

The function(s) of taxation: the impacts of regulatory taxes on taxation

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Abstract

Taxes can be designed to fulfil a number of different objectives for society, which can result in both intended and unintended consequences. Three of the core functions of tax include raising revenue, redistribution, and the regulation of behaviour. This article explores how regulatory taxes – taxes designed to change behaviour – interact with the other functions of tax. This article ultimately argues that regulatory taxes prioritise regulation over revenue-raising and redistribution, which may introduce messaging about taxation more generally. It communicates that it is acceptable not to pay tax, creating a possibility for ‘permissive tax avoidance’ in an anti-tax avoidance era. It also brings elements of regressivity to a tax system and communicates that it is those with the least who should pay to address environmental and societal harms.

Keywords: functions of taxation, regulatory taxation, behavioural change, inequalities in tax

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1. INTRODUCTION

Taxes raise revenue for state functions, but they also perform other functions for society, and often multiple things at once (Avi-Yonah, 2006; Posner, 1971, pp. 28-29). Amongst other functions, taxes raise revenue, redistribute wealth, and regulate (Avi-Yonah, 2006, p. 3). The pool of literature on the general functions of taxation is surprisingly thin. Lots of articles mention the functions of taxation, but few engage in a rich and meaningful way; fewer still engage with how the functions may interact with one another.

Here, this article refers to the function of taxation as the objectives that the tax was designed to perform; functions that create real financial, social, and environmental consequences for individuals, businesses, and states. However, it could also include the functions that the tax performs even where those functions were not designed into the tax originally; these functions, or the unintended consequences of tax, remain important to consider when exploring the role tax plays in society. To fully ignore them would place a blind reliance on the stated policy objectives of taxes. This article therefore considers both the aims and consequences of tax when referring to the term ‘function’.

Likewise, tax can be considered on a micro and macro scale. Individual taxes can be impacted by a particular function or have specific consequences. For example, the United Kingdom (UK) Soft Drinks Industry Levy has had specific consequences on the consumption of sugar in the UK, with consumption dropping 11 grams per day per adult by the end of its first year (Rogers et al., 2024). At the macro level, each tax forms part of the overall tax system of a state. Significant changes in how taxes are used to perform functions could have real consequences on: a) the composition of the overall tax system in a state, and b) wider messages that are communicated (intentionally and non-intentionally) around tax, such as whether the tax system of a state is a tool for redistribution, raising revenue, or changing behaviour. While one tax is unlikely to cause a large ripple across the whole tax system, many taxes could.

This article seeks to explore how the functions of regulatory taxes (both their objectives and consequences) might impact taxation at a macro level. That is not to say that environmental or social harms should not be regulated. They should be. Indeed, firms engaging with environmental regulatory taxes can improve, for example, their environmental, social, and governance (ESG) performance (Wang & Ye, 2024, p. 14; He, Jing & Chen, 2023, p. 7). The field of literature that looks at how economic instruments can regulate (and benefit the environment, for example) is rich but this article attempts to reverse the gaze. This article therefore considers whether regulatory taxes benefit *taxation*. That is to say, is a tax system full of regulatory taxes good for the overall tax system? This article ultimately identifies that there is a need for further research in this field.

To explore whether regulatory taxes have an impact on the other tax functions, this article will draw on both regulatory and tax scholarship. It will also consider the UK landfill taxes as an example of a longstanding and (relatively) stable regulatory tax. Whilst this article focuses on UK taxes as illustrative examples, most of the taxes discussed exist in many jurisdictions, and regulatory taxes are used globally. This is a discussion that transcends any given jurisdiction. Overall, this article highlights that the prioritisation of the regulatory function pushes the other two core functions to the background. This poses two initial problems that are worth exploring.

First, in placing regulation over revenue-raising, taxes can become instruments of permissive tax avoidance. Regulatory taxes, by their very design, encourage taxpayers not to pay them by shifting their behaviour; their intended behavioural consequences send messages that avoiding taxes (the legal reduction of tax liability) is both sanctioned and invited. This is in direct conflict with global messages around the need to pay tax, as can be seen in both the corporate social responsibility (CSR) and ESG literatures. There is therefore an inherent paradox that is created between paying taxes and the regulation of negative behaviour.

Second, by prioritising regulation over redistribution, regulatory taxes are a tool to perpetuate inequality through both regressivity (a higher burden on those who can least afford it) and a possible reduction in tax revenues. This problem can be created by both the intended and unintended consequences of taxes (regulatory and otherwise). Likewise, a single tax that worsens inequality does not mean an overall tax system does so. However, an increasing reliance on regulatory taxes, which are almost always regressive, to solve societal problems does introduce greater regressivity and could pose redistribution problems. There is therefore a secondary paradox between regulating social harms and addressing inequality.

Both issues run counter to all functions of taxation if these are internalised by taxpayers in any way. In the words of Avi-Yonah, 'it is necessary to resurrect a question that has not been considered recently in the tax policy literature: What are taxes for?' (Avi-Yonah, 2006, p. 3).

2. THE FUNCTIONS OF TAXATION

Work on the functions of taxation, i.e., what taxes could or should achieve in society, can best be summarised by the seminal work of Reuven Avi-Yonah, who outlined three main goals of taxation (Avi-Yonah, 2006, p. 3). The goals are that taxes can raise revenue, redistribute wealth, and regulate behaviours on behalf of the state (Avi-Yonah, 2006, p. 3). Whilst these are not the only functions of taxation, and other scholars will be cited, these three functions provide a clear and useful categorisation tool to structure the discussion that follows.

These three functions of taxation are a meaningful and useful starting point when thinking about the function that taxation can play in society. They are not the end point, however, and it is also important to think about how taxes perform multiple functions and how each of these functions relates to and interacts with the others.

2.1 Revenue-raising

Whilst there are alternatives to taxation, such as socialism (Schumpeter, 2013; cited in de Cogan, 2020, pp. 10-11), all taxes need to raise revenue to be successful:

[A]ll taxes have to fulfill this function to be effective; as the Russian government discovered in the 1990's (following many others in history), a government that cannot tax cannot survive. And there is widespread ideological agreement that this function is needed, even while people vehemently disagree about what functions of government are truly necessary, and what size of government is required (Avi-Yonah, 2006, p. 3, footnotes omitted).

This argument, that all taxes should contain a revenue-raising element, is important, as it indicates that the revenue-raising function of taxes is a permanent feature of taxation.

Revenue-raising has been described as a ‘key function’ (Hickman, 2014, p. 1723); that the general assumption is that the primary purpose of taxation is to raise revenue (Duff, 2016, p. 895); or, at least, that taxes raise ‘sufficient revenue’ (Daniel et al., 2017, p. 1).

There is not a country in the world that does not have some form of taxation.¹ While the taxes used vary significantly across countries, the Organisation for Economic Co-operation and Development (OECD) has identified that consumption taxes are the most important revenue source on average (yielding 31.6% of tax revenues) (Weigel & Bunn, 2024, citing OECD data). This is followed by social insurance taxes and individual taxes at 25.2% and 23.6% respectively, while other taxes (such as environmental taxes) share a much smaller proportion of tax revenues (2.9%). Some taxes are therefore better at raising revenues than others, and Avi-Yonah highlights that experience from OECD countries would indicate that a mixture of income taxation and consumption taxation improves the overall revenues collected by a state (Avi-Yonah, 2006, p. 8).

