FIXING THE GLOBAL CRISES: TAXING THE MODERN ECONOMY

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SUMMARY

The current tax system has been established over a long time, combining arising concepts with legacy policies. Some have fallen by the wayside, whilst others have become the norm. We now live in an income and consumer centred tax system. These are relatively recent concepts in comparison to land and business taxes, collected in medieval times.

As the current approach has not been designed for the modern economy it is unnecessarily complex. This means that the tax system is not the same for everyone. Paradoxically, this approach exacerbates wealth inequality. As businesses generate wealth and not people, the current system neglects the wealthiest parts of the system whilst burdening the poorest, thereby worsening poverty.

Problematically, whilst the migration of people has legal restrictions, businesses can relocate their headquarters with ease. This disparity, currently, prevents governments from the effective regulation of businesses, owing to competition between governments over the collection of corporate tax. Yet, we don't need to change international laws to correct this, just taxation policy.

This essay explains the problems of the current approach and how we create an effective tax system; one that recognises that all financial transactions involve businesses but not people, and that only businesses generate wealth. Crucially, by implementing the new *business tax at the point of transaction*, governments can proactively address many of the current global crises.

INTRODUCTION

How do we tackle global warming, loss of habitat, increasing pollution, the cost-of-living crisis, rising exploitation of children, rising poverty, the displacement of people, and the risk of artificial intelligence induced job losses? These are seemingly disparate problems that require government regulation. The approach and extent of the regulation is a political decision. Its implementation is currently limited to legislation and not economic policy.

Business legislation is ineffective. As law making is a slow process, it cannot keep pace with the advancement of technology, nor the new business models this creates, nor with changing social attitudes, such as those towards ethics and sustainability. Moreover, it requires law breaking businesses to be identified, tried, and punished. Consequently, corporate regulation is out of date, inconsistent, subject to error and bias, and the process is expensive and inefficient. Moreover, it cannot constrain foreign businesses, thereby disadvantaging domestic ones.

The alternative is to use economic policy. Taxation strategies could encourage and dissuade, desirable and undesirable commercial practices. However, under the current economic system, addressing the problem of businesses evading tax remains dependent on the legal system. Yet, if we restructure the approach to tax collection, we can make economic policy a powerful political tool to promote change, through self-regulating mechanisms without dependency on the legal system.

THE CURRENT EXCEPTION BASED SYSTEM

A key problem with current economic policy is that it is an exception-based system. Take for instance income tax, when someone applies for a job they are told what they will earn before tax and not what they keep after tax. This is not, in itself, useful information. It can be confusing, and it creates avoidable resentment of the system. In contrast, in a tax system designed for the modern economy, businesses would tell employees what they earn, and this is what they keep.

Currently, there are many exceptions that must be accommodated by the system. These include someone working for several employers, or receiving benefits - disability, child, carer, or job seeking allowances. Also, people may change jobs or take unpaid leave. They may have a private income from a trust, a pension, as a landlord or from selling assets. There are so many provisos, and so the system is complicated, because it is income centred and there are many different types of income and circumstances of people.

ACCEPTANCE OF A FLAWED TAX SYSTEM

In Britain, taxes today either have an origin in times of war, such as income tax during the Napoleonic wars (1799) and purchase tax during WWII (1940) or from the medieval feudal economy, such as property tax and business tax. The methodology of revenue collection has not been planned with the modern economy in mind. Instead, it has been driven, often by short-term necessity, as a patchwork of policies adding to the legacy system.

Once implemented these taxes set a precedence, and over time social attitudes acclimatise to them and they become the norm. Nowadays, we accept the need to pay tax on our incomes (Pay As You Earn *PAYE*, Employee National Insurance contribution, Dividend Tax, and Capital Gains Tax), for consuming goods (Value Added Tax *VAT* and various Duties) and for living in a house or flat (Council Tax). Also, businesses accept paying tax on profits (Corporate Tax), for employing people (Employers National Insurance contribution) and for the use of land (Business Rates). Indeed, if we ask, "are these taxes equitable?" we have a political debate about the pros and cons of wealth redistribution. Yet, if we consider the question "is the system the same for everyone?", then the answer is no.

Someone earning an income under PAYE has a much higher rate of tax than someone paying income tax on dividends, who in turn pays a higher rate of tax than someone under capital gains, buying and selling assets. There are, of course, arguments for the need to pay lower tax on dividends than PAYE, as this enables the self-employed and microbusiness owners to cope with irregular and uncertain income. Yet, why is this benefit afforded to investors in the stock-market? So, a need to amend the system in one area inevitably leads to an undeserved benefit being gained by other groups of people or businesses.

