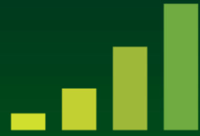

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Tax measures

Stuart Adam

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

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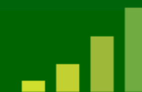
Personal allowance and higher rate threshold

- Income tax personal allowance to continue to increase faster than inflation, to £11,000 in 2016–17 and £11,200 in 2017–18
  - Had previously said would increase to £10,800 in 2016–17 and £11,000 in 2017–18
  - Costs £1.2bn in 2017–18
  - Basic rate taxpayers £40 a year better off
- Higher rate threshold will increase to £43,000 in 2016–17
  - Costs £0.2bn in 2017–18
  - Higher rate taxpayers with incomes less than £122,000 gain £70 a year from combination of two policies
- Total cost of changes to personal allowance and higher rate threshold between 2010–11 and 2017–18 will be about £11bn
  - Basic rate taxpayers will be £639 a year better off in 2017–18 as a result of these changes
  - Higher rate taxpayers will be £442 a year worse off



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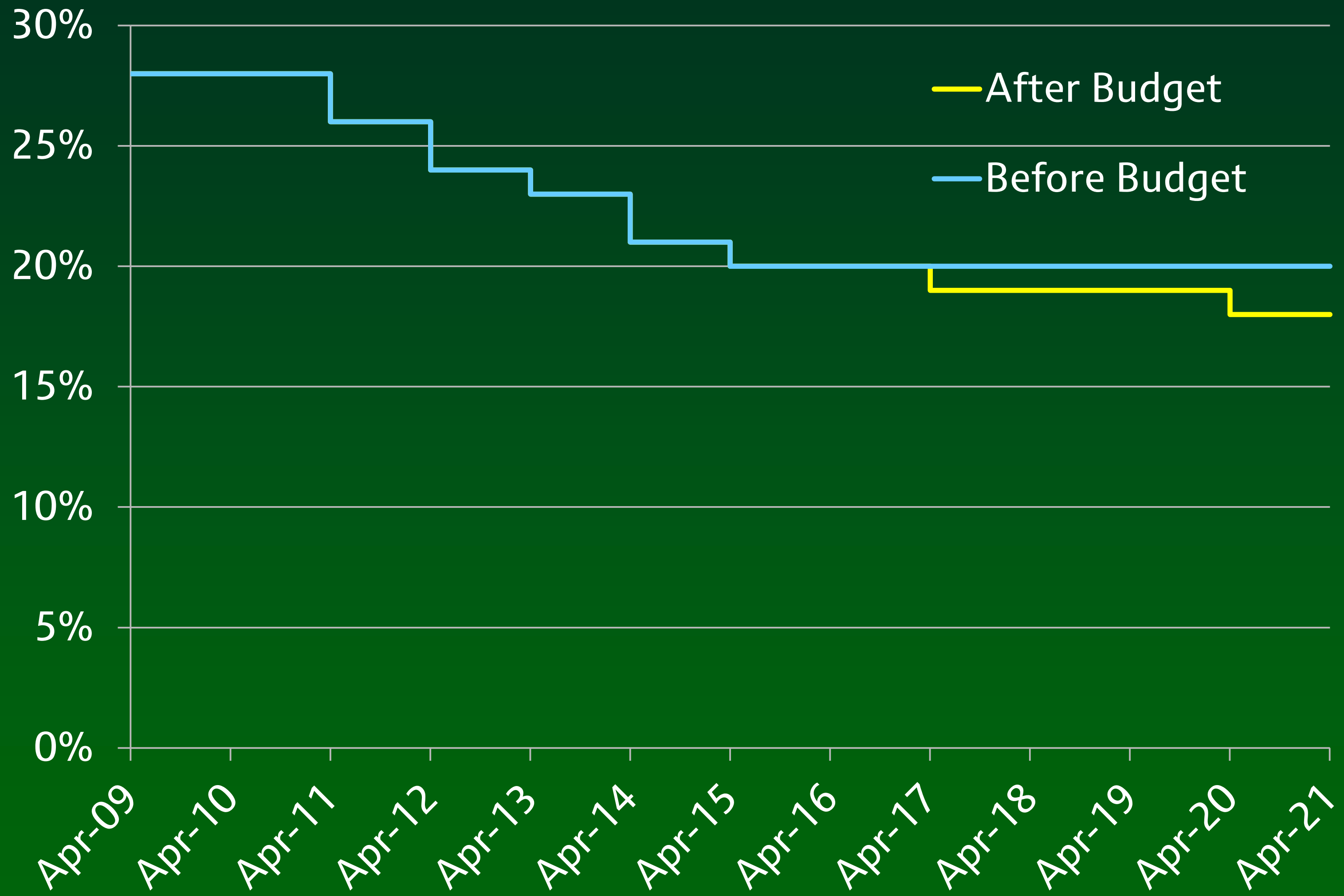
UK headline corporation tax rate