Additional work has been undertaken to develop the current thinking around the functions of taxation and how a state finances itself; something that goes beyond the revenue-raising role that taxes play. Taxation can stabilise and manage the economy and overcome financial volatility (Loutzenhiser, 2019, p. 9). An example of this function can be seen in the Tobin Tax, a proposal which sought to curb currency speculation and stabilise exchange rates by taxing foreign exchange transactions (Tobin, 1978; Felix, 1995). The Tobin Tax was predicted to introduce stability that would encourage longer-term investment and stability, as well as generating revenue for the state (Felix, 1995, p. 204).

Taxes can also build up, as well as stabilise. De Cogan draws on the work of Schumpeter to highlight the critical role that taxes play in the formation of a state (de Cogan, 2020, p. 9). Schumpeter (1991, p. 108) argues:

We have seen that without financial need the immediate cause for the creation of the modern state would have been absent. ... Taxes not only helped to create the state. They helped to form it. The tax system was the organ the development of which entailed the other organs.

This, de Cogan argues, transforms ‘the search for finances from a prerequisite into an instrument of the state’ (de Cogan, 2020, p. 10). Once the state is formed, this function of taxation moves to the background but is not completely lost (de Cogan, 2020, p. 10). When a state makes a decision about whom, what, and how to tax, (or ‘on whose shoulders the tax burden shall fall’ (Daly, 2023, p. 541)) tax still reflects the ever-changing social norms and social values of that state: ‘A country’s tax system is thus both an important and a highly visible symbol of its fundamental political and philosophical choices’ (Bird & Zolt, 2005, p. 1631).

Social values in tax have, however, been described as ‘grime in what would otherwise be a pristine revenue-raising machine’ (Abreu & Greenstein, 2018, p. 5 (footnote omitted)). Yet, divorcing revenue-raising from the other functions of taxation is not straightforward and invites the categorisation of good and bad tax policy on a single factor: good tax policy raises revenue, bad, spends money (Abreu & Greenstein, 2018,

¹ Whilst there are countries that do not impose income taxation or value added tax (VAT), this is often accompanied by either corporation tax, capital gains, duties, or a withholding tax on certain payments. Some countries distinguish between citizens and non-citizens, but some element of taxation remains.

pp. 12-13). This is reflected in what feels like a rather bipartisan debate in the scholarship around tax expenditures: those who argue that revenue-raising is a core function of taxation are highly critical of the use of tax expenditures to implement social policy (Surrey, 1970, 1973; Knauer, 2014).

This feeds into some of the strongest (and most important) criticism of putting the revenue-raising function of taxation onto a pedestal. Hickman argues that the importance of revenue-raising is often used as a shield to defend tax exceptionalism (Hickman, 2014, p. 1720). Olson has highlighted that, in the US, the revenue-raising function has led to a judicial reluctance that is in favour of the Inland Revenue Service (Olsen, 2010, pp. 230-233).

In addition, focusing solely on revenue-raising brings in broader tax scholarship, such as tax compliance and tax avoidance. Setting tax rates too high can lead to behavioural change (albeit perhaps unintended behavioural change), demonstrating that how taxes raise revenue can (even if inadvertently) also regulate behaviour. For instance, in income tax, Stiglitz identifies three ways in which tax avoidance can manifest (Stiglitz, 1985, pp. 325-326): first, through the postponement in any tax paid; second, the individual may engage in 'tax-induced transactions' to reduce the overall tax liability, and, third, through the shifting of revenue-raising activities, such as from income to capital gains (which are often taxed at a lower rate, such as in the UK, for example).

It can also lead to smaller changes, such as when income tax eats into a taxpayer's consumption decisions. In economics, the negative impacts of tax rates and rate changes on consumption are called 'deadweight losses' (or excess burdens) (Feldstein, 1999), which eat into the revenue raised by a tax (Harberger, 1964), or, while empirical evidence remains limited (Kleven et al., 2020, p. 120), lead to larger behavioural shifts, with individuals or businesses leaving (or at risk of leaving) a tax jurisdiction altogether (see Agrawal & Foremny, 2019; Agrawal, Foremny & Martínez-Toledano, 2023). It also manifests in the shifting of profits to another jurisdiction – one of the rationales behind the OECD Base Erosion and Profit Shifting (BEPS) scheme, which seeks to combat such artificial shifts where this is no economic activity.

Due to these criticisms, as well as others, not all scholars agree that revenue-raising is the only (Riza, 2016, p. 66), or even key function of taxation. Often, as Posner argues, taxation is doing other things (such as transferring money from one group to another), or multiple things at once (Posner, 1971, pp. 28-29). Hickman (2014, p. 1721 (footnote omitted)) highlights:

But the government's reliance on tax collection notwithstanding, it does not necessarily follow that raising revenue is the only, or even the primary, focus of the contemporary US tax system and those charged with administering it.

While revenue-raising is clearly an important function of taxation (in terms of both its objectives and consequences), it is clearly not the only possible function of taxation. Taxes can provide more than just revenue-raising for a state, and it may be the case that revenue-raising could or should be sacrificed for other objectives. It is clearly important to consider the other functions of taxation and how they relate to one another: the three functions are 'not necessarily compatible' (Riza, 2016, p. 66).

2.2 Redistribution of income or wealth

While tax systems have been understood as ‘being geared primarily’ to raise revenue for the state, this is not exclusively the case (Daly, 2023, p. 541). Recent decades have seen a ‘dramatic escalation’ in the use of taxes for non-revenue-raising goals (Hickman, 2014, p. 1728), which would allude to other functions of taxation coming to the foreground.

The second of Avi-Yonah’s goals of taxation is redistribution, which aims to reduce ‘the unequal distribution of income and wealth that results from the normal operation of a market-based economy’ (Avi-Yonah, 2006, p. 3). Historically, the redistributive function of taxation has explained why income taxes replaced tariffs and duties as a primary revenue-raising tool: consumption taxes are traditionally seen as regressive, while income taxes allow the state to tax according to ability to pay (Avi-Yonah, 2006, p. 11). Income tax was therefore seen as ‘the center of the tax universe’ (Bird & Zolt, 2005, p. 1632), and a way to redistribute wealth from the wealthy to those who are less wealthy (Avi-Yonah, 2006, p. 12). There has been critical debate on whether income taxes or consumption taxes are better at redistributing wealth, and whether redistribution is strongly needed (Bankman & Weisbach, 2006).

Redistribution can take multiple forms, including taxing on someone’s ability to pay, or correcting the existing distribution where this is considered to be unjust (Loutzenhiser, 2019, p. 8). In fact, it is impossible to look at redistribution as a single-faceted concept:

In examining the redistributive role of taxes, it is equally difficult (and often not very useful) to disentangle the following issues: the amount of resources available to the government, the tax regime that provides those resources, and the effectiveness with which the government uses the resources (Bird & Zolt, 2005, p. 1635).

