



David Willetts

David Willetts is Executive Chair of the Resolution Foundation and was Chair of its Intergenerational Commission.

Why should we tax wealth?

The welfare state must be funded in a way that spreads the cost fairly across the generations.

- The UK population is aging, putting increased pressure on the health and pensions system.
- Over the last 40 years, the wealth-to-income ratio has moved from around 3:1 to 7:1, largely due to increases in the value of houses and pensions.
- To pay for increased healthcare costs, there needs to be changes to the taxation of domestic properties, inheritance tax and to the way pensions contributions are deducted.

The problem

Like many global economies, Britain faces a slow-motion fiscal crisis. A report by the Resolution Foundation's Intergenerational Commission shed light on the deep-seated demographic forces driving up public spending. The big post-War baby boomer cohort are moving out of jobs and into retirement. They will soon be claiming their pensions and become heavy users of the NHS. Following decades of an increasingly favorable worker to non-worker ratio in the UK, the trends are now going into reverse. The impact of this is a 'double whammy' of increased public spending combined with a shrinking tax base. These pressures do not arise from policy decisions to increase the size of the state: it is just meeting commitments that have already been made. And even if there were to be an unprecedented shift to privatized healthcare, it is hard to see how the over-60s would be expected to adjust to the new system, even though they are the group driving the increase in public spending. The big issue in British budget policy over the next decade is deciding which taxes to increase — and by how much. This is where the taxes on property come in.

“Following decades of an increasingly favorable worker to non-worker ratio in the UK, the trends are now going into reverse, creating a ‘double whammy’ situation of increased public spending combined with a shrinking tax base.”

Why wealth?

Back in the 1970s, the total stock of wealth held in the UK amounted to two or three times national income. Today, the ratio of wealth to income is close to seven times. Wealth has soared relative to people’s income, but the tax the UK Exchequer receives on that wealth has barely changed at all — staying at around 2.5 percent of GDP for most of the last 50 years. Measured by the Gini coefficient, wealth is now twice as unequally distributed as income.

Some of the increase in the value of assets over the past four decades is explained by people’s hard work. But this is only one of several factors. Four-fifths of the growth in net property wealth since the 1990s comes from ‘passive’ gains in house prices, rather than people taking ‘active’ steps like moving or improving houses. Similarly, the increases in pension valuations come not from increases in personal savings but because a promise to pay an income above a certain age becomes more valuable as life expectancy rises. In both cases, we are seeing extraordinary wealth effects that are unlikely to be repeated on anything like the same scale. The beneficiaries are mainly the baby boomers. They hold more than half of Britain’s GBP12.8 trillion in total wealth. They are the very same generation whose increasing need for health and social care is driving the increases in public spending. So, in order to help meet the costs of those services, it

makes sense to see if there are ways in which their significant comparative wealth can be taxed.

Three proposals for taxes on wealth

In light of the above, the Intergenerational Commission has proposed: reforms to property taxes; replacing inheritance tax with a broader lifetime receipts tax; and the modification of current tax reliefs on areas such as pensions.

Council Tax was designed as a compromise between property-based rates and a Poll Tax on users of local services. It has increasingly come to resemble the Poll Tax that it replaced. It is highly regressive — the tax rate of a family living in a GBP100,000 house is five times that of a family living in a property worth GBP1 million. We propose replacing Council Tax with a new progressive property tax. This is set so that the lowest-value 10 percent of properties in each region pay no tax, and all others pay 0.85 percent of property value each year (with a higher rate for the most valuable 10 percent of properties).

Inheritance tax (IHT) consistently ranks as the most unpopular of all taxes in the UK. It is a classic bad tax, with a high headline rate but few people liable to pay (even though many fear they will be liable). People also rightly think they should be able to pass on some of their wealth to their descendants, as part of the intergenerational contract within their families. Last year, GBP125 billion was passed on in inheritances and gifts, but only 4 percent of estates were liable for IHT. There are many exemptions, which means the very richest end up paying little IHT. They can shift a larger proportion of their wealth into exempt assets like agricultural land and unlisted shares. Inheritance tax should be replaced with a new ‘lifetime receipts tax’, which shifts the tax liability from the giver to the receiver with fewer

exemptions. We propose each person should have a GBP125,000 lifetime tax-free allowance for gifts and inheritances, above which they would pay lower tax rate than today’s IHT.

The current pension tax relief regime — which overwhelmingly benefits people on the highest incomes — should be replaced by a flat rate of income tax relief. At the same time, we should place a new national insurance (NI) charge at half rate (6 percent) and above a high threshold on income from occupational pensions.

A sensible, well-designed increase in tax to match the vast increase in the stock of wealth is an opportunity to fund security in later life for older people today and tomorrow. It is better than putting all the burden of increased tax on the earnings generated by the hard work of the younger generation. We should fund the welfare state in a way that spreads the cost fairly across the generations. ■

“Baby boomers hold more than half of Britain’s GBP12.8 trillion in total wealth.”



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Taxation of wealth

When it comes to addressing societal issues, how can we use wealth tax to maximum effect?

- Wealth taxes have the potential to address issues such as wealth imbalances and rising health and welfare costs.
- However, not all wealth taxes address all the issues completely — or even partially.
- Net wealth taxes have generally created neutrality, efficiency and equity issues.
- Annual real property taxes have proved a relatively efficient way of taxing wealth.



Widespread concerns about unequal wealth accumulation and growing government expenditure obligations have led many to call for increased taxation of personal wealth. Some see wealth tax reform as a means of funding essential government services, at the same time as supporting equality of opportunity through wealth redistribution. However, when implemented in the past, certain wealth taxes have proven to be inefficient, distortive and inequitable and have consequently become less popular. Given this history, a hasty and ill-considered revival of old wealth taxation policies could do more harm than good. The essay below sets out points that are beneficial to bear in mind when determining whether a wealth tax warrants further consideration, based on a particular country's fiscal and social circumstances.

Wealth tax — a brief background

Any worthwhile decision on tax reform needs to be informed by the current context, bearing in mind the challenges of current global fiscal policy. Wealth taxes may directly address the general issues of imbalances in wealth accumulation, and specifically the issues of wealth accumulation through real property (arising in part of population growth), and rising health and welfare expenditure. However, not all kinds of wealth taxation can address these problems totally or even partially.

The term 'wealth tax' could actually be applied to several different types of taxes, all of which are conceptually distinct. Taxes on land, capital gains, inheritance, and lifetime gift receipts each address certain elements of wealth, while 'net wealth taxes' are explicitly designed to be levied on total taxpayer wealth.

“While net wealth taxation may at first seem to be a logical, broad-based means of taxing wealth, it has historically been only a minor contributor to revenue.”

Considering the wealth tax alternatives

While net wealth taxation may at first seem to be a logical, broad-based means of taxing wealth, it has historically been only a minor contributor to revenue, and has created neutrality, efficiency and equity issues when implemented in OECD member countries. This is principally because net wealth taxes take no account of any return on wealth (i.e. they are akin to taxes on a notional or fixed return on wealth). So, asset-rich/cash-poor taxpayers earning little or no income on their wealth are treated in the same way as taxpayers who earn large returns on their wealth. Furthermore, it is hard for net wealth taxes to allow for circumstances where assets decline in value. As a result, there has been a global ‘retreat’ from wealth taxation among policymakers, which the OECD set out in the paper *The Role and Design of Net Wealth Taxes in the OECD* (2018). Whereas 12 OECD countries had net wealth taxes in place in 1990, this number dropped to three in 2018. As such, in many cases, net wealth taxation has generally been experienced as too economically burdensome compared to the revenue that it raises.

Net wealth taxes have also created a cottage industry out of tax avoidance involving both domestic and offshore tax planning, partly due to the complexity of wealth tax laws. This can exacerbate the effects of capital flight for the jurisdiction imposing wealth taxes, which ultimately undermines economic growth (i.e. by taxing wealth, governments chase wealth away, and ultimately end up with less wealth to tax and less revenue-generating economic activity).

An alternative approach to taxing wealth is implementing a lifetime gift tax, which is sometimes seen as preferable to an inheritance tax. However, taxes of this kind are often highly unpopular politically, and plagued by issues around how difficult it is to define a gift, and how to apply workable compliance measures.

In contrast, real property taxes have proven to be a relatively efficient means of taxing wealth as they have a lower negative impact on long-term economic growth when compared to other wealth taxes. Taxation on real property also tends to redistribute wealth from older, wealthier, property owners to younger people, while raising additional revenue needed to fund recurrent government expenditure. Real property taxes are also not as susceptible to avoidance strategies and capital flight, as the property is immovable. Investigating the optimum scope of real property taxes may therefore represent a sensible starting point for an analysis of possible wealth taxation policy changes.

Mitigating property tax downsides

Real property taxes may have a particular impact on cash-poor, older property owners who have high-value property because they have owned property for decades. Therefore, any good property tax should be designed to minimize the particular burden on such property owners. We believe a ‘reverse mortgage’ system can be effective in this regard, whereby cash-poor property owners could pay a property tax out of the equity in their property, with total tax payable for the period in which the property is owned to be capped at 30 to 40 percent of a property’s value.

A common argument against real property taxation is that it treats different classes of wealth differently (by taxing property over and above other asset classes). This is viewed as an undesirable distortion by

“Real property taxes are also not as susceptible to avoidance strategies and capital flight, as the property is immovable.”



many, however, there are also strong arguments in favor of taxing land, as it is finite, where other forms of wealth are not.

Consideration of real property tax reform is an opportunity to consolidate and streamline all taxes that are levied on real property, including domestic rates and real estate transaction taxes in jurisdictions where these taxes are legislated. Real estate transaction taxes have a very high marginal excess burden. There is merit in considering abandonment of transaction-based taxes and myriad other property taxes for a single, progressive, annual property tax.