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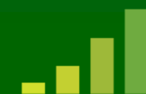
Statutory corporate tax rates in the G20, 2015

UK, 2020
UK, 2017
UK, 2015
Turkey
Saudi Arabia
Russia
EU
South Korea
Indonesia
China
Canada
Italy
South Africa
Mexico
Australia
Germany
Japan
India
Brazil
France
Argentina
USA

0 5 10 15 20 25 30 35 40

Corporate tax rate (%)



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Note: EU value is an unweighted average.
Source: PKF worldwide tax guide 2014; KPMG tax profiles; table II.1 of OECD Tax Database

Corporation tax changes

- Rate cut from 20% to 19% in April 2017 and 18% in April 2020
  - Costs £2.5bn in 2020-21, but will be nearer £4bn thereafter
- Annual investment allowance set at £200,000 from January 2016
  - Costs £0.8bn

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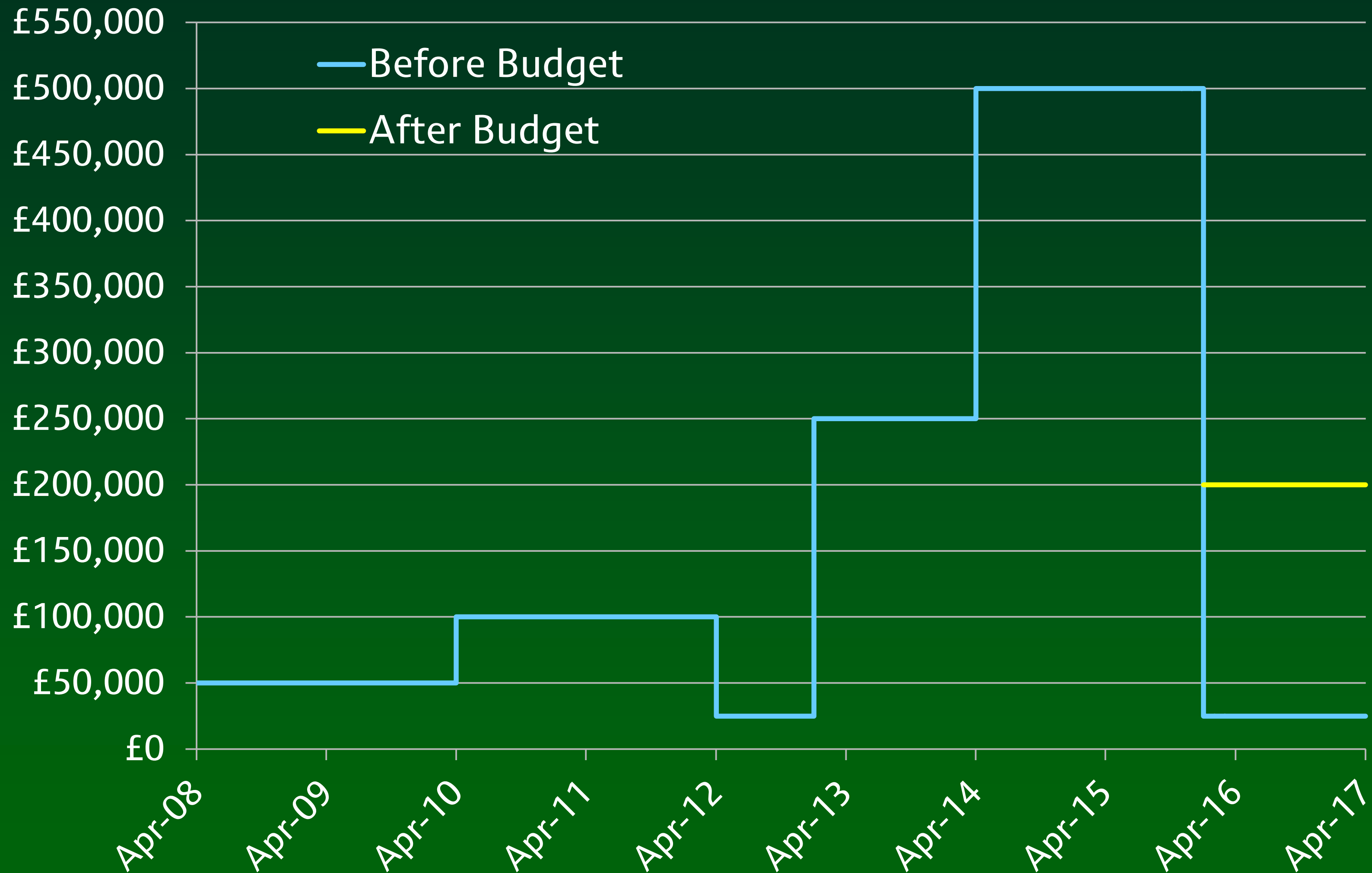
Annual investment allowance



