Taxation and Big Brother: information, personalisation and privacy in 21st century tax policy

A paper, published today (8 March) in Fiscal Studies, asks what the implications of improved technology could be for tax collection in the future. The author, Professor Joel Slemrod of the University of Michigan, weighs up the advantages of a more personalised and possibly fairer approach to taxation against the potential risks posed to personal privacy by the collection of the necessary information.

The financial costs of collecting information have fallen, and technology is increasingly going to make it possible to collect and utilise more information about individuals. The author points out that it would be possible to tailor taxation to suit the particular characteristics of individuals, such as the number of children they have or the amount of money they give to charity. This could either be done, as is already the case to some extent, through income tax, or in the future through a consumption tax. It would theoretically be possible for the government to issue ‘smart cards’, similar to supermarket loyalty cards, which could vary the amount of tax paid depending on information recorded on the card.

Modern tax theorists argue that the most efficient way to implement redistributive taxation would be to base tax liability on the immutable abilities of individuals. Because of the impossibility of discovering people’s real abilities, the bases for taxation have instead been more obvious characteristics correlated with ability such as income. However, technologies using genetic information and ‘brain fingerprints’ could make ability a possible criterion in future. This reminds us that the question of tax reform is not based only on efficient but also on ethical considerations.

Even a system based on information from companies rather than from individuals could end up invading personal privacy: information would be collected about employees from employers rather than directly from individuals. This is already the case with the PAYE system in the UK.

Interestingly, the author comments, a command economy is able to collect tax efficiently because it is always able to withhold the tax at the source of income—state-owned enterprises. George Orwell himself did not go into much detail about the tax system in Oceania – perhaps because he wanted to hold his readers’ interest – although he mentions that a flat tax of 25% is in place there. This might draw our attention to the fact that to design a tax system in a democracy, we need not only to consider issues around the invasion of privacy, but issues of fairness; the collection of personal information can facilitate the progressive and otherwise equitable tax system that democracies tend to favour.

On the other hand, Slemrod suspects that there may be a demand from citizens to protect their privacy by moving away from a more personalised tax system. He speaks of a Ulyssian constraint that government could place on itself in preventing the collection of too much data about individuals. He is referring to the story in the Odyssey where Odysseus has himself bound to the mast and has the ears of his crew stopped with wax and so that they would not
steer the ship off course towards the Sirens. If legal barriers were to be placed in the way of the collection of the relevant data, then a system based on personalised taxation would become impossible to sustain.

The author suggests that the invasion of privacy might seem less irksome to citizens if the revelation of information were a two-way process. If there is transparency about how taxes are spent, the costs of collection and the distribution of the incidence of taxation, individuals might be less anxious about revealing information about themselves. This is in contrast to the original Big Brother in Orwell’s 1984, who has unlimited access to information about people’s lives but controls and limits their perception of government activity.

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Notes to editors
2. Joel Slemrod is Professor of Economics at the University of Michigan; his biography can be found at http://webuser.bus.umich.edu/departments/busecon/faculty/slemrod/bio.html
3. This article was originally presented as the IFS annual lecture 2005.