Redistributing property tax revenue

For the tax to achieve its intended aim, property tax revenue should be redistributed very carefully. For

example, a maximum of two-thirds of the proceeds could be spent locally, to provide for essential local services, with one-third consolidated into an equalization fund that could be spent throughout a jurisdiction.

Conclusion

In summary, while wealth taxation will always carry equity, efficiency and neutrality concerns, real property taxation reform is a means of minimizing these, while maximizing efficiency and addressing squarely some of the current fiscal policy concerns facing governments.

It should also be acknowledged that great progress has been made toward reducing wealth inequality between countries. This has led to considerable gains in productivity and elevated the living standard of some of the most

disadvantaged members of the global community.

Whatever future reforms are undertaken as a result of the current debate around wealth and tax policy should recognize the extent to which existing policy positions have fostered absolute, as well as relative, economic benefits across the globe. ■

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Keval Bharadia

Keval Bharadia worked for the London Stock Exchange for 15 years, heading up product development for the derivatives business between 2007–2010. After leaving the city, he moved into the field of international development working for grass-roots human rights organizations and consulted for international NGOs including Oxfam, Christian Aid and Stamp Out Poverty.

The future of capital taxation

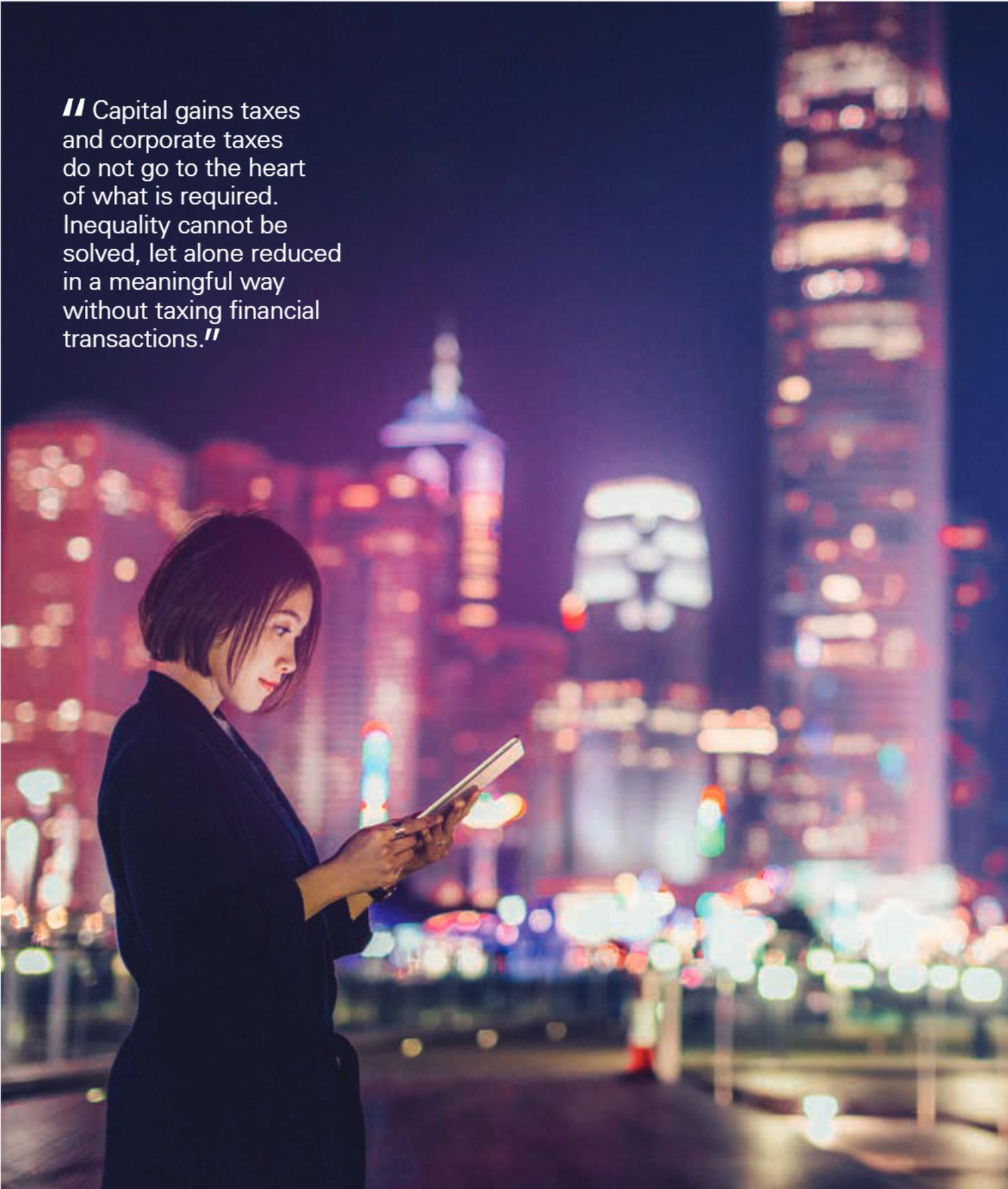
Without effectively taxing financial transactions, the inequality gap will continue to widen.

- Without effective taxes on capital, extreme concentrations in wealth occur.
- The trading of derivatives was originally conceived to help mitigate future risks on crops and homes by locking in

prices or expunging obligations. It has now become a speculative market.

- Modernizing the UK's stamp duty on shares — the world's oldest financial transactions tax (FTT) — and extending it to products like derivatives, would raise an additional GBP5 billion a year.

// Capital gains taxes and corporate taxes do not go to the heart of what is required. Inequality cannot be solved, let alone reduced in a meaningful way without taxing financial transactions.//



// Modernizing the UK’s stamp duty on shares — the world’s oldest financial transactions tax (FTT) — and extending it to products like derivatives, would raise an additional GBP25 billion during the life of a parliament.”

I spent 15 years working at the London Stock Exchange, the last three as head of Derivatives Product Development during the global financial crash.

When I launched one of the first over-the-counter trading and clearing services for European derivatives in 2006, I was optimistic my industry colleagues at the world’s biggest investment banks would honor their word and use it to help counter rising systemic risk in the global financial system. They didn’t. Soon there were homeowners losing their properties because bad debts were repackaged inside clever derivatives with triple A credit ratings.

My peers, including wealthy investment bankers, brokers and traders, continued negotiating multimillion pound trades after the crash. Their immunity to the social and economic turmoil that was unravelling around us felt strange to me. Despite the evictions, unemployment and recession we were witnessing as part of the general economic situation, for them it was business-as-usual.

What became apparent, working at the stock exchange for a decade and a half, was the truth behind the old casino adage: “the house always wins.” The finance sector can garner vast streams of insider intelligence to easily predict market movements. Whether markets go up or down, it makes money by extracting value from the full breadth of society and the economy. Counter to common perception, this is where capital goes to become unproductive!

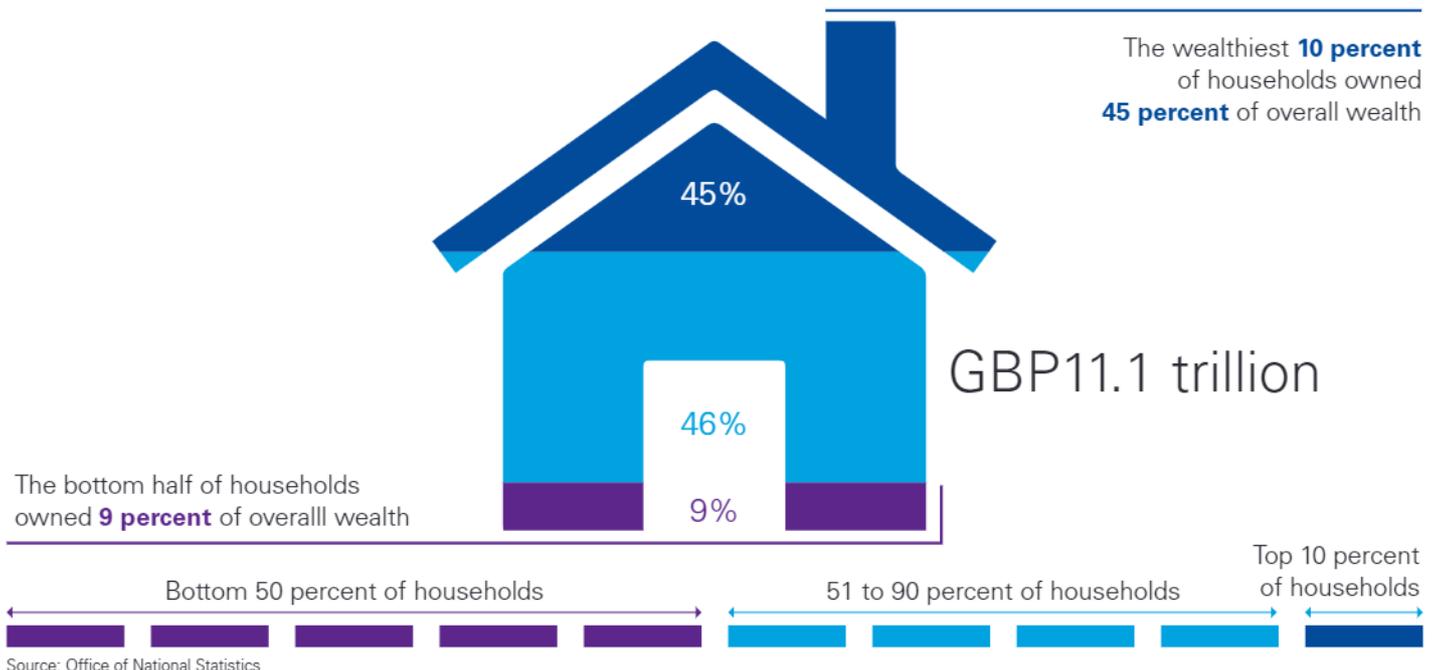
The trading of derivatives was originally conceived in earnest — to help mitigate future risks on crops and homes by locking in prices or expunging obligations. Early records indicate that the Babylonians used them extensively. Common examples are the farmer, who, when worried about what the weather might do to crop yields, locks in a price

now for future harvests, to help provide some stability and security in the event of bad weather and poor yields.