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- Annual investment allowance set at £200,000 from January 2016
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- Companies making profits ≥£20m must pay tax 3 months earlier
  - Raises one-off £7.8bn

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Taxing banks

- Bank levy gradually reduced from 0.21% to 0.10% by January 2021
  - By 2021 there will have been 13 tax rates in 10 years

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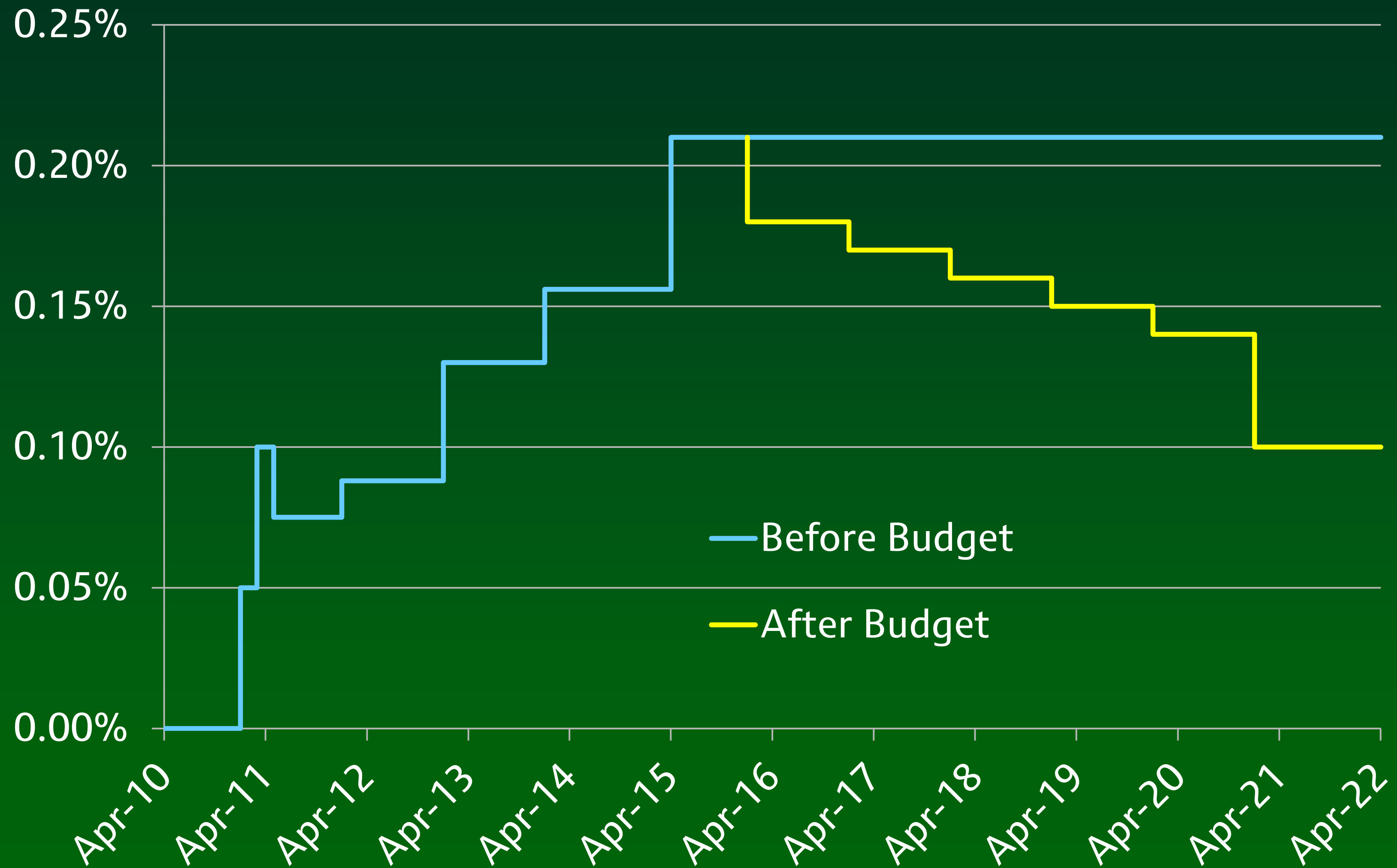
The bank levy



