Comment
Views on the politics of the Budget

View from the government

David Gauke
The Exchequer Secretary to the Treasury

Our ambition is to build a fairer, more efficient and simpler tax system.
On 21 March the Chancellor announced this government’s third Budget. It is a Budget that rewards work and will help Britain earn its way in the world as we work towards dealing with our debts and rebuilding our economy.

Underpinning our deficit reduction plan is a programme of far-reaching tax reform. Our ambition is to build a fairer, more efficient and simpler tax system where ordinary people understand what they pay. And we want our system to be more competitive than that of any other major economy in the world.

To achieve this, we are committed to adhering to the principles of good taxation that the Chancellor reaffirmed last week. Taxes should be simple, predictable, support work, and they should be fair, with the rich paying the most and the poor the least. When we came to office the system did not meet these criteria and reform was desperately needed.

We have already made real progress: reforming the tax policy making process, establishing the independent Office of Tax Simplification (OTS), embarking on a programme of reform of corporation tax, and taking a million people out of tax by increasing the personal allowance.

The policies the Chancellor announced in the Budget help us to make the tax system fairer.

We are taking a new, more effective, approach to taxing the best off so that they will pay more tax overall. Taken together, the 25% cap on income tax reliefs and the increase in stamp duty rates for high value properties will mean that the wealthy contribute five times as much. The increase in the personal allowance – the biggest cash increase ever – will benefit 23.6 million people and lift an additional 840,000 people out of income tax altogether.

The OTS recommended a radically simpler system for the smallest businesses and at Budget we committed to implementing just that. We are going to allow small businesses to use cash basis accounting, which will mean that filling in a tax return will become easier for up to three million companies. The OTS recommended income tax and national insurance integration, and we are pressing ahead, with detailed proposals to be published shortly.

Simplification is not just for businesses. For ordinary taxpayers, the government has already demonstrated a commitment to making the tax system simpler. We are now starting to make it more transparent as well. We know that some people find the system remote and confusing and do not understand how much tax they pay. So in 2014/15 the government will send personal tax statements to 20 million people, setting out how much tax they have paid for the year and how the government has spent that contribution.

But making the tax system simpler is not always easy and does involve some difficult choices. These are decisions that this government is prepared to make. So at Budget we committed to a phased withdrawal of age-related income tax allowances (ARAs) for older people and freezing ARAs at their 2012/13 levels from 2013/14 until they align with the personal allowance. This government has a proud record in protecting pensioners but this measure raises revenue and addresses significant complexity, highlighted in the OTS’s recent report on the taxation of pensioners.

And the government is pressing ahead with plans to make the UK’s tax system more competitive. We have always been clear that the 50p additional rate of income tax undermined these efforts and so was temporary. The damage it does to competitiveness can only be justified if it raises significant amounts of revenue. HMRC’s review revealed that it did not, so we have committed to reduce it to 45p next year.

We know that our reform of corporation tax is beginning to have the desired effect. Instead of leaving the UK, companies are moving here. The cut at Budget of corporation tax by an extra 1% to 24%, with further cuts to come, can only strengthen the UK’s competitiveness.

So, we are delivering on our promises and making real progress. As the Chancellor said in his Budget speech, we need to give Britain a modern tax system fit for the modern world. We will continue to work hard to achieve this.

View from Labour

Owen Smith
Shadow Exchequer Secretary to the Treasury

Huge uncertainties surround decision to cut the 50p rate.
Budgets are tricky things to get right. The law of unintended consequences appears magnified when applied to the fine print of the Red Book and those who lose out in light of its effect have a tendency to cry loud and long – and to bear a grudge. Those are the immutable facts of life for a Chancellor, impossible to defy and difficult even to amend. But this Chancellor was supposed to be gifted, blessed with the rare, twin talent of political perspicacity and economic sagacity. Not so, it seems.