But times have changed. Derivatives trading has now essentially become the world’s biggest betting shop for the wealthy, contributing greatly to rising inequality. Large speculative bets are made cheaply because they offer traders the ability to leverage their positions at a fraction of the cost of an underlying asset that does not need to be owned. Due to the trillions of capital exposed, huge profits are made when asset prices move by only fractions of a decimal place. Today, stock and derivatives exchanges share the stage with investment banks and the financial community as the epicenter of capital accumulation and concentration.

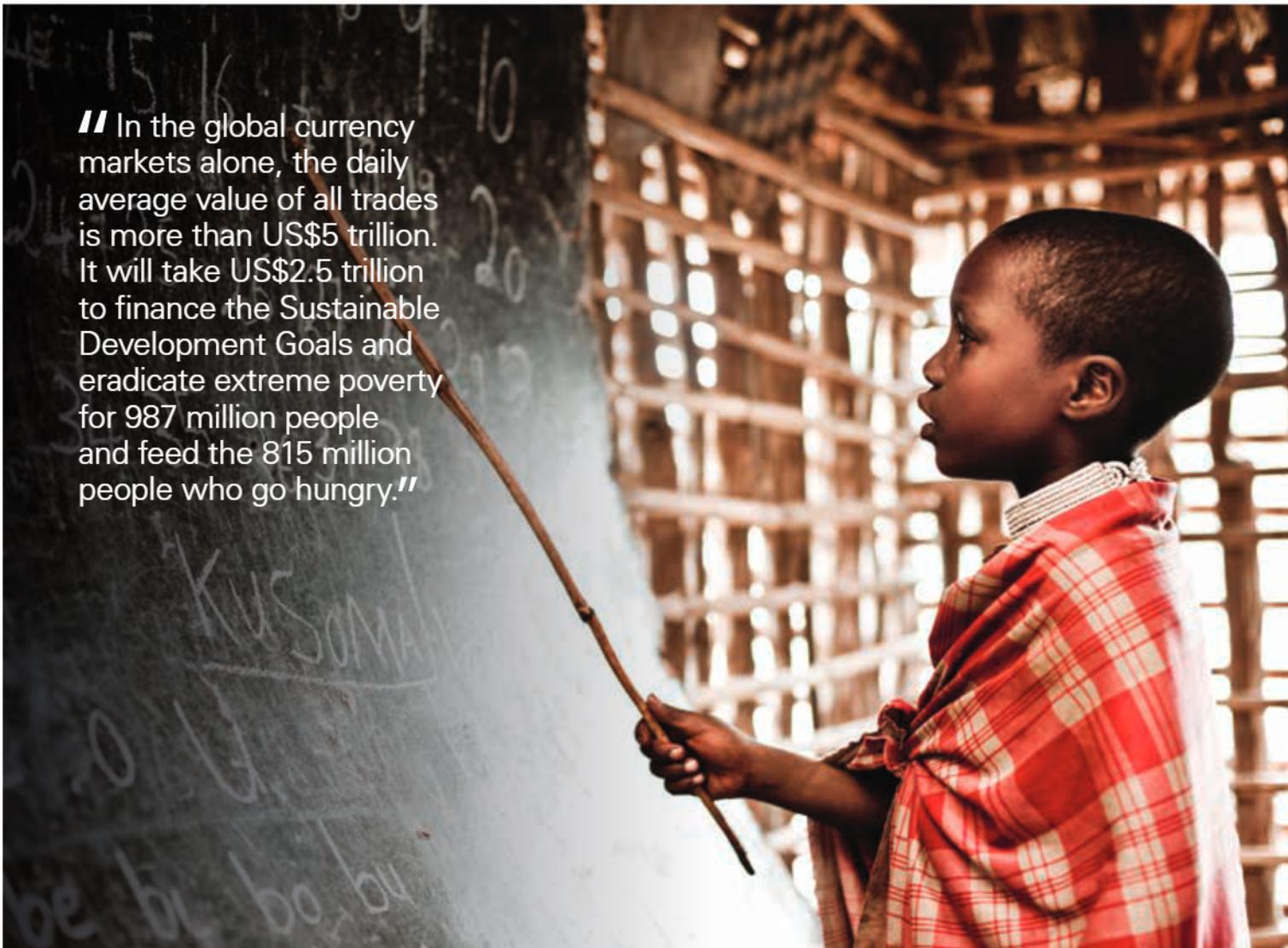
Inequality cannot be solved, let alone reduced in a meaningful way without taxing financial transactions. Capital gains taxes and corporate taxes do not go to the heart of what is required.

Without effective taxes on capital, extreme concentrations in wealth occur. Last year saw the biggest increase in billionaires in history, one more every 2 days. According to a report by Oxfam,⁵ 82 percent of all wealth created in the



⁵ <https://policy-practice.oxfam.org.uk/publications/reward-work-not-wealth-to-end-the-inequality-crisis-we-must-build-an-economy-fo-620396>

// In the global currency markets alone, the daily average value of all trades is more than US\$5 trillion. It will take US\$2.5 trillion to finance the Sustainable Development Goals and eradicate extreme poverty for 987 million people and feed the 815 million people who go hungry.//



last year went to the top 1 percent, with not a cent to the bottom 50 percent. The highest paid hedge fund manager is earning GBP1.2 billion per year, taking home the average annual UK salary every 3 minutes.

In the UK, inequality is widening dramatically because ineffective and inadequate taxes on capital allow wealth to grow at an exponential rate.

The top 10 percent in the UK who own 45 percent of wealth are immune to austerity, low wages and cuts to public services. Excess wealth needs taxing and redistributing to close the inequality gap, as does a reversal of austerity. There's plenty of money for everyone, but unfettered capitalism is allowing those at the top to pull away from the rest.

Modernizing the UK's stamp duty on shares — the world's oldest financial transactions tax (FTT) — and extending it to products like derivatives, would raise an additional GBP25 billion during the life of a parliament. As set out in an influential paper by former financier, Avinash Persaud, not only would this produce much-needed extra revenue to improve spending on hospitals and schools, even a small tax would disincentivize high-frequency trading, with the result a safer economy.

If comprehensive FTTs were introduced across all major financial trading activity, we would have an opportunity to tackle some of the world's biggest issues. In the global currency markets alone, the daily average value of all trades

is more than US\$5 trillion. It will take US\$2.5 trillion to finance the Sustainable Development Goals and eradicate extreme poverty for 987 million people and feed the 815 million people who go hungry.

FTTs would not be detrimental to society — they would vastly improve it. A socially just FTT is essential if we are to eradicate exponential capital accumulation and tackle extreme wealth creation. What is our economy for, if not to improve the lives of ordinary citizens! Placing more tax on the financial sector is plain common sense. ■



Christine A. Wernet

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Consumption taxes: Is progressivity the answer?

How a targeted, well-thought-through tax on consumption could play a role in reducing inequality.

- In their current form, consumption taxes tend to be regressive.
- An equal society tends also to be a peaceful society.
- Progressive taxation is potentially a means to reduce inequality without stunting economic growth.

Consumption taxes in context

Two central reasons for taxation are generation of government revenue and the redistribution of income among the population. Governments have used taxation as a means to generate revenue for centuries, and some governments have been using taxation as a means of resource reallocation since at least the 1800s.

Consumption taxes, such as sales taxes, could be used to redistribute income and decrease inequality, but the problem is that consumption taxes tend to be regressive. Regressive taxes burden lower-income groups more than higher-income groups because less affluent individuals spend a higher proportion of their income on consumer goods than do more affluent individuals.

Sales tax is tax that is placed on goods and items that are sold, such as clothing, furniture, tools, etc. As an example, in the US, some states place a sales tax of 7 percent on all items sold. In this case, if an item is purchased for US\$100, the individual will owe US\$7 in sales tax to the government. Another consumption tax is the excise tax. Excise taxes, which are also regressive, are placed on certain items such as alcohol, tobacco and gasoline. Excise taxes place a heavier burden on the poor than on the rich because, like sales taxes, they account for a larger proportion of their total income.

Responsible tax behavior in a global context would require governments to use different forms of progressive taxation to not only generate income, redistribute income and reduce inequality, but to do so in a way that does not stunt economic growth. Progressive taxes are taxes that require those who earn more money to pay higher tax rates. In many countries, income taxes are progressive. Proponents of progressive taxes argue that wealthy individuals have a moral obligation to society to pay higher taxes.

