# A NEW TAXATION PARADIGM

**Introduction:**

As taxation is both an administrative and a political issue of prime importance to all societies and their power-structures, are changes in modes of taxation both rare and slow. Income taxes, profit taxes and VAT dominate, and are so heavily entrenched in our societies so we hardly even notice how outdated this combination has become.

All societies are burdened by tax problems. This problem is two-fold:

1. Taxes drive the socio-economic behaviour of all tax subjects - turning them into ‘slaves’ of whatever economic and tax models that prevails.

1. It is a major administrative problem for the state (etc) to collect all the taxes needed - and even harder to show that funds are used in a justifiable manner.

As tax fatigue spreads throughout the world, and tax evasion is becoming an art (tax planning), and therefore hardly raises eyebrows anymore, are tax bureaucrats ever busy inventing new taxes - along traditional lines - in order to finance the constantly increasing administration of their respective states. That the state’s cost increases is not strange. Technical infrastructure, administrative systems, collection activities and fraud detection also costs money, at the same time as all the traditional undertakings of the state gets more expensive in the light of a higher tax burden for people working the systems. Add to this the challenges of more recent date, such as environmental and humanitarian problems brought about by globalisation, which also require large investments by the state.

The problem is that the human incentive system works *against* more taxation - at the same time as corporate and individual greed has proved beyond doubt that communal needs *must* be communally financed. To anyone willing to examine the evidence it is clear that ‘*the market*’ can<u>not</u> solve the problem of (e.g.) *low cost* education, housing and medical care, nor can the market ensure that resources are *fairly* distributed within reasonable time-frames (e.g. food and medicine *before* those starving dies, security *before* those threatened must flee, peace of mind *before* those exposed to stress drops out of the system, etc). Many more examples could be listed, but I trust the point is already made.

A serious divide is also building between tax payers and authorities in terms of trust. This is critical to any society, since a society without trust is like a bird without wings. This problem has accelerated rapidly in the West, where ‘modern taxation’ has been in place for generations. Taxation has now become a source of funding also for bail-outs of large corporate players that (by both the Bush and Obama administrations) have been labelled ‘*too large to fail*’. This label has firmly institutionalised the fact that for listed multinationals in general - and for those in the financial sector in particular - can profits be privatized and losses nationalised. The fact that creative accounting also allows managements to receive bonuses, at the same time as taxpayers are carrying their losses, has further emphasised this downward trust-spiral.

A new tax paradigm must take the issue of incentives into consideration. In today’s world have taxes become a ‘collective punishment’, where the intended principle of *solidarity* (collective pooling of funds for the financing of the common good) has been replaced by individual efforts to become (legally or illegally) exempt.

**Current Taxation Models:**

Today's taxes are based on individual tax subjects' profit, income and consumption. This mere summary of the model shows how it drives the '*bowling alone*' syndrome - i.e. the fact that what we used to do together with others, we now often do in solitude. This means the model – in philosophical terms - works *against* the very concept of taxes as a means of communal funding of the common good. This note is in no way meant as a political statement. It a simply a reflection over how the system actually counteracts its own intended objective. Any system that counteracts its own intended objective is poorly constructed, outdated or simply inefficient.

Current taxation models actually drive rather than impede the vicious spiral whereas the 'corporate view' tends to equal the world to a single stockpile of increasingly scarce resources - resources that you as a tax subject better book, reserve or consume as quickly as possible, so that no competitor get their hands on them first.

Current *corporate* tax regimes encourage companies to consume unlimited quantities of what in accounting terms is considered 'free' utilities, including fresh air, underground- or sea-water. Although water is charged if it comes from a treatment facility is e.g. cooling water taken from the sea not charged by the general public 'owning' it. Many other collective resources, including large parts of the state's administrative and/or infrastructure capacity, are also consumed partly free of charge. An example is a company that interacts with local and central government bodies on a daily / ongoing basis. Such a company doesn't carry any greater part of these authorities' fixed costs than do those companies who only interact with such governmental bodies once in a while. Another example is a private bus or trucking company using non-toll roads, which consumes much larger quantities of commonly funded infrastructure than what those do who use toll-roads. In accounting terms is this resource hence a 'free utility'. Consumption of what seems like a free resource will *not* have to be economized with - at least not in the eyes of a corporate CEO.

It can also be noted that VAT is a tax on the *value added* component only, meaning the company can deduct (as a production expense) the VAT they are charged by the suppliers, making this tax a non-driver for *lean production*.

