



Fairness and taxation

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Is this unfair?

- Corporate income tax paid in 2015:
- Facebook £4,327
- One Direction £8.2 million

One Direction paid more UK tax than Facebook

Luke Graham, special to CNBC.com
Friday, 13 Nov 2015 | 9:15 AM ET



Financial reports filed by One Direction reveal the pop band paid more corporation tax in the U.K. than social media giant Facebook.



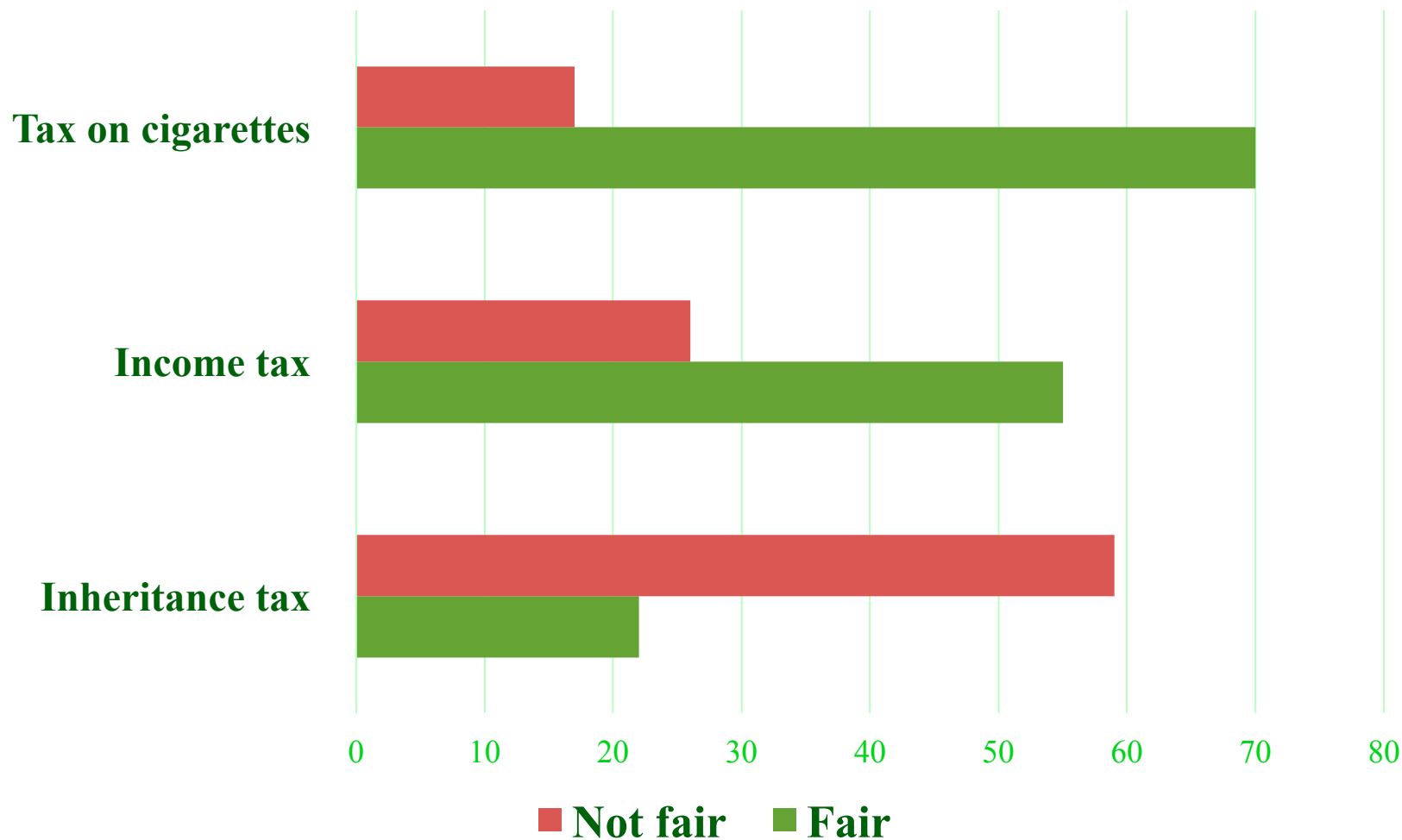
The taxation and benefit system

- The government raises revenue through taxes
- It uses the revenue to
 - provide public goods
 - redistribute income between people
- Main taxes
 - Income tax
 - VAT
 - Council tax
 - Tobacco and alcohol taxes
- Main public goods
 - NHS
 - Education
 - Infrastructure
- Main benefits
 - State pension
 - Tax credits
 - Housing benefit
 - Child benefit
 - Disability living allowance

Which taxes are the most fair?

- Inheritance tax
- Taxes on cigarettes
- Income tax
- **Which tax is the MOST fair?**
- **Which tax is the LEAST fair?**

Yougov poll – “is this tax fair?”



What do we mean by fair?

- Vertical equity
 - redistribution between people
- Horizontal equity
 - the system treats similar activities and people similarly
- Equality of opportunity

Vertical equity

- Olivia earns more than Bryan
 - concerns over vertical equity would lead us to redistribute from Olivia to Bryan



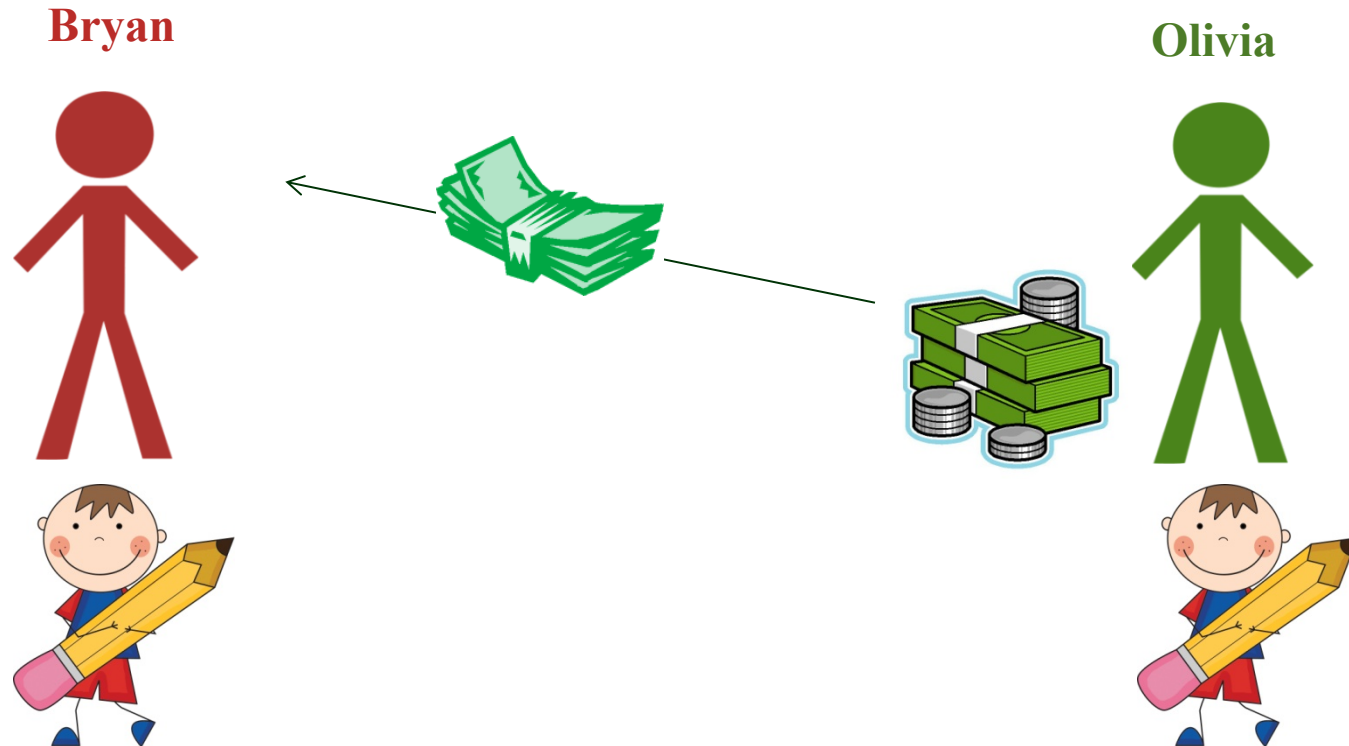
Horizontal equity

- The tax system should treat similar people in a similar way



Equality of opportunity

- The children of Bryan and Olivia should have equal opportunities in life



What do we mean by fair?