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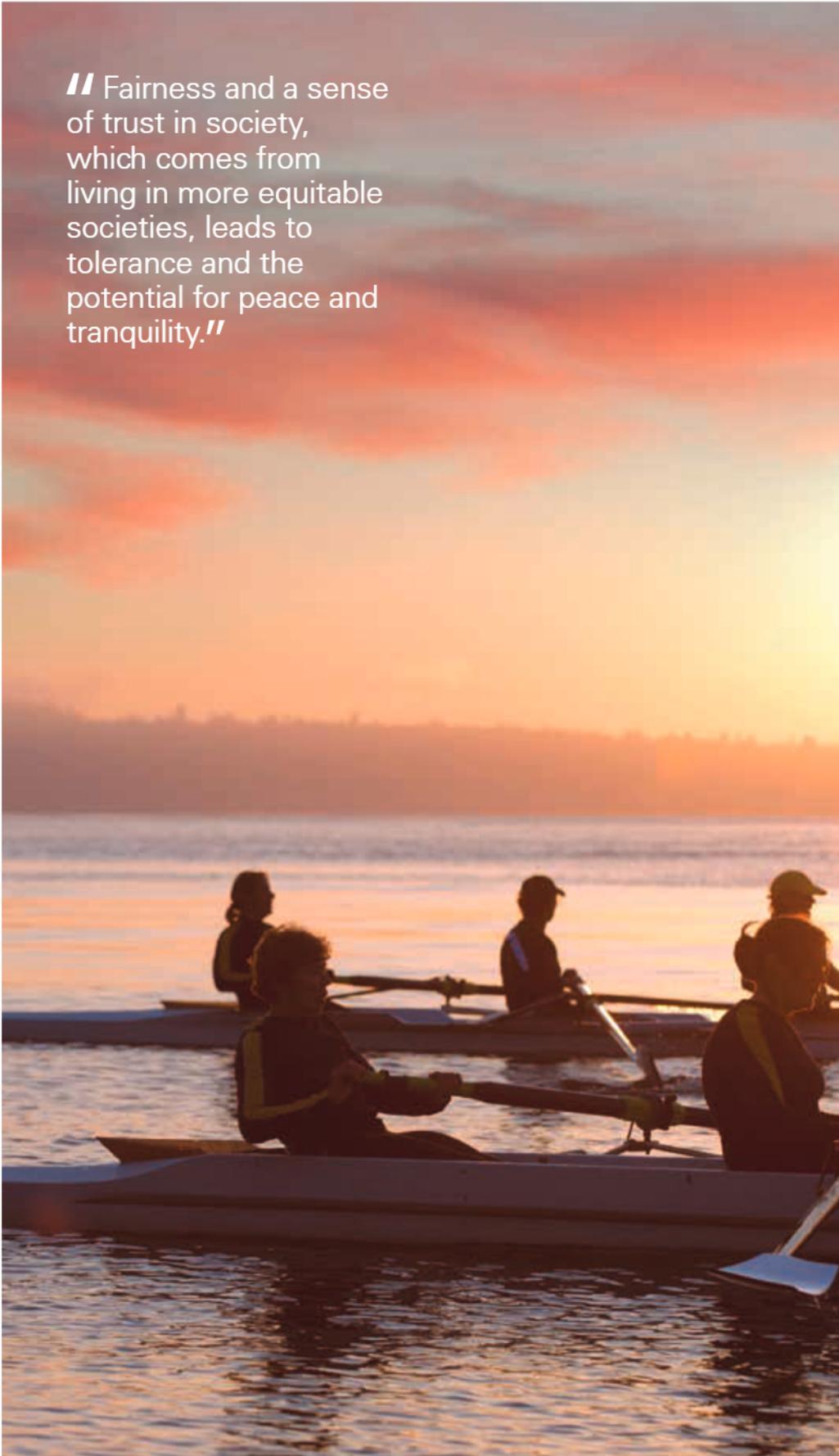


Why are progressive consumption taxes necessary?

Progressive consumption taxes are necessary because they can be used to reduce inequality. There is an enormous amount of inequality globally, both between and within countries. It is irresponsible for governments not to use the revenue generated by taxation (and other sources) to reduce inequality in their own countries and in countries around the world.

Global inequality between countries in per capita incomes began increasing with the colonization process 500 years ago. In the past, there were not major differences in the incomes of the average person from country to country. However, today there are vast differences in the resources available to people in countries around the world. While most individuals in wealthy countries live a life where food, clean water, material goods, and health care is widely available while many individuals in poor countries have difficulties meeting their basic needs. The differences in the access to these resources is stark. For example, people living in developed countries often die of diseases related to obesity like heart disease and cancer. Whereas people living in less developed countries are more likely to die from malnutrition and parasitic diseases.

In addition to inequality between countries, there is also great inequality within countries that needs to be addressed. Generally speaking, there tends to be more inequality within less developed countries, like Brazil, where there are vast divides between the haves and the have-nots. The wealthy often live in armed, gated communities and enjoy many luxuries, while the poor live in shanties in deep poverty. There's even inequality in developed countries like the US where the top 10 percent of the population live in great wealth while roughly 20 percent of the population is impoverished.



“ Fairness and a sense of trust in society, which comes from living in more equitable societies, leads to tolerance and the potential for peace and tranquility.”



The reason that governments should be motivated to reduce inequality both locally and globally is not only because it is morally wrong but because inequality leads to violence and terrorism. Numerous studies show that inequality increases violence. Fairness and a sense of trust in society, which comes from living in more equitable societies, leads to tolerance and the potential for peace and tranquility. Contrary to conventional thinking, wealth does not trickle down. Lowering taxes on the wealthy only leads to the consolidation of wealth, the entrenchment of class structure and the reduction of social mobility. Governments must intervene in order to distribute resources more equally.

Suggestions and solutions for the problem

Progressive consumption taxes could be used to engage in responsible taxation and to decrease inequality. Nearly all goods and services sold in the private sector could be subjected to a progressive consumption tax. In this case, each household unit would report both their taxable income and their annual savings to the government, the difference between the two, the family's annual consumption expenditure, would be taxed. Standard deductions and a graduated tax would also need to be in place, as well as tax exemptions for food, prescriptions, medical expenses, childcare, etc... in order to assure that lower income individuals pay less.

Alternatively, progressive consumption taxes could include taxation on non-essential items that wealthy people are more likely to purchase, such as: jewelry, data, expensive weddings, land, luxury goods, expensive cars, exclusive homes, second homes, private planes, digital resources, robots, etc. This is the model

followed in, for example, a number of European countries which apply a higher rate to luxury goods. Some also exempt essential items such as food. Progressive consumption taxes could even be applied to the products and services produced or to the consumption of non-sustainable energy. Progressive consumption taxes on property could be based on the cost of an item. For example more expensive cars would be taxed at a higher rate than less expensive cars. Progressive consumption taxes like these would ideally result in wealthy individuals, especially those in developed countries, paying more taxes.

Progressive taxation on consumption can be used to decrease inequality and create more equitable societies, both globally and locally, by funding high-quality education and healthcare for everyone. In less developed countries, education and healthcare are the seeds of development; in developed countries, they are equalizers. In both cases they lead to more equal and peaceful societies that foster tolerance and respect for the human rights of all global citizens. ■

// Progressive taxation on consumption can be used to decrease inequality and create more equitable societies.//



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Can consumption taxes be progressive?

An examination of mechanisms to enhance progressivity.

- Consumption taxes are generally considered to be regressive.
- Attempts to make consumption tax progressive can be complex and lead to fraud.
- The best approach may be to simplify consumption taxes — reducing the rates but widening the base.
- Revenue from consumption tax system should then be used to create transfers to the less well-off to address the issue of progressivity on a holistic basis.



// Most people would judge that a tax-collection system is fair if it satisfies two limited criteria: horizontal and vertical equity.//

Taxes come in a number of shapes and sizes, with income taxes and consumption taxes the two main categories. An income tax is a tax on the net income of an individual or business, whereas a consumption tax is levied on the purchase of goods and services. Revenues from consumption taxes, specifically value added tax (VAT) — also known as goods and services tax (GST) — constitute a major revenue source for countries around the world. The OECD estimates that 20 percent of the OECD members' tax revenue comes from VAT/GST and another 12 percent comes from various excise taxes and duties on goods and services.

Consumption taxes are often perceived as regressive or falling disproportionately on low-income households. This article discusses the regressivity of consumption taxes (Part 1) and steps jurisdictions have taken to reduce the regressivity (Part 2), before proposing other ways to improve consumption taxes (Part 3).

1. The regressivity of consumption taxes

One of the general principles of taxation and tax policy is that the tax burden should be fairly distributed among taxpayers. Most people would judge that a tax-collection system is fair if it satisfies two limited criteria: horizontal and vertical equity. The criteria state respectively that it is desirable (i) for similarly situated taxpayers to be treated similarly under the law, regardless of circumstances such as the nature of their income or their transaction; and

“There is a general consensus that, in aggregate, taxes should be distributed progressively with respect to income.”

(ii) that overall, a taxpayer’s liability should increase with ability to pay. While both criteria involve a subjective judgment, there is a general consensus that, in aggregate, taxes should be distributed progressively with respect to income.

Whether a tax is considered progressive or regressive depends on the share of income paid in taxes. If the share rises with income, the distribution of the tax burden is called progressive; if it stays constant, it is proportional; and if the share falls, the distribution is called regressive.

General consumption taxes, such as VAT, that apply to all goods and services at the same tax rate, regardless of the wealth level of the consumer, are generally considered regressive. This is because low-income taxpayers tend to devote a larger share of their incomes to the payment of this tax than wealthier taxpayers, as demonstrated in the example below.

	Person A	Person B	Person C
Weekly income	US\$422	US\$525	US\$776
Weekly groceries	US\$75	US\$75	US\$75
VAT on groceries ⁶	US\$14.4	US\$14.4	US\$14.4
Share of income paying VAT on groceries	3.4%	2.7%	1.9%

However, economists at the OECD and elsewhere have argued that VAT systems are only regressive when measured as a percentage of current income but are generally either proportional or slightly progressive

when measured as a percentage of lifetime expenditure.⁷ Measuring taxes with respect to current income allows an analysis of the immediate distributional effects of consumption taxes, whereas a lifetime expenditure-based approach would provide a potentially more reliable measure that accounts for periods in which a taxpayer is earning and accumulating assets, and then spending down those assets once

the earning power declines. While these arguments are interesting, it is very likely that — in the eyes of the general public — a VAT would be considered regressive. Again, the fairness of a tax depends on subjective observations, and it is very unlikely that in the example above Person A will consider her lifetime expenditure and income patterns and consider its tax burden ‘fair’ over the long term.



