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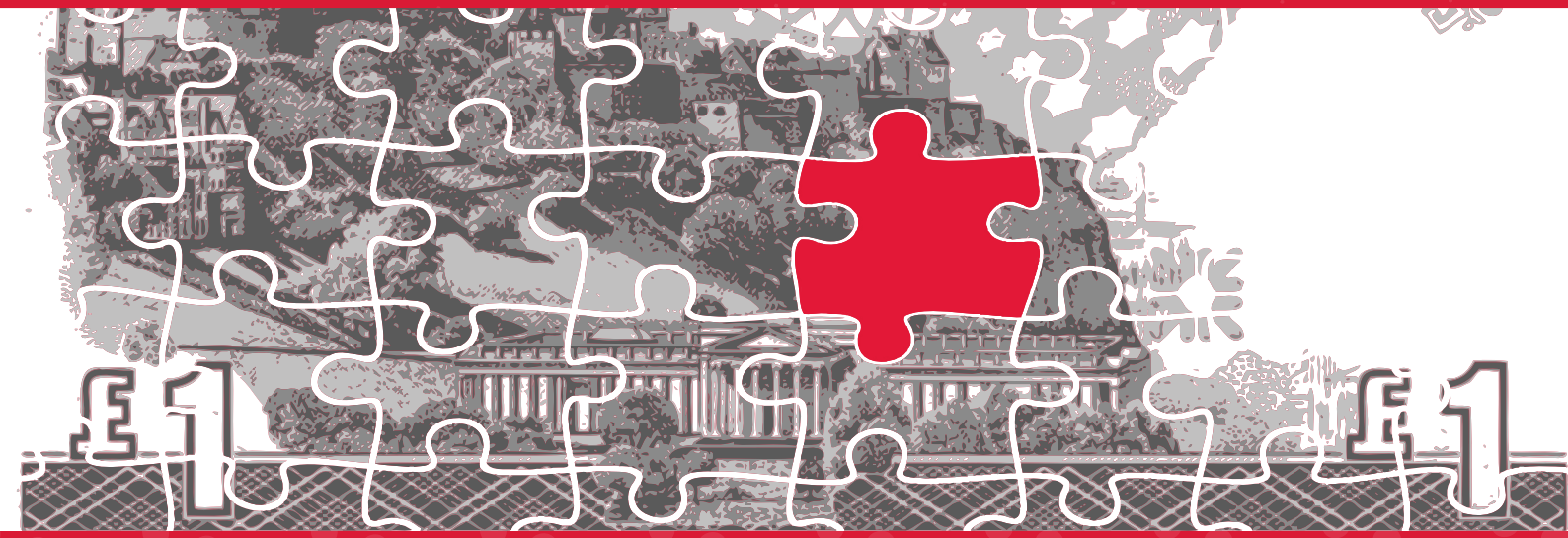
Five questions on tax and the Common Weal



Summary Report

Mike Danson, Laurie Macfarlane and Willie Sullivan

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Purpose

The purpose of this report is three-fold:

- To open up a debate about tax which has been suppressed
- To dispel two myths: that tax is nothing more than a necessary evil and that tax is very unpopular
- To look at ways in which public finances can be secured by increasing the proportion of national wealth taken in tax but in realistic and affordable ways which

The data, evidence and references for everything in this summary report can be found in the main report.

The case for tax

Tax is much more than a 'necessary evil' which we need if we want public services. In fact, tax pays an important economic and social role.

- Firstly, it funds public services and national infrastructure which is absolutely key to economic prosperity and social wellbeing. Without the benefit of these services and infrastructure the economy would be seriously jeopardised.
- Secondly, it has a crucial redistributive effect, not by taking money from some and giving it directly to others but because it creates a large range of opportunities for people to gain good employment which makes them prosperous. It is by funding jobs for teachers, nurses, librarians, road workers and so on and through the goods and services they purchase with their wages that we direct national wealth towards the many.
- Thirdly, it is an enormously efficient way to allocate certain resources across the economy. While the market can be effective in allocating resources efficiently in some parts of the economy, in others the market is hopelessly inefficient. For example, wherever there is a natural monopoly or a market solution will not work adequately, public provision overcomes the problems of market allocation. For example delivering a health service, mass education, a police force or a road building programme simply won't be done properly via market means alone and we know what happens in terms of profiteering when monopoly industries are put in private hands.
- Fourthly, public provision is 'counter-cyclical'. When the economy slows down, the purchase of goods and services slows down with it and the provision of employment

can drop sharply. Since public provision is not solely reliant on markets it can continue to purchase goods and services which boost the economy and it can continue to support jobs which would otherwise be lost. Without this stabilising effect of public spending, economic downturns could rapidly turn into crises.