- We care about the effects of the tax and benefit system **as a whole**
 - not about each individual part of the tax and benefit system
 - (do we care if the steering wheel of a car is good at braking?)

Is this unfair?

- Corporate income tax paid in 2015:
 - Facebook £4,327
 - One Direction £8.2 million
- Facebook
 - paid profits to workers in bonuses in that year
 - workers paid income tax (at a higher rate than the corporate tax rate)
- One Direction
 - earned income on which they would have had to pay higher income tax rate
 - they incorporated so they could pay the lower corporate income tax rate

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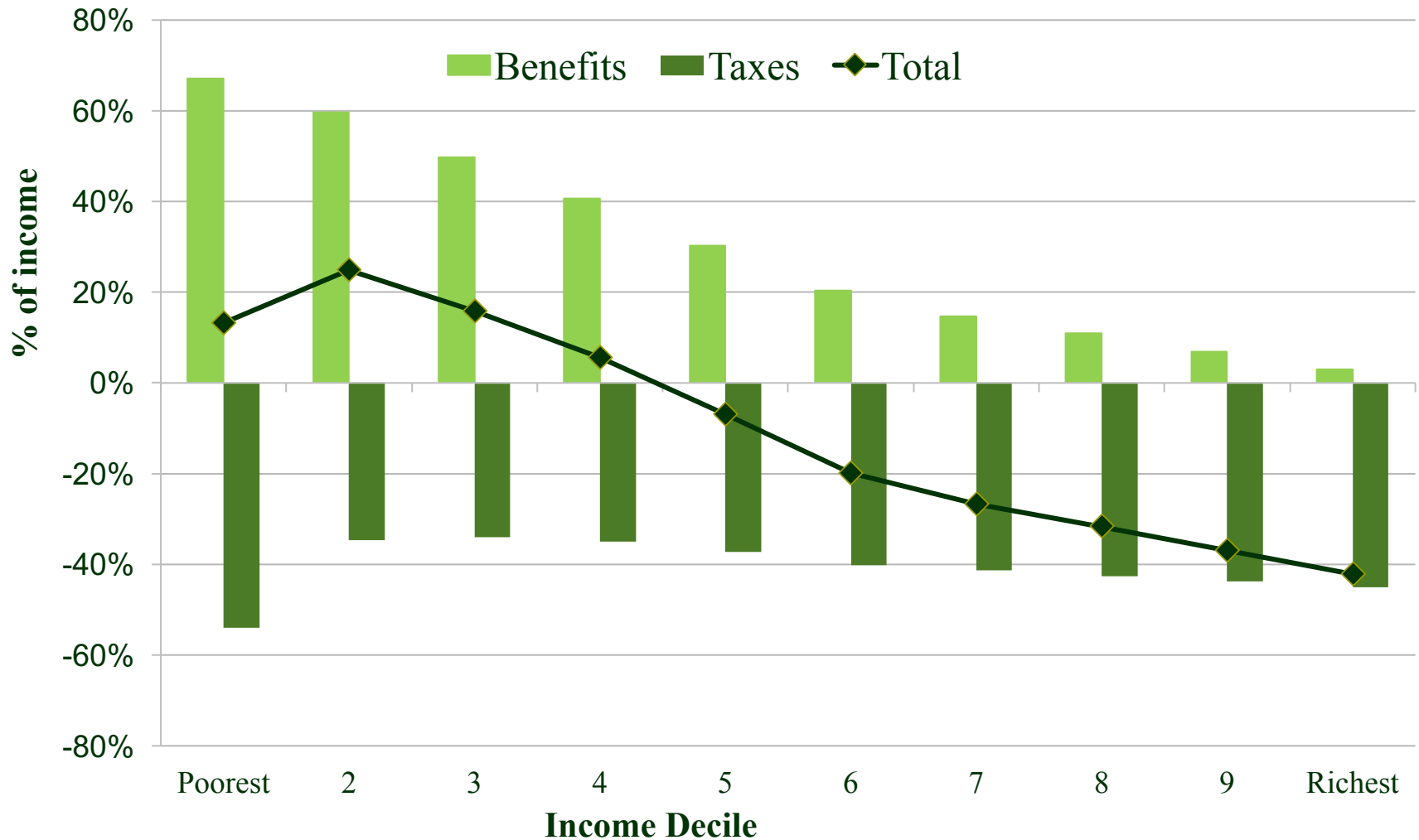


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Distributional effect of the tax and benefit system

2014-15, excluding most 'business taxes'

