Taxes and benefits: the parties’ plans

James Browne and David Phillips
What’s coming up

• Go through each party in turn (Labour, Conservative, Lib Dem)
• Discuss individual measures
  ➢ Reforms to come in by 2014–15, costed as if in place in 2010–11
  ➢ Count all changes relative to current system
    – Revenue impacts
    – Winners and losers
    – Incentives, efficiency and complexity
• Compare the parties
• No single decile chart incorporating all reforms for each party
  – Difficult to estimate in many cases
  – Not clear that distributional impact is best shown by decile chart
## Tax and benefit measures planned by Government

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- Restricting relief on pension contributions over £130k
- Cut personal allowance in real terms, freeze higher rate threshold
  - Hits high income individuals, particularly richest 1%
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- Increase employer, employee and self-employed rates by 1%
- Raise employee threshold by £1,170
- Progressive tax rise overall
The distributional impact of pre-announced National Insurance changes only

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<tr>
<th>Income Decile Group</th>
<th>Change in net Income</th>
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<tr>
<td>Poorest</td>
<td>-0.0%</td>
</tr>
<tr>
<td>2</td>
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<tr>
<td>3</td>
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<td>4</td>
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<td>5</td>
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<td>6</td>
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<td>7</td>
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<td>8</td>
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- Fuel, alcohol and tobacco duty escalators
- Increases in landfill tax and climate change levy
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- Freeze threshold until 2014–15
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- New 5% rate of Stamp Duty Land Tax above £1 million
- End of stamp duty holiday for first-time buyers
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- Introduce ‘patent box’ in 2013
- Increase small companies’ rate from 21% to 22%
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- Landline duty of 50p/month
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<td><strong>Grand Total</strong></td>
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- Some benefits will increase by less than inflation in 2011
- Temporary extra winter fuel payment expires
- Introduce ‘toddler tax credit’ of £4/week in 2012–13
Pre-announced reforms – winners and losers

• The Labour Government plan tax increases and benefit cuts totalling £15.8 billion per year

• Richest lose the most
  – Biggest losers are those amongst the top 1% (earning over £130,000) making big pension contributions
  – Increase in NI also hits high earners the most

• But others lose out as well
  – NI changes also hit those on moderate to low earnings
  – Increase in duties hits people buying cigarettes, alcohol or fuel. In percentage terms biggest hit for households with average total expenditure
  – Cuts in benefits hit middle income households hardest in cash terms, and low income households in percentage terms

• Overall progressive tax rise. The biggest losers are top 1%, with low and middle income households losing, but much less
Simple and efficient?

- Increases in NI, duties, restriction of tax relief on pension contributions will weaken work incentives, particularly for higher earners

- Several planned tax changes worsen distortions, or introduce new complexities
  - Restricting pension contribution relief is complicated, unfair and inefficient
  - 5% stamp duty rate on properties worth more than £1 million increases a very damaging tax that distorts the housing market
  - ‘Patent box’ is a poor way of encouraging innovation and patent income hard to identify

- By contrast, increasing NI rates is a fairly straightforward tax rise
  - Relatively simple to administer, low compliance costs
  - Is a ‘jobs tax’ – but so are income tax and VAT
Labour manifesto

• No new measures in the Labour manifesto
• Pledges not to increase certain taxes
• Not increase basic, higher and top rate of income tax
• Not impose VAT on food, children’s clothing, books, public transport
  – These tax breaks distort spending decisions
  – There are better ways to redistribute to the poor
Conservative manifesto: giveaways

• One big tax cut
  – Increase employee and employer NI thresholds by more than Labour would to ‘protect’ more workers from rate rise
  – Costs £5.4 billion
The distributional impact of Conservative NI proposals only

![Bar chart showing the change in net income for different income decile groups relative to today and relative to Labour/Liberal Democrats. The chart indicates that the richest income decile group experiences the greatest increase in net income, while the poorest decile group sees a slight decrease.](chart.png)
Conservative manifesto: giveaways

