownership and right to the full fruits of their labour. Furthermore, 'taxation as slavery' and 'redistribution as against liberty' are not the only principles which Marxism offends. If anything an individual earns through working extra hours is confiscated, then the principle of 'redistribution as disincentive' clearly applies, as the individual will have no incentive to work extra hours when receiving nothing in return.

Utilitarianism

Utilitarianism can fairly be described as one of the most influential theories ever devised in the study of philosophy. Almost all competing theories, including those of Karl Marx and John Rawls, have dedicated some discussion to utilitarianism.

John Stuart Mill, one of the greatest writers of the 19th Century and advocate of utilitarianism, explains the theory's central tenet as "*hold[ing] that actions are right in proportion as they*

³⁸ Robert Nozick, op. cit., p. 169

tend to promote happiness, wrong as they tend to produce the reverse of happiness.”³⁹ It follows that a just society under utilitarianism is one where resources are distributed in such a manner as to bring the greatest utility, or happiness, to the largest number of people. This is a prime example of a patterned principle of justice, however, it does not automatically offend Nozick’s principle of ‘redistribution as against liberty’ as one might initially expect. Suppose a particular resource is distributed according to utilitarianism, d_1 , and subsequent to individuals using their resources in various ways, the distribution moves to d_2 . Under utilitarianism, the ultimate goal is always to maximise utility; this principle transcends any other principles of personal liberty. Therefore, if redistribution occurs in pursuit of maximising utility, this is *prima facie* justified under utilitarianism, even if it does encroach on what we understand as ‘personal liberties’. However, this analysis only considers ‘act utilitarianism’, whereby the validity of each independent action is considered. Alternatively, ‘rule utilitarianism’ sets a series of rules which, followed continuously, are designed to maximise utility. It is arguable that the constant violation of people’s liberties through redistribution would in fact result in less overall utility, as individuals would rarely be able to trade their goods or bestow gifts etc. A rule which thus either protected people’s exchanges, or prohibited redistribution, would consequently be fully compatible with ‘rule utilitarianism’ and would not offend the principle of ‘redistribution as against liberty’.

Whether or not the principle of ‘taxation as slavery’ conflicts with utilitarianism depends on the size of the population being taxed. One of the anomalies with utilitarianism generally is that it justifies a larger population using a smaller one as a forced labour, as in purely numerical terms more people derive utility from such an arrangement. Therefore, the principle of ‘taxation as slavery’ is compatible with utilitarianism so long as the taxed population is sufficiently smaller than the untaxed population. If, however, under rule utilitarianism liberties were protected, the taxation of any proportion of the population would be incompatible with the ‘taxation as slavery’ principle.

The relevance of the principle of ‘progressive taxation as disincentive’ is again dependant on one’s specific interpretation of utilitarianism. Traditional utilitarianism is a quantitative theory, that is, it seeks to create the greatest utility for the largest number of people. However, Mill discusses the idea of the qualitative utility of different resources; “[i]t would be absurd

³⁹ John Stuart Mill, *On Liberty and Utilitarianism*, ed. with intro. By Alan M. Dershowitz, (New York: Bantam Books, 1993) p. 144

*that... the estimation of pleasures should be supposed to depend on quantity alone.*⁴⁰ He continues, “[a] *being of higher faculties requires more to make him happy...*”⁴¹ With regards to the progressive taxation of a particular resource, income for example, consider the two men from one of Nozick’s discussions – the first man who enjoys hill walking, and the second who prefer material goods. The progressive taxation of income would likely act as no disincentive for the first man, as the pursuits which bring him the greatest utility cost no money. Alternatively, should the materialistic man be subjected to progressive taxation, he must either work harder to enjoy the full utility in his resources (i.e. purchase goods or services) or else he must forgo some of his overall happiness. Either way, his utility is somewhat frustrated. This is the situation if progressive taxation is still for the purpose of income redistribution from the wealthy to the less so. What many will find more disturbing is how utilitarianism could in fact justify regressive taxation – taxing the poor and redistributing to the rich. As the first man does not require most of his income to go hill walking, whilst the second man takes greater utility from purchasing goods with a higher income, utilitarianism would support the redistribution of wealth to the second man. This regressive taxation could in fact act as a disincentive for first man, who is now poorer, to work at all; he does not need most of his income, which will be taxed anyway – why work?

Despite its longevity, Utilitarianism is not without problems. Rule utilitarianism would surely have to include protection of liberty, which would render any attempts at taxation for the purpose of redistribution contrary to the principles of ‘redistribution as against liberty’ and ‘taxation as slavery’. Disturbingly, act utilitarianism would most likely allow violations of basic liberties, including forced labour. Finally, whilst progressive taxation would act as a disincentive under utilitarianism, the theory would more likely advocate some form of regressive taxation, which, being most burdensome on the poor, would act as a disincentive for the poorest individuals to work.