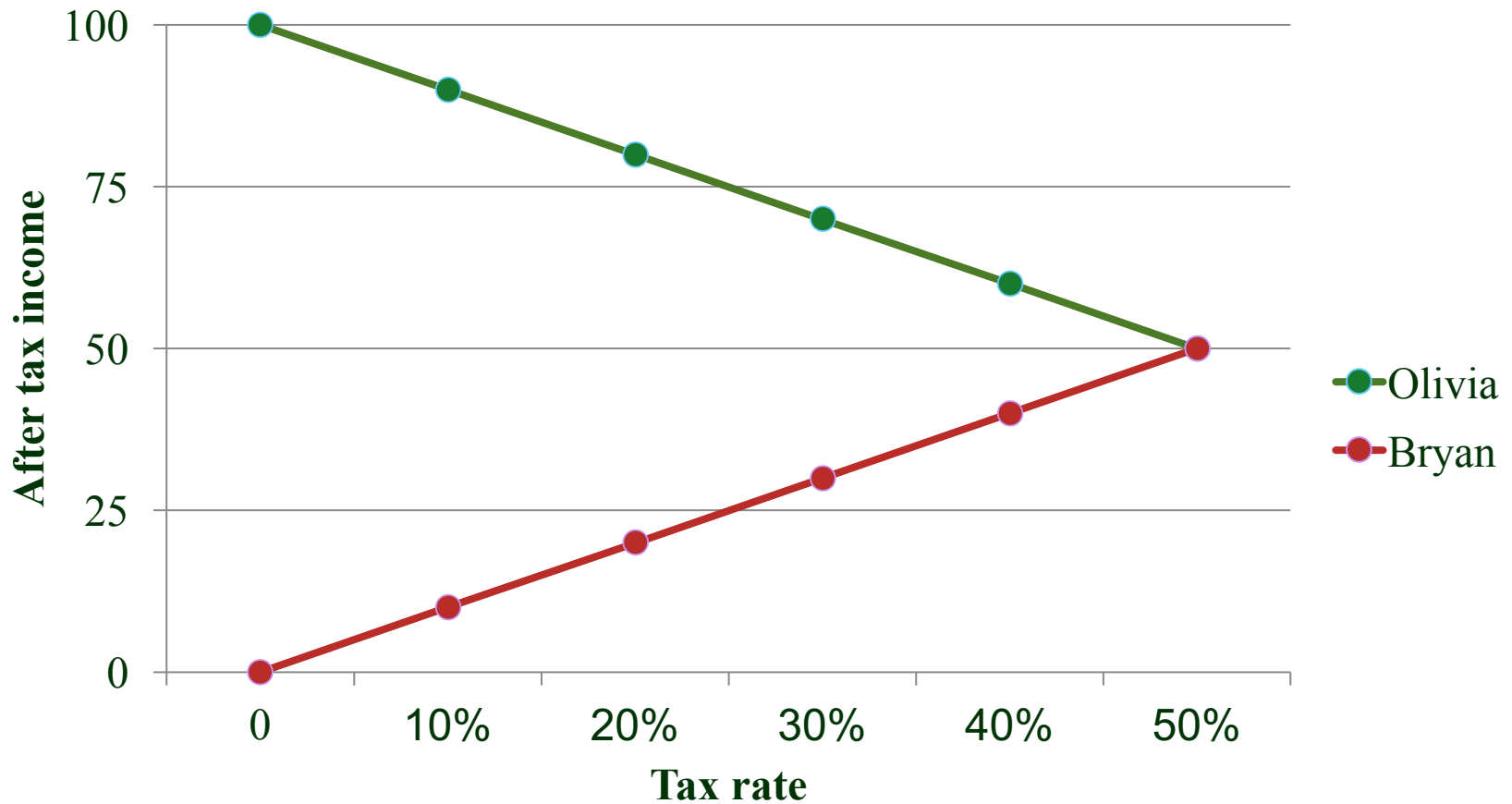


Vertical equity

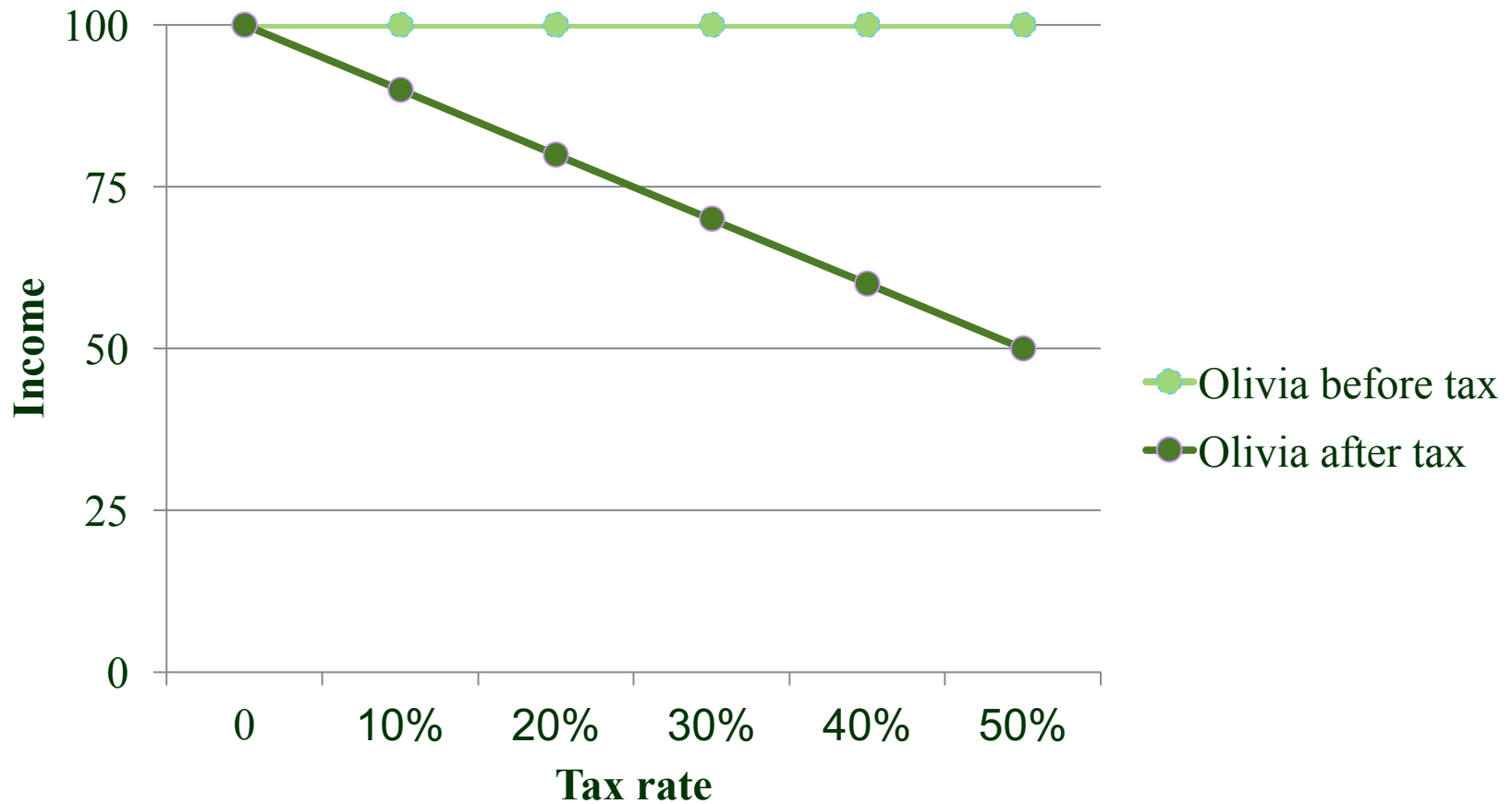
- Olivia earns £100 and we want to redistribute some of that to Bryan