• One big tax cut
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• Several smaller tax cuts
  – Increase inheritance tax threshold to £1 million. Costs £1.2 billion
  – Freeze council tax for two years. Costs £1.0 billion
  – Transferable personal allowance for 1/3 of married couples. Costs £0.5 billion
  – Increase stamp duty threshold to £250,000 for first-time buyers permanently. Costs £0.3 billion from 2012–13

• Total gross giveaway: £8.0 billion

• Corporate tax plans (rate cuts, base broadening) to be revenue neutral
Conservative manifesto: takeaways

• Small tax rises
  – Extend £30,000 charge to all non-doms. Raises £1.8 billion (Conservative costing; HM Treasury says much less)
  – Bank levy of at least £1 billion

• Small benefit cuts
  – Reduce threshold for reducing family element of Child Tax Credit from £50,000 to £40,000. Saves £0.4 billion (assumes complete take-up, likely to be less than this)
  – Stop government payments to Child Trust Funds for families with incomes above £16,190. Saves £0.2 billion

• Net giveaway of £5.7 billion relative to Labour, net takeaway of £10.1 billion relative to today
Conservative proposals – winners and losers

• Still the richest that lose out most:
  – Top 1% still lose most as going ahead with Government plans on restricting pension contribution relief
  – NI plans mean richer households pay more on average
  – Benefit from inheritance tax change, but non-doms lose

• Low and middle income households gain from Conservatives’ NI changes

• Transferable personal allowance benefits married couples where only one pays basic-rate income tax. Mainly low and middle income households

• Progressive but less so than Labour. Biggest losers are top 1%, with middle income households being main beneficiary of smaller overall tax increase
Simple and efficient?

• Plan to limit impact of NI rise, but would retain other changes that are more distortionary and complex, and introduce more complexities

• Conservatives’ NI proposals would strengthen incentive to work at all relative to Labour’s, but as still increasing rates, would still weaken incentive to increase earnings slightly

• Transferable personal allowance strengthens incentive for first earner in a married couple to work, but weakens incentive to work for second earner

• Corporate tax plans would make it more attractive for multinationals to locate profits in UK, but discourage investment in equipment and machinery
  – Why do reforms have to be revenue-neutral within corporation tax?
  – If rate cuts desirable, unlikely that cutting capital allowances is the most efficient way of financing them
Liberal Democrat manifesto: giveaways

• One very large tax cut
  – Increase income tax personal allowance to £10,000. Cost: £16 billion
  – Would take 3.6 million out of income tax
  – Worth £700 a year for those aged under 65 with incomes between £10,000 and £113,000
  – Those with incomes above £120,000 would not benefit because of tapering of personal allowance
The distributional impact of the Lib Dems’ increase in the income tax personal allowance only.

![Bar chart showing the distributional impact of the Lib Dems' increase in the income tax personal allowance.](chart.png)
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• Earnings-index state pension from 2011, not 2012. Cost: £0.3 billion

• Revenue-neutral reform to business rates.
  – Based on land value instead of property value
  – Localised
Liberal Democrat manifesto: takeaways

• Tax rises and benefit cuts mean package overall represents a £3.9 billion tightening relative to Labour, £19.7 billion relative to today:
  – Restricting tax relief on pension contributions to the basic rate. Raises £5.5 billion
  – Reforming Air Passenger Duty to become a per-plane tax. Raises £3.2 billion
  – Tax on bank profits. Raises £2.1 billion
  – Capital gains tax: align rates with income tax, reduce allowance and reintroduce indexation allowances. Raises £1.8 billion
  – ‘Mansion tax’ – 1% annual charge on domestic property values above £2 million. Raises £1.6 billion
  – Withdrawing family element of Child Tax Credit immediately after child element. Raises £1.2 billion
  – End government contributions to Child Trust Funds. Raises £0.5 billion
  – Reforms to Winter Fuel Payment eligibility. Raises £0.1 billion
  – Anti-avoidance and anti-evasion measures to raise £4.4 billion

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Do the plans add up?