⁶ Based on OECD average VAT rate of 19.2 percent — OECD, *Consumption Tax Trends 2016*.

⁷ OECD Tax Policy Studies, *The Distributional Effects of Consumption Taxes in OECD Countries (2014)*.

2. Approaches to limit the regressivity of consumption taxes

Some countries address the regressivity of consumption taxes by introducing reduced rates or exemptions on basic goods and services to alleviate the tax burden on lower-income

households. According to proponents of such measures, the tax is made more progressive by identifying key expenditures that are the most important to these households. While the OECD found that applying reduced rates on basic goods such as food does have the desired progressive effect, it also found that reduced rates constitute poor tools targeting support to low-income households as, in the aggregate,

upper-income households would benefit as much or more from these policy decisions. In other words, simply excluding a good or service from taxation may reduce the burden on low-income households, but such a measure is not targeted only to low-income households.

Some jurisdictions use a multiple VAT rate structure to address regressivity by taxing certain goods that are

“What matters is the progressivity of the entire tax system. The income tax and benefits system is the best place to do that.”

— John Rolfe



disproportionately important to low-income households at lower rates. Introducing a multiple rate structure in the consumption tax system may have adverse consequences on the efficiency of the tax. In 2007, Copenhagen Economics undertook a study on the application of reduced VAT rates in the EU. The study found empirical evidence indicating that compliance costs associated with multiple VAT rates can be sizeable. It further found that differences in VAT rates between similar products may give rise to a substantial number of administrative and legal conflicts about the proper classification of specific goods resulting in businesses and tax authorities disputing borderline cases. Finally, the study stressed the need to consider alternatives to multiple VAT rates to accomplish the desired policy goals. Targeted subsidies may have smaller mechanical revenue consequences and greater effectiveness.

In this respect, other countries take a broader approach when considering the regressivity of consumption taxes. As the economist John Rolfe argued: “What matters is the progressivity of the entire tax system. The income tax and benefits system is the best place to do that. The GST is not the best place.” One way to improve progressivity is thus to use some of the revenue from a consumption tax to create universal transfer payments or to implement progressive direct tax changes. For instance, considering the regressivity of its GST system, in 2012, Singapore introduced the GST Voucher scheme under which, in 2017, about 1.35 million eligible Singaporeans received up to SGD300 (US\$225) in GST Vouchers — Cash. In addition, about 437,000 elderly Singaporeans received the GST Voucher — Medisave — of up to SGD450 (US\$337), while about 880,000 households received utilities rebates of up to SGD380 (US\$285) from the GST Voucher — U-Save. In addition, when Canada adopted its GST, it also introduced a refundable tax credit.⁹

“Consumption taxes cannot, at least for now, be made more progressive without creating additional compliance and administrative burdens.”

3. How to improve consumption taxes

As discussed above, consumption taxes are in practice regressive and countries are attempting to limit the regressivity with more or less success. The question remains as to whether the regressivity of consumption taxes could be reduced. Introducing multiple rates for targeted products is not the best approach for addressing the regressivity of consumption taxes. One possibility to introduce progressivity into the consumption tax system is to have consumption tax rates that increase by level of income of the consumer, instead of lower rates for selected goods and services. Under such a system, a wealthy individual would always pay a higher VAT rate than a lower income individual. In addition, such a system would likely combine the advantage of taxing consumption with a progressive tax burden. However, such a system is not realistic today as it would require a level of data exchange and technology that is currently unachievable to address concerns related to administration, compliance and fraud. One way to achieve a simplified version of such a system would be to allow low-income households to make VAT-free purchases if they provide a proof of income qualification (e.g. special ID card). However, such a simplified system would likely increase the risk of fraud (e.g. individuals using ID cards that are not their own) and create issues of audit traceability (e.g. how should such VAT-free purchases be audited, who would be liable in case of fraud, and so on) as well as perhaps not accounting for changes in income tax status in a timely

fashion. There is also a possibility that the use of such ID cards would be a source of stigma to users.

As a consequence, consumption taxes cannot, at least for now, be made more progressive without creating additional compliance and administrative burdens. But the focus should not be on whether each individual tax levied is progressive, but on whether the overall tax and expenditure system is progressive. As a consequence, adjustments to the income tax system and targeted redistribution through the social safety net system are likely to produce a more efficient and progressive tax system than changes to the consumption tax.

“The focus should not be on whether each individual tax levied is progressive, but on whether the overall tax and expenditure system is progressive.”

In fact, countries should aim at making their consumption taxes as efficient as possible to reduce the tax burden on consumers. One of the major criticisms of consumption taxes is their high rates (a 19.2 percent average rate for OECD countries). If consumption taxes are made as efficient as possible, the rates could be reduced without impacting countries’ revenues from them. One of the ways countries currently are looking into improving efficiency is to ensure that the consumption taxes are effectively levied where consumption occurs. In this respect, the OECD International VAT/GST Guidelines endorse the destination principle as an international norm and recommend that business-to-business (B2B) and business-to-consumer (B2C) transactions in general be taxed in the country where the customer is established, except certain services. For B2C services, the guidelines recommend that the nonresident vendor

⁹ Richard M. Bird, Jack M. Mintz and Thomas A. Wilson, *Coordinating Federal and Provincial Sales Taxes: Lessons from the Canadian Experience*, National Tax Journal Vol. VI No. 4 (December 2006).



should register for and charge a VAT in the country where the consumer is located. For B2B services, the guidelines suggest that the business recipient should self-assess VAT using a reverse charge or similar mechanism. More than 50 jurisdictions have so far embraced the principles of the Guidelines focusing mainly on cross-border sales of digital services. More recently, jurisdictions have started addressing challenges resulting from cross-border sales of goods to final consumers. While these new rules create new, sometimes complex, challenges for businesses, countries that fully implement the OECD guidelines ensure taxation of the full consumption taking place within their borders.

Another change that could be implemented quickly would be for countries with a multiple rate system to move toward a single rate system, which, as demonstrated above, should be the leading practice. As such a transition would have a negative impact on low-income households, revenues gained from unifying the VAT rates could be used to address that transitional effect with a more targeted approach. Other changes may be more difficult to achieve and require questioning long-established policies. In this respect, some have argued that countries should aim to broaden their tax base to achieve a system that taxes all (or nearly all)

consumption in the country.⁹ Traditionally, countries exempt certain sales from VAT/GST either on account of social reasons (e.g. healthcare and education) or because the supplies are difficult to tax (e.g. financial services).¹⁰ As pointed out by Wolfers et al., countries will likely have to expand their tax base in ways not previously contemplated such as financial services. In addition, the authors argue that countries should look into taxing the healthcare sector, which is currently generally exempt, because, at least in western countries, the population is aging and there will likely be a shift of consumption from traditional consumer goods and services to healthcare. Other areas that the authors suggest should be taxed include education, housing, and consumer-to-consumer transactions.

However, having a single rate, broad-based system is not enough when taxpayers do not comply (either voluntarily or involuntarily) with the tax rules. For instance, the EU estimates that the VAT Gap (i.e. the difference between the amount of VAT revenue actually collected and the theoretical amount that is expected to be collected) amounted to EUR151.5 billion in 2015. In this respect, we start observing countries leveraging new technologies, such as real-time reporting, e-invoicing, data and analytics tools, to ensure compliance with the VAT rules and thus reduce the VAT Gap. This trend will

likely accelerate in the near future when these technologies have been tested and popularized, as shown by recent reports published by the OECD.

Consumption taxes, as employed today, have a regressive incidence across income groups, especially on lower-income households. There are a variety of approaches that have been recommended to addressing that issue, including a comprehensive tax base taxed at a single rate with good enforcement. In dealing with regressivity, however, attention will need to be paid to the entire tax system, including direct taxes, and the use of other forms of assistance to offset the impact of consumption taxes. In doing so, countries should question whether their taxation system is designed for the 21st century, taking into consideration technological disruption and changes to business models. ■

“ Countries should aim at making their consumption taxes as efficient as possible to reduce the tax burden on consumers.”

⁹ Lachlan Wolfers, Shirley Shen, John Wang and Aileen Jiang, *VAT: A Pathway to 2025*, International Tax Review (Nov. 28, 2017).

¹⁰ *Id.*



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Indirect taxes and the digital economy — What to tax?

- While there are direct tax debates about which countries have taxing rights over a given transaction, there is near unanimous agreement that indirect taxes should be applied to B2C transactions based on the destination principle.
- The question in indirect taxes is not 'what' to tax but 'who' will collect the tax.
- Key issues include ensuring indirect tax is applied to all cross border transaction and also to what extent it should be applied to C2C transactions.



“There is near unanimity in the view that indirect taxes should be applied to B2C transactions based on the destination principle.”

On a superficial level, the question of what to tax by way of indirect taxes [such as a Value Added Tax (VAT) or a Goods and Services Tax (GST)¹¹] in the digital economy is a comparatively easier problem to solve relative to many other forms of taxation. The answer is relatively uncontroversial — indirect taxes such as a VAT seek to tax final private consumption expenditure¹² in the place or location in which the relevant good or service is consumed.¹³

As Professor Rebecca Millar recently noted,¹⁴ there is a real contrast in the challenge for policy makers in taxing cross-border transactions under corporate taxes as compared with indirect taxes:

Yet the conclusion that “something needs to be done” simply does not have the same significance for VAT as it does for income tax. This is not because VAT on global digital transactions is easy to collect: it is not. Nor is it because VAT raises different collection problems than income tax: for the most part, it does not. What is different about VAT is the almost universal agreement on the substantive jurisdictional principle that should be used to determine the tax base. Some countries might pay lip service to the destination principle, particularly countries with limited tax collection capacity and a high reliance on VAT to meet their revenue needs. Other countries — or their tax administrations

¹¹ For convenience, in the balance of this article we use the term “VAT” to refer to a VAT or a GST.