Redistribution from Olivia to Bryan



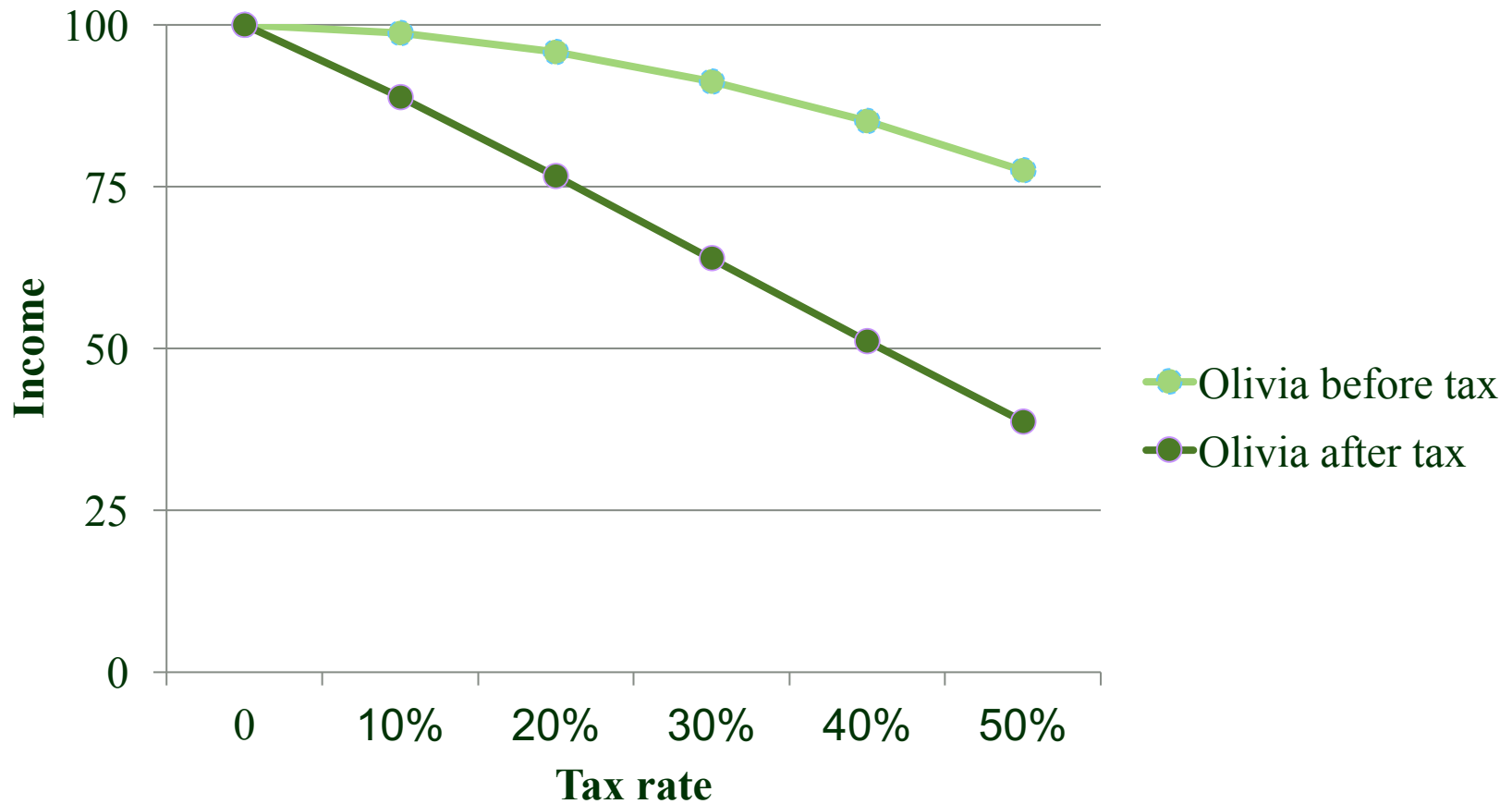
I assumed that Olivia's behaviour did not change because of the tax



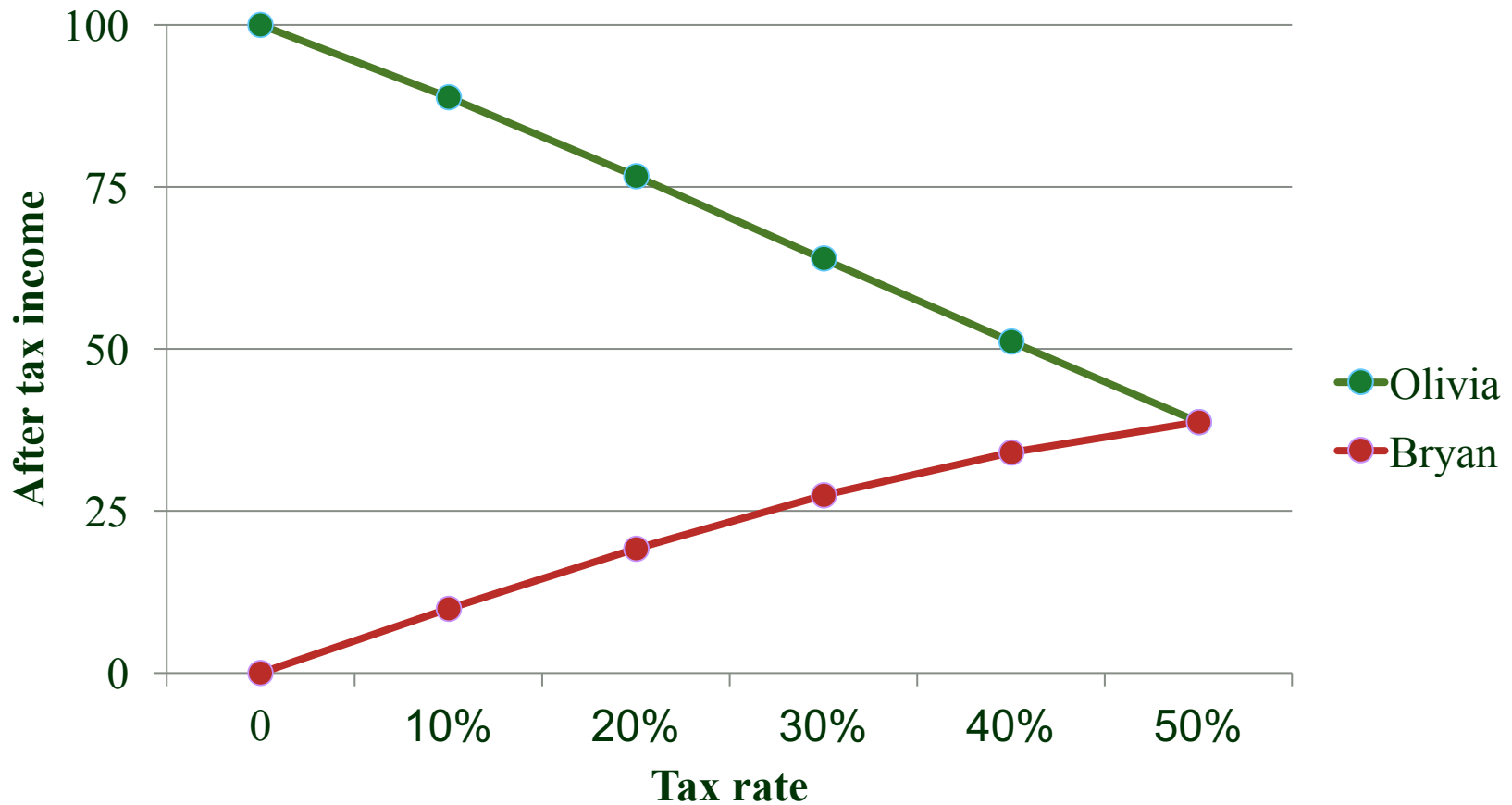
But how will Olivia respond to being taxed?

- If I say I'll pay you £10 for each press-up you do
 - how many will you do?
- What if I put a tax of 10% on that and say I'll only pay you £9
 - how many will you do?
- What if the tax rate went up to 90% so I only pay you £1
 - how will that affect your behaviour?

