## Wealth of Nations

*Andy Wood asks whether Adam Smith's seminal work has any relevance for a modern Western economy like Britain's today*

In March 1776, Adam Smith published his seminal work 'Wealth of Nations'. But what is this book?

Published during the early shoots of the industrial revolution, it was a pioneering text in the field of economics. Smith and the Wealth of Nations is perhaps to economics as Darwin and the Origin of Species is to biology.

Smith took outdated, received wisdom relating to trade, commerce, and public policy and restated them based on new principles that are still used widely today. For example, he outlined the concept of gross domestic product as the measurement of national wealth.

The work is 950 pages in length and, even in 1776, one reviewer stated that "…the sale of [Wealth of Nations]… has been more than I could have expected from a work that requires much thought and reflection… qualities that do not abound among modern readers." It is hard to imagine that such qualities have improved amongst readers since then!

Despite that reviewer's doubts, the Wealth of Nations is one of the second-most cited book in the social sciences.

Not surprisingly, Smith did have clear thoughts on the design of a tax system. He set out what are now often referred to as his 'four canons'. These can be summarised as follows:

- A citizen's tax contribution should be "as nearly as possible, in proportion to their respective abilities". In other words, taxes should be fair and equitable ('Fair and equitable').
- The tax which each individual is bound to pay ought to be certain and not arbitrary… and the timing, manner, and amount of tax payments "ought to be clear and plain" ('Certain, clear and plain').
- Taxes should be paid "at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it" ('Convenience').
- Taxes "should cost as little as possible to collect" ('Collection').

Almost 250 years later, do Smith's 'four canons' hold any water?

**Fair and equitable**

Here, Smith was saying that taxes should be contributed in proportion to their means. I think one would be hard pressed to find arguments against this principle.

Stripped back, I guess this would mean that, as the personal balance sheet increases, the tax man would take a proportional share of that increase. Income is income, right?

Actually, no.

Instead, we have a seminal distinction between capital, capital gains and income. Even among those three main funnels, there are further shoots which coins might end up in resulting in different tax rates.

Capital gains are taxed at (much) lower rates of tax than income. Further, wealthy people tend to have more opportunity to invest in assets and create those capital gains. Some commentators might say that this is not fair.

Of course, for many, those capital gains would have been financed by income that has already been taxed. However, some capital will be inter-generational and may, or may not, have suffered inheritance tax. On the basis that a gift also increases the personal balance sheet, should a receipt of capital be taxed as well? Is this more inequity?

Even when one takes out the scalpel and starts dissecting income, we see different types of income taxed in different ways. Self-employed income is currently, after including NICs, taxed at lower overall rates than employment income. However, investment income is not subject to NICs at all. Some people might say that it is unfair that a trust fund kid potentially pays less tax than someone who works night shifts in a hospital.

In fact, some might say it's all back to front – earned income should be taxed at a lower rate than cash which falls into one's lap through investment, trusts or inheritance?

As such, it is hard to say that the UK system is fair and equitable.

**Certain, clear and plain**

*Retrospective taxes*

In his second canon, Smith sets out that the tax which each individual is bound to pay ought to be certain and not arbitrary.

For me, the most pressing challenge in this area is the spectre of retrospective taxes.

At the beginning of 2020, the House of Commons published a report which outlined the circumstances in which retrospective legislation can (and has been used) to counter perceived tax avoidance. It is reasonable assumption that this was produced largely as a result of the April 2019 loan charge furore. More on this below.

This paper directly cites the Wealth of Nations and Smith's four canons.

Of course, retrospective legislation is inconsistent with certainty. One should not be assessed today on income and benefits that were received, and transactions that took place, many years ago.

For decades, whenever the concept of retrospectivity has reared its head, we have heard warnings of how its use should be exceptional as it erodes this concept of certainty.

Indeed, Denis Healy's introduction of such measures in April 1978 led directly to what became known as the 'Rees Rules'. Dawn Primarolo's 2004 statement while Paymaster General led to the ICAEW tax faculty produced a note (TAXREP 8/05) around retrospective tax legislation where it stated its opposition to such legislation 'in principle' because, among other things, it failed the test of certainty – again, echoing the words of Smith's canon.

Interestingly, around the same time, Phillip Hammond MP made the following comments:

"A taxpayer is entitled to know with certainty – be it an individual or a multinational corporation—what he may or may not do in planning his tax affairs. He is entitled to expect that his treatment be laid down in statute, not determined by administrative fiat; he is entitled to expect that another taxpayer in similar circumstances will receive treatment similar to his; and he is entitled to be protected from retrospective or retroactive legislation.

"There can be no doubt that this Bill carries us further down the path away from that ideal in several key respects: by giving powers that ought to be exercised by Parliament to officials, so that Revenue guidance will determine how much of the complex corporate anti-avoidance legislation works in practice, and by the use of retroaction not just back to the date of a press release…

"…In so doing, the Bill introduces an arbitrariness that undermines the fairness and predictability that are essential elements of an effective tax system."