The decision to try and sneak through an effective tax rise for 4.4 million pensioners, airily waved away as mere ‘simplification’ was ham-fisted to say the least. One suspects it was a half-hearted attempt to mask the measure, having spotted at the last hour that, after the deluge of leaks, it was just about the only big news left in his speech. Either way, it was the wrong thing to do: politically, for sure, as the polls bear testament, but morally, too, given the simultaneous change for which, in part, it was designed to pay.

Cutting the 50p rate for the 300,000 UK citizens earning more than £150,000 per year, was an act of low politics, dressed up as high-falutin’ economics. More than 56 pages of suitably impressive-looking, and deliberately obscure, text and graphs and equations make up the justificatory report on The Exchequer effect of the 50 per cent additional rate of income tax which accompanied Wednesday’s Budget.

Hidden in the hieroglyphics, only called out explicitly on page 51 of 56, is a simple message, first articulated by the Rt. Hon. John Redwood MP, in a recent book, The Future of Conservatism, when he wrote: ‘For the first time the Treasury (accepts) the existence of the Laffer curve.’ That’s the act of
faith concealed at the heart of this ostensibly technical and objective analysis, the act of faith which ultimately justifies for this Chancellor his unfair decision to tax pensioners more and millionaires less.

But don't just take my word for it, examine the facts yourself. The Chancellor concedes that in the first year of its application the 50p rate garnered approximately £1bn for the Exchequer. The number is only approximate, because after one year there isn't really enough data to be sure, which some might have thought a good reason to wait a little longer before declaring judgement.

It is clear that more people were more ingenious than the Treasury had anticipated at avoiding the tax by taking income earlier or translating it into other means of remuneration. Just as it's clear that to do so in succeeding years would have become progressively harder. Less apparent, however, is how the Chancellor slid effortlessly from stating that the rate had raised an extra billion to declaring its removal worthwhile a mere £100m in revenues forgone. But that's the magic of Mr Laffer.

Because as table A2 on page 51 reveals, although the government concedes that the static cost of cutting 5p off the rate will be £3bn in 2013, rising to £4.2bn in 2016, its impact will be offset by an anticipated, Laffer-inspired, behavioural change which will increase receipts by £2.9bn, rising to £4bn. Meaning we'll only lose £100m.

Dig deeper and one finds that this handy trade-off has at its heart an act of naked political manipulation. A key variable in the calculation of the effect of shifting the rate is the Taxable Income Elasticity (TIE) assumed in plotting the curve. Set it at 0.35 – as the Treasury had previously done – and the loss would inevitably be far larger, tweak it to 0.45 – as the current government has decided is 'sensible' (see para A.19 on page 50) and you derive this limited loss of £100m.

Dig deeper still, and you'll find that this TIE, far from reflecting the broad base of academic evidence, is contingent on one recent paper and that the HMRC itself pegs the standard error to the TIE at 0.33 – no doubt, the root of the OBR's concerns that there are 'huge uncertainties' around the £100m estimate – thus exposing that fact the true TIE could lie anywhere between 0.14 and 0.81, and the Exchequer effect as of equally uncertain dimensions.

Osborne's Budget is about politics and economics. And neither are any good.

A political assessment

Philip Stephens
Chief Political Commentator, The Financial Times

In this Budget, politics trumped simplicity. Slow growth gives Mr Milliband plenty of ammunition to taunt the Coalition, but he also has to produce a credible alternative. It's the small things that catch out the politicians. Gordon Brown was badly scared by his decision to scrap the 10p starting rate of income tax in favour of a cut in the basic rate. George Osborne has been tripped up by an angry media response to an economically sensible but politically clumsy Budget measure to freeze allowances for the over 65s.

Overall, the Budget bore the mark not just of Coalition politics, but of Coalition politics conducted in the public square. Nick Clegg got the big increase in the threshold for all taxpayers he had been loudly demanding for some months – a tribute, Liberal Democrats will tell you, to the party's continuing faith in the liberalism of John Stuart Mill. Mr Osborne got half of what he wanted on the top rate of income tax – his initial bid was for a return to 40p, but he settled in the end for 45p. The net result was that Mr Clegg's party could claim it had given a hand up to those at the bottom of the pile and the Chancellor judged that between the top rate cut and lower corporation tax he had declared Britain to be 'open for business'.