Egalitarianism and Desert-Based Theories

The nature of these final sets of theories is such that they can be dealt with relatively swiftly. Egalitarianism is a classic example of a patterned principle of justice. Whilst it separates into

⁴⁰ John Stuart Mill, op. cit., p. 146

⁴¹ Ibid., p. 147

many different forms which would require extensive discussion, pure egalitarianism shall be concentrated upon.

Pure egalitarianism is essentially equality in its most basic form – the equal distribution of income and wealth amongst all people. This theory does not allow for distinctions between people on any grounds, such as how hard one works, or what skills one has. If $d1$ is egalitarian, once again through people dealing with their holdings the distribution would naturally become $d2$. To maintain equality, redistribution would have to occur, offending Nozick's 'taxation as slavery' and 'redistribution as against liberty' principle. A progressive tax employed to implement such redistribution would naturally offend Hayek's principle of 'progressive taxation as disincentive', as individuals who were able to earn more would have no incentive to do so in light of a progressive income tax. Moreover, an egalitarian system would in itself act as a disincentive to work. If individuals received exactly the same remuneration regardless of how long or hard they worked, regardless of the profession they led, there would be a disincentive for anybody to undertake an array of challenging occupations, or exert themselves beyond the basic minimum requirements of a particular job. Finally, a redistributive tax under egalitarianism would be in opposition to Hayek's 'taxation as arbitrary'. Every individual would have to pay a different proportion of their income according to how much more they had managed to accrue than everybody else. This clearly does not respect any form of equality within the tax system itself – the tax would be based not on actual earnings, but an end goal of pure equality amongst all people. It would be simple discrimination against any individual who was a harder worker, or more lucky, or more entrepreneurial.

As Heather Milne describes,

*"[a] desert claim makes reference to a departure from equality that has come about through the infliction of costs on a person, either by himself or by others; the former makes a claim to reward and the latter claims to compensation."*⁴²

Distribution therefore occurs according to what people deserve; desert arising from activities such as working, whether this is through making and selling goods, or providing ones services to others⁴³. This theory naturally allows for inequality, as some individuals will inevitably work harder, and consequently earn more, than others. It would therefore appear

⁴² Heather Milne, "Desert, Effort and Equality", *Journal of Applied Philosophy*, Vol. 3 No. 2 (1986) p. 238

⁴³ Joel Feinberg, *Doing and Deserving*, (New Jersey: Princeton University Press, 1970) pp. 55-94

that taxation for the purpose of redistributing incomes is not required, the system itself embracing unequal distribution of wealth. However, traditional desert-based theories do not consider the trades which occur between individuals – if one man donates some of his earnings to another, the recipient cannot be said to have earned the money; strictly speaking, he does not deserve it. In such a society, some form of redistribution would have to take place to maintain a *d1* based entirely on desert. The familiar problem of offending ‘redistribution as against liberty’ consequently arises, as redistribution would effectively render any gifts void. Interestingly, this would not offend ‘taxation as slavery’, as the recipient of a gift would not necessarily have laboured for his endowment. In fact, redistribution would more likely occur through a 100% gift tax as opposed to an income tax, which does not concern this paper. Nonetheless, Michael A. Slote provides a caveat which, combined with justice as desert, would circumvent problems arising out of the giving of gifts, namely ‘consent’.

“I do not doubt that some notion of desert has a role to play in the concept of justice, but in no case do I think that that notion exhausts the idea of justice. There is, I believe, an important further element in the notion of justice, the notion of free consent.”⁴⁴

This element of consent allows individuals to exercise the use of their holdings as they wish, having being earned. No redistribution is therefore necessary, as any inequalities arising are deemed just and deserved.

⁴⁴ Michael A. Slote, “Desert, Consent and Justice”, *Philosophy and Public Affairs*, Vol. 2 No. 4 (Summer: 1973) p. 333

Conclusions on Redistribution

“A fine is a tax for doing something wrong. A tax is a fine for doing something right.”

- Anonymous

Part one of this paper has attempted to demonstrate why progressive taxation on income for the purpose of redistribution is both unjustified and ineffective at tackling inequality. It would be impossible to address all arguments in support of a progressive tax system, however a discussion of some of the leading philosophical arguments has shown how, in supporting progressive tax, they are either self-contradictory, or in opposition to the basic tenets of liberty. To justify support for redistribution through progressive taxation, one would have to demonstrate why the principles of ‘redistribution as against liberty’, ‘taxation as slavery’, ‘progressive taxation as arbitrary’ and ‘progressive taxation as disincentive’ are either incorrect, or may be justifiably disregarded in favour of some other principle. Few, if any, theories of justice succeed at this. Rawls’ ‘Justice as Fairness’ does not permit the violations of liberty committed by a progressive income tax, and recognises disincentives such a system produces. Marxist theories would have to deny liberties as basic as self-ownership in order to justify redistributive taxation, a denial which would completely undermine Marxism’s defence of the worker, and the proletariat’s right to the full fruits of his labour. Utilitarianism would not only potentially justify the greatest violations of liberty in pursuit of redistribution of wealth (supporting slavery), but redistribution of wealth from the poorest in society to the richest would potentially be justified. Alternatively, under rule utilitarianism, individual liberties would most likely require protection, in which case redistributive taxation could not occur without breaching such protection. Under egalitarianism, one would have to explain why simple equality is a more desirable principle than any other basic liberty in order to justify redistributive taxation. Nonetheless, such a tax would be arbitrarily discriminatory, and act as a disincentive to work beyond the bare minimum required. In fact, only desert-based theories of justice do not offend the four principles discussed, by very nature of the fact that redistribution is neither advocated nor required.