A redistribution therefore occurs where there has been a change in tax burden, or where the revenue raised is used for redistributive purposes: redistribution is not simply ‘just the shape of the tax schedule’ (Kaplow, 2007, p. 57).

Taxes that specifically target the wealthy (or those considered more able to pay) to achieve a redistributive aim have been labelled as ‘Robin Hood’ taxes by both scholars and the media.² In a nutshell, these taxes are levied on those with means, so that wealth or income can be redistributed to those with less. Oates has argued that redistributive taxation should be conducted at a national level (as opposed to regional or local level) to negate taxpayer mobility (taxpayers simply moving to a different region or locality to avoid the redistributive tax) (Oates, 1972). However, Bakija and Slemrod have found that while the rich do flee when looking at redistributive state sales and inheritance/estate taxes in the US, the resulting deadweight losses are quite small (Bakija & Slemrod, 2004). Effective redistribution could, therefore, depend on the mobility of taxpayers (Mirrlees, 1982); although Leigh has found little evidence that more local redistributive taxes do result in higher taxpayer migration (Leigh, 2008, p. 101).

² Whether this is a helpful label remains up for discussion. There are many examples in the literature, and it would be impossible to cite them all here. Simply search ‘Robin Hood Tax’ in Google Scholar. For example: Franko, Tolbert and Witko (2013); Cate and Kumar (2016); Ullmann (1973); Sachs (2010).

The redistributive function of taxation reduces inequalities in societies (Christians, 2018, p. 6). Progressivity (where tax increases in line with ability to pay) alone does not provide a complete picture on redistribution; it is instead a complex picture comprising factors such as the levels of taxes, the incidence of taxes and welfare benefits, and how the revenues are used (Kaplow, 2007, p. 60). Indeed, the tax revenues are likely to have a ‘significant distributive impact’ through their spending (Kaplow, 2007, p. 71). In this way, the revenue-raising function of taxation has a significant crossover with tax’s ability to also redistribute. It also means that while a single tax may not be redistributive, the overall tax system can remain redistributive.

2.3 Regulation of behaviour

Taxes can also change behaviour through decisions on what to tax and what not to tax. In this way, taxes can ‘steer private sector activity in the directions desired by governments’ (Avi-Yonah, 2006, p. 3); it can also compensate for negative externalities, where it can be ‘appropriate’ for taxes to correct behaviour (Stewart, 2022, p. 98). These more regulatory taxes are better known as Pigouvian taxes (Pigou, 1924). Applied to environmental (and social) taxation, Pigou’s work equates to a ‘tax (subsidy) per unit on the externality-generating activity equal to its marginal external damage (benefit)’ (Andersen, 1994, p. 36). Baumol argued that Pigou’s work seeks to guard against the under-pricing of goods which do not bear all of their costs (Baumol, 1972). Christians (2018, p. 21 (footnote omitted)) provides the example of a factory that dumps its toxic waste rather than disposing of it properly:

The pollution caused by the toxic waste, both immediately and for an indefinite future, creates costs for all those who are directly or indirectly impacted by the river. By avoiding this cost, the factory can sell its goods more cheaply to customers, leading to an oversupply of goods relative to their actual cost as the demand/supply curve would represent perfect market equilibrium. The theory that costs should be *internalized* tells us that we ought to use taxes (as opposed to something else – such as tort or criminal law) to correct the error.

Pigou’s work therefore arguably laid the groundwork for thinking about how taxation can capture environmental harms (Milne, 2018, p. 2).

Taxes can be ‘regulatory carrots’ (Gamage & Shankse, 2017, p. 362). They can also be regulatory sticks. These concepts derive from the idiom, which makes reference to the cart driver who uses both a carrot (dangling in front of a donkey pulling the cart) and a stick to motivate the donkey. It also forms part of motivation theory, first attributed to Jeremy Bentham, which identifies that some individuals act for reward, whilst others from fear:

Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do, as well as determine what we shall do (Mill & Bentham, 1987, p. 65).

Translating the concepts to the carrot and stick theory, the pain represents the stick, whilst the pleasure, the carrot. Bentham argues that these concepts are the only way in which behaviour can be changed (Mill & Bentham, 1987, p. 83).

Whilst other motivation theories exist, the carrot and stick analogy is helpful in categorising the two functions that taxation can play in regulating behaviour. There is a distinction to be made between incentives that discourage behaviour (negative

incentives or penalties), and incentives that encourage behaviour (positive incentives or rewards) (Service et al., 2014, p. 25).

The additional financial burden created through the imposition of taxation on environmentally or socially unwanted behaviour can provide a regulatory stick for behavioural change (Driesen, 2010, p. 206). In environmental literature, scholars have noted that taxes can be used to penalise polluters (Scott, 2010, p. 111), and that for smaller businesses, these taxes could constitute a significant incentive in themselves (Gunningham, 2002, p. 21). However, Feld and Frey argue that this should be coupled with further incentives in order to uphold what they say is the psychological tax contract (Feld & Frey, 2007).

This tax contract comprises the idea of tax morale, which is a ‘complicated interaction between taxpayers and the government establishing a fair, reciprocal exchange that involves the giving and taking of both parties’ (Feld & Frey, 2007, p. 104). They argue that without further incentives, taxpayers with low morale will not pay their fair share (Feld & Frey, 2007, p. 106). Therefore, incentives are needed to enforce taxation and ensure tax compliance (Feld & Frey, 2007, p. 105).

Tax incentives, or regulatory carrots, are therefore important to consider as part of the regulatory function of taxation. Grabosky argues that positive incentives can provide flexibility and freedom: ‘Positive incentives allow freedom of choice; penalties do not’ (Grabosky, 1995, p. 262). In the tax context, however, incentives for individuals are not perfect. Mumford (2001, p. 416) argues:

One of the more difficult issues involved is that of class, especially when one considers that tax incentives are usually constructed by members of a higher income bracket with the aim of enticing members of lower income brackets into behaviour likely to modify their earning capacity/living conditions.

As with the design of tax policy, the design of tax incentives is riddled with pitfalls. Common tax incentives also receive strong criticism: as above, tax expenditures deprive the state of revenue (although revenues can be controlled with the right mix of carrots and sticks (Gamage & Shankse, 2017, p. 368)) and hypothecated environmental or social taxation is considered unpalatable (Advani, Leicester & Levell, 2011).

It should be noted that there are several possible regulatory approaches to change behaviour: tax is not the only tool (for a succinct review of environmental literature, see Taylor et al., 2012). However, there has been a trend towards using economic instruments for regulation, which are considered ‘less restrictive’ and ‘incentive-based’ (Baldwin, Cave & Lodge, 2010, p. 9).

As such, taxation became an attractive tool for behavioural change and has ‘an increasingly important place at the table’ (Milne, 2018, p. 1). Braithwaite (2007, p. 3) argues:

If regulation entails directives to act in certain ways but not others, backed by enforcement practices, formalized as law and justified in terms of protecting the public interest, taxation should be at the center of the regulatory stage.