In political terms, however, the Budget was less than the sum of its parts. David Cameron and his colleagues looked vulnerable to Ed Miliband's charge that the top rate tax cuts favoured their wealthy friends – this in spite of the taxes on top-end housing and another Revenue crackdown on tax avoidance schemes. On Mr Clegg's side, credit for the gains for low and middle-income families from the increase in thresholds was lost to the furor over the treatment of the elderly.

This was partly careless tactics. The misnamed 'granny tax' was just about the only significant measure in the Budget that had not been leaked in advance. Mr Osborne sought to gloss over it as a simplification measure. The combination of surprise and sleight of hand proved disastrous in shaping the media's response. Never mind that almost every sensible independent observer, including the Institute for Fiscal Studies, declared the freeze a sensible piece of tax reform. Politics is not always fair.

The Budget was not, in spite of Mr Osborne's claim to the contrary, a serious effort to rationalise the tax system. As happened with his predecessors, politics trumped simplicity. The oil, pharmaceutical, aerospace, broadband, green and video-game industries were among those offered tax lollipops. The compromise on child benefit for 40p taxpayers will add another layer of complexity.

Overall, the immediate political optics obscured the bigger challenge for the Coalition. The best that could be said of the economic forecasts in the Budget is that the outlook seems no worse than had been thought. That's not encouraging. The best guess of the Office for Budget Responsibility is that the economy will bump along the bottom for most of this year before showing stronger signs of (still anaemic) recovery in 2013.

Compare that with the judgment made by Mr Osborne when he first unveiled his strategy to eliminate the structural budget deficit. Back in those heady summer days of 2010 the assumption was that the worst would be over by now and that 2013 would see the economy return to robust growth. The Coalition would go into the 2015 election declaring the public finances had been restored to rude health.

Slower growth means it will take that much longer to pay down debt. The picture now is was one of austerity running up to and through that election, with another £1bn of welfare cuts in between. There is plenty of ammunition here for Mr Miliband, the more so since only about one fifth of planned public spending cuts have yet taken effect.

Yet here too, strangely enough, is the thing from which Mr Osborne takes political comfort. Much are they are angry with the Coalition, the voters have not concluded Labour has a better answer. It is not enough for Mr Miliband to taunt the Coalition. He has also to produce a credible alternative.
A simpler Budget?

John Whiting
Tax Director, Office of Tax Simplification

In the run-up to the Budget, the Office of Tax Simplification (OTS) published five reports on aspects of our tax system, with plenty of ideas for simplifications. The reports are for the Chancellor and it is pleasing that his Budget took forward many of our recommendations.

The headline measure was the move to a receipts and payments basis for small, unincorporated businesses, which so many told us was already widely in use. We had recommended a £30,000 turnover limit but the Chancellor has gone for a much higher figure – the VAT registration level. Our idea for more flat-rate allowances for various expenses is being taken forward, together with many of our recommendations for administrative improvements (see the HMRC document Making tax easier, simpler and quicker for small business). We also have consultation on disincorporation and our tax-advantaged share schemes report to come.

There was progress on some of our previous recommendations – notably the income tax/NIC merger of operational aspects. IR35 is progressing slowly and last year’s OTS reliefs report clearly influenced some of the improvements to EIS.

Our interim pensioners report documented the areas of the tax system that cause pensioners most difficulties. Unsurprisingly, age allowances are a major source of complexity and we had identified a number of routes to explore to improve matters, including the idea of freezing them and allowing the basic allowance to catch up. The Chancellor clearly decided there was a need to act now in this area.

So, did simplification win in the Budget? Inevitably there are other areas of the Budget that seem to be introducing more complexity into our system – child benefit withdrawal being the most obvious. But overall I would argue that the small OTS team had a beneficial impact, even if it’s clear we won’t be short of work for some time yet!

What did we learn about the 50p tax rate?