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Taxing banks

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  - By 2021 there will have been 13 tax rates in 10 years
  - Costs £1.8bn from 2021-22
- UK banks taxed only on liabilities in the UK, not worldwide, from 2021
  - Significant giveaway, a large slice to HSBC
- 8% corporation tax surcharge on bank profits from January 2016
  - Raises £1.3bn

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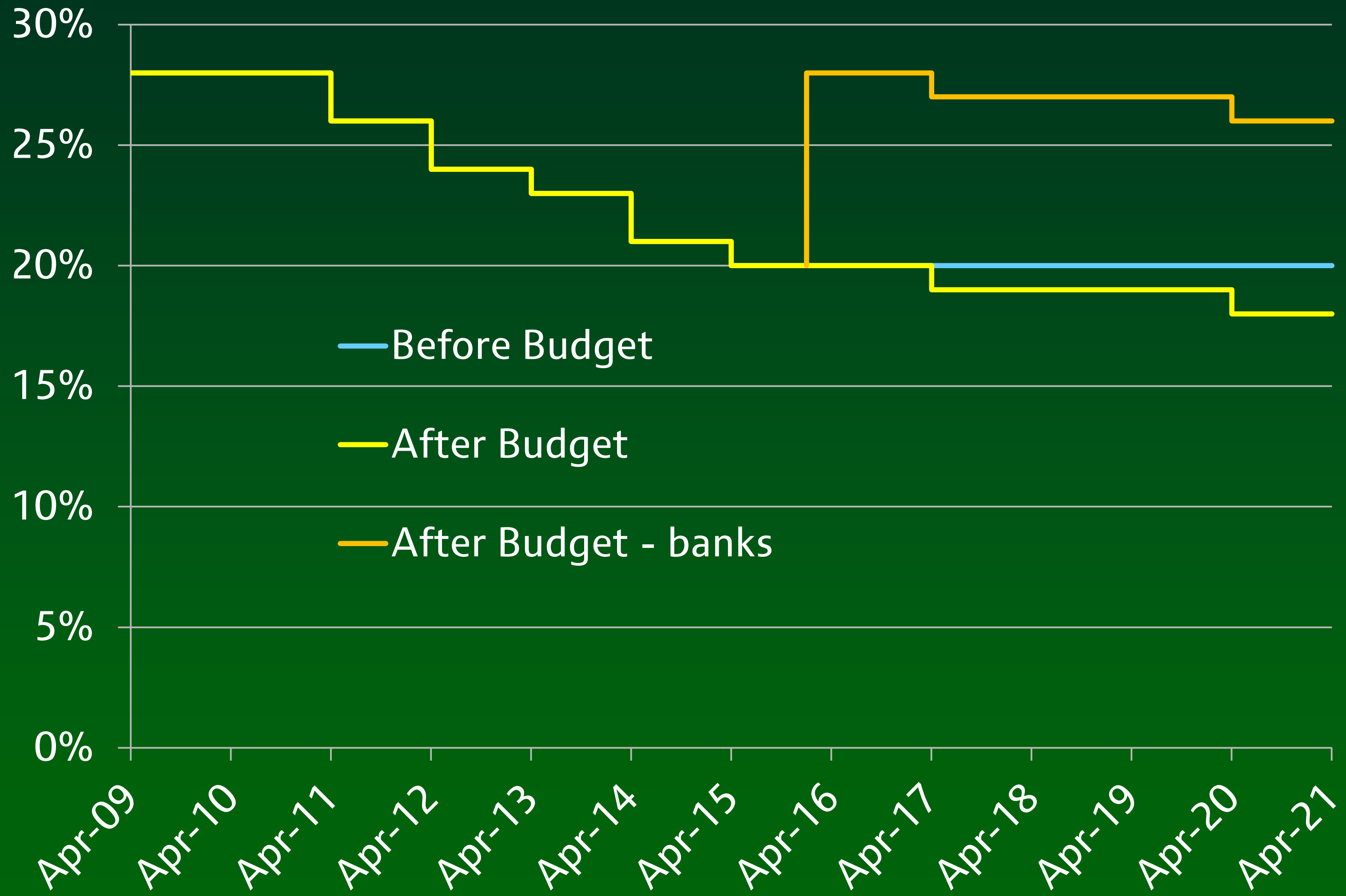
UK headline corporation tax rate



