British Discover Raising Tax Rates Lowers Revenue

The British government has tried to raise tax revenues by raising tax rates on the highest income Britons. The January 2012 self-assessed tax returns were anticipated to provide more revenue because it was the first reporting period of the new, highest 50% tax rate for the highest earners. The Treasury, however, has reported that instead of tax revenues rising during that reporting period, revenues actually dropped from £10.86 billion in January 2011 to £10.35 billion in January 2012.

Senior British Treasury officials have said that this was the consequence of rich Britons maneuvering to avoid paying the higher tax rates. The Treasury data does not reveal exactly how much of the drop in revenue occurred in the new, high tax bracket (the data covered all self-assessment reporting for that period); no one doubts where the drop in taxes occurred.

The Liberal Democrats, junior partners with David Cameron's Conservative Party, had insisted on government support for the higher tax rate as a way of demonstrating that the rich were paying their "fair share." Industrial organizations, however, have urged the government to refrain from this sort of higher tax rates on the wealthy because it will drive Britain's most productive citizens out of the country (at least for tax purposes).

During the decades of Labour Party rule, British citizens with high incomes, such as rock stars, often assumed a domicile with lower tax rates such as Monaco or Switzerland, which meant that the British Treasury received little or no revenue when a lower tax rate might have persuaded these self-imposed exiles to pay taxes to their homeland.

The British veterinarian-writer "James Herriot" (or Alf Wight) ironically, was a member of the Conservative Party and a supporter of low tax policies. When his books began to sell, Wight was stunned to learn of the near confiscatory rates on high incomes above a certain level. He was not a rich man, but rather a late bloomer as a writer who had worked hard as a country vet for decades. Wight did not elect the non-British domicile route, though advised to by friends and solicitors. Wight preferred to stay in the Yorkshire village of Thirsk, even though at that time the highest tax rate was 83 percent. He was obviously the rare bird, and part of his motivation appears to have been bringing tourist dollars to his fellow villagers at Thirsk and the other part his modest lifestyle which required little money.

For every Alf Wight there must be dozens or hundreds of Britons such as Ringo Starr (pictured above) who has domiciled in Monaco and splits his time between Surrey, California, and Monaco. The Beatles famously recorded the song "Taxman" (written by Beatle George Harrison) when they discovered that the huge record sales they produced were swooped up by the government:

> Let me tell you how it will be,
> Here's one for you, nineteen for me,
> 'Cause I'm the taxman.

The pure economics of progressively higher income tax rates on government revenue are not theoretical. Professor Alfred Laffler worked out the "Laffler Curve" more than 30 years ago and it has invariably proven an accurate predictor of the effect of changes in tax rates upon revenue. Dr. Laffler noted that if the tax rate on income was 0 percent, then no revenue would be raised because whatever the income of a tax base, none would be taxed. The other side of the curve was just as valid. If the tax rate on income was 100 percent, then no revenue would be raised because no one would produce taxable income. As a consequence, much like any other Bell Curve, there is a point of maximizing revenue which lies somewhere between 0 percent and 100 percent and this tax rate is probably not near the confiscatory levels which "tax fairness" advocates usually demand.

The same principle applies to capital gains taxes. Although there is a compelling policy argument in favor of abolishing the capital gains tax entirely, because any such tax reduces the rationalization of investments within an economy to the intelligent use, the impact upon capital gains tax rates and revenue is well documented. When capital gains tax rates are too high, then people simply do not sell securities or real estate — the gain from that transaction would be scooped away by the taxing authorities. On the other hand, a reduction of the capital gains tax rate produces much more activity, as people buy and sell assets without the inhibition of higher rates. The much greater number of transactions, even with a lower tax per transaction, produces more revenue.

So the drop in the British government's revenue for January 2012 should not be shocking to anyone. Indeed, anything but a drop in revenue would be the real surprise.