# What if we don't have direct taxes and we only ever tax...

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If you talk to tax practitioners they will tell you that tax is divided into two broad types.

Firstly there is direct tax, which, they say, is charged on things like income and profits. Examples would, of course, be income tax and corporation tax but capital gains tax also very clearly falls into this category, as does National Insurance.

The second type of tax is, perhaps unsurprisingly, called indirect tax. These are taxes on specific transactions. The obvious example is VAT, but there are plenty of others. Excise duties, fuel duty, all carbon taxes, insurance taxes, landfill tax and many other taxes fall into this category.

The more I think about it though the more artificial I think this divide is, and the less helpful thinking about tax in this way has been for the creation of good taxation policy. This realisation has, in part, been fuelled by a survey work I have undertaken on 147 different corporation tax systems. The outcome of that work is not yet published but the finding was unambiguous: there isn't a single corporation tax system that I can find in the world (and the survey covered the corporation tax systems of more than 98% of the world's GDP) that charges that tax on anything like accounting profit.

Now, of course, we know that in the UK, but then we are reputed to have one of the more complex tax systems. To replicate that finding literally everywhere was, if not surprising, then at least an eye-opener because what this means is that a so-called direct tax is actually no such thing. Corporation tax is, in fact, a tax on specified transactions, just like VAT. If confirmation were needed, when the European Union with drafting the articles for its proposed Common Consolidated Corporate Tax Base it had to be explicit on this issue. In article 10 of the draft CCCTB it says:

*The tax base shall be calculated as revenues less exempt revenues, deductible expenses and other deductible items.*

You only have to think about that for a moment to realise that what it is saying is that specific transactions are taxed, or are tax allowable: it is not profit that is the basis for this proposed European corporation tax. This is not peculiar to the CCCTB; in effect what I now realise is that this is the commonplace basis the tax assessment for what are supposedly called profits (and in effect, income) around the world. We may start all tax computations with a figure for income, or profit, but that is in itself misleading. That figure is only an approximation to the revenues that are taxable, and even more so, to the expenses that are deductible, and the process of adjustment is not one that comes up with an alternative profit figure; it is an exercise to identify the chargeable and allowable transactions that are within the scope of tax. That is something quite different.

Now, maybe I am slow in realising this, but if I am, then I suggest that I'm far from alone. This suggestion is one I have not seen made. The appreciation does, however, have significance. Once we begin to think that we're charging transactions to tax it becomes very much easier to think about alternative ways of taxing. It was many years ago that I recall reading the new economic thinker James Robertson suggesting that the object of a tax system was to tax the ‘bads’ in an economy whilst leaving the ‘goods’ alone. This idea is very difficult to reconcile with any concept of taxing either profit or income, but it is very easy to reconcile with a transaction-based approach to taxation: any transaction-based tax necessarily allows for this opportunity, and the truth is that we may only have transaction-based taxes.

The same realisation is also important for another reason, and that is in tackling tax avoidance. The CCCTB definition is very interesting here, and contrasts with the logic of UK jurisprudence on this issue, at least until the introduction of the General Anti-Abuse Rule. That is because the EU rule works on the basis that everything is taxable unless exempted whereas UK taxation law has worked on the basis that nothing is taxable unless specifically charged. Again, a transaction-based approach allows for a change of emphasis.

It does more than that though: it also changes the way in which we need to look at accounts. As I have often noted in the past, the IFRS Foundation have specifically stated that the International Financial Reporting Standards that they publish are not a suitable basis for the preparation of tax calculations, even though they are the only accounts that many companies might produce. Those accounts focus upon a profit figure, which we know to be inherently unreliable. If accounts are, however, to be useful for taxation purposes then there may well be a need for a different focus that seeks to identify particular forms of transaction that may, or may not, be taxable,  but that then opens the question as to who will produce those accounts, and who will set the standards for their production.

I don't have answers to these questions is yet: I would be interested in informed comments.