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- 8% corporation tax surcharge on bank profits from January 2016
  - Raises £1.3bn
- What is the rationale for a higher corporation tax rate for banks?
  - Bank levy designed to discourage risky leverage (with mixed success)
  - But corporation tax just discourages declaring UK profits
  - Future profits not a good proxy for cost of past bail-outs, future risk posed, implicit insurance provided,…
  - Maybe profits less responsive (e.g. internationally mobile) than profits of other companies?

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Dividend tax changes (1/3)

- Dividends outside pensions and ISAs subject to income tax
  - In 2012–13, 4.6m taxpayers received £45bn of taxable dividends
  - Mixture of portfolio investors and company owner-managers

- Effective tax rates currently 0% (basic), 25% (higher), 30.6% (additional)
  - Lower than ordinary income tax rates
  - Partly reflects corporation tax already paid: combined rates 20%, 40%, 44%
  - But no NICs on dividends → incentive to set up company and take dividends
  - Lighter taxation of dividends also reduces disincentive to invest

- Budget announced significant reform
  - Effective tax rates all increased by 7.5 percentage points from April 2016
  - But first £5,000 of dividend income to be tax-free
  - Raises £2.5bn

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Dividend tax changes (2/3)

- Winners:
  - Higher-rate taxpayers receiving dividends of less than £21,667
  - Additional-rate taxpayers receiving dividends of less than £25,250

- Losers:
  - Higher- and additional-rate taxpayers receiving dividends above those levels
  - Basic-rate taxpayers receiving dividends of more than £5,000

- Unaffected:
  - Basic-rate taxpayers receiving dividends <£5,000
  - People holding shares within pensions or ISAs

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Dividend tax changes (3/3)

- Less (more) incentive to set up as a company if would be a loser (winner)
  - Government thinks this reduces cost by £0.6bn
- Less incentive to take dividends (above £5,000) rather than salary
- Disincentive to save heavily in shares (outside pensions and ISAs) and to generate profits and dividends
  - Government thinks this increases cost by £1.0bn
- These incentives partly offset by cut in corporation tax rate

- Now separate tax-free allowances for savings income, dividend income and capital gains as well as the basic income tax allowance
  - If use all of them, can receive over £28,000 a year free of income tax/CGT
  - Why favour people who receive money in a variety of forms?

