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Options for increasing taxes

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Background

- The three main parties have committed to (varying degrees of) further fiscal consolidation over the next Parliament
- To date, none has proposed significant net tax increases
- Would not be surprising were the next government to raise taxes

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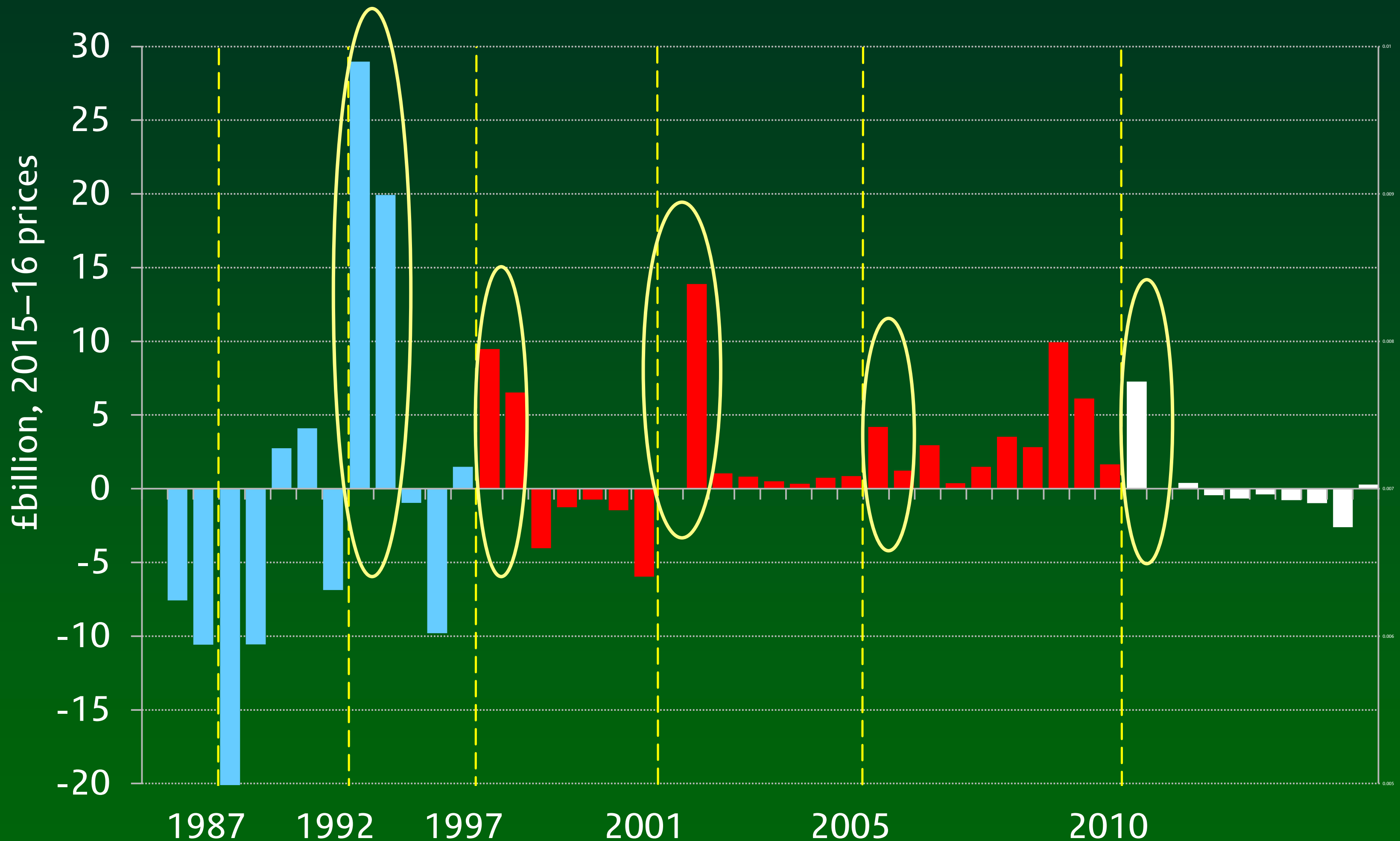
Taxes increases tend to follow elections



