Tax without design

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Tax without design?

• We entitled the Mirrlees Review “Tax by design”
  – But does the current system look “like someone designed it on purpose”?

• In particular have recent changes been:
  – Consistent?
  – Coherent?

• But first, where do revenues come from?
Composition of tax revenues

Share of total net taxes and NICs

- Income tax
- VAT
- NICs
- Other indirect taxes
- Capital taxes
- Onshore corporation tax

Notes and sources: see Table 2.5 of The IFS Green Budget: February 2014.

Fall in revenues from “sin taxes” and petrol duties more than offsets rise in VAT

Increasingly coming from a relatively small number of high income people

Top 1% contributed:
- 11% in 1979
- 21.3% in 1999-2000
- 27.5% in 2011-12

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Direct taxes

• The basic structure looked fairly straightforward in 2009.
Income tax and employee NICS marginal rates 2009-10

Notes: Marginal rate of income tax and employee’s National Insurance Contributions. Previous years’ thresholds have been uprated to 2014-15 prices using the CPI. Assumes employee contracted into State Second Pension.
Direct taxes

- The basic structure looked fairly straightforward in 2009
  - Gone a bit downhill since then
Income tax and employee NICS marginal rates 2015-16 (married, non-working spouse)

Notes: Marginal rate of income tax and employee’s National Insurance Contributions. Thresholds are expressed in 2014-15 prices using the CPI. Assumes employee contracted into State Second Pension.
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Income tax and employee NICS marginal rates 2015-16 (married, non-working spouse, 2 children)

Notes: Marginal rate of income tax and employee's National Insurance Contributions. Thresholds are expressed in 2014-15 prices using the CPI. Assumes employee contracted into State Second Pension.
Direct taxes

• The basic structure looked fairly straightforward in 2009
  – Gone a bit downhill since then
• Note no adjustment for inflation of:
  – Point at which child benefit is withdrawn
  – Start of 60% marginal rate of income tax
  – Start of 45% marginal rate of income tax
• Latter two have already fallen more than 12% on real terms
Direct taxes

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• Note no adjustment for inflation of:
  – Point at which child benefit is withdrawn
  – Start of 60% marginal rate of income tax
  – Start of 45% marginal rate of income tax

• Latter two have already fallen more than 12% on real terms

• Over the longer term big increases in number of higher rate payers
Number of higher-rate taxpayers (millions)

Note: includes additional-rate taxpayers
Direct taxes

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• One for the really nerdy:
  – Parameters in the employer NI system rise with the RPI
  – Parameters in the employee NI system rise with the CPI
The continued neglect of NICs

- NICs are tax on earnings just like income tax
  - Almost no relationship between payment and benefit entitlement
- Yet while income tax rates have fallen, NI rates have risen
  - With (almost certainly) unintended consequences
Basic rate of income tax and main rates of NICs since 1979

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Basic rate of income tax</th>
<th>Main employee NICs rate</th>
<th>Main employer NICs rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-80</td>
<td>0%</td>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>1984-85</td>
<td>20%</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>1989-90</td>
<td>25%</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>1994-95</td>
<td>30%</td>
<td>25%</td>
<td>30%</td>
</tr>
<tr>
<td>1999-00</td>
<td>35%</td>
<td>30%</td>
<td>35%</td>
</tr>
<tr>
<td>2004-05</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>2009-10</td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Note: Between 1986-87 and 1998-99, the employer rate shown is that applying at the UEL, while between 1986-87 and 1988-89 the employee rate shown is that applying up to the UEL.
Total income tax and employee NICs rate by income in 1978–79 and 2015–16

Notes: Figures expressed in 2014–15 prices using the RPI. Assumes single man, no children, all income earned for individual aged under 65, one job, contracted into S2P/SERPS.
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Taxation of savings and capital

- Lies at the heart of the tax system
- Often a tension between desire to tax returns:
  - Less heavily than earnings to encourage savings/investment
  - As heavily as earnings to prevent avoidance
- But no need for the incoherence this has created
  - notably in CGT
Contribution required to match an ISA

- ISA
- Cash
- Pension (emp'ee)
- Pension (emp'er)
- OOH
- Rental house
- Equities

20% taxpayer
Contribution required to match an ISA

- ISA
- Cash
- Pension (emp'ee)
- Pension (emp'er)
- OOH
- Rental house
- Equities

20% taxpayer
40% taxpayer
Pensions

• If any area of the tax system requires stability, clarity and a coherent sense of direction it’s the taxation of pensions
  – We have none of these
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• Continual reductions in the most coherent parts of the system – annual and lifetime allowances
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• No action on the excessively generous bits
  – NI treatment of employer contributions
  – Tax free lump sum
Pensions

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  – No sense of where this will end
• No action on the excessively generous bits
  – NI treatment of employer contributions
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• Whatever the merits of the announcement in this year’s Budget
  – Is this a good way to make tax (or pension) policy?
Indirect taxes

• VAT rates have risen over 30 years to 15%, then 17.5%, now 20%
  – But little or no policy direction
• We have among the narrowest VAT bases in the OECD
  – And extending it to pasties is no great move towards coherence
• Though certainly not a move away
VAT on food?

**Products currently facing 20% VAT**

Cereal, muesli and similar sweet-tasting bars

Potato crisps

Marshmallow snowballs with no biscuit base

Chocolate bars that are ‘eaten with fingers’

Sweet-tasting dried fruit for snacking

Chocolate buttons not for use in baking

Frozen yoghurt and ice cream

Gingerbread men decorated with chocolate
### VAT on food?