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Restricting mortgage interest relief for landlords

- Mortgage interest payments currently tax-deductible for landlords
- Budget announced restriction of tax relief to the basic rate
  - To be phased in over 4 years from April 2017
  - Raises £0.7bn from high-income landlords
- Budget speech: 'landlords have a huge advantage in the market as they can offset their mortgage interest payments against their income, whereas homebuyers cannot.'
- Nonsense
  - Landlords taxed on rental income and capital gains
  - Owner-occupiers not taxed on (implicit) rental income and capital gains
  - Deduction of costs is appropriate counterpart to tax on returns
- Exacerbates tax bias towards owner-occupation

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Inheritance tax

- New transferable main residence allowance
  - £100k in 2017–18, rising by £25k a year until reaches £175k in 2020–21
  - Increases effective IHT threshold to £1m for married couples (if main residence worth at least £350k)
- Also £325,000 threshold to be frozen in cash terms until March 2021
  - already frozen from April 2009 to March 2019
- Overall cost of both policies £940m in 2020–21

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New transferable main residence allowance

- Similar to policy discussed in Treasury document leaked to Guardian (published 17 March 2015):
- *‘There are not strong economic arguments for introducing an inheritance tax exemption specifically related to main residences’*
- *‘Some commentators, including the IFS, are very likely to make these points and be critical’*
  - Increases bias towards buying owner-occupied housing over other assets
  - Pushes up house prices
  - Inequitable that some smaller estates attract more IHT than larger ones simply because a smaller proportion is held in property

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Reducing pension annual allowance for high earners

- Maximum tax-relieved contribution reduced for those with incomes (including employer contributions) above £150k from April 2016
  - Sliding scale from £40k at £150k to £10k at £210k
  - Expected to raise £0.9bn in 2018–19
- Continues instability of last five years
- Moving away from sensible system
  - tax relief on contributions, returns untaxed, pay tax on withdrawals
- Why allow £40k of contributions at £150k but only £10k at £210k?
- Strong disincentive to increase income between £150k and £210k

- ‘we will not propose any further changes to the system during the next Parliament’ – Conservatives, 12 April 2015. But now…

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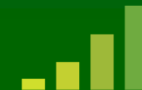
Consultation on pensions taxation

- Government to consult on whether to keep current approach or move to something more like ISAs
  - potentially with a government top-up
- Big difference is that tax would be collected up front
  - bad: individuals would not be able to 'tax-rate smooth'
  - bad: above-normal returns would not be subject to tax
  - good: top-up could improve on existing subsidies
- In 2013–14 income tax and NICs revenues would have been flattered by up to £41bn
  - much would represent revenues simply being brought forward rather than a true strengthening in the public finances
  - could we trust successive governments to run appropriately stronger headline fiscal position?
  - could we trust future governments not to tax pensions twice over?



