

CHAPTER XIII

LOCAL INCOME TAX AND TRADING PROFITS

THE suggestion is made from time to time that some form of local income tax should be substituted for the present system of rating. The idea underlying this proposal is that taxation should be based upon "ability to pay," and it is at first sight plausible and attractive. Adam Smith says that "the subjects of every State ought to contribute towards the support of the Government, as nearly as possible in proportion to their respective abilities," but he qualifies this by adding "that is, in proportion to the revenues which they respectively enjoy under the protection of the State". He adds: "The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate who are all obliged to contribute in proportion to their interests in the estate." These are significant words, especially when we recollect that elsewhere he says: "Ground rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign. . . . Nothing could be more reasonable than that a fund, which owes its existence to the good government of the State, should be taxed peculiarly." (*Wealth of Nations*, Book V, Chap. II, Pt. II, Sec. 1.)

In fact Adam Smith does not use the term "ability to pay," but the word "ability" alone which evidently he interprets to mean "benefit received." It may also be remarked that although he uses expressions which might imply that all incomes should be taxed equally, his

detailed analysis shows that this is not his view. The ultimate sources from which taxes may be paid are rent, interest, and wages. He fully approves of a tax upon rent, but not a tax upon interest because it may discourage the employment of capital, and still less a tax upon wages.

The idea of "ability to pay" is incapable of exact definition. As applied in practice, it is the highwayman's maxim of ability to collect, and every system of income tax abounds in arbitrary graduations, exemptions and abatements in order to make it at all tolerable.

Apart from these general considerations the proposal for a local income tax bristles with practical difficulties. The total revenue from local rates in Great Britain is in round figures £624,000,000, the total yield of income tax and surtax is £2,488,000,000, both figures are for the year 1958-59. Any Chancellor of the Exchequer is likely to look askance at a proposal which will impinge so strongly upon one of his chief sources of revenue.

Moreover, the efficiency of the system of national income tax depends upon the fact that it deals with the taxpayer's total income from all sources, and that a very large part of the tax is collected by deduction at source before the income reaches the taxpayer. The latter provision ensures prompt collection and prevents evasion, but it is evidently not applicable to a local income tax.

How is income to be localized? The Royal Commission on Local Taxation said: "It is, however, clear on reflection that a local income tax—*i.e.*, an income tax imposed and levied by local authorities within their own district—tends more and more to be incompatible with modern social and political arrangements. The very conception is indeed obscure, for to what locality does an

income belong? To the place or places from which it is derived? Or to the place or places where it is enjoyed, *i.e.*, where the recipient more or less permanently resides?"

If it is assessed in the district in which the taxpayer earns, people who live in residential districts and earn their living elsewhere will contribute nothing to the district in which they live; and a small minority who earn their livings in the district will bear the whole burden. If it is assessed in the district in which the taxpayer resides, well-to-do residential districts will have ample revenue and a low rate of taxation, while the industrial districts will have a heavy rate of taxation falling mainly on the wage earners who live in them.

Would the income of companies be assessed or only that of individuals? Where does the income of a concern with many branches arise, and where would it be taxed? Where does the income of holders of government stocks, pensioners, etc., arise and where would it be taxed?

It is not necessary to elaborate these points. Anyone who is familiar with the income tax system will know the difficulties, and in fact the more thoughtful advocates of a local income tax now propose that it should be collected nationally and distributed to the localities. It would, therefore, become with some modification something of the nature of a treasury subvention or grant-in-aid, the objections to which have been considered in the preceding chapter.

Moreover, this proposal would aggravate some of the worst features of the rating system. It would perpetuate the exemption of valuable vacant land. It would increase the partial exemption which poorly developed land at present enjoys. Any reduction in rates, so effected, would

tend to be absorbed in higher rents, and in some cases the last state of the ratepayer would be worse than the first.

PROFITS OF MUNICIPAL SERVICES

Another source from which some part of the revenues of local authorities may be derived is the profits of trading undertakings, such as water supply, tramways and omnibuses, and markets.

In the year 1958-59 the aggregate expenditure of local authorities in England and Wales in respect of trading services exceeded the aggregate income by more than £11,000,000.

There is, therefore, no reason to believe that in the average case any substantial relief to rates can be obtained from this source, although isolated cases may be found in which the reduction is considerable.

To take the profits of a municipal undertaking to relieve rates, means that a higher charge must be made for the service than would otherwise be the case. It is a form of indirect taxation levied upon the users of that service. No good reasons can be found why passengers in omnibuses for example should pay more in local taxation than others. Further, all taxation levied upon articles or services of common use necessarily falls most heavily upon the poorer sections of the population.

This practice has nothing to commend it. Municipal services should be run so as to provide the best possible service at the lowest possible cost. The accumulation of reserve funds of reasonable size is proper, but, after provision has been made for this, any surplus should be used either for improving the service or reducing the charge. The monopoly power vested in the local authority should not be used as an instrument of taxation.