• Revenue raised from anti-avoidance seems optimistic
  – General Anti-Avoidance Principle would have to deal with a large proportion of avoidance to raise £2.2 billion
  – Unclear that enough resources will be freed up to combat £1.4 billion of evasion

• But changes to CGT may raise more than they estimate

• So no clear overall bias in their costings
Liberal Democrat manifesto: winners and losers

• Increase in personal allowance benefits upper-middle income most in percentage terms, particularly two-earner working-age couples

• Higher-rate taxpayers saving for a pension or making quick capital gains and those living in valuable homes would be hit

• Also (smaller) losses for mid-to-high income families with children, and 60 – 65 year olds, and small gains for severely disabled

• Difficult to say who will ultimately be made worse off by bank tax, taxes on freight planes and anti-avoidance measures

• Compared to Labour Government plans, bigger take-away from higher-income households, with middle, not low, income households biggest beneficiaries
Liberal Democrat manifesto: decentralisation

• Would introduce all the Calman Commission’s proposals on devolving tax-setting powers to the Scottish Parliament
  – income tax (within limits), stamp duty land tax, air passenger duty, landfill tax and aggregates levy
  – Labour would do most of this, Conservatives not committed to these exact proposals but promise some devolution

• Localise business rates
  – Would double the proportion of tax raised locally
  – May limit accountability of local authorities if those affected don’t live in the area and so can’t vote for the council

• Allow councils to charge higher council tax on second homes
Simple and efficient?

- Increase in personal allowance strengthens incentive to work at all
- Higher taxes on saving weaken work incentives for richer households, as well as weakening incentives to save
- Restricting tax relief on pension contributions for all higher rate taxpayers is complex, inefficient and unfair
  - More coherent and less complex than the government’s plan
  - But affects far more people
- Other tax rises remove distortions and inconsistencies
  - Taxing capital gains more like income (and allowing for inflation)
  - Taxing benefits in kind like other remuneration
Comparing the parties: total ‘takeaway’

• Government are planning a £15.8 billion ‘take-away’
  – About £610 per household per year

• Conservatives are planning a smaller £10.1 billion ‘take-away’
  – About £390 per household per year

• Liberal Democrats are planning a bigger £19.7 billion ‘take-away’
  – About £760 per household per year
Comparing the parties: winners and losers

• Government tax increases are progressive
  – Richest households, especially top 1%, face biggest increase in tax as a proportion of income
  – Lower and middle income households hit but to a much lesser extent

• Conservative plans progressive but a little less so
  – Middle-income households gain most from overall lower takeaway

• Liberal Democrats plan a bigger takeaway from richer households than Government or Conservatives
  – To finance an income tax cut that benefits upper-middle-income households the most, not low-income households
Comparing the parties: work incentives

- Government plans to increase in NICs rates weaken work incentives
  - As do other plans

- Conservative plans to raise NI thresholds strengthen incentive to work at all – but incentive to earn a bit more still weaker than today

- Transferable personal allowance means incentive to have one earner as opposed to no earners or two earners

- Lib Dem plans to increase personal allowance strengthen incentive to work at all (and by more than Conservative NI plans)

- But weaker work incentives for richer households, as well as weaker incentives for saving and investment.
Comparing the parties: simple and efficient?

• Overall, Government’s proposals are not appealing even considering the need to raise revenue
  – Increase complexity and distortions in the tax system
  – Restricting pension contributions relief particularly badly designed

• Conservatives plan to forgo much of straightforward NI rise

• But go ahead with the most damaging of Labour’s tax rises

• And introduce more complexities of their own
  – Transferable personal allowance to recognise marriage
  – Permanently lower rate of stamp duty for first time buyers
Comparing the parties: simple and efficient?

• Liberal Democrats plan a much more radical reform
  – Big income tax cut funded by increased taxes, mainly on richer households
  – Significant decentralisation of tax-raising powers

• Restricting pensions contribution relief to the basic rate for all higher rate taxpayers is misconceived
  – Almost as bad as other parties’ plans and applying to millions more people

• But removal of distortions is welcome
  – Taxing (some) capital gains at the same rates as income
  – Taxing benefits-in-kind the same as other pay