Of course, this is almost as if Adam Smith had been reincarnated!

However, sadly, just over a decade later, Hammond was the architect of the retrospective loan charge. It is perhaps ironic that Hammond later became Lord Hammond of Runnymede, the place where the Magna Carta was signed.

Speaking of Damascene conversions, when a potential Excess Profit Tax was being mooted in the lead up to the most recent Budget, Mel Stride MP stated in the media that such a measure suffered from being retrospective and 'this was not a good way to go.' Stride was Financial Secretary to the Treasury at the time the Loan Charge was introduced. This new view, bearing in mind his refusal to appear in front of House of Lords Committee investigation in to the loan charge, might stick in the craw of many loan charge victims.

Since then, we have had the 2020 Budget. This was the retrospective Budget. Here, we saw changes around Automatic Penalties, the reverse of the Inverclyde decision and changes to Entrepreneurs' Relief that were all retrospective.

In my view, retrospective law needs to end. However, the UK system seems to be increasingly reliant on such measures.

*Complexity*

The other glaring issue is the complexity of the UK tax – it simply is not clear or plain.

There are two key areas. Firstly, the length of the legislation, now well in excess of ten million words (ten million words!) This is plainly too large and, begs the question, how can any lay person have a hope in hell of understanding the tax legislation? By comparison, the Hong Kong tax code is less than 2% the length of the UK legislation.

It is, quite frankly, time to set fire to much of what we have and start again!

Believe it or not, we have an Office for Tax Simplification (OTS). Since it was established 10 years ago we have seen further legislation churned out. The equivalent of a bunch of cub scouts cleaning oil off rocks with toothbrushes, while the beached super tanker belches tonnes of fresh crude into the sea every minute.

The second point is the legislation is often complex for now apparent reason. A Frankenstein's monster of original policy with carrots and sticks stitched on to it on an annual basis.

Take Stamp Duty Land Tax (SDLT). Once upon a time it was a sleepy tax where one really only needed to identify whether something was residential property or not and apply one set of rates or another depending on the price of the property.

However, now it matters whether the residential property was acquired by a Company (as there is a special 15% rate) and whether the property was purchased by a non-resident purchaser (2% surcharge). Are you a first time buyer? Well, first time buyer's relief might be available… but hang on a minute, that's been suspended whilst the stamp duty holiday is in play. Also, if you're an individual, then you have to pay an additional 3% if you already own a property and you're not replacing your main residence. Oh, you're a Company? Bad luck, you pay the additional 3% anyway. Are multiple properties being purchased? If so, you could have multiple dwellings relief or, alternatively, if its six or more properties the residential property is magically transmogrified into a non-residential property… and that's just the basics really.

Where are the fire lighters?

**Convenience**

The penultimate canon is that tax should be levied in the manner most convenient to the taxpayer.

I recently saw a stat whereby HMRC suggested that 90% of taxes were paid voluntarily. However, I would aver that one can only do something on a 'voluntary' basis where there is choice! I would like to see what the proportion of tax payable in the UK that is automatically deducted at source by PAYE.

By the same token, one might say that having the tax taken from you before it is nestling in your pocket is also the most convenient method of paying tax.

For those who are members of the Self-Assessment club, and find themselves completing a tax return and handing over cash on at least an annual basis, paying tax is straightforward. This includes direct debit, bank transfer and the good old cheque.

However, in January 2018, it became no longer possible to use personal credit cards to settle one's tax liabilities.

It is perhaps worth noting that taxpayers in the canton of Zug can pay tax bills of up to CHF100,000 using their Bitcoin or Ethereum wallet!

**Collection**

Of course, if it costs £1 to collect £1 of tax then there is little point in having the tax. HMRC, in their 2018/19 report stated: "It cost £4 billion to run HMRC is 2018 to 2019, and our work generated £627.9 billion in tax revenues for the UK's public services. That's only around half a penny for every £1 of tax revenue we raise."

This seems pretty efficient. However, as mentioned above, HMRC take the gloss of their own achievements by (as we have seen) stating that 90% of taxes are collected without them doing anything at all and mainly because most tax is deducted at source. So, perhaps this particular investment return is relatively passive.

Of course, the future is more technology, more automation and that all payments will probably one day be made via a big payroll in the sky… probably run by Capita.

The most recent Budget also announced further investment of £100m in HMRC – around fraud, evasion and other non-compliance. The amusingly titled Taxpayer Protection Taskforce will conscript more than 1,200 new investigators to combat fraud within Covid-19 support packages. We are told that they will generate £2.2b of revenues – which represents just a little over 60% of the funds HMRC admits has been erroneously claimed under the Covid support schemes.

**Conclusion**

Of course, a modern tax system should incorporate new, enhanced principles. It should not be limited to those set out centuries before.

However, to me, it seems that the UK tax system lacks many of the basic, uncontroversial attributes conjured up by Smith in 1776.

I think that is to the detriment of the UK tax code. Further, I don't see things improving any time soon.

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