Olivia's income when she changes her behaviour, in response to the tax she works less



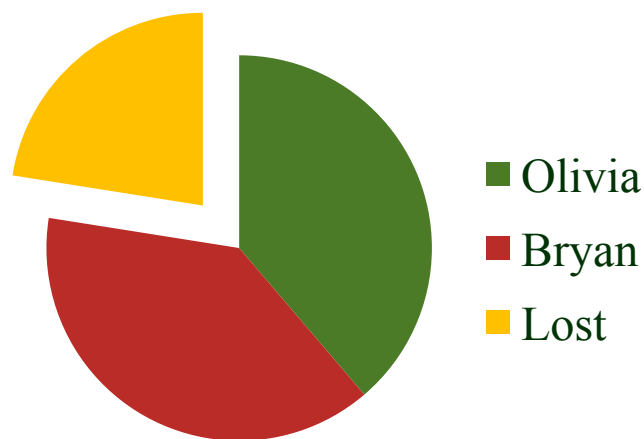
Redistribution from Olivia to Bryan, when Olivia responds to the tax



Olivia responds to tax, so the size of pie shrinks

The size of the pie shrinks

(50% tax rate)



- There is a trade off between redistribution and efficiency
- the higher we tax Olivia the less incentive she has to work
- this results in both her and Bryan getting less

How much the pie shrinks will depend on many things

- Economists use empirical evidence to better understand how much the pie will shrink
 - how much do people respond to incentives, like changes in tax rates
 - does it depend on things like whether they have children, whether other adults in their household are working,
 - what incentives does Bryan have to work
 - how does tax affect Olivia and Bryan's incentives to invest in their own human capital (go to university, get training, ...)

Lifetime as opposed to current income

- Can really change our impression of the impact that taxes or benefits have on redistribution
 - many more people at some point in their lives
 - have low income
 - have kids
 - are lone parents
 - have health problems
 - at some point in their lifetime than in any snapshot
- Short term needs also matter
 - particularly relevant for ‘safety net’ benefits more than for taxes

We care about people who are poor now and people who are poor over their lifetime

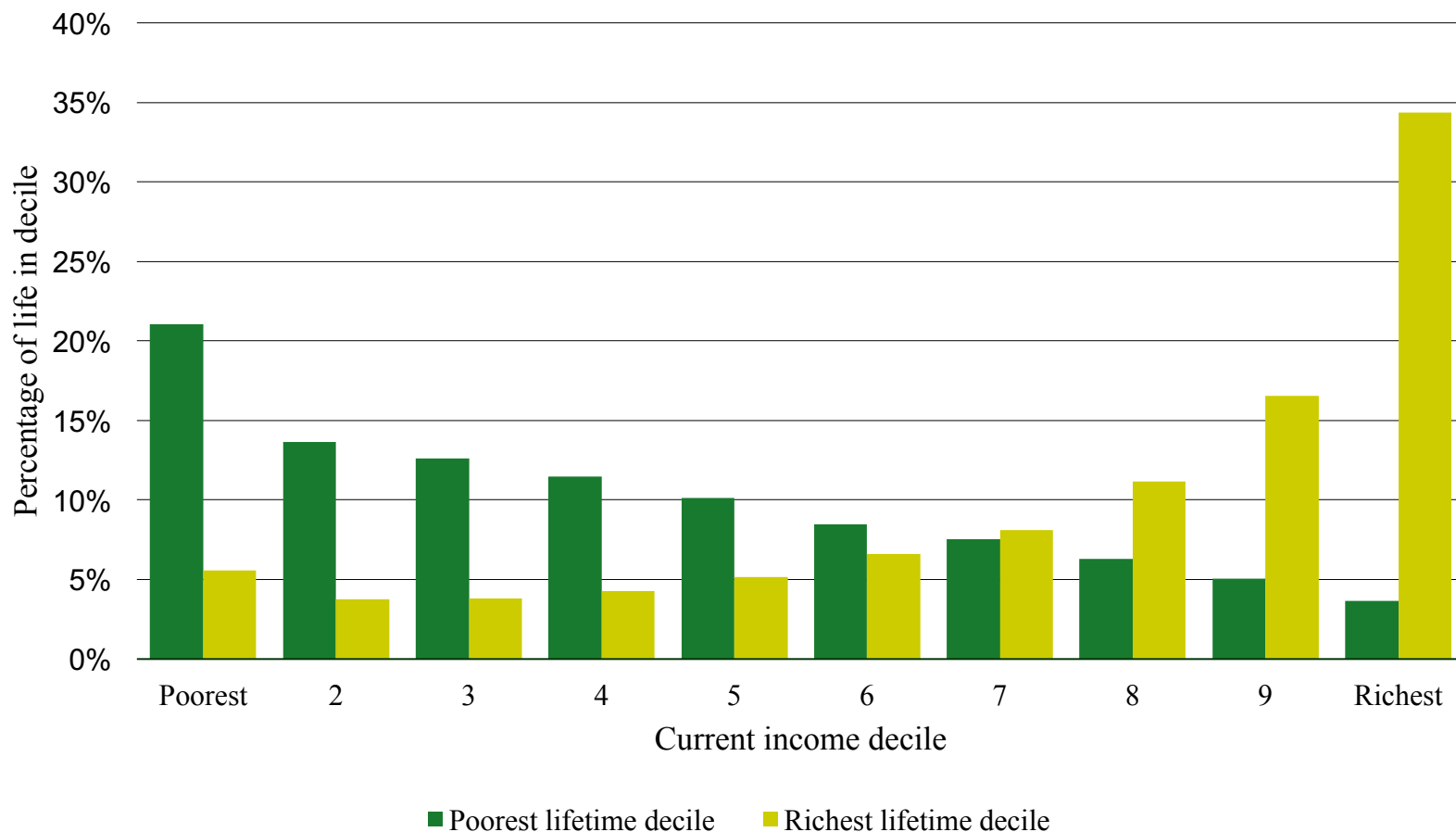


Figure 6, Levell, Roantree and Shaw (2017)

Out-of-work benefits versus in-work benefits

- Out-of-work benefits
 - if you are unemployed or disabled you get benefits
- In-work benefits
 - tax credits for people in work, increases their pay
- Out-of-work benefits reduce incentives to work
 - e.g. if we taxed Olivia and gave Bryan an out-of-work benefit
 - this reduces the incentives for both Olivia and Bryan to work
- In-work benefit
 - give Bryan better incentives to work

Out-of-work benefits do more redistribution than in-work benefits if we look at current income