Paul Johnson
Director, Institute for Fiscal Studies

Experience tells us to treat revenue estimates with caution. As expected George Osborne announced that the 50p rate of income tax on incomes above £150,000 will be lowered to 45p from April 2013. He used analysis by HMRC suggesting that the introduction of the 50p rate raised only about £1bn a year, a lot less than the £2.5bn or so suggested by the Treasury when the increase was announced. And it estimates that cutting it to 45p will cost only £100m.

How much confidence should we put in that estimate? After all if nobody were to change their behaviour in response to this tax cut it would cost £3bn in lost revenue. But HMRC thinks that this £3bn loss will be offset by behavioural change resulting in an additional £2.9bn of revenue.

The raw figures are certainly startling. Total recorded incomes for those with incomes over £150,000 rose 14% in 2009/10 and then fell by a quarter in 2010/11. Income from dividends for this group rose by 78% in 2009/10 and fell by 73% in 2010/11.

One thing this tells us without the need for any fancy econometric analysis is that there was an awful lot of forestalling in anticipation of the higher tax. HMRC estimates that £16–18bn of income was moved into the earlier year.

But to work out exactly how much of the total drop in recorded income was down to forestalling, how much was down to in-year behaviour change – be it avoidance, evasion, lower work effort or emigration – and how much would have happened in any case required some pretty tough analysis.

By comparing what happened to the affected group with what happened to those on incomes between £115,000 and £150,000 they came to the conclusion that the revenue-maximising top income tax rate is most likely in the range 45%–50%, and hence changing the rate from 50% to 45% should make little difference to revenues.

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Who pays for dishonest conduct?

Anthony Thomas
President, Chartered Institute of Taxation

A sledgehammer to crack a nut ...

The 2012 Overview of Tax Legislation and Rates confirmed that provisions to tackle dishonest conduct of ‘tax agents’ were proceeding.

It is right that HMRC should crack down on the few agents that are dishonest but I remain concerned about these proposals. They are a sledgehammer to crack a nut and the extent to which HMRC has excessive powers being handed to them is worrying.

There seems to be a ‘disconnect’ between these provisions and the system currently being considered on the tax agent strategy used to identify poor agents.

A major concern is the potential disruption to third parties who
are likely to bear much of the cost. The CIOT and others applied pressure to HMRC to amend the draft legislation to permit third parties (for example former employers) to make representations. At least this should minimise the risk of being ‘named’ when a former employee is subject to this legislation.

Another concern relates to the definition of ‘tax agent’. We need to be aware that the definition goes much further than a traditional agent. It covers anyone not in the tax profession acting dishonestly when producing a document which is relied upon for tax purposes. There is clearly a huge communication problem for HMRC to inform everyone potentially affected by these provisions.

The draft legislation issued in December 2011 seemed to be aimed at sole practitioners and was confusing an individual acting dishonestly and the firm which employs that person or indeed employed someone 20 years ago. This needs clarification as tax practitioners in industry seem to be excluded but the legislation is far from clear. It remains to be seen if the Finance Bill will improve matters. I still remain of the firm opinion that HMRC do not need any further powers!

Changes to VAT

Robert Maas
Technical Director, Institute of Indirect Taxation

This year’s VAT changes have focused largely on what the Treasury call ‘correcting anomalies and closing loopholes’. Translated into English this seems to mean ‘reversing all of the things that were decided against us in the Tribunals and the courts in the last couple of years’.

The interesting question this raises is will it give HMRC a quiet life or will it turn into a string of European Commission v UK cases before the CJEU?

It is hard to argue against the fact that the zero-rating of some foodstuffs is a mess. But the Chancellor has shied away from a full review of this area and has homed in instead on hot food and sports nutrition drinks. Ironically the first is an area where the law seemed to be developing coherently, apart from the dilemma of what is the premises.

But ‘areas adjacent to’ a retailer is so vague that it is unlikely to help many people decide. Zero-rating is, of course, a transitional derogation so it is unclear to what extent EU law can be called an aid by taxpayers.