Progressive taxation as a means of redistributing wealth has also been shown to have no effect on inequality. As previously stated, inequality in the UK is higher than the average for OECD countries, and has been rising by 0.8% per year since the 1980s. And whilst many factors certainly contribute to inequality, the fact that income inequality is higher **after** tax only demonstrates that the current progressive system is failing.

Finally, these conclusions do not suggest that a government cannot pursue a policy of changing wealth or income distributions. Maintaining a basic level of welfare, for example, is perfectly justified, as it does not demand a progressive tax system. That a government may spend its revenue providing for the basic needs of its people does not require that wealthier members of society are taxed more than their proportionate share; that a government may attempt to better the position of the least well off in society does not necessitate a disproportionate burden on more affluent individuals. What is more, the principles discussed do not preclude taxation entirely. Even with regards to the principle of 'taxation as slavery', Nozick concedes that tax, as a means of raising revenue, is a necessary evil; even the most minimal state requires revenue. The focus of any government's tax department should therefore be on how to raise sufficient revenue to cover government spending, whilst being as small an imposition as possible upon citizens. This issue is what Part Two of this paper shall proceed to address.

Part Two

Revenue

Raising Revenue

“I don’t know if I can live on my income or not – the government won’t let me try.”

- Bob Thaves

Setting aside the issue of redistribution, the second, and perhaps main, purpose of income tax is raising revenue. In many systems around the world, tax on income constitutes the greatest proportion of government revenue. In the United Kingdom in 2008, tax on income and profits constituted almost 30% of total tax revenue, equating to £150,158m⁴⁵. It is no surprise then that *“in every election contest over five decades from 1951 to 2001, politicians have made the tax system, its fairness or otherwise, and the threat of tax increases or the promise of tax reductions, a prominent campaign issue.”*⁴⁶ Paul Johnson et. al. continue to show correlation between a government’s raising or lowering of income tax and their subsequent performance at the general election⁴⁷

Given the highly politicised nature of tax, income tax in particular, the obvious goal of any incumbent government wishing to remain in power must be to set income tax at a sufficient rate so as to raise revenues for government spending, whilst remaining low enough to satisfy the electorate. Part Two of this paper seeks to demonstrate how a government can achieve this aim with a proportionate income tax levied at a low rate (relative to the current rates of income tax in the UK). Having discussed at length the failings of a progressive tax system in Part One, the merits of a proportionate system shall be discussed first. This will be followed by an explanation of how a government can lower tax and increase revenue simultaneously, before concluding with a full proposal demonstrating how a proportionate income tax would achieve this end.

⁴⁵ OECD (2010), op. cit., p. 210

⁴⁶ Paul Johnson, Frances Lynch, John Geoffrey Walker, “Income Tax and Elections in Britain, 1950-2001”, *Electoral Studies*, Vol. 24 No. 3 (September: 2005), p. 394

⁴⁷ Ibid., p. 404-5

Why Proportionate Tax

“The flat tax would be so simple, you could fill it out on a postcard. A post card would say, in effect, having a wonderful time; glad most of my money is here.”

- Steve Forbes

A proportionate, or flat rate, tax system is one where everybody pays the same percentage of their income in tax. This is as opposed to a progressive system, where higher earners would pay tax at a higher rate. Having considered the pitfalls of a progressive system in Part One, the merits of a proportionate system shall now be discussed.

A proportionate system is not redistributive, thus not contending with Nozick’s ‘redistribution as against liberty’. Even if the revenues accrued under a flat rate income tax are spent on services primarily for the benefit of the poor, wealthier individuals are not required to be disproportionately disadvantaged in order to facilitate this. Therefore, a government can pursue a policy of changing distributions, or providing a basic level of welfare, under a proportionate tax system.

A proportionate system is not arbitrary – it does not discriminate against any member of society by reason of their success. It also does not require any individual to pay more than their proportionate share in tax; all men are treated equally under a proportionate system. It also does not act as a disincentive to work, as one is not liable to pay a greater proportion of their income in tax by virtue of working harder or being more successful.

Finally, whilst a proportionate system is still tax, thus offending ‘taxation as slavery’, as previously discussed Nozick himself accepted that some degree of tax is necessary to raising government revenues. What shall be displayed is that having a proportionate system at a low rate constitutes the lowest possible tax burden on all citizens.