If the preceding arguments were correct you would expect to see two things: a close correlation between the amount of national wealth taken in tax and the level of inequality and a tendency to have strong and steady economic performance in nations with higher proportions of national wealth going to tax. We do indeed see both of these correlations. And there is one important further correlation; it is not how progressive a tax system is that seems to create the best outcomes but the total proportion of national wealth taken. In fact, Britain has a more progressive tax system than the Nordic countries (who do not need to compensate for the vast wealth inequalities in Britain) but the Nordic countries have much better social outcomes. The volume of tax is an important contributory factor.

In the future debate about tax in Scotland, it is essential that the anti-tax propaganda is matched with a calm and careful explanation about the many positive effects of tax.

Public attitudes

It is widely believed that public attitudes to tax are entirely negative. It is widely accepted that tax is demonstrably highly unpopular among the public. It is also widely believed that political parties which stand on higher tax manifestos are punished in elections. Neither proposition is supported by the facts.

There is a wide range of polling data on tax and virtually none of it would lead to the conclusion that tax is an 'untouchable' issue. For example:

- Since 1983 the British Social Attitudes Survey has asked whether people would like taxes to be increase and invested in better public services, for tax and public services to be sustained at their current level or for tax to be reduced and to have fewer public services. In 30 years, the proportion favouring a tax cut has never risen above 11 per cent.

- In a TNS poll, given an option between cutting services or raising tax, all but one age group favours raising tax by a substantial majority

- In September 2011, a ComRes survey for BBC Radio 4 showed that the majority support a simpler, easier to understand and harder to avoid tax system. If this could be achieved, 74 per cent of respondents said they would be prepared to pay a bit more in tax.

- Only four per cent of people claim tax as the most important issue facing Britain

On the argument that 'tax loses elections', two case studies are given:

- There is a widespread belief that Labour lost the 1992 General Election because of the impact of the Conservative's 'tax bombshell'. Campaign. However, the most

authoritative study of the election dismisses this and shows that in fact the surprise result was an error in polling methodology.

- It is widely believed that the SNP lost the 1999 Scottish Election because of its 'Penny for Scotland' policy. Not only is there no evidence to support this other than 'intuition' but it does not sit well with the fact that this election saw the second highest poll for the SNP in the party's history. It also fails to explain why, when they dropped the policy four years later, it lost a significant share of the vote and that share went instead to parties that proposed raising tax.

There is very little credible evidence that the public is hostile to tax if it is spent well.

Setting the scene

It is important to take a very quick look at the existing tax system in Britain. It is widely criticised for complexity, high levels of evasion and avoidance, instability and perverse incentivisation. The definitive study into the UK tax system was carried out in 2011 by Nobel Prize winner Sir James Mirrlees. That study concluded that tax in the UK is "inefficient, overly complex and frequently unfair". In fact, it goes further to describe the overall tax system as "absurd" and calls for major reform. No action has been promised.

The other important contextual point is that a major problem for the UK tax system is that Britain is a highly unequal society with high levels of poverty and large volumes of low-pay employment. In fact, only six OECD countries have higher levels of inequality than Britain and Britain is ranked as one of the developed countries with the lowest wage economy. The lack of widespread wealth has significant implications for the tax base.

So what can be done?

There is much that this report does not seek to do. It focuses on five simple questions to establish whether it is possible to secure public finances in Scotland. Some of these questions imply economic reform; we do not make light of the effort that will be required to reform Scotland's low-pay economy. Nor does this paper seek to discuss tax as an economic development strategy or propose how tax can be devolved to lower levels of government. But it does seek to show that it is perfectly possible to secure the public finances necessary to deliver the universal welfare state.

Question One: Could we generate increased tax take on existing tax rates if we can successfully reform the economy to create a higher wage labour market?

The report models the impact on tax revenues if Scotland is able to move away from being a low-pay economy. The paper models what would happen if there was a partial move towards the track record of the best economies at Scotland's level of economic development and then again if we are able to achieve a track record similar to the best. It models the tax take not of increasing tax rates but of increasing pay rates and decreasing unemployment. It concludes that:

- A partial move towards a high-pay economy would deliver an increase in tax take from £10.7 billion to £12.9 billion without altering tax rates at all
- A more substantial move towards a high-pay economy would increase tax take to £14.8 billion without raising tax rates

The full methodology is detailed in the main report. This shows that the ultimate goal must be to fix public finances by fixing the economy. Creating a high-pay economy is worth £4bn more in tax alone, a sum that would end talk about the need to 'ration public services'.

Question Two: Is it possible to greatly reduce tax evasion and avoidance in a small country?