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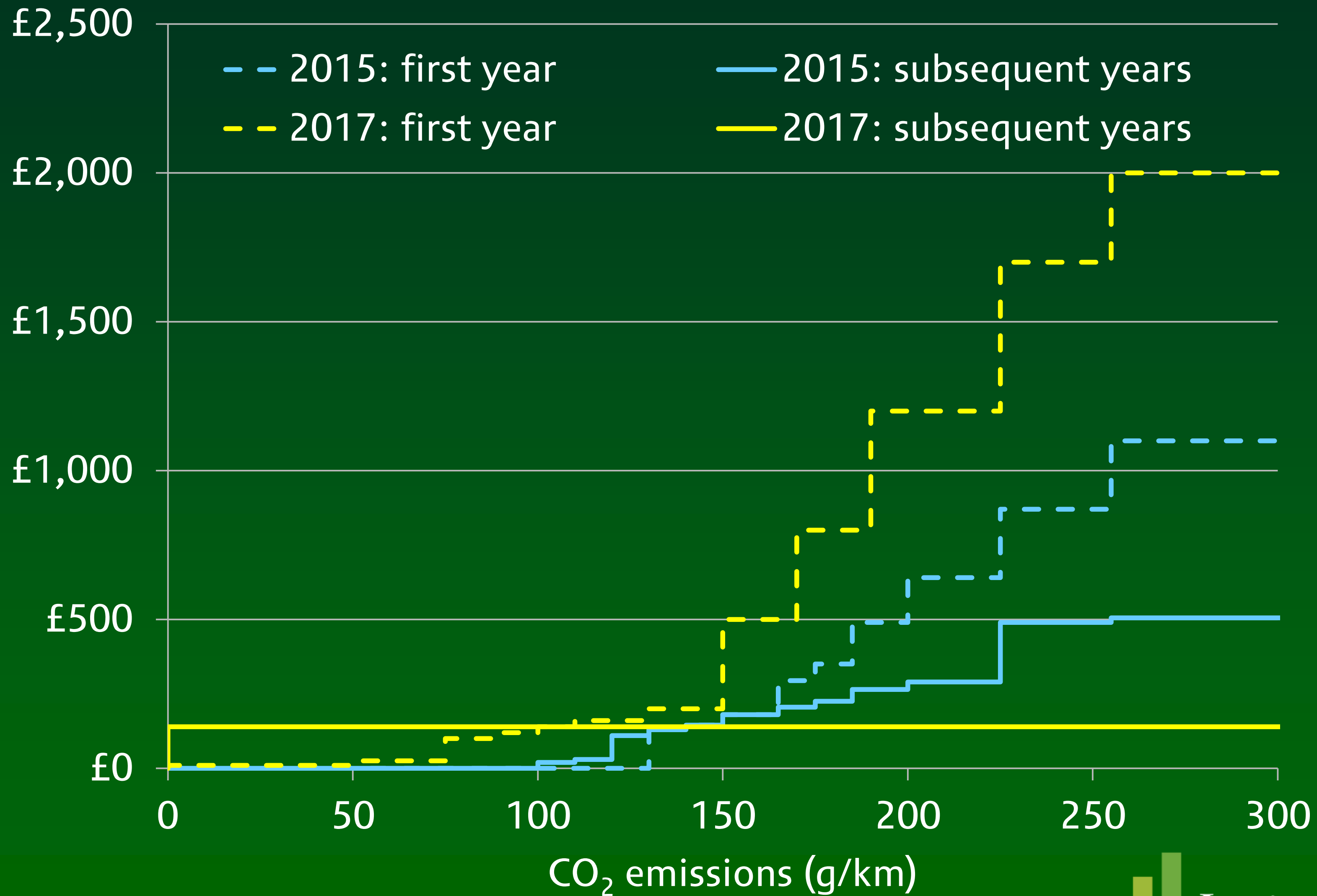
VED for new cars to raise £1.4bn in 2020-21



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Note: Assumes petrol/diesel car, list price <£40,000

Other indirect tax rises

- Climate change levy exemption for renewables ended
  - Raises £0.9bn
  - Why tax business use of renewable-sourced electricity?
  - ➢ Should be aiming for consistent pricing of carbon emissions
- Insurance premium tax increased from 6% to 9.5% from Nov 2015
  - Raises £1.6bn
  - Why tax business use of insurance?
  - ➢ Should be aiming to apply VAT to insurance instead

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Other notable tax announcements

- NICs employment allowance increased from £2,000 to £3,000
  - But abolished for firms with a single employee
  - Raises £0.6bn
- Broadly sensible reform to taxation of 'non-doms'
  - Raises £0.5bn
- Lots of anti-avoidance and -evasion measures
  - £2.8bn a year from tackling evasion would be a huge return on investment in HMRC
- Lots of consultations and reviews
- Confirmed intention to legislate to 'prevent' increases in headline rates of income tax, NICs or VAT
  - Can't bind future selves – and why should they need to?

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Summary: winners and losers

Winners:

- Most income tax payers, a bit
- Wealthy home-owners and their descendents
- High-income people receiving modest dividends
- Most companies (i.e. their customers/employees/shareholders)

Losers:

- High-income people saving a lot in a pension or renting out property
- People receiving large dividends
- UK-born / long-term resident non-doms
- People buying insurance or (after 2017) new cars
- Firms using insurance or renewable-source electricity
- Highly profitable, low-leverage banks
- Tax evaders

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Conclusions

- Huge number of major reforms
- Hard to discern a theme or strategy
- Several of the changes make no economic sense
  - Buy-to-let mortgage relief, VED hypothecation, CCL on renewables, IHT main residence relief, pension annual allowance withdrawal
- Announcing paths for future tax rates raises hopes of future stability
  - Rates of corporation tax, annual investment allowance and bank levy as well as income tax, NICs and VAT
- The more uncertain costings are almost all revenue-raisers

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