The merits of a proportionate system can also be assessed against Adam Smith’s guiding principles of taxation⁴⁸. The first principle is proportionality itself, which is satisfied by a

⁴⁸ Adam Smith, op. cit., pp. 1103-06

system which imposes the same proportion of tax on all citizens regardless of any distinguishing factors. The second principle, certainty, is also satisfied. A flat rate tax is applicable regardless of how much or little work one does over the course of a year. A man's tax burden under a proportionate system is the simple calculation of $x\%$ of his income. Finally, a proportionate income tax system is undoubtedly more convenient and efficient than a progressive system. As shall be demonstrated, a flat rate tax with a sufficiently high pre-tax allowance would no longer require all the complexities of tax credits and exemptions which exist under the current system. Consequently, tax assessment and collection would be a significantly simpler and cheaper operation for the government to undertake. In 2008 the All Party Parliamentary Taxation Group reported that 15% of the tax-payers had either over- or underpaid on income tax⁴⁹. A large proportion of such discrepancies would no longer occur under a simpler proportionate tax system.

Finally, whilst the matter of tax evasion and avoidance is discussed at greater length below, it is pertinent to note that a proportionate tax system is significantly less susceptible to avoidance and evasion due to its simplicity. Many of the exceptions and loopholes within the current system would not exist with a flat rate tax. Furthermore, the National Audit Office estimated in 2007 that around £300m in income tax had been underpaid simply because of the complexity of HMRC's self-assessment system⁵⁰, not taking into account any intentional deception.

⁴⁹ All Party Parliamentary Taxation Group, *The Future of Income Tax Administration in the UK*, available at <http://www.techpolicyinstitute.org/files/PPRMay08.pdf> on 11/05/11, p. 5

⁵⁰ National Audit Office, *Helping Individuals Understand and Complete Their Tax Forms*, HC 452 (London: HMSO 2007), p. 17

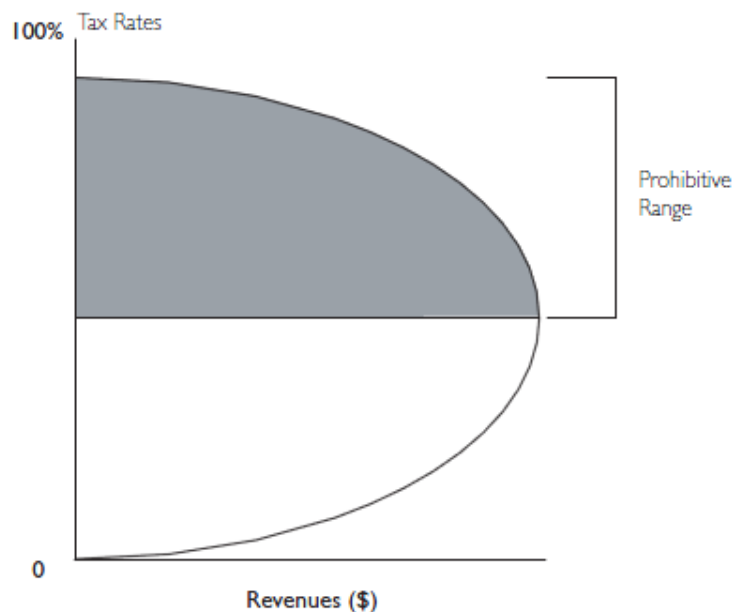
The Laffer Curve

“The fairer and lower tax rates are, the less tax evasion, avoidance and noncompliance there will be.”

- Arthur B. Laffer

Although popularly attributed to the economist Arthur Laffer, the ‘Laffer curve’ has been discussed in various works dating as far back as the 14th century. Shown in Fig. 3, the curve is a hypothetical explanation of the relationship between the rate at which a tax is levied and the revenue accrued. The Laffer curve assumes that a 100% tax would accrue £0 revenue because, at least in a capitalist society, there would be no incentive for people to work. As a 0% tax would obviously also result in no revenue, it remains that there must be an optimum rate of taxation where the highest possible revenue is collected with the least degree of disincentive for workers.

Figure 3⁵¹



⁵¹ Arthur B. Laffer, “The Laffer Curve: Past, Present, and Future”, *Backgrounder*, No. 1765 (June: 2004), p. 2

The Laffer curve does not however advise as to what level of taxation will return the greatest revenue. What rate of taxation acts as a disincentive is obviously going to be dependent upon a nation's economy, and the opinions of citizens. Jude Wanniski explains this point with two historical examples⁵². During World War Two and the siege of Leningrad, the Russian people worked for “900 days at tax rates approaching 100 percent”⁵³ as part of the effort to hold off Nazi invasion. Despite high taxation, the protection of the state in providing a military force was a greater incentive for the people of Leningrad. In contrast, for many years after World War One high income tax rates remained in place in the United States of America. Warren G. Harding utilised the promise of lowering income tax in his 1920 election campaign, and was “elected in a landslide.”⁵⁴ This result demonstrated the American people's disquiet with high tax rates.