The report proposes three ways in which tax evasion and avoidance can be greatly reduced even in an individual small country:

- Have a precise definition of who is and is not a Scottish resident. This should include all people who are citizens of the country, whether they are physically present or not (they would receive credits for any taxes paid in a country of residence). It should also include all people who spend more than 183 days in any country in a tax year whether they are citizens or not. Then tax all its residents on all their world-wide income and gains, without exception, minus credits for tax paid elsewhere.
- Companies with international income that operate within Scottish territory can be taxed on a fair part of their world-wide income. This means that most issues arising from transfer pricing, thin capitalisation and licensing abuses cease to be a concern.
- A presumption can be made that where any transaction undertaken primarily to secure a tax advantage, or where any step in a transaction is added for that purpose, then the financial benefit that transaction can be ignored, and tax can be charged as if it had not taken place.

There has been a lot of ill-informed assumption that 'in the modern world there is nothing you can do about tax evasion'. This is categorically not true; it is a matter of having the will to end avoidance. There is insufficient data at the Scottish level to model precisely what value of additional tax this could generate. However, a systematic approach to ending avoidance would potentially generate substantial increases in tax revenue.

Question Three: Is there a realistic possibility of generating new tax income from wealth, land and property taxes?

The IPPR and Landman Economics wealth tax model was used to assess the potential for various forms of wealth tax in Scotland. The report is realistic about the problems of collection and

evasion, but even with these problems there is substantial opportunity to generate more tax revenue on the basis of taxing large accumulations of wealth. In this context it is important to note that wealth inequality in Britain is even wider than income inequality and yet while 43.4 per cent of tax take comes from tax on income, only seven per cent comes from wealth taxes. The following are the assessments of the capacity to generate new tax revenue from wealth, allowing for evasion factors:

- A one per cent annual tax on net wealth (all non-pension assets) above £500,000 would raise gross revenue of £562 million
- A one per cent annual tax on property values above £1 million in Scotland would raise gross revenue of £250 million.

The paper also models the potential impact of a redistributive Land Value Tax. There are many options for such a tax but the capacity to increase tax take on those with more wealth while reducing it on those with the least wealth and generate more income at the same time is significant. Tax on the same assets may be included in different of these optiosn so they should be seen as a menu rather than a programme. However, using a range of options, raising £1bn a year from various wealth, land and property taxes is a realistic prospect.

Solution Four: What potential is there to generate greater national income from Scotland's natural resources?

Scotland is rich with natural resources, but these are among the most unequally distributed resources in the developed world. If the value of national natural assets can be captured for the collective benefit of all rather than the private benefit of a few large corporations and land-owners, significant additional public revenue can be raised.

The report looks at two options. The first is a tax on the whisky industry which makes a margin of profit of 60 per cent from a Scottish heritage industry yet returns very little value to Scotland from this (of all investment into the 'Scottish' whisky industry, two pounds out of every three is made in London, not Scotland). A one-pound-a-bottle tax would raise more than £1bn, even allowing for any reduction in sales. There is a very strong case for Scotland gaining some proper financial benefit from an industry that relies wholly on Scottish natural assets and the nation's heritage.

The second is the capacity to exploit Scotland's renewable energy resources for the public benefit. It has not been possible to model the income that can be generated from Scotland's renewable industries but if this is developed in public ownership, significant additional resources will flow into the public purse.

Question Five: Can reform of consumption taxes raise more income in a progressive manner?

The paper looks at the work Mirrlees did to establish whether consumption taxes can be used to generate greater public income in a progressive way. The report concludes that there is significant scope for this. However, these are major changes and may not be easy until wages increase. The report concludes that this is an issue Scotland should look at in the future but does not model the possibility to raise greater income.

Conclusion

In summary, this report seeks to encourage people to talk about how tax can be better managed. It draws three main conclusions:

- The big goal is to reform the economy to increase wages and strengthen the tax base. This will take time but the rewards are billions of pounds of increased tax take without altering tax rates.
- Until this can be achieved, combinations of wealth taxes, resources taxes and exploitation and ending tax avoidance can raise multiple billions of pounds of income to secure public finances in the interim
- There are a number of longer-term approaches that should be explored including a shift from income to wealth taxation, a shift from property to land taxation and an exploration of what can be done with consumption taxes

Overall, the pessimism about Scotland's ability to maintain its public finances is based on an unwillingness to look at tax in an open-minded way. If we do, we discover that it is perfectly possible to maintain strong public services in Scotland through prudent tax policies.

Web: www.reidfoundation.org

Phone: 0845 557 6844

Email: contact@reidfoundation.org

The Reid Foundation
PO Box 8781
Biggar
ML12 9AG