Even if the tax subject is taxed for the eventual pollution incurred (whether measured as $CO^2$, ecological footprint or otherwise), and for whatever profit they declare – and such taxes contribute to the funding of state administration and commonly owned infrastructure - is the key driver for any sustainable business, i.e. *lean production*, <u>not</u> inspired by today's output-driven taxation models. As long as the output rules our taxes will number-crunching (rather than lean production) remain the quickest and easiest route to lower tax expenses.

Today's corporate taxes are, as noted above, mainly output-driven (rather than input-driven). In the past were corporate taxes sometimes turnover-based. Such taxes are nowadays all but abolished, since they tend to strike unfairly those businesses that have large turnovers but slim profit margins. In all of today's systems are accounting systems and other control mechanisms the key to controlling the tax subject. But any tax system that is based on number-crunching of output data also provides its tax subjects with ample opportunity both for over-consumption of resources that are not directly charged for, and for minimizing actual tax expenses with the help of creative accounting and statistics. Companies' incentives are hereby - through their reliance on complex accounting models – much more geared towards number-manipulation than towards lean production. As long as the result of each and every activity is presented in numbers, and taxed accordingly, will the way the numbers are computed, and eventually presented, be at the core.

**Scarce vs Plentiful Resources:**

If instead actual consumption of *scarce* resources was heavily taxed, while the actual consumption of *plentiful* resources was much more lightly taxed (or not taxed at all) – and this was done instead of taxing the mathematical compound we call 'profit' - would companies rush to develop technologies based on the use of low-tax plentiful resources, rather than on the use of high-tax scarce resources. At the very minimum would companies work to reduce their consumption of highly taxed scarce resources.

'Plentiful' resources are in today's eco-terminology more commonly referred to as *renewable* resources. Here tax incentives must be structured so that the resource-consumers pay a tax for the use of the renewable resource that at least equals the cost for restoring it to its original state, once it left the production process (e.g. to clean or cool air and water, to clear bio-materials from toxic substances, etc). In line with this would the consumption of e.g. sun- and wave-energy be free of tax, since there is no direct cost linked to its renewal. However, if the captioning of such sun- and wave-energy encroaches on the general public's access to the same, *this* must be compensated for, through an (input-driven) consumption tax.

The use of *scarce* (non-renewable) resources will quickly be reduced to a minimum if they are taxed in a way that discourages their use. So would for instance the use of fossil fuels quickly come under control if the cost for them rocketed, *at the same time* as alternative fuels were made available free of tax (at cost). The significant as well as rapid decrease in fuel consumption in cars such as Mercedes Benz, BMW and Volvo - from around one litre per 10 kms to just half of that - as a direct consequence of the oil price reaching 150 USD per barrel, confirms that technology is ultimately pushed by the markets, not by universities or governments. Even if the two latter play critical roles in terms of knowledge, focus and regulations, will true innovation always be driven by demand. And a lower price-tag will always appeal to the majority.

Nevertheless, when using resource-terminology in this way we must never lose sight of the *human* resources. Human resources are perhaps the only resource that tends to become more and more under-utilised in our post-modern societies, leaving the responsibility to keep them alive and well to the state. If human resources were included among what above is referred to as plentiful or renewable resources, and companies using it were taxed to whatever extent required for picking up the cost for replenishing their original capacity after they left the production line (minus increased age, and the direct consequences hereof), then would accrued taxes imposed on human resources basically match the costs for public health care and human well-being. Employing people for underground mining activities would hence mean higher tax brackets than employing them for sitting in an office or flying an aeroplane. This would ensure that also human resources were cared for when a lean production process was planned.

Rather than inspiring *lean production* are the world's current tax systems encouraging tax subjects to hide away and/or manipulate the basic parameters used for tax-calculation. Today's taxes are in essence designed to punish those who earn profits or pollute – both being output-driven approaches - not to encourage companies to use *less* of what is costly to replace or replenish but *more* of what is harmless to consume or even destructive to let remain idle. In the industrialized world in particular do tax systems actually punish companies for employing human resources, which is the greatest logical error of all, as I will explain below.

Yet another negative effect caused by output driven tax philosophies is that even more scarce resources are needed in order to finally eliminate the harmful waste products and/or side-effects that a less than lean production model generates. Eventually must all pollution be cleaned up, all depleted resources be replaced, and all unemployed people be re-employed, or otherwise fed. Today is the system such that the more successful the tax-subjects are in hiding the consequences of their production, the less taxes and/or fees they will be charged - and the larger part of their own actual cost will they be able to dump on the state. The state can, in the end, not ignore the overall consequences, why it will – if enforcing such a tax philosophy - end up footing the bill for all the costs the tax subjects manage to avoid paying for.

