

## Using Universal Basic Income for Tax Reform

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**Abstract:** Universal Basic Income (UBI) has existed in various theoretical and practical forms for several hundred years. Whilst UBI is typically associated with welfare and social security policy, UBI concepts can also be used for tax reform. Coupling these concepts with several key reform concepts could result in a fairer and more efficient and effective tax system. This article will examine what areas of tax systems could benefit from UBI - driven reform.

### Introduction

Universal Basic Income (UBI) is typically associated with welfare and social security, however an alternative use for UBI is tax reform. Coupling UBI concepts with tax reform could be highly beneficial for the tax system resulting in a more effective, efficient and fairer tax system. The structure of this article is as follows: firstly, a UBI will be explained, as well as the benefits it can provide. This will then be followed by a consideration of how UBI concepts can be used for tax reform.

### What is UBI?

UBI is a specific type of sustenance payment, a payment that assists the recipient in affording her basic necessities. Other similar sustenance payment policies include: Basic Income (BI) and Guaranteed Annual Income (GAI). For simplicity, this article will only use UBI as catchall term. The key factor of UBI is its universality i.e. every citizen of the nation is a guaranteed recipient regardless of socio-economic or employment status. The payments are also tax-free and are independent to an individual's taxable income.

The idea is not a new concept, having existed for several hundred years in various forms and recently re-entering political discussion as part of the rights-based welfare movement. UBI itself is a response to the effects of wealth

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inequality such as lowered educational outcomes (Holmes, 2013) and overall poorer health (Karlsson et al, 2009) which UBI proponents suggest could be addressed through the targeted or wholesale adoption of a UBI program. Empirical evidence tends to support this conclusion.

At this time only ‘trial’ BI/UBI programs have been implemented. The evidence from these trial programs has been overwhelmingly positive however. A series of programs in India showed improved health and labor force participation amongst recipients with the most significant improvements occurring within traditionally disadvantaged classes such as women and the disabled (Standing, 2013). In Kenya, citizens receiving the automatic payments were found to have lower stress, improved psychological health, and lowered spending on ‘temptation goods’ such as alcohol and tobacco (Haushofer and Shapiro, 2013). In Iran, a subsidy program beginning in 2010 has resulted in a sharp decline in the percentage of individuals living below the poverty line (Salehi-Isfahani, 2016) as well as wealth inequality (Soleimaninejadian and Yang, 2016). The success of the trial programs is also echoed by the Bolsa Familia program in Brazil which provides low income families with a monthly stipend for ensuring their children are vaccinated and attending school (Wentzel, 2013). Overall it can be firmly concluded that UBI or UBI-type programs have highly positive effects on its recipients.

Proponents also argue that UBI offers solutions for several of the ‘issues’ often attributed to the current welfare system. For example, by eliminating welfare payments, UBI provides a greater incentive to work rather than to not work. This in turn can reduce welfare program expenditure by a government and avoid the poverty trap of traditional welfare systems (Muller, 2013). Having a UBI system in place may also provide an economic stimulus as citizens have more disposable income because expenditures on basic needs are met by the UBI (Wright, 2005).

UBI is not without its criticisms, particularly the method of funding the program and its impact on employment and the economy. For example, during the Iran trials, prices for bread and energy increased by large factors (Salehi-Isfahani and Mostafavi-Dehoozi, 2017). However this inflation may have been exacerbated by international sanctions and general fiscal irresponsibility of federal government at the time of introduction (Salehi-Isfahani, 2016). In terms of UBI effect on employment, in contrast to the positive impacts on labor force participation in the India and Kenya experiments, the 1970s Manitoba Basic Annual Income Experiment (Mincome) resulted in an 11.3 percentage point reduction in labor force participation by recipients (Calnitsky and Latner, 2017).

It is unclear why the Canadian experiment had a negative impact on labor force participation whilst the Indian and Kenya experiments had a positive impact. This may be due to the differences in socio-economic conditions between countries such as Canada and India/Kenya, however as the Mincome

experiment has been the only UBI-type experiment in the western world, any conclusion based on the Mincome data is largely speculative. Several countries such as Finland and the Netherlands have recently begun UBI trials which could provide better insights into the impacts of UBI on a first world economy.

In terms of funding a UBI, the major issue is the total cost (Sampford, 2016). For example, if the US were to implement a UBI providing \$1,000 per month (approximately the level of the poverty line) to all adults, it would cost the federal government approximately \$2.7 trillion annually or 14.5% of the US GDP. This figure does not consider the costs of administering the UBI nor population fluctuations and the impacts of ‘greying’ populations. The obvious source of funding is tax revenue. However as the cost of providing a UBI would be more than the combined cost of Federal Social Security, Medicare and Veteran’s Benefits (United States Office of Management and Budget, 2016) this would not be feasible or sustainable. As such, cuts in government spending, particularly a reduction or elimination of income support programs and other government subsidies may also partially address the funding issue.

## **How UBI Can Influence Tax Reform**

As noted above, any UBI will heavily rely on tax revenue for funding. Whilst cuts in government spending are required, significant tax reform will also be necessary to meet the demands placed upon the system. Rather than reform occurring independently from the UBI policy, the reform can be informed by and even aided by UBI concepts. This section of the article will examine what areas of the tax system can be influenced by UBI concepts. The areas that will be examined are: compliance, complexity and tax rates.

### **a. Compliance**

Compliance is a key factor for the success and sustainability of any UBI system with a high level of compliance necessary to secure funding. Regardless, compliance is a constant feature of tax reform. Braithwaite suggests non-compliance can be linked ‘to failure to see benefits, failure to see fairness in the system and failure to feel any moral obligation to pay tax’ (Braithwaite, 2009). With the proper framing of a UBI, the issue of lack of realizable benefit may be addressed. A UBI would provide a realizable and tangible benefit in the form of ‘free money’. With the addition of the benefit of the UBI payment being linked to tax system compliance, the issue of failure to see benefit may be addressed.