Indeed, the OECD also argues that taxes should form ‘a central pillar of green growth policy’ (OECD, 2024); while Milne highlights that the evolution of using environmental

taxation demonstrates their versatility in addressing environmental challenges (Milne, 2018, p. 7).

The design of taxation can have both intended and unintended behavioural change. Where a tax is designed to have an intended behavioural change, it is arguably paternalistic in nature:

Paternalists embrace taxation as a way to redeem harmful choices. They view sin taxes as a win-win proposition. The thinking goes something like this: by using a tax to raise the price of harmful goods, individuals buy less of those goods. Their well-being will thus increase, and society overall will benefit (Thom, 2021, p. 3).

Whilst Thom introduces a somewhat religious angle to their argument, regulatory taxation is a form of state paternalism. It involves the state identifying a behaviour that they deem to be harmful and intervening with taxation policy to steer people and business away from that behaviour (either with negative or positive incentives attached to that tax policy).

Even where there is an intention to change behaviour, an environmental or social tax may not do so if the rate is not set high enough (Milne, 2018, p. 4). Here, Pigou's theory on externalities requires the rate to be set at a price that is equivalent to the cost of the harmful behaviour. In practice, this is difficult to achieve, especially on the first try (Määttä, 2006, p. 46). In the environmental sphere, much work has been undertaken on carbon pricing, where it has been argued that shifts in behaviour will only be seen where the price is 'highly credible' and where those prices are predicted to increase over time (Edenhofer, Franks & Kalkuhl, 2021, p. 1099).

In contrast, if the rate is set too high, then this may encourage tax mobility or tax avoidance. These 'unintended consequences', which can happen 'even frequently' (Stewart, 2022, p. 97), reflect the power of tax to change behaviour even when it is not used as a direct function. The UK government is quite cognisant of the potential impact of these unintended consequences and has adopted an 'IN CASE' framework (a behavioural framework) to anticipate any such consequences (Government Communication Service, 2021). Whilst it is important to recognise this latent function of tax policy design, this article would argue that rigorous tax design, which consults widely with those impacted, could help minimise any unintended consequences.

2.4 Relationships between the three functions of taxation

Even in outlining the functions of tax, it becomes clear that they do not and cannot operate in isolation; individual taxes are also part of the broader tax landscape. The functions that taxation performs for society therefore give rise to a complex web, with functions interacting with one another to enhance or take away.

For instance, greater revenue raising can allow for a greater redistribution of wealth due to redistribution's complex interaction between tax design and how tax revenues are spent. Revenue-raising's 'significant' role in redistribution should not be underestimated (Kaplou, 2007, p. 71): even where a tax becomes more regressive, it can become more redistributive due to its increased size (Torregrosa-Hetland & Sabaté, 2021, p. 313). As such, too much of a focus on progressivity as redistribution (taxing only the wealthy, for example) will potentially impact on the revenues raised if too

narrow a taxpayer or tax base is targeted (for example, only the ultra-wealthy or the ultra-mobile).

Progressivity does remain relevant to regulatory taxation. Where we impose taxation for environmental harms, it may not be the polluter who bears the burden of this taxation. Instead, research has shown that it is often the consumer who pays the price of this taxation (Jacob & Zerwer, 2024); and it is often the consumer who is least able to do so. This reflects a tension between the regulatory and redistributive functions of taxation.

Likewise, regulating behaviour through taxation could affect a tax's ability to raise revenue. Imposing a tax that creates true behavioural change will see a diminishing tax base over time for that particular regulatory tax (fewer emissions as emissions drop, fewer cigarettes sold as smoking declines). Where the tax does not evolve to expand the tax base, or increase the rate, the revenues from these taxes should theoretically decline (or rise more slowly than it would but for the regulatory tax). Likewise, creating tax expenditures (through, for example, subsidies and reliefs) to encourage behavioural shifts in a positive way removes revenue that would otherwise be collected. It also creates a more complex tax system.

Overall, the different functions are all part of the web of taxation; it is likely that focusing on or changing one of these functions will have impacts on the other functions.

3. HOW THE REGULATORY FUNCTION AND OTHER FUNCTIONS OF TAXATION CAN INTERACT: A CASE STUDY OF THE LANDFILL TAX

One of the key interactions in environmental and social taxation is between the revenue-raising and regulatory functions of taxation. It is useful to explore an example of an environmental tax in detail, to highlight the tensions its regulatory function can place on the other functions.

The landfill tax is one of the core environmental taxes in the UK. Introduced in 1996, it is one of the UK's older environmental taxes (*Finance Act 1996* (UK), s. 39), and was introduced to 'encourage the minimisation, re-use and recovery of value from waste where it is economically efficient to do so' (Parliamentary Debates, House of Commons (UK), 1996a (David Heathcoat-Amory, Paymaster General)). It was a tax intended to regulate, and was seen as 'another step towards green taxation' and was 'widely welcomed' (Parliamentary Debates, House of Commons (UK), 1996b (John Gummer, Secretary of State for the Environment)). At the start of its life, however, it was highlighted that the tax was unlikely to discourage landfill due to the lack of cost-effective and sustainable alternatives to landfill (Morris, Phillips & Read, 2000, p. 164). Its low starting rate also 'provided little financial incentive' (Fletcher, Hooper & Dunk, 2018, p. 161), and was evaluated to have had a 'relatively low impact' on the production and disposal of UK waste at the turn of the millennium (Martin & Scott, 2003, p. 686). It has now been almost 28 years since the introduction of the UK landfill tax, and much has changed.

There are landfill taxes in many jurisdictions, including the New Zealand Waste Disposal Levy (*Waste Minimisation Act 2008* (NZ)), some States in Australia (see Parliament of Australia, Senate Standing Committee on Environment and Communications, 2018), the United States (Statista, 2023), 23 out of the 27 members of the EU (European Environment Agency, 2023), and a domestic 'garbage fee' for

rubbish collection in Russia (Semenova, 2021). The broad implementation of some form of landfill tax makes it an apt case study for how regulatory taxes interact with the other tax functions. It is also deemed to be an environmentally effective tax: the OECD acknowledged that ‘countries with high landfill taxes tend to have lower landfill rates’ (OECD, 2019, p.29). This correlates with academic research that estimates that a EUR 1 increase per tonne of landfill tax is associated with a 0.009 million tonne reduction in waste generated (Malek et al., 2023, p. 91).

In the UK, section 40 of the *Finance Act 1996* outlines the charge to landfill tax:

40.— Charge to tax.

- (1) Tax shall be charged on a taxable disposal made in [England or Northern Ireland].
- (2) A taxable disposal takes place where material is disposed of and either –
 - (a) the disposal is made at a landfill site (see subsection (4)), or
 - (b) the disposal requires a permit or licence mentioned in subsection (4) but is not made at a landfill site. ...

The landfill tax therefore targets waste that is disposed of at landfill (or waste that should have been disposed of at landfill). The current rates of landfill tax are GBP 103.70 (standard rate) and GBP 3.30 (lower rate), and the tax is calculated by multiplying the rate by the whole tonnage of waste disposed of at landfill (*Finance Act 1996*, ss 42(1) and (2)). Inert waste, such as rocks and soil, enjoy the lower rate (*The Landfill Tax (Qualifying Material) Order 2011* (UK)).