Source: Green Budget, Figure 10.1

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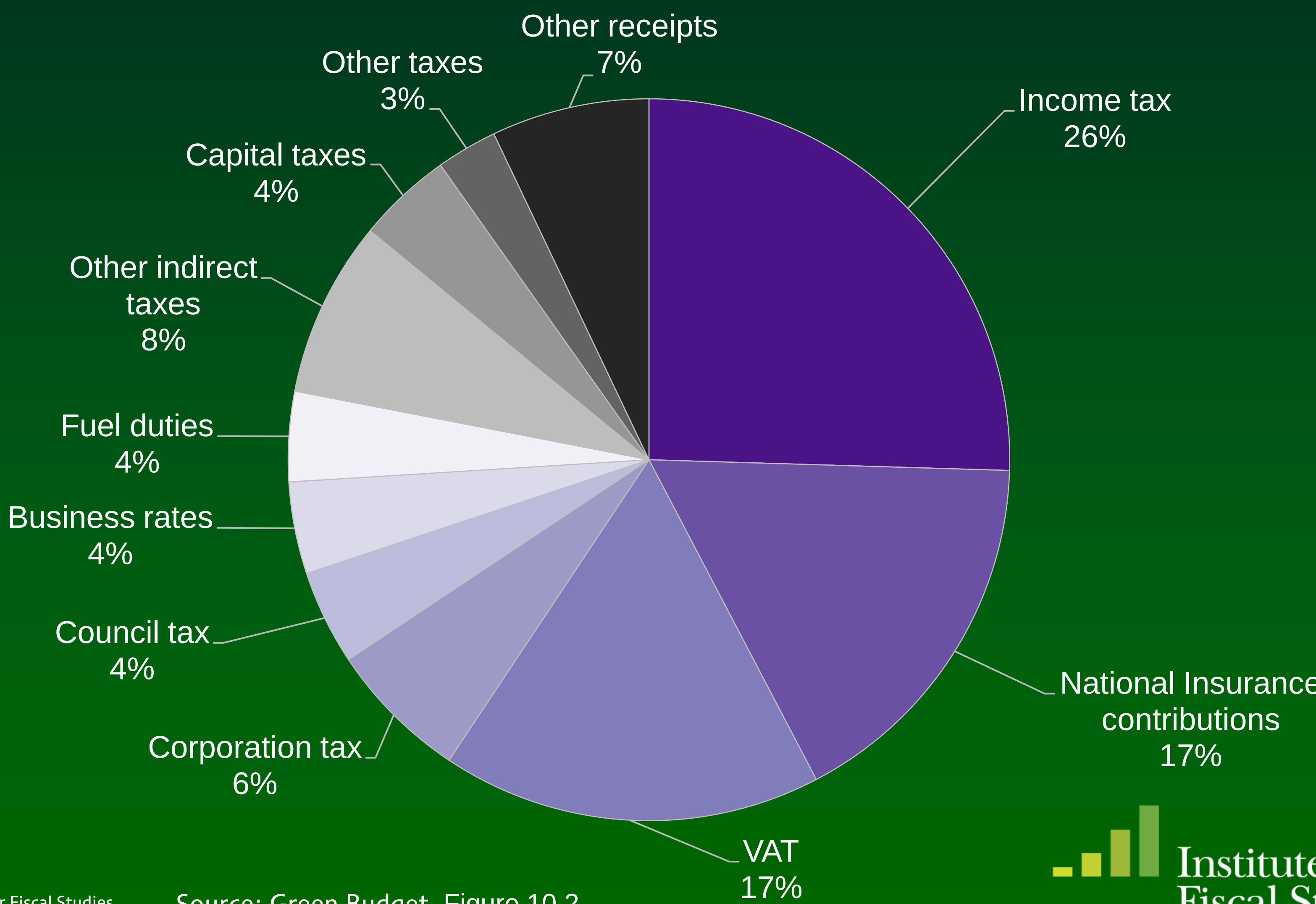
Outline

- What options might a future tax-raising government consider?
  - Increasing broad-based taxes
  - Increasing taxes on the rich
  - Scaling back tax reliefs and exemptions

