FLAT TAXATION WILL FLATTEN THE PEOPLE

by

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The rich are a very altruistic group always concerned to improve the lot of the poor by grabbing tax cuts for themselves. The latest phase of this campaign is the “flat tax” aimed at making the poor proud by giving them the opportunity to pay tax at the same rate as those rolling in money. Like the ‘trickle down effect’, it’s all a big con.

The UK revenues from corporation tax now account for less than 2.5% of the GDP, the lowest ever. As a result, the tax burdens on individuals have increased and millions have been forced to accept low pensions, crumbling infrastructure and hospital queues. Yet none of this has stopped the New Right from continuing its bleat for shifting taxes from capital to labour and consumption.

The flat tax has received favourable nods from Liberal Democrats, the Conservatives, the US Republicans and the Adam Smith Institute. One of the characteristics of the New-Right is that it promotes highly partisan policies in a populist language to recruit support. In essence, the promise is that the redistributive power of the state has to be eroded by what are termed 'flat taxes’. This is sold by seductive appeals to low or even fairer taxes. The New-Right ideologues claim that this would raise tax revenues and eliminate tax avoidance.

The claims are not new. In the 1980s, the UK top rate of income was reduced from the punitive 83% to 40% and the corporate tax rate was reduced from 52% to 30%. Yet this has not reduced organised tax avoidance which now runs at around £100 billion each year. The reduction in headline tax rates was accompanied by an increase in indirect taxes (or VAT) to the rate of 17.5%. The regressive tax system already forces the less well-off to pay a higher proportion of their income in taxes.

'Flat taxes' were first adopted by Jersey in the 1940s, a tax haven synonymous with global tax dodging and corruption. Now they’re coming back into fashion as part of the prescription for new market economics. Under the influence of the International Monetary Fund, the World Bank, multinational corporations and local oligarchs, clapped-out economies and non-tax functioning countries such as Russia, Romania, Latvia, Lithuania, Serbia, Ukraine, Slovakia and Georgia have introduced privatisations, tax breaks for companies and flat taxes.

Slovakia merits a closer look because it is being held out as a successful example of the 'flat tax' revolution. On 1 January 2004, Slovakia adopted a flat rate of 19% for individuals and companies. Before that it had a progressive system of taxation and individuals, depending upon their income, paid income tax at the rate of 10%, 20%, 28%, 35% and 38%. Now above a certain threshold, individuals pay income tax at the single rate of 19%. The corporation tax rate of 25% has been reduced to 19% but tax holidays can be granted for 5 or more years to foreign multinationals. Resident companies are taxed on worldwide income; non-residents are taxed on their Slovakian-source income only thus giving them further incentives to launder profits through transfer pricing, residence/domicile and other strategies. Slovakia has attracted foreign direct investment though multinational corporations remain headquartered in Western nations because they have the infrastructure (roads, communications, hospitals, education, etc.) that enables them to function.

This 'flat tax' was hailed as a success because it increased tax revenues from SK 200 billion in 2003 to SK 209 billion in 2004. That’s hardly surprising since the shattered economy grew at a rate of 5.5% per annum. However, there were major changes in the tax flows. A comparison of the 2003 and 2004, statistics showed that revenues from income tax as a percentage of total tax take declined from 18.3% to 14.6% (a decline of nearly 21%) and corporation tax revenues declined from 15.4% to12.5% (a decline of 19%). The government made up the shortfalls by higher excise duties and VAT. Prior to 2004, Slovakia had two rates of value added tax (VAT). A higher rate of 20% and a reduced rate of 14% for many essential items (such as basic food, medicines, electricity, coal, books, newspapers, magazines) were replaced by a single standard rate of 19%. This raised the price of most goods and services and penalised people in lower income groups. Unsurprisingly, the VAT revenues increased from 60.9% to 64% of the total tax revenues.

The 'flat tax' con shifted burdens to local employers and labour. For each employee, the employer has to make a social security contribution (equivalent to the national insurance contributions) of 35.2% of the salary. The employee's contribution is 13.4% of the salary. As a result, the average employee suffers an effective tax rate of 32.4% (19% + 13.4%) whilst the local employer (companies) suffer an effective tax rate of 54.2% (19% + 35.2%). This is much higher than most Western European countries and distorts competition by favouring "brass plate" operations. In case, Slovaks were thinking of retiring, the retirement age for men and women has been increased from 60 and 55 respectively to 62, soon to be raised to 65. Further plans to reduce labour rights and social security payments are being developed.

The Slovkian case shows that contrary to the claims of the New Right 'flat taxes' are neither lower nor fairer. They certainly shift taxes from capital and the wealthy to labour and consumption. Multinational corporations enjoy the biggest tax benefits but ordinary people lose rights and work until they drop.

The New-Right is keen to make Britain a major guinea-pig for its 'flat tax' experiment and to further shift taxes away from companies and the rich. Studies suggest that the introduction of a flat tax in Britain at 23% (current higher rate is 40%) would make 27 million people worse off. A rate of 18% would make 15 million people worse off and also leave a tax loss of £20 billion, either requiring higher VAT, indirect taxes, or further erosion of healthcare, education, pension and other public services. The Adam Smith Institute proposal of a tax rate of 22%, with a personal allowance of £15,000, could leave 25-30 million people worse off and a £60 billion reduction in annual government revenue.

With rampant tax dodging, there is a strong case for eliminating tax perks for corporations and millionaires. Flat taxes will not increase tax revenues in Britain or encourage the badly needed redistribution of the burden. Far from doing this the flat tax will increase income inequality, social exclusion and misery as well as disastrous cuts in public spending. Which is exactly what it’s all about and should be opposed.