An example of such a mechanism is a piece of Australian legislation titled the *Tax Bonus for Working Australians Act (Bonus Act)*. The *Bonus Act* was

passed in 2009 in response to the Global Financial Crisis (GFC) as part of a larger fiscal stimulus package, which is often credited with guiding Australia through the GFC relatively unscathed. The *Bonus Act* created a tax bonus payment entitlement of \$250, \$600 or \$900 for a limited class of individual Australian resident taxpayers who had lodged an income tax return for 2007–08. To receive this entitlement a person had to have an adjusted tax liability greater than nil and a taxable income less than or equal to \$100,000. The sum received would be determined by reference to an individual's taxable income for the 2007-08 income year.

The inclusion of a similar condition in any UBI legislation could address the lack of realizable/foreseeable benefit issue suggested by Braithwaite. For instance, to be eligible for UBI payments in the coming financial year, an individual must lodge her tax return no later than a nominated date. Coupling the receipt of 'free money' with the condition of filing a tax return would give individuals an incentive to comply with the requirements of the tax system. As the key aspect of a UBI is its being universal, this condition would also serve to capture higher wealth individuals. For example, the ATO experienced an increase in tax return lodgements in the 2008-9 year, which was attributed to the *Bonus Act* payment (Australian Federal Government, 2009). As such it is a realistic proposition that a UBI in conjunction with a tax return lodgement condition would lead to increased tax system participation even amongst higher income individuals.

A higher rate of tax participation and compliance would be invaluable to the administration and general success of a UBI policy. Whilst the inclusion of such a mechanism may undermine the concept of universality, this is more of a philosophical consideration than a practical one. Eligibility requirements are however not uncommon for benefits as demonstrated by the Alaskan Permanent Fund.

#### **b. System Complexity**

System complexity is another key issue in tax reform. High levels of tax complexity result in the taxation system being less transparent and being seen as unfair. A system perceived as being unfair has been shown to result in lower levels of compliance, both intentional and unintentional (Braithwaite, 2003 and McKercher 2002). A UBI system would offer more simplicity due to lower amounts of red tape and technicality compared to most current systems. Complexity could be reduced due to the elimination or reduction of eligibility-based programs and subsidies as well as system features such as deductions and exemptions. Tax rates are examined in the next section.

A less complex system may also result in a reduction of intentional tax avoidance/evasion. Intentional avoidance can occur in two ways. First, due to the cost and difficulty of complying with the tax system for the 'average'

taxpayer (Cussons, 2007), individuals may be tempted to willfully not comply. This can stem either from a perception of the system being more favorable to high-income individuals and corporations, or simply due to the costs of complying being too high (Cussons, 2007). Secondly, a more complex system may also be more open to exploitation due to excessive regulation, use of abstract and complex legal jargon and constant changes in legislation and policy. Such a system fosters a perception that the system is only accessible to those that can afford 'top level' accountants and lawyers as well as fostering an antagonistic climate between tax payer and authority (Bătrâncea, 2012).

Greater simplicity would improve perception of the tax system. A tax system that is more understandable by a greater number of individuals, particularly those of a lower educational background, is seen as fairer to the 'average' person and less favorable/exploitable by the rich (Saad, 2014). A fairer and more transparent system could also lead to a reduction in the usage of tax planning strategies employed by middle-income individuals due to an increased sense of system justice (Murphy, 2005). In terms of regulation, a more simplified system could also lead to more efficient and effective regulation due to a reduction in the possible planning strategies that can be employed. Participants would also be incentivized into complying with the system due to the realizable benefit offered by the UBI.

### **c. Tax Rates**

For a UBI to be sustainable, personal income tax rates will likely need to be adjusted to a higher rate. Economic modeling suggests this rate may need to reach or even exceed 50%. This would somewhat undermine the purpose of the UBI of providing additional income to improve the affordability of basic necessities and improve an individual's socio-economic situation. Further, an increase in tax rates may also have a negative impact on labor force participation as high tax rates generally disincentivize working due to lessening a worker's available income (Hoynes and Moffitt, 1999). If this were to happen, the recipients, particularly those in low socio-economic groups, would be no better off than they were under the traditional welfare systems with many possibly even experiencing regression in their financial situation. As such this will be an important consideration when determining what level tax rates should be adjusted to.

An alternative solution to significantly increasing the personal income tax is to increase tax rates in other areas such as sales. This however would also suffer from similar problems as higher taxes on activity such as sales or business income could discourage these activities. It is at this point that UBI may begin to lose popularity and policies such as targeted BI or NIT begin to gain support. The advantage of such a policy is that the sheer volume of recipients is limited thus reducing the necessary costs whilst still maintaining the benefits of supplemental income.

## **Conclusion**

Sustenance payments such as the UBI, BI or GAI are increasing in political popularity due to deepening wealth and income inequality and changes in the labor market. As a result of this growing popularity, several western countries are either beginning UBI trials or examining the feasibility of a UBI policy. Whilst typically associated with welfare, an alternative use for UBI concepts is tax reform. The introduction of a UBI can improve tax compliance by providing an incentive to tax payers as well as reducing the barriers to compliance through eliminating system complexity.

Reform is not a simple matter however, as there are issues with funding feasibility and sustainability. Whilst the elimination of welfare and subsidy programs will provide a significant proportion of the necessary funds, the balance will still need to be sourced from other areas. This will require an adjustment of tax rates, which may have a negative impact on recipients despite the additional income provided by the UBI. Thus tax rates are an extremely important consideration for any UBI and tax reform policy. Overall UBI concepts do potentially offer an effective method of tax reform.

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