- Do not take a stance on which – if any – tax rises are appropriate

- But some options should definitely be avoided

Composition of government revenue, 2015-16



Source: Green Budget, Figure 10.2

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Broad-based tax increases

- Small increases in rates of three big taxes could raise substantial sums
  - 1 ppt rise in all rates of income tax would raise £5.5bn
  - 1 ppt rise in all employee and self-employed NICs rates would raise £4.9bn
  - 1 ppt rise in the main rate of VAT would raise £5.2bn

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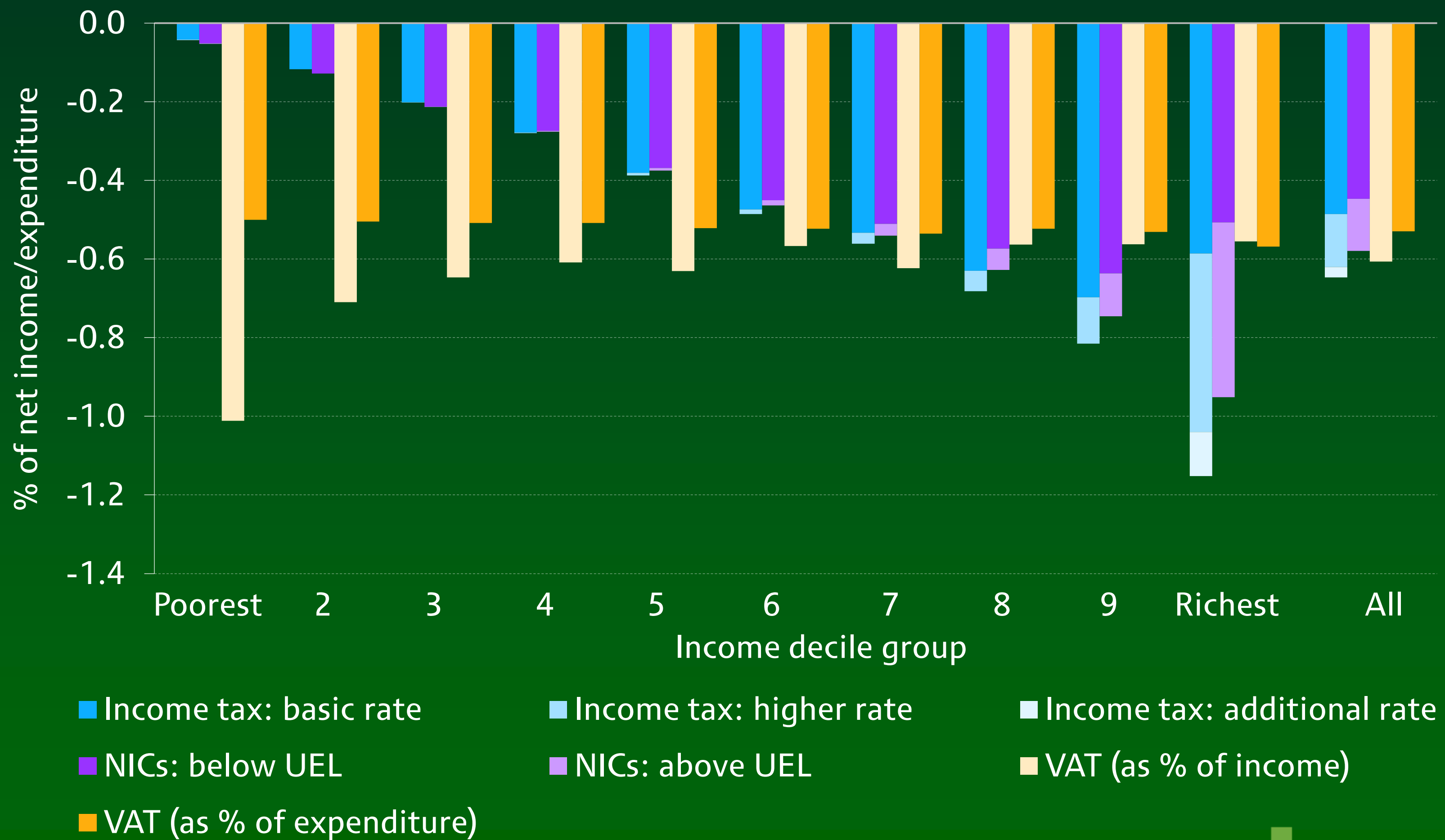
Distributional impact of broad-based tax increases