**Human Resources:**

My claim that the taxation of human input equals the greatest logical error of all may require some elaboration. Both wage taxes and income taxes are currently crucial sources of income for governments across the globe. However, as indicated above, do humans constitute the only resource which causes the society to be worse off if the corporate sector does not 'consume' it. Although unemployment as a concept is a heritage from the industrial era, from which many countries are now moving away, it is still a mental burden also for post-modern societies. In developed economies is unemployment becoming much more of a social than an economic malaise. Agricultural societies did not have unemployed people, and post-modern professional societies do not need the employer-employee relationship to organise its primarily knowledge-based production. But to be 'unwanted' by the same economic activities that we collectively praise for bringing us a good life, is discouraging and degrading. From this grows discontent, and eventually social evils based on alienation.

Due to the surprisingly heavy taxation of human input in any organisation's activities - whether private or public - will all self-financed organisations actively try to reduce their consumption of such human resources. Since salaries proper, i.e. the pay the 'human resource' receives him-/herself for doing the job, actually *are* market-driven, is it not because of them that employees have become too expensive in the eyes of their employers. It is because of wage- and income taxes, from which the *corporate bottom line* (i.e. the key driver for any CEO in today's stock-price driven environment) suffers directly - *without* adding any advantages whatsoever to the employer vis-à-vis the competitors.

Here politicians tend to fool themselves. By taxing human resources as if they were commodities they cause un-employment, which the governments themselves have to bankroll the consequences of. As taxes are among the easiest costs for any manager to estimate will s/he have no problem to see the advantage in reducing tax expenses by reducing staff numbers. Since staff costs are semi-fixed costs, i.e. do not vary in *direct* relation to production volume (as do e.g. raw materials), there is always a theoretical window of opportunity that a few staff less shall be able to produce the same output as the current number. By pushing the remaining staff to work harder and/or more efficiently may this also be achieved in the shorter term. However, over time will staff reach their limits, and physical as well as mental and psychological stress will take its toll. This combined consequence of laid off staff and overworked (remaining) staff, is nowadays for the state to manage and carry the cost for. This is a cost the state is causing itself through the tax regime it enforces, but one that our politicians seem conceptually unaware of - or at least unwilling to tackle.

Human resources should not be taxed as commodities, but as assets. Not only would this alter the view of the human resource from 'cost' to 'worth'. It would also allow book-depreciation of investments made in HR in the same way as in other capital investments. An already depreciated asset is not continuously taxed, and is therefore inexpensive to keep. This would also make training a depreciable investment, rather than an expense, once again making it more attractive to maintain and invest in staff, instead of having a high staff turnover due to poor working conditions.

## The following parameters are crucial for a taxation system intended to also serve as an incentive system

- Just like today's VAT shall <u>all</u> tomorrow's taxes relate to the point of procurement, not to the point of accounting.

- Unlike today's VAT shall the tax expense be carried in full by the procurer, as a cost, not be split in an incoming and an outgoing component, where only the net is accounted for as a production cost.

- Unlike most of today's VAT shall the tax-level vary from resource to resource, where renewable resources carry lower tax rates than non-renewable ones, and where scarce resources carry higher tax rates than plentiful ones (etc).

- Unlike today's VAT shall producers rather than consumers carry the cost of the tax, where governments through its political processes define which resources are acceptable to consume higher levels (lower taxes) of and which resources should be strictly economized with (higher taxes).

- Unlike today's VAT and profit taxes must the intention of tomorrow's taxes actually be to differentiate - not to treat all producers' processes as equal. The tax shall punish processes that cause harm to the environment at large - by levying discouragingly high taxes on the *resources* they use - and promote processes that do not cause harm to the environment - by levying encouragingly low, outright symbolic or even zero taxes on the *resources* they use.

- The system shall be flexible enough to drive the choice of resources used in any production process. It shall be possible to levy discouragingly high taxes on harmful resources used by a producer, *at the same time* as lower, outright symbolic or even zero taxes are being levied *on the same producer* for those resources they use that cause lesser (or do not cause any) harm to the environment.

- By using the above indicated flexible system shall producers be encouraged to step-by-step eliminate the use of non-renewable and/or harmful resources in their production processes - reducing their production costs and increasing cost-efficiency and market competitiveness.

- Using this flexible system will governments also gain the opportunity to lay down *medium- and/or long term tax-increase schemes*, where the taxes for consuming non-renewable and/or harmful resources are being stepped up over a number of years, rewarding producers that develop and/or invest in technologies where such resources are replaced by renewable or harmless resources. By announcing such tax-increase schemes well in advance can governments also encourage R&D in its own right, and producers have no reason to accuse the government of being opaque, biased or unfair.

- With this model, taxes will also become incentives for lean production.