The landfill tax was devolved to Scotland in 2015 (*Landfill Tax (Scotland) Act 2014* (UK)), and to Wales in 2018 (*Landfill Disposals Tax (Wales) Act 2017* (UK)). It is important to acknowledge this devolving landscape when looking at the revenues raised by all landfill taxes in the UK. Under article 2 of the *Scottish Landfill Tax (Standard Rate and Lower Rate) Order 2024*, the 2024-25 rates of Scottish landfill tax are also GBP 103.70 (standard rate) and GBP 3.30 (lower rate). Likewise, the succinctly named *Landfill Disposals Tax (Tax Rates) (Amendment) and Tax Collection and Management (Wales) Act 2016 (Miscellaneous Amendments) (Wales) Regulations 2024* also prescribes rates of GBP 103.70 and GBP 3.30 for the Welsh landfill disposals tax. There is therefore a uniformity in rates across the UK, even if the taxes are devolved.

3.1 Regulation over revenues

A tax designed to shift behaviour (one that prioritised regulation) should see either a diminishing tax base or a slower tax base growth over time. As behaviour moves away from the now more costly behaviour, such as emissions, or waste disposal, the regulatory tax reduces or limits the growth of the harmful behaviour that the tax is applied to. The landfill taxes in the UK all multiply the applicable rate to each tonne of waste: less waste at landfill means that the rate is applied to fewer tonnes.

An environmental tax that is effective but does not change could therefore see its revenues drop over time. An environmental tax could be reformed to avoid this: by broadening the tax base or increasing the rates significantly (above inflation). This is likely to happen at the start of an environmental tax’s life, due to the difficulties in reaching a true Pigouvian tax on the first attempt (Määttä, 2006, p. 46). An illustration

of this can be seen in the historic rate of the landfill tax, which was GBP 7 per tonne at the standard rate at the start of its life in 1996 (IFS, 2023). Yet, the equivalent of the current rate in 1996 (factoring in inflation) is GBP 53.62,³ showing that the rates of landfill tax in the UK have grown significantly over time. If tax rate increases were to outstrip any reductions in the tax base, then a regulatory tax would continue to raise increasing levels of revenue.

A tax could also be altered so that its tax base broadens; bringing in new environmental and/or social harms can counter the impact of any behavioural changes on revenues. The New Zealand waste disposal levy, for example, is expanding to cover additional landfill types that will greatly increase its tax base.⁴ Combined with increases in its tax rates, the New Zealand waste disposal levy is predicted to rise ‘significantly’ from its NZD 36 million in revenues in 2022 (Ministry for the Environment, 2024b). Interestingly, New Zealand established that the tax in its form in 2022, which charges NZ\$10 per tonne, was insufficient to change behaviour (Ministry for the Environment, 2020); this expansion and increase therefore reflects an increasing emphasis on the waste tax’s ability to regulate behaviour.

The UK landfill tax (now comprising England and Northern Ireland) raised GBP 626 million in the 2022-23 financial year (HM Revenue and Customs (HMRC), 2023a). The total tax receipts in the UK were GBP 789 billion in 2022-23 (HMRC, 2024), which means that the landfill tax represented 0.08% of the UK’s total tax receipts. It is therefore quite a small tax, but not too different in terms of revenue-raising to the other environmental taxes in the UK.

HMRC lists the receipts of the UK landfill tax as set out in Table 1 (HMRC, 2023a):

Table 1: Receipts from UK Landfill Tax

Financial Year	GBP million	Notes
2013 to 2014	1,189	
2014 to 2015	1,144	
2015 to 2016	919	The landfill tax was devolved to Scotland (Scottish landfill tax).
2016 to 2017	874	
2017 to 2018	757	
2018 to 2019	683	The landfill tax was devolved to Wales (landfill disposals tax).
2019 to 2020	641	

³ Calculated in accordance with Bank of England, ‘Inflation calculator’, available at: <https://www.bankofengland.co.uk/monetary-policy/inflation/inflation-calculator>. (accessed 28 May 2024).

⁴ See Ministry for the Environment (NZ), ‘Waste disposal levy expansion’ (last updated 20 June 2022), available at: <https://environment.govt.nz/what-government-is-doing/areas-of-work/waste/waste-disposal-levy/expansion/> (accessed 28 May 2024).

2020 to 2021	566	COVID-19 pandemic.
2021 to 2022	667	
2022 to 2023	626	

The devolution of the UK landfill tax complicates the picture. Clearly, there are significant drops in the receipts to HMRC once Scotland and Wales both take over the administration of this tax via Revenue Scotland and the Welsh Revenue Authority respectively. Yet even before the tax was devolved at all, there were some small reductions in revenues between 2013 and 2015; there has also been a drop in revenues from 2018 to 2023. This decline could be attributable to increased tax avoidance (or, fly-tipping), which was a concern from increasing the landfill tax rates (National Audit Office (UK), 2022). However, HMRC estimates that the landfill tax gap (the difference between what was collected, and what should have been collected) peaked in 2018-19, and that it has been in decline since (HMRC, 2023b).

It could also be attributed to shifts to other environmentally harmful behaviour such as incineration, a risk associated with the landfill taxes (Powell & Craighill, 2014, ch. 15). Recent UK data on overall waste treatment appears to be a little dated, but between 2016 and 2018 there was an increase of 28.3% in incineration without energy recovery, and a 15.5% increase in incineration with energy recovery (Department for Environment, Food and Rural Affairs (UK) (DEFRA), 2023). However, this article argues that *where* the behaviour shifts to (whether that is to avoidance, to other environmentally harmful activities that are not taxed, or to greener alternatives) is almost irrelevant. The important point from the perspective of *regulatory taxation* (as opposed to the point from the perspective of environmental protection) is that the tax base could be shrinking, and the revenues could be dropping.

Scottish receipts are also dropping. In its commentary on the Scottish landfill tax receipts, Revenue Scotland (2024) stated:

Total SLfT [Scottish landfill tax] declared due in Q3 of 2023/24 was the lowest of any quarter, and even lower than Q1 of 2020/21, which was affected by COVID-19 restrictions. Tonnes of standard taxable waste reported were the lowest for any quarter, and 26% lower than the previous low in last quarter. Total tonnes of lower rate waste were the lowest since Q4 2021/22, and 18% lower than last quarter.

This maps on to a general reduction that has been seen in the amount of waste disposed of at landfill in Scotland. In 2015, 3,384,725 tonnes of waste were landfilled (Scottish Environment Protection Agency (SEPA), 2024). This dropped to 2,344,931 tonnes in 2022. With less waste being landfilled, the landfill taxes have a smaller tax base, and revenues decline.

This is further corroborated by the UK Office for Budget Responsibility (2024a), who forecast that the UK landfill taxes' revenues will fall over time:

The subsequent downward trend in landfill tax in both cash terms and as a share of [gross domestic product] reflects the continued downward trend in the tax

base outstripping the effect of more limited inflation-linked rises in the duty rate.