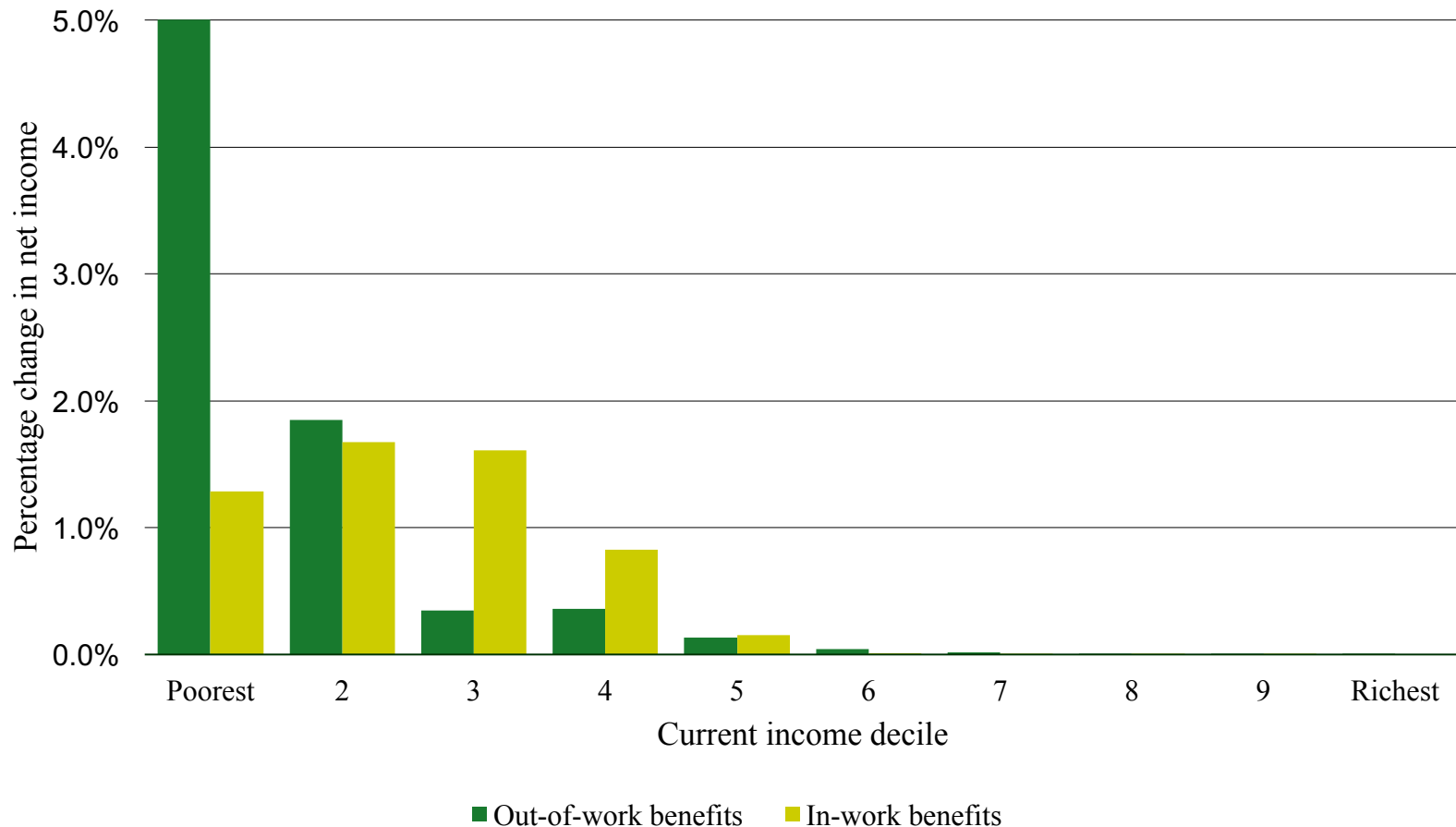


Figure 9, Levell, Roantree and Shaw (2017)

However, from a lifetime perspective they do about the same amount of redistribution

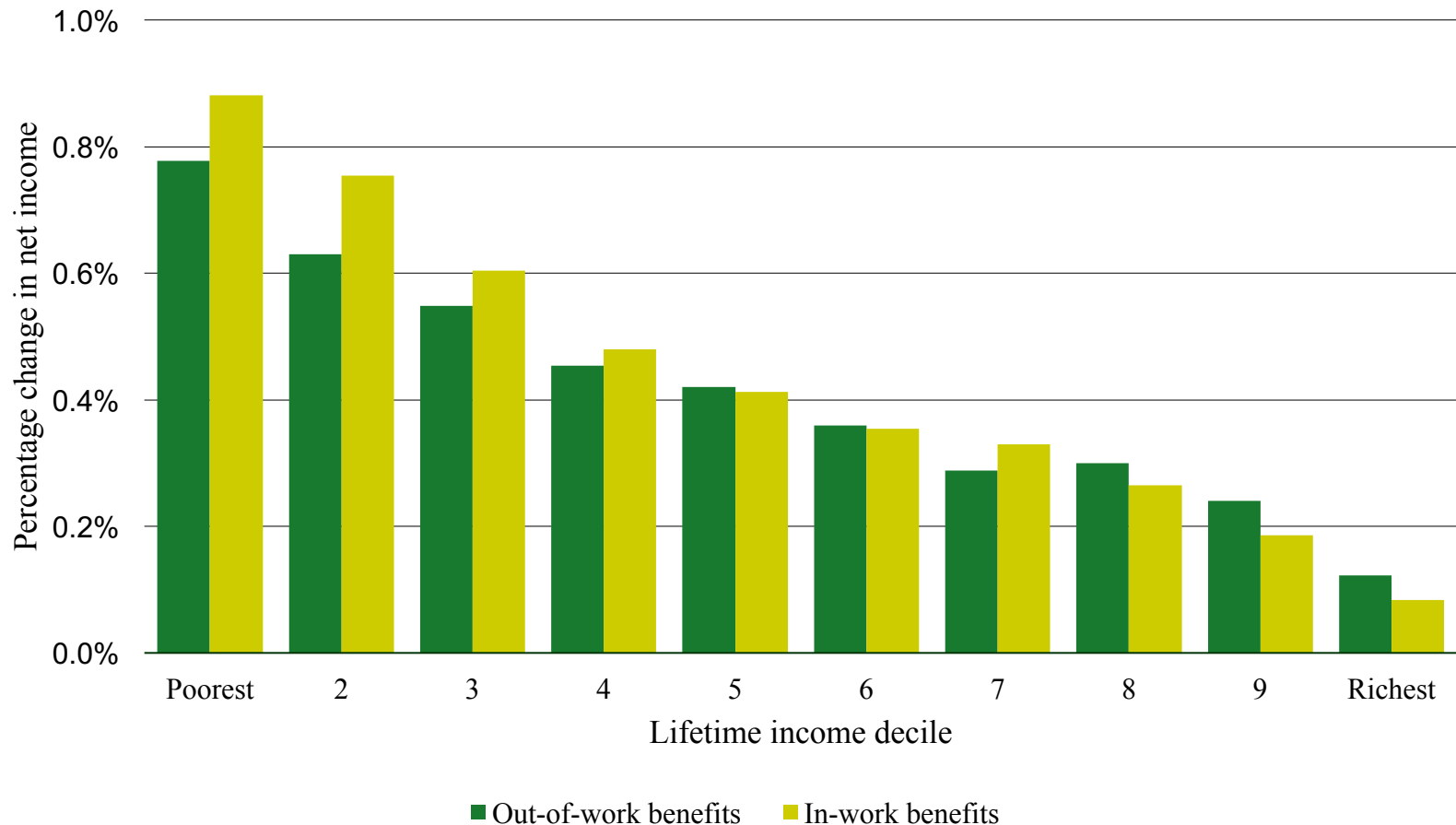


Figure 10, Levell, Roantree and Shaw (2017)

The reason: on average, even lifetime poor spend majority of their working lives in (low-paid) work