Source: Green Budget, Figure 10.5

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Broad-based tax increases

- Small increases in rates of three big taxes could raise substantial sums
  - 1 ppt rise in all rates of income tax would raise £5.5bn
  - 1 ppt rise in all employee and self-employed NICs rates would raise £4.9bn
  - 1 ppt rise in the main rate of VAT would raise £5.2bn
- All these reforms would weaken work incentives and exacerbate other existing tax-induced economic distortions:
  - Increase disincentive to save in taxed forms (income tax)
  - Increase incentive to shift form in which income is taken (NICs)
  - Increase distortion towards buying zero- and reduced-rated goods (VAT)
- Could also raise £3.7bn (£9.9bn) by freezing all income tax and NICs thresholds for first two (five) years of the next Parliament

Other broad-based tax increases

- Increasing corporation tax by 1ppt would raise £1.5 billion
  - International mobility of tax base contributes to smaller yield
  - Would discourage investment and increase bias towards debt finance

- Increasing council tax, business rates or fuel duties by 10% would raise around £2.5 billion
  - Pros and cons to each of these

- But recent trend has been to cut rates of these taxes

Increasing taxes on the well-off

- Small group of well-off taxpayers already pay a large share of taxes …
  - e.g. 25% of income tax revenues come from 0.5% of adults
  - Reflects unequal distribution of resources & progressivity of tax system
- … and have seen largest tax rises over consolidation to date
  - 6.2% of net income for the highest-income 10^{th}
- Next government could decide to further increase this contribution
- Increase rates of income tax, NICs or CGT for high income individuals
  - Or change thresholds
  - Affects small and relatively responsive groups

Increasing taxes on the well-off

- Could raise more from inheritance tax
  - Reducing threshold by £5,000 or increasing rate by 1 ppt would each raise £100 million
  - … but why not tax gifts made throughout life like bequests at death?

- Further reduce annual or lifetime limits on pension contributions
  - Most recent reductions forecast to raise £1.1bn by 2017-18
  - … but reducing subsidies to pension saving preferable

- Proposals to introduce a 'mansion tax'
  - Council tax lower as proportion of value for more valuable
  - Strong case for taxing high-value properties more heavily
  - … but new mansion tax is unnecessarily complicated

Scaling back tax reliefs

- Remove zero and reduced rates of VAT (up to £39bn)
- Scale back subsidies to pension saving
  - NICs-exempt employer contributions (£17.3bn) and tax-free lump sum (£?)
- Eliminate CGT reliefs
  - Entrepreneurs' relief (£3.3bn), forgiveness at death (£?)
- Widen the inheritance tax net
  - Abolish business assets (£590m) and agricultural land (£440m) exemptions; extend 7-year rule (£?)
- Scale back business rate reliefs
  - for low-value (£620m), empty (£990m) and agricultural (£?) properties
- Apply NICs regime for employees to self-employed (£2.7bn)
- Abolish the single occupant's council tax discount (£1.4bn)
- Abolish the transferable allowance for married couples (£520m)

Temptations to resist

- Increasing stamp duty land tax (SDLT)
  - Repeatedly used as revenue raiser by current and previous governments
  - Extremely distortionary: transactions should not be taxed at all
- Restrict pensions tax relief to basic rate
  - Pension contributions tax exempt as pension income taxed on receipt
  - Why is higher-rate relief on contributions wrong but higher-rate tax on pension income OK?
  - Far better to reduce generosity of genuine subsidies to pension saving

Conclusions

- Would not be surprising to see tax rises after the general election
- We have discussed a number of options
  - Broad based tax increases
  - Tax increases focused on the better-off
  - Removing or reducing reliefs and exemptions
- Certain tax rises should definitely be avoided
- Design of any tax increase matters hugely

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