The landfill taxes are therefore taxes with a declining revenue, and this would indicate that the regulatory function has taken priority over the revenue-raising one: the landfill tax has contributed to a successful shift in behaviour.

The landfill taxes in the UK are not the only environmental taxes with declining revenues. In its first year of operation, the UK plastic packaging tax has already seen a drop in revenues between the first quarter and final quarter of 2022-23 (HMRC, 2023c). Whilst it is very early days for this environmental tax, it is another example of a regulatory tax potentially achieving its function of changing behaviour. It should be noted that not all environmental and social taxes drop in revenues, as a regulatory tax may not be effective, or simply aim to slow the growth of a particular behaviour. The UK climate change levy and carbon price floor have had relatively stable revenues over the past decade; whilst they have been successful at phasing out the burning of solid fuels (in lieu of electricity and gas), revenues have remained consistent (HMRC, 2023a). This levy is also the biggest revenue-raiser of all the UK environmental taxes.

However, overall environmental tax revenues appear to be in decline. In the UK:

Environmental taxes provided 5.3% of all UK tax and social contribution revenue in 2022, down from 5.6% in 2021 and the lowest share since 1997 (Office for National Statistics, 2023).

The starting point for the analysis in this article, therefore, is that regulatory taxes are experiencing gradually decreasing revenues, neglecting the revenue-raising function of taxation in favour of regulation.

3.2 Regulation over redistribution

Due to the importance of tax revenues for redistribution, the potentially declining revenue stream of a regulatory tax provides less opportunity to reduce ‘the unequal distribution of income and wealth’ (Avi-Yonah, 2006, p. 3). This notion of taking from those who can afford it (taxing) and giving to those with less means (redistributing) only works where there are revenues to redistribute. Clearly the taxes explored above still have revenues, but a focus on regulation at the expense of revenues may lead to a diminished redistributive function.

This is particularly the case where the justification for the environmental tax is coupled with a commitment to reduce income or other taxes. The UK landfill tax was proposed as a way to reduce national insurance contributions:

Since the revenue will allow the main rate of employer’s national insurance contributions to be reduced, the tax will provide for a further boost to employment (Parliamentary Debates, House of Commons, 1996a (David Heathcoat-Amory)).

This double dividend effect of regulatory taxation (that other taxes can be reduced because of the new revenues from regulatory taxes) is problematic. Whilst the double dividend effect of regulatory taxation may look like ‘a free lunch’ (Speck et al., 2011, p. 112), it is not guaranteed (Oates, 1995, p. 916).

Environmental taxes have also been argued to be regressive in nature, which means that the tax burden disproportionately falls on those with lower incomes, or less means to pay the tax. Where there are indirect taxes, such as regulatory taxes, that target businesses or business activity in particular, a distinction needs to be made between the legal incidence (who is actually required to pay the tax) and economic incidence (who bears the burden of the tax) (Kosenen, 2012, p. 162). This means that while a regulatory tax may not specifically target individuals, the costs of the tax can trickle down to the individual.

Whilst there has been little research on the regressivity of waste taxes in particular, an Italian waste tax imposed on individuals was shown to be regressive and impose a higher financial burden on low-income households (Agovino, Marchesano & Musella, 2021, p. 9). Taxes on domestic heating and electricity have been found to be regressive ‘in practically all studies’ (Kosenen, 2012, p. 165). Other taxes, such as transport fuel taxes, have a higher impact on middle-income households (Johnstone & Alavalapati, 1998, p. 10). Social taxes that add a cost to food also impact the poorest the most, with lower-income families spending a greater percentage of their household budget on food (Cornelsen et al., 2015, p. 19; Johnstone & Alavalapati, 1998, p. 12). An increase in a regulatory tax that targets pollution may ‘deteriorate the welfare of all and may be regressive’ (Chiroleu-Assouline & Fodha, 2014, p. 140); a Danish CO₂ tax was also determined to be regressive (Wier et al., 2005, p. 249), as was a carbon tax in Brazil (Moz-Christofolletti & Pereda, 2021, p. 10).

That regulatory taxes can be regressive is not a particularly controversial statement; research has shown that environmental taxes operated on their own (without other policy measures to support them) have an 84% chance of being regressive (and a very significantly lower chance of being progressive) (Alvarez, 2019, p. 391). The regressivity of a regulatory tax does not mean that a tax system is regressive overall, but an increasing reliance on tax as regulatory tool brings greater regressive elements to a tax system.

Regulatory taxes can be made less regressive:

[W]hatever the degree of regressivity of the environmental tax alone, it is possible to re-design a recycling mechanism that renders the tax reform Pareto-improving, by modifying the progressivity characteristics of the tax system, instead of lump-sum transfers or any other form of homogeneous compensation (Chiroleu-Assouline & Fodha, 2014, p. 128 (footnote omitted)).

But regulatory taxes on their own are not a mechanism for redistribution, and such broader incentives are likely to have a financial cost: eating into the revenues of that particular tax (which will also impact on the redistributive ability of a given tax). Whilst regulatory carrots alongside taxes can be self-financing (Gamage & Shankse, 2017, p. 367), it is likely that the use of incentives will limit the overall revenue-raising ability of a tax. Overcoming the undesirable distributional effects of regulatory taxes will therefore come at a further cost of the revenue-raising function.

The UK landfill taxes are imposed on businesses and landfill operators, so it does not apply to households (*Finance Act 1996*, ss 40(2) and (4)). This means that the landfill taxes will add a cost to the disposal of commercial and construction waste, rendering the business activities of those involved more expensive. Whilst individuals will not pay the tax personally, it will have an impact on the prices they pay for certain goods and

services. There are some exemptions and reliefs from the tax (such as pet cemeteries (*Finance Act 1996*, s. 45)), but very limited positive incentives for waste disposal otherwise. This, combined with the declining revenues of the landfill taxes, show that redistribution is not a core function of the landfill taxes.

Overall, Johnstone and Alavalapati (1998, p. 1) argue:

While environmental measures should not be the instrument through which distributional objectives are realised, their growing importance means that distributional implications can no longer be ignored...

Since this argument was put forward in 1998, the number of environmental taxes in the UK and around the world has only increased. How the regulatory function of these taxes interacts with both their revenue-raising and distributional functions is therefore important. Once again, a focus on regulation can come at the expense of redistribution in the tax system.

4. REVERSING THE GAZE: HOW REGULATORY TAXES AFFECT TAXATION

Whilst there has been much research on how taxes can help achieve environmental or social goals – such as their advantages *vis-à-vis* other regulatory measures, as well as their effectiveness at creating behavioural change (see section 2) – there has been no such consideration of how regulatory taxes impact the goals of taxation at a macro level.

It is clear that a focus on the regulatory function of taxation, such as through environmental or social taxation, pushes the other functions to the background. Much in the same way as the state-building function decreases in importance once a state is fully established (de Cogan, 2020, p. 10), it may be that having one function of taxation at the fore is a positive (or at least not a negative) for taxation. This article would like to highlight two ways in which these functional interactions may be problematic.