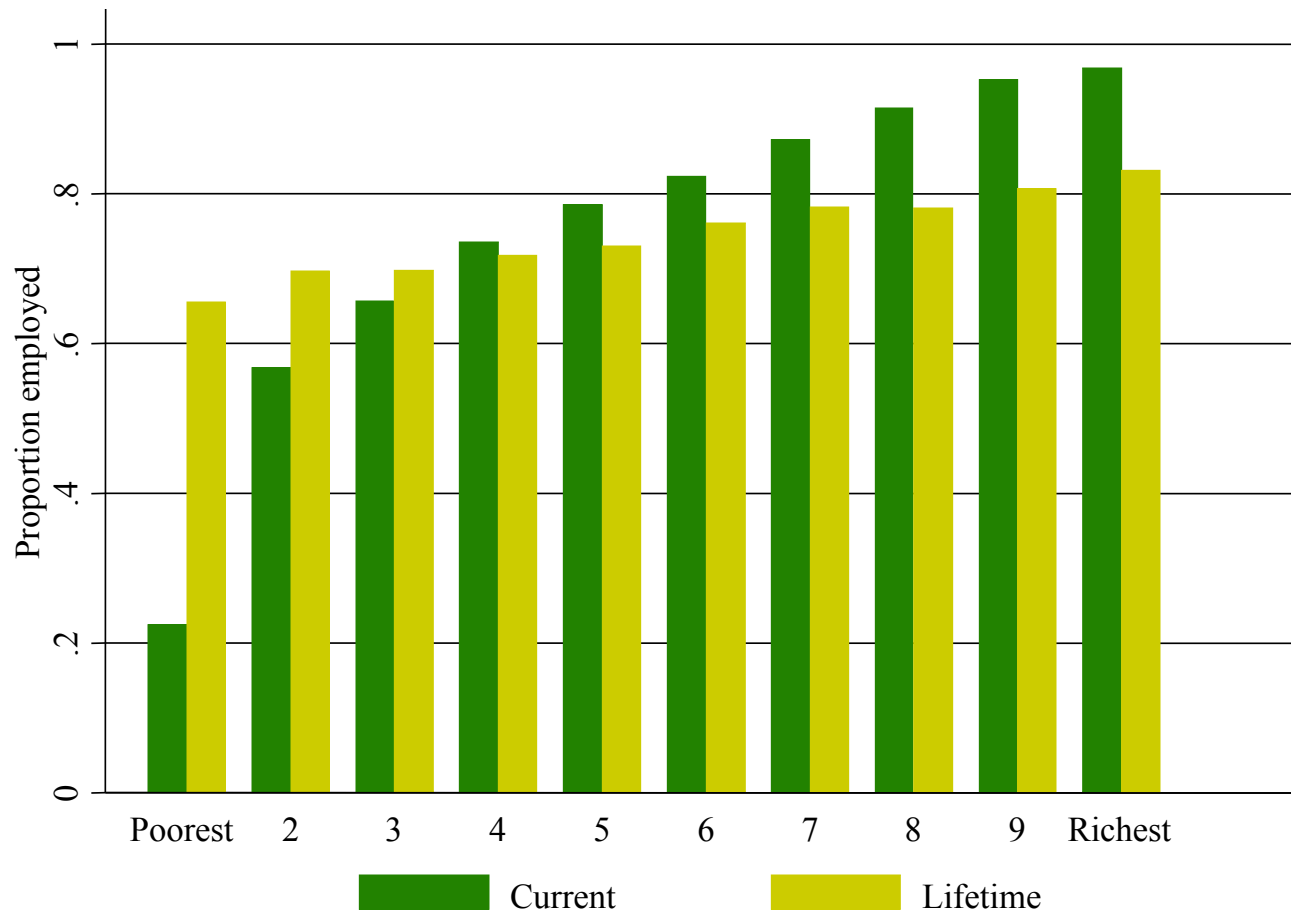
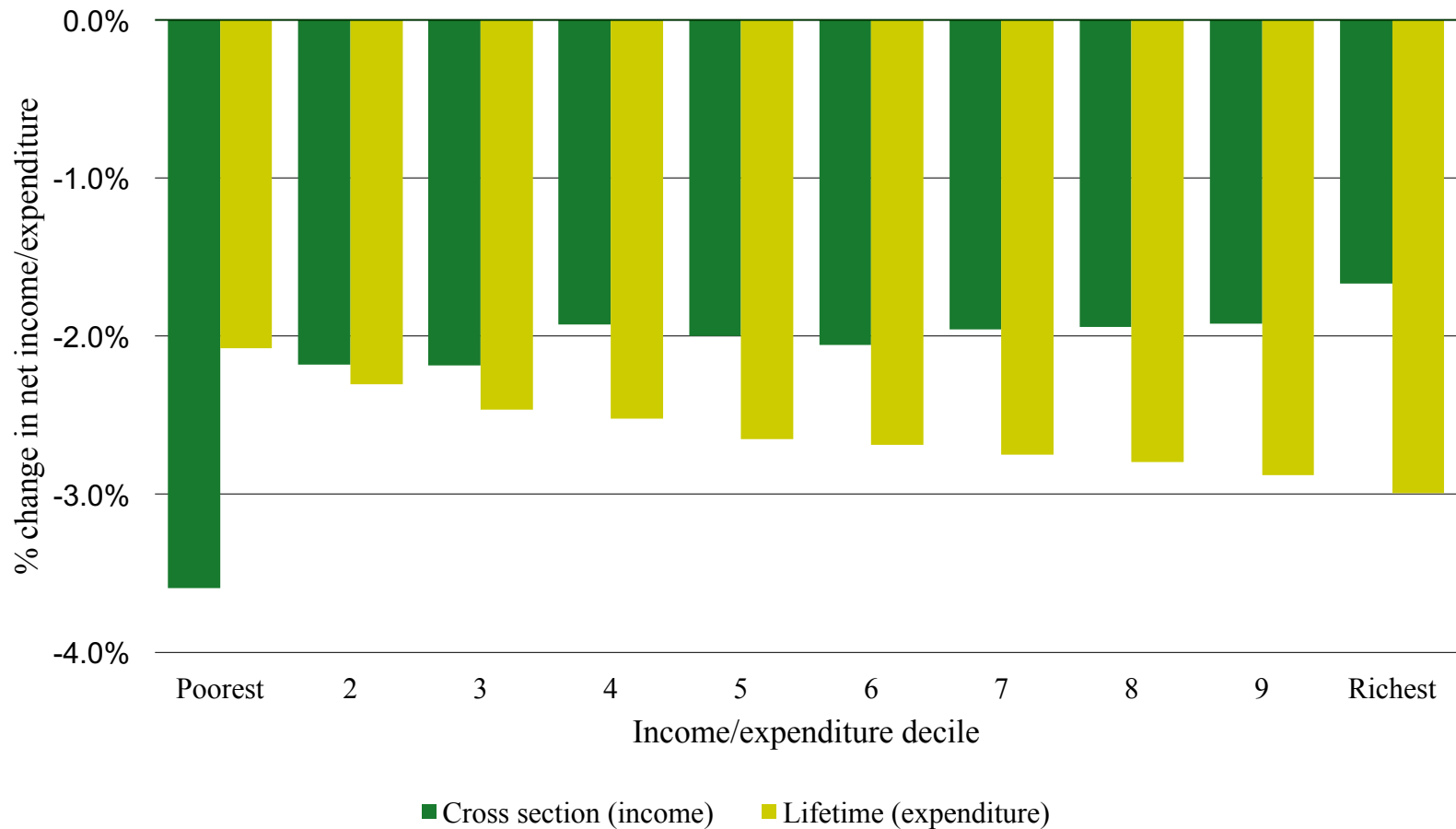
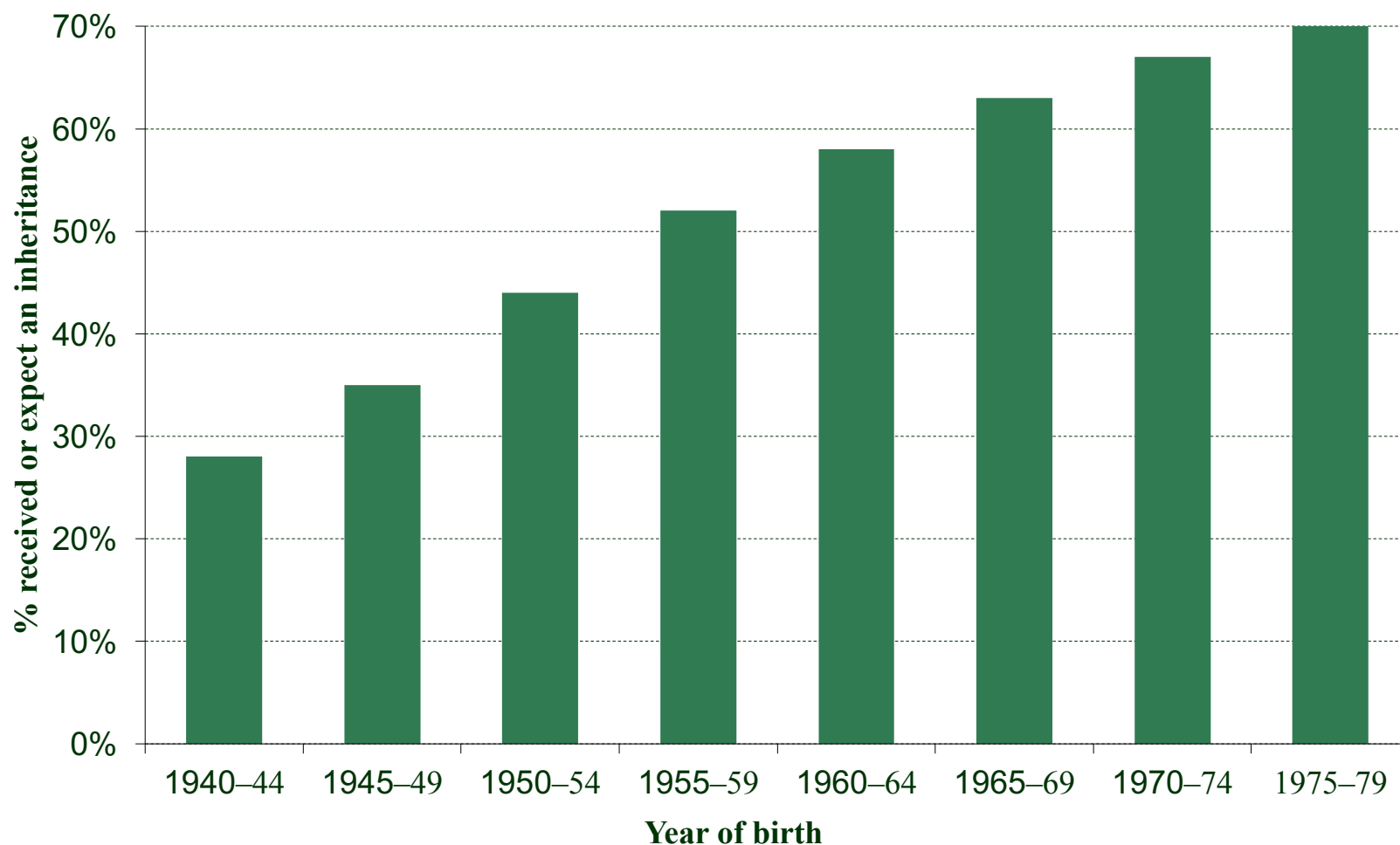