An alternative interpretation of the Laffer curve considers not incentive to work, but incentive to avoid/evade tax. At high levels of taxation there is a far greater incentive to pursue arrangements for the purpose of avoiding or evading tax, whereas at low rates of tax such incentives are significantly reduced. Whatever the disincentive (working or paying tax honestly), the operation of the Laffer curve's predictions can be seen in examples from around the world. Figures 4 and 5 display economic data from the tax cuts enacted during John F. Kennedy's tenure as President of the USA. As can be seen, the annual change in tax revenue was significantly greater in the years after taxation rates were cut. If this rise in tax revenue was simply due to inflation or the increased wealth of citizens, one would expect the rise in revenues to be similar to the rise in GDP. However, Figure 5 demonstrates that whilst the growth rate of total income tax revenue increased by 6.4%, the change in growth of GDP was only 0.5%. Furthermore, the increase in tax revenues cannot be attributed entirely to increased employment either, as the change in the rate of unemployment was only -1.9% (Figure 5).

Eastern Europe is currently the global leader in innovative taxation policy. In 1994, Estonia established a flat rate tax levied at 26%. This proved to be so successful that by 2010 not only

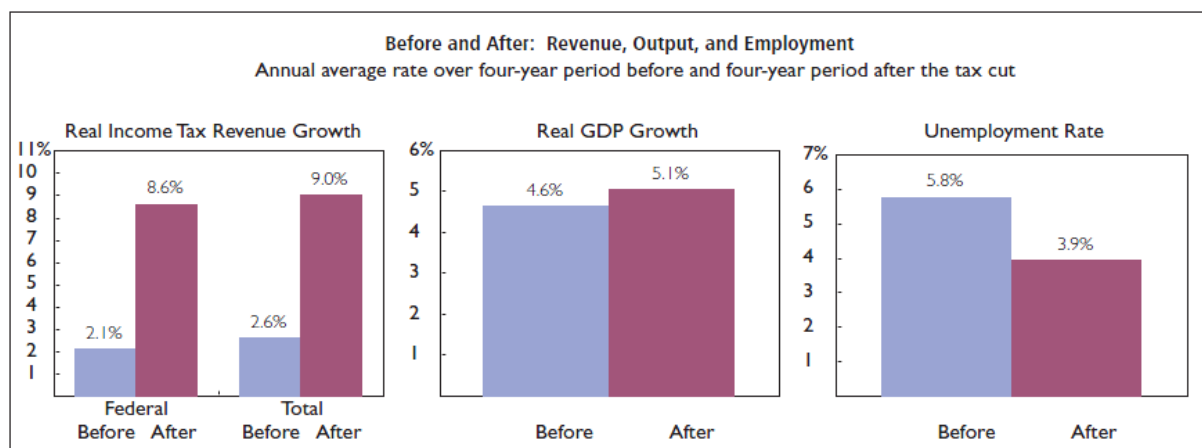
⁵² Jude Wanniski, “Taxes, Revenues, and the ‘Laffer Curve’”, *The Public Interest*, No. 50 (Winter: 1978), pp. 3-16

⁵³ *Ibid.*, p. 6

⁵⁴ *Ibid.*

Figure 4⁵⁵

Before and After: Total Income Tax Revenue (Personal and Corporate) (in \$billions)									
Federal Government						Total Government (Federal, State, and Local)			
	Fiscal Year	Revenue	Year-to-Year % change	Inflation- Adjusted Revenue	Year-to-Year % change	Revenue	Year-to-Year % change	Inflation- Adjusted Revenue	Year-to-Year % change
4-Year Average Before Tax Cut	FY 1960	\$63.2		\$63.2		\$67.0		\$67.0	
	FY 1961	\$64.2	1.6%	\$63.5	0.5%	\$68.3	1.9%	\$67.6	0.9%
	FY 1962	\$69.0	7.5%	\$67.5	6.2%	\$73.7	7.9%	\$72.1	6.6%
	FY 1963	\$73.7	6.8%	\$71.2	5.5%	\$78.7	6.8%	\$76.0	5.5%
	FY 1964	\$72.1	-2.2%	\$68.8	-3.4%	\$78.0	-0.9%	\$74.4	-2.1%
			3.3%		2.1%		3.9%		2.6%
4-Year Average After Tax Cut	FY 1965	\$80.0	11.0%	\$75.1	9.2%	\$86.4	10.8%	\$81.1	9.0%
	FY 1966	\$90.0	12.5%	\$82.0	9.2%	\$97.7	13.1%	\$89.1	9.8%
	FY 1967	\$94.4	4.9%	\$83.7	2.1%		5.6%	\$91.5	2.8%
	FY 1968	\$112.5	19.2%	\$95.7	14.3%		19.8%	\$105.1	14.9%
			11.8%		8.6%		12.2%		9.0%

Figure 5⁵⁶

had the rate been reduced to 21%, but several other countries had adopted similar low flat rate taxes, including Latvia (25%), Serbia (14%) and Russia (13%)⁵⁷. As Daniel J. Mitchell notes with regards to Russia, “[t]he economy prospered, and revenues poured into government coffers since tax evasion and avoidance became much less profitable.”⁵⁸ Figure 6 demonstrates how the Estonian, Latvian and Russian economies were performing before the implementation of a flat tax, and how economic growth occurred subsequent to the tax.