Similarly, VAT is paid by everyone equally, so people in poverty are forced to pay tax on essential goods and services. People who make difficult choices about whether to buy food, or hygiene products, or heat their homes, pay tax on these essential supplies. Inevitably, discussions about poverty lead to the question, "what is an essential cost of living?". A better question is, "why have a consumer tax, as people don't generate wealth?"

The current logic behind the taxation of businesses is arguably the most illogical. Why is the rate of Corporate Tax, and why is the government receiving this tax, based on the arbitrary location of a company's headquarters? This location is no more than a certificate of registration issued by a government who will benefit from receiving the corporate tax. This means that the ability of governments to increase corporate tax has substantial risks to the loss of revenue altogether as there is competition between governments to keep business headquarters within the economy.

Moreover, we live in the age of the internet, but Business Rates impose a cost for having shops and factories, avoided by businesses that only have an internet presence and that provide financial or information technology services. Yet, potentially worse is still to come. As we enter the age of artificial intelligence, taxing businesses for employing people promotes job losses.

THE ALTERNATIVE APPROACH

To avoid the pitfalls of an exception-based system, we must consider an economy in its entirety, and plan the tax system disregarding the legacy approach. Once we have established a new tax system, we must understand how it can be phased into the economy, ensuring stability throughout the process. Then, when implemented, we can tune the bands and rates to best meet the needs of the economy.

UNDERSTANDING THE ECONOMY

The complexity of all economies is built-up from a relatively simple repeating pattern. This pattern is the cycle of households receiving an income and businesses generating turnover, which then enables them both to be consumers (Maybury, 2020 [Paper 02]). Crucially, all goods, services and assets purchased by households are also purchased by businesses. This observation reveals the repeating pattern.

A simplification of the income-expenditure cycle is presented in Figure 1. The producer is shown on the right, whereby a business transforms input supplies into output supplies by using land and labour resources. However, as a business can operate without employees, through profit-sharing ownership and automation of production, not all businesses pay wages.

The income on the left represents the turnover of businesses and the different types of household income: wages, dividends, and capital gains. This is the point where businesses purchase input supplies to transform into goods and services and households purchase supplies to maintain their standard of living (Maybury, 2020 [Paper 01]). The same goods and services are demanded by both businesses and households, such as businesses buying laptops for their staff and owners, while people buy the same make and model of laptops for their personal use.

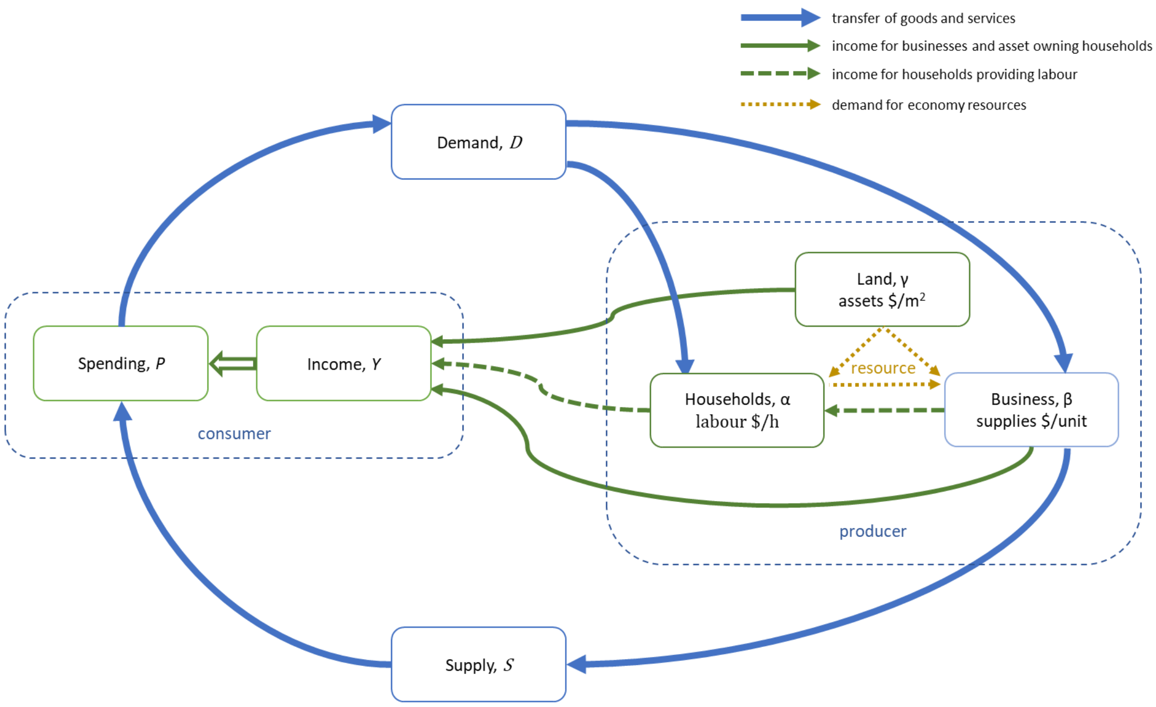

Figure 1. The income-expenditure cycle of entities in an economy.