Figure 7, Levell, Roantree and Shaw (2017)

Increases in VAT fall more on the rich if we look at lifetime income



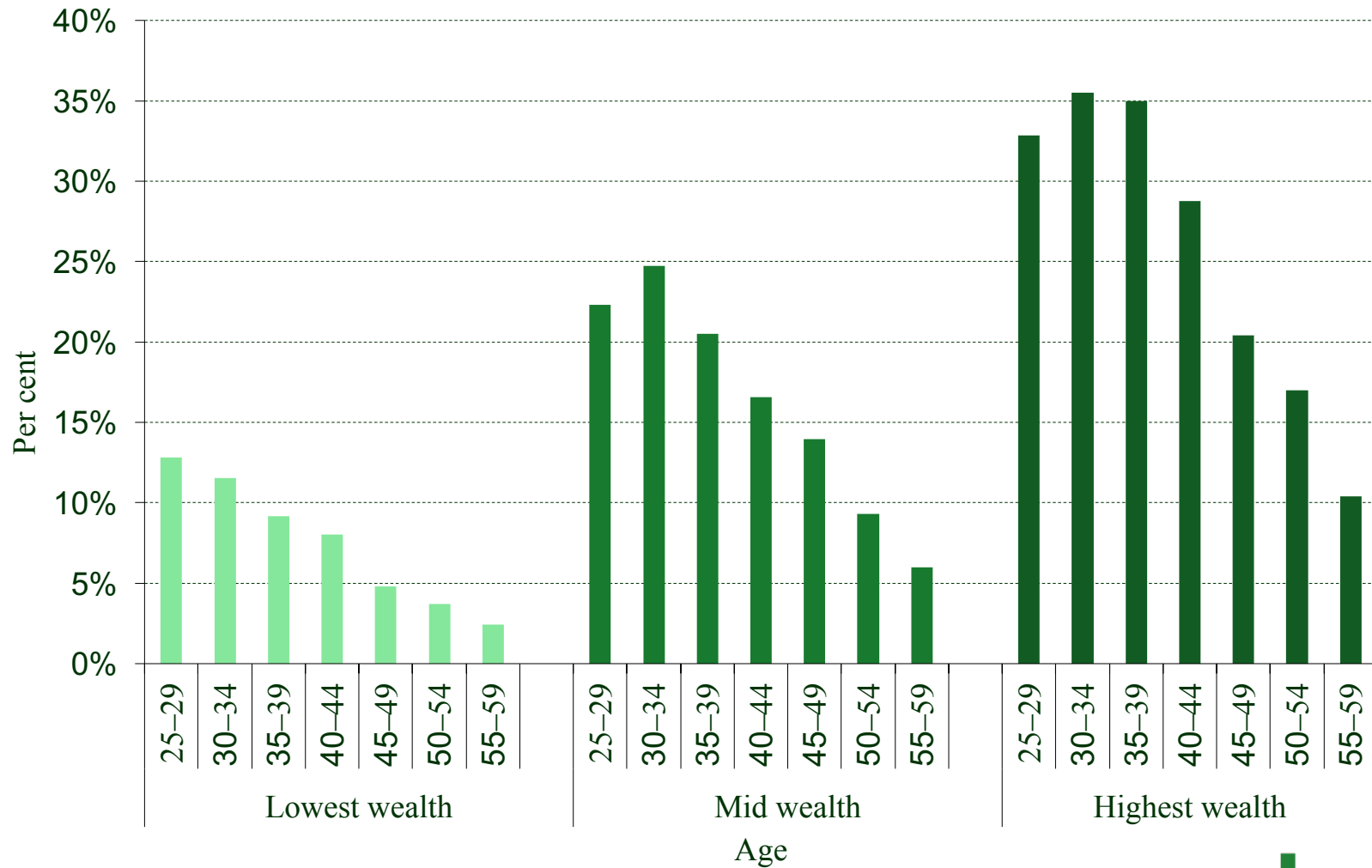
Transfers across generations growing in importance



Source: Figure 4.2, Hood and Joyce (2013)

Potential importance for equality of opportunity

% expecting to inherit more than £100,000



Source: Figure 4.3, Hood and Joyce (2013)

Key points

- There are several dimensions of fairness
 - vertical, horizontal, equality of opportunity
- We need to think of the tax and benefit system as a whole
 - redistribution plays a central role in the tax and benefit system
- Achieving a desired level of redistribution is difficult because
 - there is typically a trade off between equity and efficiency
 - we care about lifetime as well as current equality
- What does economics add
 - learn about how individuals respond to taxes and benefits
 - learn about the differences between current and life-time behaviours
 - NOT how much redistribution we want, that is moral/political choice