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The Golden Carrot

News from Louis Letourneau.

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Politicians want your vote and [Louis Letourneau](#) thinks the way they'll do it is through tax incentives.

Tax has been in the news a lot lately. The Tories, disappointed by their performance in the last election, are trying to win voters back by flirting with the idea of a flat tax. And the Liberal Democrats, disappointed at their own performance in May, are taking a long, hard look at their tax policies. The politicians believe that the way to our votes is through our pockets – and they're probably right.

The current tax system is complicated and could do with reform and simplification. At present, we have five income tax rates. There's the starting rate of 10%, which helps ease the lower-paid gently into the tax system. Then there's the basic rate of 22%, which the majority of working people pay. Next there's 40%, which higher earners pay on the part of their income that exceeds the basic rate band. But, as well as though three rates, there're also the savings rate of 20% and the dividend rate of 32½% for higher rate taxpayers.

As if all of that isn't enough, we also pay National Insurance, which is really just another tax. Phew! As an American politician once said, when confronted with the horrendously complex US tax code, it would be nice to have a system that looked like 'someone designed it on purpose'.

It's this complexity that makes the idea of a flat tax superficially appealing. Just sweep the present system away and start from scratch. Raise the personal allowance (currently £4,895) dramatically – say to £10,000 or £12,000, so that the lower paid are taken out of the tax system altogether – and tax everybody else at a flat rate of anywhere between 22% and 30%. Its advocates claim enthusiastically that it would improve compliance with the law and increase the tax take, as wealthy people wouldn't bother with expensive tax avoidance schemes to save such a low rate of tax. Apparently, high earners would just pay their bills cheerfully. And they'd work harder, because they'd be keeping more of their income in their bank accounts. They would found new enterprises and employ more people. Therefore, everyone would end up doing well.

They point to some Eastern European countries which have adopted a flat tax - but many of these didn't resemble the western model in any way. Current flat tax rates range from 12% in Georgia to 33% in Lithuania. Russia introduced a 13% flat rate on personal income and, a year later, had increased its revenues by 26%.

But if you're thinking it all sounds too good to be true, you're right. Obviously, the primary purpose of the tax system is to raise money that the Government spends on its programmes, but it can be a tool of social engineering. When the Tories cut the top rate of tax from 98% to 40% in the 80s, it was to keep our brightest people from emigrating to the

United States. It succeeded – who talks about the ‘brain drain’ now? Indeed, these days, compared with the rest of western Europe, we’re a tax haven. Multinationals would rather set up a factory here than in France or Germany.

Since New Labour came into office, the burden of tax has shifted – the winners have been workers with children (especially the lower paid), while the losers have been workers without children. So, gay men have been paying more tax in the last eight years.

If we brought in a flat tax, our tax system would cease to be ‘progressive’ - the rich would no longer pay a higher rate of tax than the average worker. Many people would consider that unfair. Also, the tax breaks that have been introduced to encourage us to spend our money in a way that benefits our long-term interests, and that of society as a whole, would be swept away – we’d no longer get tax relief for paying into a pension scheme or making donations to charity. In my work, I know how hard it can be to persuade people to make provision for their retirement – often, it’s the ‘carrot’ of generous tax relief that clinches it.

However, I don’t think we need worry about any future Government bringing in a flat tax. It would be political suicide. Why? Because the only people who’d benefit would be the rich, and there aren’t all that many of them. The working poor might benefit to some extent, but they’d lose their tax credits, so they might end up no better off than before. The people who would really suffer would be people on earnings of between £20,000 and £50,000 a year – those are the voters of ‘Middle England’, whom every political party has to attract in order to win an election.

So, simplify the tax system, by all means – amalgamating Income Tax and National Insurance might be a good start, as would abolishing the 10% starting rate and increasing the personal allowance instead. However, a simplified tax system isn’t the same thing as a simplistic tax system – the flat tax is a non-starter.

Louis Letourneau, MA is an experienced independent financial adviser (IFA), specialist in financial planning and wealth management. He founded Rainbow Finance in 1995 and has consistently challenged financial companies and Government on their attitudes to gays, lesbians and same sex couples and was instrumental in the Inland Revenue to changing its guidance notes to recognise unmarried couples in pension benefits. His work has also resulted in life insurance companies starting to relax the discriminatory underwriting criteria toward gay men and people living with HIV. He was a founder of the Rainbow Research Project which surveys and educates private pension schemes in how they recognise unmarried couples on death benefits. He was also a founder member of the Stonewall Immigration Group (which campaigned for Immigration rights for same-sex couples, achieving a significant victory in April 1997) and helped set up the gaypartners.org initiative with gay.com in early 2001, campaigning for same-sex partnership rights. He speaks regularly on national and local radio.

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