⁵⁵ Arthur B. Laffer, op. cit., p. 7

⁵⁶ Ibid.

⁵⁷ Daniel J. Mitchell, “A Brief Guide to the Flat Tax”, *Backgrounder*, No. 1866, (July: 2005), pp. 5-6

⁵⁸ Ibid.

Figure 6⁵⁹

⁵⁹ Arthur B. Laffer, op. cit., p. 16

A New System for the United Kingdom

“The nation should have a tax system that looks like someone designed it on purpose.”

- William E. Simon

This paper proposes the complete overhaul of the income tax system within the United Kingdom. As opposed to a complicated, unjust, progressive tax, it is recommended that a proportionate income tax levied at 25%, coupled with a pre-tax allowance of £15,000, would be a simpler and fairer system. Furthermore, it is asserted that a proportionate income tax system as described would result in increased revenue for the government. All figures utilised in support of this proposal are provided by Her Majesty’s Revenue and Customs for the year 2010/11, unless stated otherwise⁶⁰.

In 2010 there were approximately 30.5m individuals liable to pay income tax in the UK, with a combined income of £875bn. Under the current progressive income tax system (using 2010/11 rates and allowances, and described in detail in Appendix A), this constituted a total income tax liability of £161bn. Therefore, in order for the proposed proportionate income tax to achieve its goals, it must result in generating £161bn or more in revenue for the government.

A rise in pre-tax allowance to £15,000 would result in removing the poorest 15,083,000 people from the income tax system entirely, reducing the combined income of remaining taxpayers to £676,160m. Deducting the cost of a £15,000 pre-tax allowance from the combined income of taxpayers provides in the total taxable income, a figure of £444,905m. If a 25% flat tax is applied to the available taxable income, it generates £111,226,250,000.

This figure is £49,773,750,000 lower than income tax liability under the current system (£161bn). However, due to the proportionate income tax’s efficiency and simplicity, there are a number of savings which would naturally occur with the implementation of a flat tax. In his own flat tax proposal, Richard Teather advocates *“the abolition of various existing tax*

⁶⁰ HMRC, *Income Tax Liabilities, by Income Range, 2007-08 to 2011-12*, available at http://www.hmrc.gov.uk/stats/income_tax/table2-5.pdf on 11/05/11

allowances”⁶¹. The current system of tax credits, including Child Tax Credits and Working Tax Credits, is one of the things which cause the current progressive tax system to be so complicated. Furthermore, the system is highly inefficient and liable to being defrauded, with between 8.3% and 9.6% of payments in 2008-09 being in error or for fraudulent claims⁶². Tax credits are designed to aid the poorest taxpayers in society, however under the system proposed by this paper almost half of people on the lowest incomes (over 15 million people) have been removed from the tax system entirely. It is for these reasons that the system of tax credits would not be required by a proportionate tax system with a high pre-tax allowance, making an annual saving of £27.3bn⁶³.

Due to the large pre-tax allowance, Teather identifies further tax reliefs which could be abolished without rendering any tax-payer in a worse position. The main reliefs which could similarly be abolished under this proposal are: Individual Savings Accounts (£2.1bn); Share Incentive Plans (£375m); and Age-Related Allowances (£2.8bn)⁶⁴.

The PAYE system has been collecting income tax since 1944, and cost £1.2bn of taxpayer’s money in 2009-10⁶⁵ to operate. In 2007-08, the system received underpayments of £3.0bn⁶⁶. Whilst PAYE had its merits under a taxation system which included numerous tax schedules, allowances and credits, the proposed flat tax would require a far simple and more efficient mode of tax collection. The removal of PAYE would therefore save around £4.2bn. The implementation of a new system would be financed by the investment (£389m) which is currently being directed at updating PAYE.

The tax gap expresses the difference between what HMRC should receive and what is actually received for any particular tax; it is an estimation of the cost of tax avoidance/evasion. In 2008-09 this was approximated to be at £14.5bn⁶⁷ for income tax. Whilst the imposition of a 25% flat rate tax would not eradicate all schemes used for the avoidance of paying tax, the combination of a far simpler system (with fewer loopholes) and

⁶¹ Richard Teather, *A Flat Tax for the UK – A Practical Reality*, available at <http://www.adamsmith.org/images/stories/flattaxuk.pdf> on 11/05/11, p. 7

⁶² HMRC, *2009-10 Accounts*, HC 299, (London: HMSO 2010) R.39

⁶³ *Ibid.*, R. 10

⁶⁴ HMRC, *Estimated Costs of the Principle Tax Expenditure and Structural Reliefs*, available at http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf on 11/05/11

⁶⁵ HMRC, *Impact Assessment of Improving the Operation of Pay As You Earn (PAYE): Real Time Information*, available at <http://www.hmrc.gov.uk/ria/ia-improve-payee.pdf> on 11/05/11, p. 3

⁶⁶ HMRC, *2009-10 Accounts*, op. cit., R. 20

⁶⁷ HMRC, *Measuring Tax Gaps 2010*, retrieved from <http://www.hmrc.gov.uk/stats/measuring-tax-gaps-2010.htm> on 11/05/11, p. 9

a low rate of tax acting as a disincentive to engage in avoidance would most likely result in significant savings. As the figure of £14.5bn is only an estimation of the cost of tax avoidance/evasion, it is suitable to act as an estimation of the savings to be made from such endeavours.