First, the prioritisation of regulation over revenues will push taxpayers away from paying tax. There is a current, global focus on combating tax avoidance, as is seen in the OECD BEPS project. It can also be seen in broader discussions of tax and CSR, and ESG measures. The use of regulatory taxation encourages behavioural change by using a financial stick or carrot to move the individual or business away from the tax base. There is an argument that such an approach facilitates permissive tax avoidance. Second, the prioritisation of regulation over redistribution is an additional mechanism through which inequalities are perpetuated. These inequalities ensure that tax systems hit those with the least, hardest.

It is not as straightforward as this. The discussion above highlights how the functions are delicately connected to one another, and that designing a tax with one function in mind will impact the others, which in turn may have secondary impacts. This article seeks to start the discussions on how regulatory taxes can impact taxation.

4.1 A tax system that encourages permissive tax avoidance

Whilst some regulatory taxes have stable revenues that do not decline over time, some do not. The overall decline in environmental tax revenue has been explored above, but this also applies to social taxation as well (although not universally, alcohol duties in the UK continue to do very well, for example (Office for Budget Responsibility, 2024b)); in the case of tobacco duties for example:

Tobacco duties fell in cash terms from 2011-12 to 2016-17, despite real-terms increases in the duty rate. This reflected falling cigarette consumption driven by above-inflation duty rises, changing attitudes to smoking, policies (such as the display ban) and the growing popularity of e-cigarettes (Office for Budget Responsibility, 2024c).

As regulatory taxation shifts behaviour away from the tax base, it is encouraging people to not pay the tax if they change their behaviour. Taxpayers are therefore changing their behaviour, at least in part, *because* of the regulatory tax.

This is not surprising. Existing research has shown that regulatory taxes are effective, and that regulatory taxes have significant signalling effects to taxpayers. Ghalwash shows that individual consumers are sensitive to changes in taxes that raise the price of heating (but less so for transport) (Ghalwash, 2007, p. 35). This impact is stronger where the tax is clearly framed to the consumer (Cornelsen et al., 2020). Downstream taxes (imposed directly on households or industry) are more visible and have a greater effect (Moz-Christofolletti & Pereda, 2021, p. 4).

Yet, there has been no empirical research that explores whether this powerful push to ‘not pay the regulatory tax’ to achieve environmental or social goals impacts broader views and attitudes towards taxation. This article argues that consistently introducing an increasing number of regulatory tax measures may engender a tax culture of not needing to pay taxes due to the constant pushes to change behaviour to pay less. This article argues that this may create, or worsen, an environment of permissive tax avoidance. There is a conflict between shifting behaviour to minimise a regulatory tax liability, and the societal drive to ensure individuals and companies are paying their taxes.

‘Permissive tax avoidance’ is a strong and loaded label. The scholarly and legal interest in tax avoidance tends to be when that avoidance crosses a line. In this way, tax avoidance tends to be defined as aggressive, abusive, and/or artificial avoidance that subverts the intention of tax legislation (see, for example, Seely, 2021, p. 11; Prebble & Prebble, 2010, p. 696), but ‘avoidance’ is a term that lacks consensus. Tax avoidance is distinguished from tax evasion by its legality (Slemrod & Yitzhaki, 2002, p. 1428), so at its core, tax avoidance is a legal activity. Tax planning, a related term (and arguably a ‘subset’ of avoidance (Loutzenhiser, 2019, p. 100)), is also concerned with the legal reduction of tax liability and tends to be associated with the availability of reliefs and exemptions in tax legislation (Seely, 2021, p. 11). The word ‘planning’ paints a picture of the taxpayer taking an active (if not necessarily abusive) role in reducing their tax liability.

Yet, with a regulatory tax designed to change behaviour, it is the state taking the active role, not the taxpayer. There is a clear financial signalling and political will to shift behaviour in a way that perhaps goes beyond designing a relief and allowing taxpayers to avail themselves of it. In this case, the lure to avoid the tax is a stick, rather than a carrot. Whether permissive tax avoidance would also capture unintended consequences of taxes is less clear: but there is an argument that those unintended consequences may be less ‘permissive’ than their intended counterparts.

This article interprets the ‘tax avoidance’ in ‘permissive tax avoidance’ in its most innocent light:

[I]f two people marry in order to reduce their tax burden they are practising tax avoidance; if they tell the Revenue that they are married when they are not, they are guilty of tax evasion (Loutzenhiser, 2019, p. 99).

Clearly, shifting behaviour due to an intentional regulatory tax is not abusive avoidance as this is the policy objective of regulatory taxation – but it nonetheless reduces tax liability in a legal way. As a regulatory tax specifically encourages taxpayers to lower their tax liability, it is explicitly permissive in a way that an unintended consequence (such as an individual choosing to work less due to a change in the income tax brackets) is not.

This ‘permissive tax avoidance’ sits in direct conflict with the global push for tax transparency and tax payment that can be seen in international tax policy and scholarship on corporate tax avoidance. The OECD BEPS project now comprises multiple action points and pillars, but all seek to address aggressive tax planning at the international scale. This particularly relates to ‘tax planning strategies that multinationals use to exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations ... where they have little or no economic activity’.⁵ In a nutshell, BEPS is therefore concerned with multinational companies paying the right amount of tax in the right jurisdiction.

Corporate social responsibility (CSR) comprises economic, legal, and ethical responsibilities that organisations should adhere to (Carroll, 1991). There is a plethora of academic literature on the relationship between tax avoidance (the legal reduction in tax liability) and CSR. Sikka, for example, argues that the payment of taxes ‘provide[s] a litmus test for corporate claims of social responsibility as it involves transfers of wealth and contrived avoidance cannot easily be reconciled with claims of ethical business conduct’ (Sikka, 2010, p. 154).

Whilst not everyone has agreed with all of Sikka’s conclusions (Hasseldine & Morris, 2013), Sikka’s work has, as of mid-2024, been cited 587 times on Google Scholar. For example, there have been studies showing whether the use of tax services impacts the amount of tax paid (Huseynov & Klamm, 2012), whether firms with excessively irresponsible CSR activities have a higher likelihood of avoiding tax (Hoi, Wu & Zhang, 2013), and whether there is a link between CSR and tax aggressiveness (Lanis & Richardson, 2012). These studies have themselves been cited hundreds of times.

More recently, Kovermann and Velte, in a review of the CSR and tax avoidance literature, show that there are multiple perspectives regarding the relationship between CSR and tax avoidance (Kovermann & Velte, 2019, p. 22). There is also a divergence in the scholarship between those who think there is a positive relationship between CSR and tax avoidance, and those who think there is negative relationship (Kovermann & Velte, 2019, p. 22). Indeed, there is such a wide range of findings that the ‘empirical research is of not much help, yet’ (Kovermann & Velte, 2019, p. 35). But it remains the case that there is a rich field of scholarship that is dedicated to determining whether or not organisations should or will engage in tax avoidance as part of their CSR commitments. There is a clear tranche who argue that organisations probably should pay tax and not engage in tax avoidance.