¹² OECD (2017), International VAT/GST Guidelines, OECD Publishing, Paris at para 1.2.

¹³ Ibid at para 1.11.

¹⁴ Millar, R. (2014). Looking ahead: potential global solutions and the framework to make them work. *The Future of VAT in a Digital Global Economy 2014*, Vienna, Austria: Presentation.

and/or courts — might disagree about what the destination principle requires in particular circumstances. Nonetheless, there is little or no significant disagreement on the fundamental principle. Nor is there any significant disagreement about the most important aspect of the neutrality principle, which entails the notion that there should generally be no tax burden on business-to-business (B2B) transactions under a VAT. Thus, whatever it is that needs to be done, it is unlikely to involve a fundamental re-think of the jurisdictional basis upon which decisions are made about which country has the right to tax consumption.

While many corporate tax commentators embark on a quest to

identify the elusive concept of where value is created, and they vigorously debate whether to apply source or residence based taxation, Rebecca Millar's quote highlights the fact that there is near unanimity in the view that indirect taxes should be applied to B2C transactions based on the destination principle.

Indeed, the major work being carried out by the OECD's Working Party No.9 on Consumption Taxes has been in establishing clear guidelines upon which the destination principle can operate in respect to the digital economy. Their recent major focus has been on plugging three potential gaps in indirect tax revenue which have grown more prevalent through digital economy business models. They are:

Policy issue	Approaches
No VAT was being paid on low value goods importations into a country. This came to the fore through the growth (and relative ease) of consumers ordering goods online for delivery to their home destination.	<ul style="list-style-type: none"> — Lowering the thresholds below which an exemption from VAT applies. — Applying simplified VAT registration systems. — Imposing VAT registration and payment obligations on online marketplaces, rather than the vendors who sell on them.
Suppliers of digitized services could sell from remote locations to consumers (i.e. B2C) into a country without VAT	<ul style="list-style-type: none"> — Requiring non-resident suppliers to register for VAT, collect and remit VAT according to the jurisdiction in which the customer is located. — Imposing VAT registration and payment obligations on online marketplaces, rather than the vendors who sell on them.
VAT exempt businesses could save VAT by purchasing services and intangibles from offshore without VAT	<ul style="list-style-type: none"> — VAT should be collected from the purchasing business under 'reverse charge' rules.

Work in implementing these measures globally (or at least among OECD countries) is likely to continue over the next few years.

At the opening of this article we said that on a superficial level the challenges of the digital economy under a VAT are

relatively straightforward to resolve. However, let's examine two areas where there is considerable uncertainty or inconsistency of approach amongst policy makers.



“ Perhaps the major source of controversy in indirect taxes globally right now is in resolving the problem of ‘who’ will collect the tax. In particular, in seeking to collect VAT on B2C importations of low value goods and B2C cross-border supplies of services, governments are faced with a number of choices.**”**

The issue in indirect taxes is not ‘what’ to tax — the issue is ‘who’ will collect the tax

Perhaps the major source of controversy in indirect taxes globally right now is in resolving the problem of ‘who’ will collect the tax. In particular, in seeking to collect VAT on B2C importations of low value goods and B2C cross-border supplies of services, governments are faced with a number of choices. They could seek to:

1. Collect the VAT from the non-resident supplier, but they may lack the practical ability to enforce the collection of the tax (for example, where the non-resident supplier has no assets or other physical presence in the jurisdiction).
2. Collect the VAT from the end-consumer (but history shows compliance with these types of measures is extremely low).
3. Collect the VAT from an online marketplace (in lieu of the seller).
4. Collect the VAT from the debit or credit card issuer used in the transaction (though there is some doubt about whether most of these issuers would have sufficient transaction level data upon which to calculate and account for the tax);
5. Collect the VAT through a so-called ‘split payment method’, in which the purchaser pays the VAT into a separate bank account which is diverted for the tax authority’s benefit.
6. Collect the VAT by deeming a permanent establishment to exist in the country if goods or services are supplied to customers in that country either through a local domain name address, or through local payment processing.

As things stand right now, there is a patchwork of solutions being adopted around the world. In 2017, the OECD released a document entitled "Mechanisms for the Effective Collection of VAT/GST when the Supplier is not located in the Jurisdiction"¹⁵, but disappointingly this document seemed to fuel more of an 'anything goes' style approach. In an effort to provide countries with flexibility of approach, the OECD lost sight of two core objectives. The first being that the more globally consistent the approach, the more effective the enforceability, and the more tax revenue will ultimately flow to every country. The second error was in ignoring the fact that online sellers and online marketplaces often sell to a global marketplace and therefore the greater the consistency of approach, the more their one-time investment in systems and processes could be replicated. In short, consistency in approach produces a win-win for both governments and online marketplaces.

Interestingly, Australia in 2017 (for B2C services) and in 2018 (for low value goods) legislated to collect the VAT from online marketplaces in priority to the actual offshore sellers. This approach, while controversial, shows some signs of gaining momentum with a number of other jurisdictions signaling an intention to follow suit.¹⁶ The question remains whether the collection of VAT on cross-border supplies from online marketplaces may ultimately be extended to domestic sales too, as a means of combating increased VAT fraud. Only time will tell.

Whether to tax C2C supplies

Virtually all VAT systems around the world have, as a precondition for registration and VAT payment obligations, that the supplier is carrying on either a business, or they are an entrepreneur, or they carry out some other commercial activity.

Many countries are fast discovering that advances in digital marketplaces mean that businesses or entrepreneurs need not have a physical shop front, need not hire employees, and in fact, need not really have inventory either. As a result, the traditional tax base of applying VAT in situations akin to when a business has a permanent establishment must surely be under threat.

The question this raises is whether a profit making pursuit, coupled

with a de minimis exclusion (where compliance costs would exceed the tax collected) is all that is really needed as a precondition for imposing VAT liabilities?

Many digital marketplaces now facilitate trade between private individuals. Consider the growth of peer-to-peer (P2P) lending, the rise of online accommodation platforms, and even ride sharing companies in their role as an intermediary between a passenger and



¹⁵ OECD (2017).

¹⁶ For example, the EU, New Zealand, Singapore.

a transportation provider. Developments in other areas of commerce, with labels such as the 'sharing economy', 'crowd funding' or 'crowd sourcing' further illustrate the point.

The central question is why should the profit or gains derived from these activities fall outside the VAT net? Already there is some tax authority activity in this area, especially in relation to crowd funding and ride sharing.¹⁷ But to what extent are

these merely symptoms of a bigger issue — which is that VAT systems need to be adapted to tax the value added, irrespective of whether it is by a traditional business or a consumer sitting online. The value added by employees is already taxed in the hands of the business or company they are servicing, but what about the value added by these other forms of independent contracting?

Again, while this issue is not limited to the digital economy, the growth and expansion of the digital economy makes it increasingly easier to generate profit without the traditional indicia of a business. The challenge for governments around the world is to ask whether their VAT systems are fit for the modern way in which value may be created in the digital economy, and therefore whether all forms of private final consumption expenditure are truly subject to tax.



¹⁷ See for example, European Commission, VAT Committee, "Question concerning the Application of EU VAT Provisions", Working Paper No.836 (6 February 2015), and Australian Taxation Office, "GST and Crowdfunding", 3 January 2017.



Femke Groothuis

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The future of tax is green

The world is changing and so should our fiscal systems.

- In the 28 countries of the EU, half of government budgets are based on personal income tax, payroll tax and social contributions.
- Just 6 percent of tax revenues in the EU are 'green' taxes, mostly placed on energy and mobility.

- There is a possibility to move from taxes on income to more green taxes, for example, by putting a price on pollution and the consumption of natural resources in general — fossil fuels, waste, water and the extraction of metal ores.



// Currently, governments prefer to put a high tax burden on honest work instead of putting a price on pollution. High labor taxes unfortunately tend to nudge companies to reduce headcount, which harms employment.//

The problem? The polluter doesn't pay

In my hometown of Utrecht, a 'miniature Amsterdam' in the centre of Holland, citizens lose 13 months of their lives due to air pollution. Fine particles emitted by cars, trucks and mopeds penetrate our lungs, damaging lung function and aggravating cardiovascular diseases.¹⁸

Every year, pollution kills nine million people globally.¹⁹ How this relates to tax may not be immediately evident. But even today, polluters receive massive fiscal support. In just 11 European countries,

fossil fuel producers and consumers receive over US\$100 billion of tax breaks each year.²⁰ Global fossil fuel subsidies are at least US\$500 billion per year.²¹

This means that taxpayers' money is spent on activities that harm people and create even bigger additional costs for society in terms of healthcare costs, lost vitality and labor market impacts as children and adults are inhibited to develop their full potential. The welfare losses from pollution are estimated at US\$4.6 trillion a year.²²

Currently, governments prefer to put a high tax burden on honest work instead of putting a price on pollution. In the 28 countries of the EU, half of

government budgets are based on personal income tax, payroll tax and social contributions (basically, the amounts employees and employers pay on salaries). High labor taxes unfortunately tend to nudge companies to reduce headcount, which harms employment.

