

Flat Tax

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The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. ... Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations

Since the times of Adam Smith, economists all over the world have recommended flat tax as a more just and less noxious means of taxation. If we search on the Internet for “flat tax”, we get thousands of links, articles, books, studies, and arguments in favor of the flat tax.

The reason is quite simple: a taxation which has for objective to impair the natural principle of equal taxation and to favor one group of taxpayers and to disadvantage another necessarily entails large tax evasions, obstacles to economic growth, huge bureaucracy, and the affected groups’ efforts to introduce counter-measures into the tax system in the form of more relieves, more exemptions, more deductible items, and more special rates. The introduction of a flat tax would increase tax justice, while reducing the time and administrative costs of taxation and boosting economic growth.

In the Czech Republic, the introduction of a flat tax would lead to an elimination of selective deductible items for the income tax, introduction of a single rate for both individuals and corporations, elimination of the capital income tax in order to prevent double taxation, and introduction of a single rate for the value added tax.

The unequal system of taxation is always both unjust and harmful. Two taxpayers with the same income, for instance, who want to secure themselves financially for the old age, pay different taxes, if one of them buys e.g. a life insurance accompanied by tax advantages, while the other prefers to save money in a bank. In a different example, two taxpayers with identical incomes want to buy a place to live in. One uses a loan entailing tax advantages to buy a new apartment and pays lower taxes than the taxpayer who decides to live in a rented apartment. In order to prevent unequal treatment, taxpayers submit themselves to the tax laws and opt for the goods and services entailing tax advantages. The law thus favors certain products and services, and as such artificially increases their market share. In other words, tax advantages lead to the presence of certain commodities and services on the market, which would be less demanded under equal conditions and which entail higher costs. In this way, unequal taxation hinders economic growth.

As taxpayers have to hire more tax consultants and accountants, take more tax courses, buy more books and guides about taxes, and as ministries have to print longer tax return forms and instructions for filling them out correctly, more and more educated people have to spend their time on an activity which, however useful it may be in the given situation, would be unnecessary in a system of equal taxation. All those intelligent people could use their time and resources to think about how to raise the effectiveness of their firm; and more useful things could be produced and purchased instead of tax brochures. Even such time and financial costs are slowing economic growth.

Progressive taxation of income leads any intelligent taxpayer to try to avoid it. There are several ways how to do it. If the taxpayer runs a business, he may try to transfer a part of his orders on family members with lower tax bases. If the taxpayer is employed, he can ask for a higher gross wage as a compensation for the high marginal rates – which will cause that part of the high tax will be borne by the shareholders or customers of the company. But most of all, each taxpayer will attempt to use all the tax relieves available.

Our tax system allows taxpayers to compensate for the high tax rates, whether by using the deductible items and relieves or by transferring the tax on other persons, or in the form of tax evasions. Except for a few unfortunate taxpayers who are not capable of using all the relieves and get the worse of the system, and with the exception of several lucky taxpayers who know how to use the system to their own benefit as much as possible, the current system leads in fact to equal taxation – but with huge costs and damage to economic growth. That is why the introduction of a flat tax with a single rate of 15% would not lead to a dramatic improvement of the situation of one group and a deterioration of another. The flat tax would benefit a vast majority of taxpayers.

A flat tax substantially simplifies the system of taxation of corporations. It eliminates double taxation in the form of taxation of profit before distribution, and subsequently in that of dividends. Dividends as parts of the company's original profit are regarded as taxed. The system of flat tax eliminates the institute of deductions. Each investment, however big it may be, is considered an ordinary expense and can be included into the costs at once. What else is the system of deductions but a hidden form of double taxation? In the system of deductions, a company in an inflation environment is writing off a lower and lower real value, and its real tax base is increasing. The tax legislation will be much simpler, since it won't have to provide for the inclusion of dividends or deductions, and a number of other complications.

The system of flat tax enables to set a slightly lower tax rate than today's average and a slightly higher deductible item than the average one today, without threatening the income side of the state budget. The rates can be lower and the deductible item higher to an extent in which the states gets more income as a result of reducing bureaucracy, increasing economic growth and reducing tax evasions.

There are three possibilities of facing the problem of taxation: to leave it as it is; to make it even more complex; or to simplify it to the benefit of a vast majority of taxpayers.