ESTABLISHING TAXATION POINTS

In all business sectors, all financial transactions involve a business, but they do not always involve people. For example, businesses provide goods and services to other businesses. In some cases, this interaction can be achieved without anyone on the payroll of either business. So, there is asymmetry in the relationship between people and businesses; people need to work for a business, but not all businesses need employees. Thus, an income tax focus to economic policy is only taxing part of the system. Moreover, businesses buy supplies and assets tax efficiently, which can be used tax free by the owners. In the case of assets, such as property, this also increases the value of the company.

Although businesses can relocate their headquarters easily, the income-expenditure cycle reveals a mechanism that is inherently stable and self regulated. All businesses have visible transactions, when receiving payment, and we have the tax infrastructure to collect tax at this point, currently for VAT. Except, bizarrely, VAT is collected at the point of invoice (the date of the transfer of goods) and not of payment (the date of receiving money for the goods), which for most businesses is a much later date. This means that currently businesses pay tax before receiving payment, including in the situation of non-payment.

Business tax at the point of transaction means that the location of company headquarters is irrelevant as businesses pay tax in the country of the consumer at the point of the transfer of money. This means governments can incentivise sustainable and ethical business practices, and job creation, by using tax incentives and penalties, rather than the ineffective current approach of legislation.

BUSINESS TAX AT THE POINT OF TRANSACTION

Businesses cannot avoid paying the tax if they wish to trade in the economy as it is collected at the point of the transaction. Also, if a business tries to pass on the cost to the consumer, they will be undercut on price by a competitor. Thereby, this exploits the inherent competition between businesses and eliminates, the foolish, competition between governments over the collection of Corporate Tax. Moreover, if businesses wish to receive applicable tax relief, they must comply with the government requirements.

In terms of simplifying the system, this new Business Tax could replace VAT, PAYE, dividend tax, National Insurance, Corporate Tax, and the current approach to taxing land usage through Business Rates. This means that companies that do not have employees, and do not have shops or factories, pay the same tax rate as those that do. Moreover, governments could adjust the taxation rules to encourage businesses to be sustainable, ethical and good employers. This even allows governments to control the behaviour of multinational and foreign companies who trade in the economy.

This is a more robust and resilient approach as tax revenue as is not tied to income, which is problematic in the age of artificial intelligence. As the exploitation of new technology leads to a fall in high skilled jobs, say replacing doctors, lawyers, accountants and many other professions, the current system becomes unstable; a rise in unemployment increases demand on benefits and public services, whilst simultaneously reducing tax revenues to pay for this demand. In contrast, the new system is inherently stable. Moreover, it can be used to encourage businesses to provide good job opportunities to productively counterbalance the current one-sided bias of so-called *business efficiency metrics* that drive a reduction in staffing costs through any means available.

IMPLEMENTATION OF BUSINESS TAX

As we have become acclimatised to the current tax system, it is hard to imagine an alternative. However, consider a careful and gradual implementation. One that progressively builds over many years with each incremental change testing the effects of the approach and so developing our understanding of the system.

For example, if the business tax was first implemented at 0.5% of business turnover, then we could reduce the current corporate tax from 25% to 22.5%, assuming a nominal 20% profit margin. Alternatively, we could alleviate employment tax, reducing employer National Insurance contributions from 13.8% to 12.8%, assuming applicable staffing costs are 50% of turnover. These rate adjustments could be tuned to the sector, and the size and maturity of the business. This process would allow us to slowly phase out Corporate Tax, National Insurance, Business Rates, PAYE, VAT, and dividend tax.

This progressive implementation would follow the methodology of data science to maximises the information gained about the system from the minimum number of changes. So, we can progressively implement further changes, based on the substantiation of our models (Maybury, 2020 [Paper 00]) from of previous smaller changes, to ensure that the transition to a new economic system is stable and robust.

AFTERWORD

Wealth is generated by businesses not households. Indeed, one measure of the size of an economy, known as national income (or Gross Domestic Product *GDP*), is the sum of business profits and the sum of wages paid by businesses. This means that whatever part of an economy is taxed, such as income or household consumer spending, the tax revenue raised must originate from the wealth generated by businesses, otherwise this drives wealth inequality. So, taxing any part of the system other than businesses directly exacerbates poverty and prevents governments from being able to effectively regulate businesses, which is vital if we are to address the current global crises.

FURTHER WORK

Development of an economic forecasting framework that can be validated (see Maybury, 2020 [Paper 00]) to ensure stability and robustness of the transition to a new economic system.

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