Just 6 percent of tax revenues in the EU are 'green' taxes, placed first and foremost on energy and mobility. Virtually no taxes are raised on the use of finite resources such as water, metals and minerals and pollution such as greenhouse gas emissions. Similar structures can be found in other regions around the world.²³

¹⁸ <https://www.volksgezondheidsmonitor.nl/en/air-quality-utrecht/page111.html>

¹⁹ <https://www.thelancet.com/commissions/pollution-and-health>

²⁰ 88.6 billion euro in the 2014–2016 period, through budget expenditures, tax exemptions and price and income support in Czech Republic, France, Germany, Greece, Hungary, Italy, the Netherlands, Poland, Spain, Sweden and the UK. Gençsü, Ipek, Maeve McLynn, Matthias Runkel, Markus Trilling, Laurie van der Burg, Leah Worrall, Shelagh Whitley and Florian Zerzawy. 2017. Phase-out 2020: Monitoring Europe's fossil fuel subsidies. ODI and CAN Europe. September 2017. Available: <https://www.odi.org/publications/10939-phase-out-2020-monitoring-europes-fossil-fuel-subsidies>

²¹ <https://www.carbonbrief.org/oeecd-fossil-fuel-subsidies-373-billion-2015>

²² <https://www.theguardian.com/environment/2017/oct/19/global-pollution-kills-millions-threatens-survival-human-societies>

²³ In the United States, the ratio is 80% labor, 3% green tax. In Brazil, it's 36% versus 2%. Asian economies also show modest green-tax revenues: just 13% in India, 9% in Korea, 7% in China, 5% in Japan and 1.3% in the Philippines.



The problem's root cause? Fiscal systems adapt slowly to a fast-changing world

The foundations of the typical Western fiscal system were laid down in the era before globalization, digitization and mass consumption. They are built on the assumption that 1) taxing labor provides a stable source of income for governments and 2) natural resources are infinitely available. Unfortunately, we have moved into an era of megatrends such as climate disruption, resource constraints, mass unemployment, automation and robotization, which means the old assumptions no longer hold. Isn't it time we adapt and shift financial incentives to deal with the challenges of our economies?

As president of The Ex'tax Project I'm leading several studies on fiscal reform, and I am fully aware that it's not easy to shift from labor taxes to green taxes. For one, nobody likes to pay for something that was previously free of charge. The lobbies of vested interests are strong. Another barrier is that tax reform requires international cooperation, as shifting financial incentives will change trade patterns. The saying 'alone we go faster, together we go further' is applicable here.

// The foundations of the typical Western fiscal system were laid down in the era before globalization, digitization and mass consumption. **//**

Why we will get this done

Fiscal systems are intricate, intelligent systems. They are man-made, so man can shape them. Technically, there are no limitations to implement change. At least nine regions have already advanced on the tax shift²⁴ and international institutions such as the IMF, World Bank, OECD and European Commission have supported the approach.

How would it work? The first step is to put a price on pollution and the use of natural resources in general, such as fossil fuels, waste, water and the extraction of metal ores. Countries can start with the low-hanging fruit — options that suit national circumstances best. It's only logical to start with abolishing the (fiscal) subsidies to polluters.

In cooperation with Deloitte, EY, KPMG and PwC, The Ex'tax Project has identified more than 100 green tax base options, which should provide governments with ample opportunity to raise stable revenues. As in the current system, any reform needs to be monitored and adjusted. In case a tax base erodes (much like labor taxes do when employment declines), tax bases and rates can be expanded or increased.

Some natural resource taxes will be highly effective in changing people's behavior, others not so much. This can be addressed on a case-by-case basis. For example, in a country where water is not (yet) scarce, putting a price on water may not be necessary from an environmental

point of view, but might still help create revenues to lower other taxes.

It is vital to create long-term plans and announce measures in time, so businesses and consumers can anticipate and adapt. Ultimately, the goal is to advance to a system that taxes 'extracted value' (degradation of natural capital) rather than the 'added value' of work, craftsmanship and creativity.

Below are four benefits of extracted value taxes, illustrated by an example:

1. Improving health

When Stockholm began taxing vehicles to reduce traffic in the city centre, the number of vehicles jamming its streets fell by at least 20 percent. So did the number of children's asthma cases.²⁵

2. Protecting nature

The plastic bags levy in the UK reduced the use of plastic bags by 80 percent,²⁶ which protected waterways, oceans and sea life.

3. Increasing tax revenues for the good of the population

The Democratic Republic of Congo produces more than half of the world's cobalt. Yet, it remains one of the world's poorest countries because only 6 percent of the revenue garnered from mining exports makes it to the national coffers.²⁷ In the Netherlands, the exploitation of oil and gas fields has led to almost €286 billion²⁸ in revenues for the national coffers since the 1960s. These revenues have enabled investments in social security, education and infrastructure²⁹ which has enabled investments in social security, infrastructure, and so on.

4. Driving innovation and competitiveness

Expecting governments to act on carbon pricing in the near future, more than 1,300 companies have started to apply an internal carbon price. This shifts investments toward low-carbon options as they become more competitive compared to polluting options.³⁰

Through their economic, social and environmental impacts, taxes are the threads that connect many of the world's challenges. It's high time to re-assess our fiscal systems and to adapt them to serve the goals of inclusiveness and sustainability. ■

// Ultimately, the goal is to advance to a system that taxes 'extracted value' (degradation of natural capital) rather than the 'added value' of work, craftsmanship and creativity."

²⁴ Sweden (1990), Denmark (1993), Netherlands (1996), Finland (1997), Slovenia (1997), Germany (1999, 2007), UK (1996, 2001), British Columbia — Canada (2008), Colombia (2012).

²⁵ https://www.washingtonpost.com/gdpr-consent/?destination=%2fnews%2ftripping%2fwp%2f2018%2f03%2f27%2fcongestion-pricing-clears-the-lungs-too-researchers-say%2f%3futm_term%3d.83a930fc7aae&utm_term=.89af712532be

²⁶ <https://www.euractiv.com/section/energy-environment/news/bottle-and-can-deposit-return-scheme-gets-green-light-in-england/>

²⁷ https://qz.com/1087495/cobalt-miners-are-leaving-dr-congo-for-canada-and-europe-to-meet-demand/?utm_source=qzfb

²⁸ [Data 2017: CBS \(Accessed September 2018\), Overheid: inkomsten en uitgaven 1995-2017. Data 1969-2016: CBS \(2017\), Aardgasbaten op laagste niveau in ruim 40 jaar.](#)

²⁹ [CBS \(2015\), De invloed van de aardgaswinning op de Nederlandse economie.](#)

³⁰ <https://www.carbonpricingleadership.org/blogs/2017/11/7/carbon-pricing-a-case-for-transformative-climate-action>

Carbon taxation — How it works and why it is a good idea



Susanne Åkerfeldt

Susanne Åkerfeldt is a Senior Legal Adviser at the Swedish Ministry of Finance. She has been instrumental in fine-tuning the design of the Swedish carbon tax since the 1990s.

How carbon tax nudges 'green' behaviors.

- Carbon taxes can both reduce greenhouse gas emissions and raise revenues.
- Carbon tax can be calculated on the average carbon content of different fuels, so there is no need to measure actual emissions.
- Carbon taxes are simple to design and administer.

// In comparison to emission trading schemes, a carbon tax can be easy to implement and administer, at low costs to authorities and operators."**//**

Why is carbon taxation a good idea?

Carbon taxation can be a major instrument to successfully reduce emissions of greenhouse gases from fossil fuels. This helps jurisdictions to deliver on the Paris Agreement, at the same time mobilizing domestic resources and raising essential revenues. In comparison to emission trading schemes, a carbon tax can be easy to implement and administer, at low costs to authorities and operators.

A carbon tax can be introduced as a new tax or as an existing tax, and can be completely or partly designed to reflect the average carbon content of the fuel. Tax rates may be expressed in common trade units (volume or weight), avoiding the need to measure actual emissions. Depending on national prerequisites, the tax can be collected from fuel producers or distributors either upon extraction or import of the fuels, or further down the fuel distribution chain.

The tax will normally be reflected in the price of the fuel. This incentivizes consumers to purchase the least carbon-intensive fuel, resulting in widespread emission reductions. This 'nudge' instrument is price-efficient, as it relieves governments of the need to engage in administratively burdensome

// Carbon taxation can be a major instrument to successfully reduce emissions of greenhouse gases from fossil fuels."

ways of 'picking a winner' (a particular technology or a particular fuel) and pushing it as the basic tool for reaching emission reductions.

A carbon tax allows households and businesses to choose ways of operating that are best for them, often coinciding with cost-efficiency. This might include investments in new technologies with low or zero greenhouse gas emissions, large-scale energy systems using non-fossil energy, and small-scale energy solutions for households in rural areas, as well as a more extensive use of public transport.

A global outlook

Finland, Denmark, Norway and Sweden implemented carbon taxation in the early 1990s. Costa Rica followed suit in 1997, but it is only in the last decade that carbon taxation has really taken off globally. Within Europe carbon taxation systems now operate in 10 countries, and there has been a significant increase in uptake within jurisdictions outside of Europe. There are currently close to 30 examples of carbon taxation schemes worldwide, with more information available to read in a survey published by the World Bank initiative, Partnership for Market Readiness, *The 2017 Carbon Tax Guide: A Handbook for Policy Makers*. Examples of recent implementation are found in India, Japan, Mexico, Chile, Colombia and Argentina. A couple of Canadian provinces introduced carbon taxation in 2007–2008 and the Government of Canada is committed to ensuring that carbon pollution is priced nationwide by 2019. Bangladesh, Belgium, the Philippines, Singapore and South Africa are among countries currently debating the introduction of national carbon taxation schemes.



// It is only in the last decade that carbon taxation has taken off globally."

The highest carbon tax worldwide is levied by Sweden (further information about this is available to view on the Swedish government website). The Swedish carbon tax came into effect in 1991, as part of a major tax reform that, among other things, included lower marginal income taxes on labor and capital. The general carbon tax rate chosen per tonne of carbon in the fuels at the time was reasonably low (EUR26), and it has taken Sweden more than 25 years to reach the current level of EUR118 — a rate some see as exceptionally high.

How to levy a carbon tax

The basic logic of carbon taxation is generally to levy tax on fossil fuels in proportion to their average carbon content, as carbon dioxide emissions released in burning any fossil fuel are proportional to the fuel's carbon content. It is therefore not necessary to measure actual emissions, which greatly simplifies the system. National conditions may be brought into consideration when designing the tax. For example, derogations may be deemed necessary — at least during a transitional period — to strike a balance between environment and competitiveness, or to address distributional consequences.