<table>
<thead>
<tr>
<th>Products currently facing 20% VAT</th>
<th>Products currently facing 0% VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cereal, muesli and similar sweet-tasting bars</td>
<td>Flapjacks</td>
</tr>
<tr>
<td>Potato crisps</td>
<td>Other roasted vegetable chips, tortilla chips</td>
</tr>
<tr>
<td>Marshmallow snowballs with no biscuit base</td>
<td>Marshmallow teacakes with a biscuit base</td>
</tr>
<tr>
<td>Chocolate bars that are ‘eaten with fingers’</td>
<td>Chocolate body paint</td>
</tr>
<tr>
<td>Sweet-tasting dried fruit for snacking</td>
<td>Sweet-tasting dried fruit for home baking</td>
</tr>
<tr>
<td>Chocolate buttons not for use in baking</td>
<td>Chocolate mini-buttons for use in baking</td>
</tr>
<tr>
<td>Frozen yoghurt and ice cream</td>
<td>Baked Alaska</td>
</tr>
<tr>
<td>Gingerbread men decorated with chocolate</td>
<td>Gingerbread men on which the chocolate amounts to no more than two dots for eyes</td>
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• On road fuel duties it would seem this government has had a consistent policy to reduce them
  – At a cost of £5 billion a year relative to inherited plans
Real duty on a litre of petrol
Pence, April 2013 prices

Note: Pence per litre uprated to Apr 2014 prices using the RPI.
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- Looks less coherent when you see how policy was actually made
### Fuel duties: to uprate or not to uprate, Acts I to VI

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</tr>
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<tbody>
<tr>
<td>Apr 2012</td>
<td>Aug 2012</td>
<td>Cancelled</td>
<td>Cancelled</td>
<td>Cancelled</td>
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<tr>
<td>Apr 2013</td>
<td>Apr 2013</td>
<td>Apr 2013</td>
<td>Apr 2013</td>
<td>Sep 2013</td>
<td>Cancelled</td>
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Environmental taxes

- May be newer but they are just as messed up as the rest of the system
Implicit carbon prices in 2013 and 2020

- Households
- Small business
- Medium business
- Large energy intensive business

Comparison of gas and electricity prices (£/tCO₂e)

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Implicit carbon prices in 2013 and 2020

Households
Small business
Medium business
Large energy intensive business

Implicit carbon price (£/tCO₂e)

Gas 2020
Gas 2013
Electricity 2020
Electricity 2013
Environmental taxes

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• Carbon Price Support Rate (CPSR)
  – CPSR introduced in April 2013 to ‘top up’ the EU Emission Trading Scheme carbon price to meet the Carbon Price Floor (CPF) set by the government
  – applies to all UK generators of fossil-fuel-based electricity

• Introduced in Budget 2013 with a clear trajectory to create certainty for investors
  – Which was undone in Budget 2014
Housing

- Council tax is deliberately regressive
  - In charging a lower rate of tax on higher value properties
- It is still based on 1991 values
- What is its future after several years of freezes?
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• It is still based on 1991 values
• What is its future after several years of freezes?

• Stamp duty is one of the worst and most distorting of all our taxes
  – Its slab structure means a £1 increase in sale price can add £40,000 to the tax bill
  – It discourages transactions
  – Yet it has been ratcheted up time and again
The increase in stamp duty rates

Stamp duty liability

Sale price

- £0
- £500,000
- £1,000,000
- £1,500,000
- £2,000,000
- £2,500,000

- £0
- £50,000
- £100,000
- £150,000
- £200,000
- £250,000

May 1997
The increase in stamp duty rates

Stamp duty liability vs. Sale price

- **May 2013**
- **May 1997**
Business taxation

- A series of reforms which will have made UK CT system more internationally “competitive”
  - Big and consistent cuts to headline rate of CT
  - Reforms to CFC regime
  - Move to territorial regime under last government
  - Introduction of Patent Box
- Working with OECD on BEPS
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• But, even within the confines of source based, taxation:
  – Continued reduction in investment allowances not optimal
  – Absurd degree of inconsistency in Annual Investment Allowance
Annual Investment Allowance (AIA)
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• AIA set at £250,000 for 1 Jan 2013 – 31 Dec 2014. Would have returned to £25,000 in January 2015. Now £500,000 from April 2014 to end of 2015
Business taxation

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• But, even within the confines of source based, taxation:
  – Continued reduction in investment allowances not optimal
  – Absurd degree of inconsistency in Annual Investment Allowance
  – Problems in design of the Patent Box
In conclusion

• This matters, hugely
• £4 out of every £10 generated in the economy is taken in tax
  – Doing that as efficiently as possible can raise incomes, welfare and growth
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  – Would more coherent policy, perhaps fatally, reduce compliance?
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• But is it feasible?
  – Would more coherent policy, perhaps fatally, reduce compliance?
• Or is this simply a political failure?
[The 1992 Budget] was the most political of all my budgets, and it completely wrong-footed Labour, who were not sure whether to oppose or support a low rate band, because of its appearance of help for the lower paid. Looking back on it, it was not a very good budget. But it did help us to win the 1992 election. My next budget, my third budget, helped to lose the 1997 election for the Conservatives, but it was definitely my best budget.
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• £4 out of every £10 generated in the economy is taken in tax
  – Doing that as efficiently as possible can raise incomes, welfare and growth
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• We can do better