⁵ OECD, ‘Base erosion and profit shifting (BEPS)’, available at: <https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html> (accessed 31 October 2024). See also Brauner (2014).

Similarly, ESG provides a framework for measuring the impact that an organisation has and their future financial performance, and it has become a ‘hot topic of discussion worldwide’ (Li et al., 2023, p. 1). Friede, Busch and Bassen have found that ESG factors do have a positive impact on corporate financial performance, meaning that there is a business case for ESG investing (Friede, Busch & Bassen, 2015, p. 226). Positive engagement with ESG has been suggested to send positive signals to stakeholders that a company is trustworthy (Zhu et al., 2023, p. 54902). It has become a framework that has been adopted globally as a useful measurement of corporate performance.

There has been some very recent economic analysis on the impact of environmental taxes on ESG in Asia. Green taxation can improve a company’s performance under ESG, through the cost of the tax pushing them to invest in a more environmentally friendly way (Wang & Ye, 2024, p. 14); this can be a ‘significant positive impact’, particularly in relation to the ‘E’ of ESG (He et al., 2023, p. 7). However, this impact can be limited where the tax rate is too low, in a similar way to how the impact of the tax itself is limited where the rate is too low (Zhang et al., 2023, p. 60208).

Shifting behaviour *because* of the environmental tax can therefore improve ESG measurement outcomes, meaning that the regulatory function of taxation is favourable for ESG. Once again, however, the focus is on what environmental taxation can do for the environment, not what environmental taxation does for tax. In a similar way to the CSR literature, ESG literature has also considered whether tax avoidance should form part of the ESG framework. Chaim and Parchomovsky (2024, p. 826) argue:

Corporate tax avoidance – the pursuit of transactions and structures to reduce tax liability in a manner that is contrary to the spirit of the law – undermines a variety of social and sustainability goals espoused by the ESG movement.

Practitioners would appear to agree that the payment of tax forms part of the ‘S’ component of ESG: PwC explain that ‘[b]uilding trust in tax reporting, therefore, has the potential to translate to building trust in other areas’ (Morris & Visser, 2022). Likewise, KPMG, Ernst and Young, and Deloitte all have sections on their websites dedicated to tax and ESG (Evans-Greenwood et al., 2023; KPMG International, 2021; Chai & Toh, 2022). Overall, the payment of tax is considered to be an important part of a company’s conduct.

Many of these scholarly and political discussions focus on tax being paid. Yet, at the same time, there is a proliferation of regulatory taxes that, by their very nature, discourage their payment. This is a concerning conflict that warrants further research: there is permissive tax avoidance in an anti-avoidance era.

4.2 A tax system that perpetuates inequalities

Taxation is a powerful tool to help finance achievements of the SDGs, and it can also spur inclusive and sustainable development in other ways. Fiscal policies can simultaneously mobilize resources, reduce inequalities, and promote sustainable consumption and production patterns.⁶

⁶ United Nations, ‘Taxation and the SDGs’, available at: <https://financing.desa.un.org/what-we-do/ECOSOC/tax-committee/thematic-areas/taxation-and-sdgs> (accessed 30 May 2024).

While well-designed taxes can be used for social good, this article argues that taxes can also be a tool to limit the distribution of resources, as well as compound inequalities through regressivity. This is the case whether these impacts are intended or otherwise.

In encouraging permissive tax avoidance, regulatory taxes may crowd out ethics as the tax system becomes a mechanism to individually benefit (through changing behaviour to reduce tax liabilities). If the system is internalised as a game, then more tax may be avoided:

[T]he failure of taxpayers – individuals and companies – to pay their fair share of taxes exacerbates income and wealth disparities (Chaim & Parchomovsky, 2024, p. 827 (footnote omitted)).

Whilst this is in relation to corporate tax avoidance, it is easy to see how the reductions in revenues will worsen inequality, as the tax system becomes a less powerful tool for redistribution. This avoidance disproportionately impacts low-income individuals (Giuliano, 2005; Chaim & Parchomovsky, 2024, p. 827).

The general regressivity of regulatory taxes is also a problem. As they become a tool of choice for policy-makers to achieve environmental and social goals (because they do tick multiple boxes and allow some revenue to be raised, unlike command-and-control regulation), more of the taxes in a tax system will be regressive. Regardless of their declining revenues over time, these taxes will have a greater burden for those on a low income.

This goes against the work to reduce inequalities at a global level. The Sustainable Development Goals include a goal to reduce inequality: ‘In order for nations to flourish, equality and prosperity must be available to everyone’; this goal specifically requires states to ‘adopt fiscal and social policies that promote equality’.⁷ Regulatory taxation, more often than not, takes us away from that goal, placing the highest burden of environmental and social protection onto those with the least.

5. CONCLUDING REMARKS

The functions of taxation are not quite so clear cut as a bullet point list of the three, core functions of revenue-raising, redistribution, and regulation (Avi-Yonah, 2006, p. 3). Whilst it is not new that taxes may achieve more than one function at a time, how these functions interact with one another has received scant attention. The reality is that the functions likely muscle one another out of the way when they are brought to the fore.

This article has focused on regulatory taxes, or taxes that are designed to create behavioural change. These taxes, unsurprisingly, prioritise regulation over revenues and redistribution. It makes them effective tools of environmental and social protection. Companies engaging well with environmental taxation can perform better under ESG frameworks (Wang & Ye, 2024, p. 14; He et al., 2023, p. 7).

However, from the perspective of taxation, this article has raised two potential conflicts that this generates. First, in encouraging taxpayer to change behaviour and *not pay tax*, regulatory taxes could be a tool of ‘permissive tax avoidance’. The use of the words ‘tax

⁷ The Global Goals, ‘10: Reduced inequalities’, available at: <https://www.globalgoals.org/goals/10-reduced-inequalities/> (accessed 31 May 2024).

avoidance' here does not allude to abusive or aggressive tax avoidance actions taken by a taxpayer to subvert the intention of tax legislation; rather, that a regulatory tax is designed to push taxpayers to legally reduce their tax liability by changing what they are doing. In this way, regulatory taxes communicate the message that it is acceptable to not pay tax.

Second, by using what are almost always regressive taxes, regulatory taxes perpetuate inequalities. Clearly, one regressive tax does not mean that the overall tax and transfer system is regressive, and the use of regulatory taxes can be offset by a progressive tax system. However, there remain two important points when considering that there is now a consistent reliance on regulatory taxes to solve societal problems: 1) that increasing elements of regressivity will have an influence on an overall tax system, and 2) using tax to regulate (when such taxes are almost always regressive) sends a message that it is those with the least who must pay for environmental and social protection. This is because the other, more progressive taxes that may overcome the regressivity of a regulatory tax (such as income tax), do not correlate with the harms that the regulatory taxes aim to address.

By consistently relying on regulatory taxes to regulate, for example, the environment, societies are placing the highest cost on those who can afford it the least. These two conflicts warrant further research to explore whether permissive tax avoidance can be internalised to (or contribute towards) anti-tax sentiment, and whether the regressivity of regulatory taxes skews the cost of regulation to low-income groups.

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