One of the major benefits of a carbon tax, if compared to an emissions trading scheme, is that it can be administratively simple to design as well as to collect. A well-designed carbon tax system would be of interest to developing countries as it raises revenues without requiring a market or the design of a complex monitoring system.

// One of the major benefits of a carbon tax, if compared to an emissions trading scheme, is that it can be administratively simple to design as well as to collect."



“The basic logic of carbon taxation is generally to levy tax on fossil fuels in proportion to their average carbon content.”

The average carbon content of fossil fuels is also the method used when emissions of carbon dioxide are reported under the Kyoto Protocol. The average carbon dioxide emissions and energy factors used in this reporting can be used when calculating national carbon tax rates. To ensure a simple administration, the tax rates can be expressed in weight or volume units for the different fuels. So a carbon tax can be collected in the same way as excise duties which, in most countries, are already levied on petrol, diesel, coal and gas. This gives low administrative costs for tax authorities as well as for operators.

How to make it happen

Both in theory and in practice, it is proven that carbon taxation is an effective way to reduce emissions of greenhouse gases. It is not rocket science. More and more jurisdictions — both authorities and operators — have the opportunity to share experiences and best practice. Revenues are raised and may be used to make non-fossil options available. In fact, the more you look, the more carbon taxation presents itself as a win-win solution. ■





Barbara Bell

Director
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Barbara Bell leads the delivery of KPMG's National Environmental Tax services. The team advises on a full range of environmental taxes, including climate change levy, landfill tax and aggregates levy, and has strong links with KPMG in the UK's Sustainability and Advisory teams.

The ins and outs of green taxation

Green taxes have the potential to raise revenue while also positively changing behavior. Smart implementation will be key.

- Environmental taxes can raise revenue and change behavior to protect the environment.
- The key sticking point is that the more tax is raised, the less behavior is likely to have been changed, and vice versa.
- If a tax is successful in largely eliminating polluting activity, the policymaker has a choice: either continue to raise the tax rate, or accept a job well done and move on to a new type of green tax.



“ An environmental tax set at a high level will change environmentally ‘bad’ behavior but it will not raise much revenue for very long; conversely, a tax which raises a lot of revenue may not be significantly changing behavior.”



Historically, governments have raised the revenues they need by direct taxation of labor, income, profits and capital, or by targeting consumption through indirect taxation regimes, such as VAT. But governments also have a choice in how and where they place taxes, and over the last quarter of a century, there has been a shift from taxing these so-called ‘goods’ to taxing ‘bads’, with a view to raising revenue and changing behavior at the same time. The key conundrum is whether an environmental tax can simultaneously achieve both these objectives.

Interviewed by the BBC earlier this year, even a UK Government minister seemed unclear on this point. On the subject of the UK’s proposed plastic tax, the minister was asked whether the public would pay a 25p charge for single-use coffee cups. The minister’s response was that of course they would — which seems to illustrate a common conceptual difficulty with environmental taxes. Was the minister correct? If he was, and the clientele of all high-street coffee shops are willing to pay an additional 25p for a daily cup of coffee, that would raise a phenomenal amount of tax — perhaps GBP7 million or more per day — but it would not save the world from a single coffee cup. Perhaps setting the tax at GBP10 per cup would stop all but the richest and most profligate coffee drinkers from using single-use coffee cups — but it would raise very little revenue and could have a calamitous impact on business. An environmental tax set at a high level will change environmentally ‘bad’ behavior but it will not raise much revenue for very long; conversely, a tax which raises a lot of revenue may not be significantly changing behavior.

Did the minister actually mean to say that while some members of the public would pay 25p tax on a single-use coffee cup, others would not, and such a tax would therefore result in a net reduction in coffee cups (a good environmental starting point) and a useful amount of revenue for the Treasury? What if the tax was set at 25p in year one, rising gradually (or not so gradually) each year? Would this allow all

involved to adjust behavior and gear up to new manufacturing and purchasing practices? Could some or all of the tax raised be hypothecated to assist in the development of alternatives to coffee cups or another good environmental cause?

The template for this sort of environmental tax already exists. As an example, anyone wondering why UK households now have so many recycling bins and boxes, or why so many waste management companies have ventured into the energy-from-waste business, needs only to look at the 22-year history of the UK's flagship environmental tax — landfill tax. Now devolved to Scotland (as Scottish Landfill Tax) and Wales (as Landfill Disposals Tax), landfill tax (as it continues to be known in England and Northern Ireland) has changed the face of the waste management industry across the UK. When it was introduced in 1996/7, there were hundreds of landfill sites across the country handling 96 million tonnes of waste each year. This had fallen by April 2018 to just over 26 million tonnes of waste disposed of at landfill, with a corresponding increase in the number of closed or mothballed landfill sites. This decline in landfill is even more remarkable than it appears at first sight when one realizes that, in the mid-1990s, it was expected the amount of waste going to landfill would increase substantially over the coming decades. Indeed, the amount of waste sent to landfill has fallen by more than 70 percent since 2000, and average household recycling rates rose from 18 percent that year to 44 percent by 2016, according to UK Government data.

While the tax did not achieve this massive change on its own (European directives and other policy measures also played a part), many within the waste industry nevertheless consider it the primary driver of the change. Having been introduced at GBP7 per tonne for most wastes and GBP2 per tonne for certain less polluting materials, the standard rate of the tax was rapidly ratcheted up, reaching GBP88.95 per tonne by 1 April 2018 with the lower rate remaining a much





more conservative GBP2.80 per tonne. During a memorable period, the standard rate of the tax increased by GBP8 per tonne each year, meaning that it made economic sense for waste management companies to seek different methods of dealing with the waste that they handle, including investing in energy from waste facilities that, at present at least, are not subject to environmental taxation. Landfill tax has also driven an increase in recyclable packaging and a reduction in kerbside collections of household waste. Recycling is now big business and not the fringe pursuit of the 1990s.

The problem is, of course, that the future of landfill tax itself is now uncertain and, in revenue raising — if not environmental — terms, this will become a problem for Government. One solution would be to increase the rate of tax, but at this early stage in the life of environmental taxes, there is a danger that it would produce the perverse consequence of taxing at a high rate what might be environmentally good behavior. For some types of waste, disposal in a sealed and highly regulated landfill cell represents the best practicable environmental option, meaning that it might be cheaper not to deal with such waste, or not to deal with it properly, if the rate of tax climbs too high.

This is an increasingly familiar issue with environmental taxes or other taxes designed to change behavior. It is for the policymakers to decide whether they should adhere to their original objectives, congratulate the tax on a job well done and move on to changing some other sort of bad behavior, raising revenue as industry and consumers take time to adjust their habits. Perhaps a plastic tax is the natural successor, therefore, to landfill tax? ■

“ Landfill tax has changed the face of the waste management industry across the UK.”

What to tax and what's next?

A few concluding thoughts on the issues explored in this publication, and a look at what to expect next from the Responsible Tax project.

The KPMG Responsible Tax project was born from the recognition that tax is too important an issue to be left to unproductive shouting matches amongst small groups of people (often mostly men) through megaphones from mountaintops. That is not to say that anger at egregious avoidance and evasion is not something to shout about, but after the anger, then what?

What society and economic actors need is answers to how we can build a more responsible tax system. But in a global, networked and complex world, that's tough. There are all kinds of fast-moving moral and practical issues to which no one can claim a monopoly of truth or wisdom. So what is needed is a calm but determined space to listen to the key voices and views; to learn from each other; and, crucially, to begin to understand each other's assumptions so that real progress can be made. A responsible tax system is not going to be imposed by anyone; instead, it can only be negotiated by all of us. Politicians, officials, regulators, corporates, advisors, thinkers, campaigners and eventually, of course, citizens must all be a genuine part of the process.

Even on fundamental issues, such as the line between acceptable planning and unacceptable avoidance, or legitimate privacy and harmful secrecy, this is going to be difficult and take time. Progress depends on trust between key actors, and building trust is about building relationships and demonstrating vulnerability by asking and answering honest questions about ourselves. However, even assuming we can find agreement on desired behaviors, any responsible tax approach should also look at the fundamental issue of what society is trying to tax, why and how? This publication serves as a starting point for looking coherently at the tax options, bringing together an eclectic and informed mix of authors under the premise that uniting these diverse viewpoints is in itself an important step forward in the debate. Consensus, at this early stage, would be an impossible expectation. But what we are building is consent: to work, think and build together.

Of course, as the Responsible Tax project continues its search for answers, at least two major questions will need to be considered. The first is about issues of *spending*: what do we spend on and how much? Again, this has been largely the preserve of the political class, and is not our focus in the responsible tax debate. But we need some kind of realistic assessment of the necessary tax base in the 21st century when climate change, an aging society and the rise of the robots are going to create all kinds of stresses and strains on the tax base.

And a second question is *how to agree and enforce rules and regulations in a global system?* Much of the architecture for global tax rules is a product of postwar institutions, context and culture. The world is now a very different place — so how can responsible tax be structured in a way that is fit for our global future?

These are huge and difficult questions, but they cannot be ducked. KPMG International, working with Jericho Chambers and many other partners and stakeholders, wants to play an active part, not just in making sure corporations pay the right amount of tax, in the right place and at the right time, but also in helping to address some of the fundamental issues about how to build a responsible tax system that is fit-for-purpose in the 21st century. Of course every country is different and there will be multiple responses, but global patterns and trends are likely to emerge between how much we tax work, corporations, wealth etc. This will require not just more publications, roundtable discussions and Responsible Tax events, but a global alliance that wants to work together for the common good. The discussions continue, and additional viewpoints and voices are welcome to contribute to the digital community at kpmg.com/responsibletax.

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