To summarise, over £51bn of savings can be made in the following areas under a flat rate tax system;

- Child and Working Tax Credits - £27.3bn
- Other Tax Reliefs - £5.275bn
- Replacing PAYE - £4.2bn
- Tax Evasion/Avoidance - £14.5bn

This combined with the £111,226,250,000 raised by the 25% flat tax results in total income tax revenue of over £162.5bn, which is higher than the income tax liabilities expected under the current system of progressive tax. Figure 7 below compares the tax liability of different incomes under the current progressive system (2010/11 rates) and the proposed proportionate system.

Figure 7

Annual Income (£)	Current Tax Liability (£)	Proposed Tax Liability (£)
7,000	105	0
8,000	305	0
10,000	705	0
12,000	1,105	0
15,000	1,705	0
20,000	2,705	1,250
25,000	3,705	2,500
30,000	4,705	3,750
40,000	6,705	6,250
50,000	9,930	8,750
70,000	17,930	13,750
100,000	29,930	21,250
250,000	102,520	58,750

As can clearly be deduced from Figure 7, all individuals under the proposed proportionate tax system would pay less than under the current system. Whilst naturally some of the biggest savings are made by those on higher incomes, the £15,000 pre-tax allowance is of greatest benefit to the poorest in society, over 15 million of whom would no longer be liable to pay any income tax at all.

Finally, the stimulating effects of lower taxes on a nation's economy cannot be overlooked. Under the Kennedy tax cuts, income tax revenue increased by 6.4% (adjusted for inflation, Figure 5), and GDP grew by 0.5%. Similar gains were made under the Reagan tax cuts, revenue increasing by 6.1% and GDP by 3.9%⁶⁸. It is not unreasonable to hypothesize that the system proposed by this paper might have similar effects in the UK. The growth of GDP by any amount is naturally going to be of benefit to the economy, especially after the effects of the recession. Furthermore, a conservative estimate of 2% growth in income tax revenue under the proposed system would be worth an extra £3.25bn to the government, whilst growth similar to that experienced during tax cuts in the USA could be worth more than £10bn.

⁶⁸ Arthur B. Laffer, *op. cit.*, p. 9

Conclusion

“Everyone hates taxes, but the government needs to fund its operations, and some taxes can actually do some good in the process.”

- N. Gregory Mankiw

This paper set out with a premise, to propose a fairer and more efficient system of income taxation which would be a detriment to no individual or the government. It began by demonstrating why income tax could not justifiably be used to redistribute income and wealth. The broad principles as suggested by Nozick and Hayek have been assessed against some of the leading opposing philosophical theories, and it has been shown that whatever one's beliefs, progressive taxation for redistribution offends personal liberty, is arbitrarily discriminatory, and acts as a disincentive to work and pay one's fair share of taxes. Furthermore, evidence from the last three decades has demonstrated how progressive taxation for redistribution is failing to counter inequality in the United Kingdom. Any advocate of progressive tax or redistribution must demonstrate how this can be implemented without offending individual liberties, without arbitrary discrimination, and without acting as a disincentive on the workforce. Alternatively, it must be shown why the principles of progressive taxation and redistribution are more important than liberty and equality. And even passing this hurdle, an advocate of progressive taxation would still face the reality of the system's failure to address inequality.

A low proportionate tax rate does not seek to redistribute; it does not violate liberty. It does not discriminate arbitrarily, and it does not penalise success and hard work - it is certain, efficient, and fair. A low rate of tax allows individuals to keep more of what they earn, whilst retaining sufficient revenue for the government to pursue its agenda. It stimulates the economy, increasing GDP and benefitting everyone. The proposed flat income tax of 25% with a pre-tax allowance of £15,000 would remove the poorest 15 million people in the country from the tax system altogether. It would dramatically reduce the possibility of evasion and avoidance, and it would be a cheaper, simpler system to implement. No individual would pay more tax, whilst the government would simultaneously raise more

money. Under the proposed system, the government would have the revenue to pursue its social policies, providing welfare to those who need it, and opportunity for the poorest in society. Policies which change distributions, benefitting the poorest members of society, could be exercised without being redistributive or discriminatory against any other citizen.

In conclusion, a low proportionate income tax is the only system which is philosophically, politically, and economically justifiable. It is a system which benefits everyone, including the government. It is just, fair, and effective.

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Appendix A

Background to the Current Income Tax System

Income tax was originally intended as temporary mode of raising revenue in order to fight Napoleon. In 1799 Britain relied heavily on land taxes and customs duties, however with the start of the Napoleonic wars there was a need for new revenue. All annual incomes above £60 were to be taxed at 10%, with reductions for those incomes less than £200.⁶⁹ The tax was briefly repealed in 1802, however was reintroduced by Henry Addington, 1st Viscount Sidmouth in 1803 in a revised and more efficient format. The tax was once again repealed in 1815, not to be reintroduced for 27 years, when in 1842 it returned in much the same form as it was under Addington and has remained until relatively recently. Income tax remains a ‘temporary’ measure to this day, which must be reinstated annually through acts of parliament. The Provisional Collection of Taxes Act 1968⁷⁰ ensures that taxes can still be collected between the end of the financial year (April 5th) and the subsequent Finance Act receiving Royal Assent.

Numerous attempts at ‘tidying’ the income tax system have been made throughout the 20th century. Such reforms include the ‘Pay As You Earn’ system introduced in 1944. Under this system employers deduct taxes from employees’ wages weekly or monthly, as opposed to the previous system whereby tax was paid once or twice a year. In 1995, the Tax Law Rewrite Project sought to consolidate and simplify the numerous rules governing income tax, resulting in the Income Tax Act 2007⁷¹.

In the financial year 2010/11, the personal pre-tax allowance was £6,475. For people aged between 65-74 the personal allowance was £9,490, increasing to £9,640 for individuals over 75. These allowances reduced by £1 for every £2 earned over £100,000. There was also a minimum couple allowance of £2,670, and a blind person’s allowance of £1,890⁷².

A starting rate of 10% was levied on savings between £0-£2,440. The basic rate of income tax was 20%, levied on incomes between £0-37,400. The higher rate, 40%, was levied on

⁶⁹ HMRC, “A Tax to Beat Napoleon”, retrieved from <http://www.hmrc.gov.uk/history/taxhis1.htm> on 29/04/11.

⁷⁰ Great Britain, *Provisional Collection of Taxes Act 1968 (c.2)*, London: HMSO

⁷¹ Great Britain, *Income Tax Act 2007 (c.3)*, London: HMSO

⁷² HMRC, *Income Tax Rates and Allowances*, available from <http://www.hmrc.gov.uk/rates/it.htm> on 12/05/11

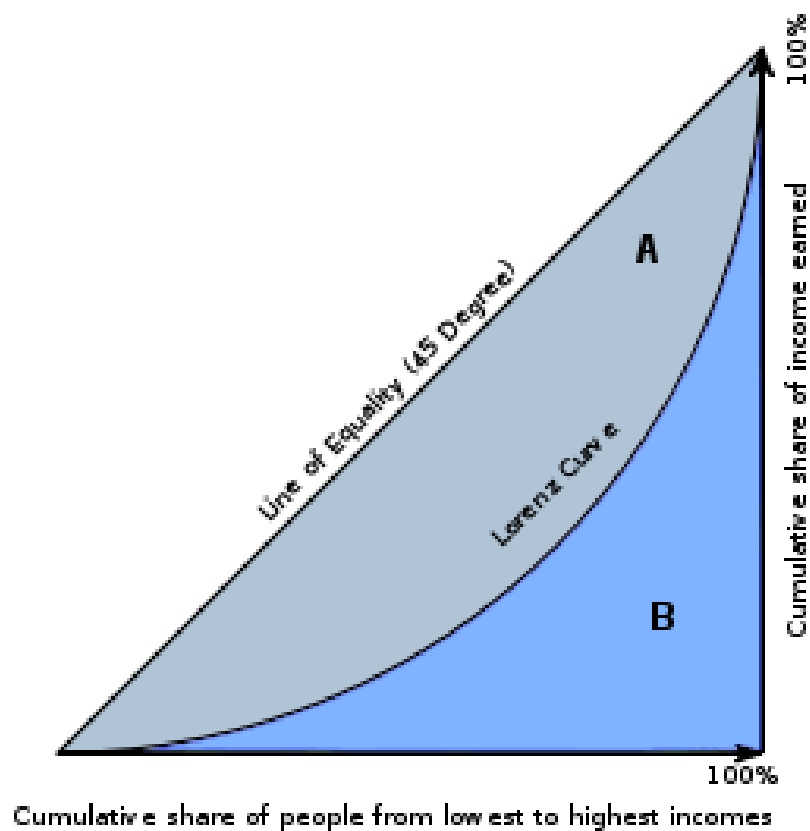
incomes between £37,401-£150,000. The additional rate of 50% was levied on incomes over £150,000.

Income tax returns differ according to the type of employment an individual is engaged in (employed, self-employed etc.), alongside which a number of tax credits can be claimed, such as Child Tax Credits and Working Tax Credits.

Appendix B

The Lorenze Curve and Gini Coefficients

The Lorenze curve plots the proportion of income of a population along the y axis that is cumulatively earned by the poorest members of a population along the x axis. A 45 degree line on the graph would represent complete equality of income.



The Gini coefficient is a figure between 0 and 1, where 1 represents complete inequality, and 0 represents complete equality. It is calculated as the ratio between the line of equality and the Lorenze curve (A) over the total area below the line of equality (A+B).