But defining the nature of a product by how it is marketed, as the Chancellor has done with sports nutrition drinks, could well be a step too far.

So could seeking to categorise land-based supplies such as hairdressing chair rental, caravans and storage, as a service rather than an interest in land irrespective of the facts.

Any court is likely to take a dim view of the State labelling something as what it is clearly not. And when does chair rental merge into cost sharing?

A Budget for all businesses?

Paul Aplin
Chairman of the ICAEW Tax Faculty Technical Committee

This was a Budget more for big businesses than for smaller ones.

In his Budget speech, the Chancellor set out his aspiration to create a tax system ‘that is more competitive for business than any other major economy in the world’. We saw tangible signs of this commitment, particularly the further cuts to the main rate of corporation tax. Add that to CFC reform, the Patent Box and an above the line R&D tax credit and we have now seen a series of very welcome moves towards his aspirational goal. These are, though, all measures designed to help the UK’s largest companies.

I spent Budget day with a BBC TV crew at a coach business in Taunton. The owner’s reaction to the Budget was a shrug: no good news on fuel duty and no good news on capital allowances. Then at my firm’s Budget breakfast presentation I shared my thoughts on the Budget with 150 local business people – and they shared their reactions with me. They felt that small and medium-sized businesses had been forgotten. The cut in the corporation tax rate was irrelevant to many of them (either because they did not generate profits at a level sufficient to pay it or because they did not operate as companies), but the cuts to capital allowances over the past couple of years had affected most of them.

There were, though, some welcome words for smaller businesses in the Exchequer Secretary’s introduction to HMRC’s Budget day document Making tax easier, quicker and simpler for small business. He acknowledged that ‘small businesses make a vital contribution to the UK economy.’ I hope that in Budget 2013 we will see some tangible recognition of that fact in measures that the businesses I spoke to last week will welcome – especially those that choose not to operate as companies. The views expressed here are the author’s own and not necessarily those of his firm or of the ICAEW.

Tough on avoidance

Richard Baron
Head of Taxation, Institute of Directors

George Osborne hates tax avoidance, and he has made it clear with actions, some predicted and some not.

We knew that a General Anti-Avoidance Rule (a GAAR) was coming. If it follows the model proposed by Graham Aaronson it should not damage business. It will create a grey area of schemes that may or may not be caught. But the whole grey area lies well inside the area of the distinctly dodgy.

A bigger threat to certainty comes from the threat of retrospective legislation to tackle schemes that save stamp duty on expensive houses. You had better not make the Treasury angry. Unlike with the GAAR, taxpayers will have no idea how much planning will make the Treasury angry. So the only safe thing to do will be to pay up.

Why not take a chance, on the basis that even if you are caught, you will only have to pay the duty avoided anyway? Because it could be worse than that. The new 15% rate when
residential property is sold to a company, plus the annual charge on company-owned mansions, make it clear that the government will be happy to impose penal charges and make you wish you had never tried stamp duty avoidance.

Finally, there are the proposals to limit the total of tax reliefs that are currently uncapped, and to deny qualifying life policy status to new policies, to the extent that the individual’s annual premia exceed £3,600. The logic is this: some taxpayers use reliefs and qualifying policies to make excessive tax savings, so we will clamp down on everyone, then (for the limit on total reliefs) think about any necessary let-outs, such as large charitable donations. George Osborne has no qualms whatever about taking the tax planners’ ball away and sending them home in disgrace.

Don’t look back in anger

Ashley Greenbank
Chair of the Tax Law Committee of the Law Society of England and Wales

The perils of retrospective legislation ...
The Budget announcements affecting high-value residential property certainly caught the eye. The increased rate of SDLT (7%), the additional charge (15%) on transfers of high-value residential property to ‘non-natural persons’, when coupled with the proposed annual levy on property held by such persons and the CGT charge on disposals of UK residential property by them may have a significant effect on the market. But from a business tax point of view perhaps the most worrying aspect was the Chancellor’s statement that he would introduce retrospective legislation if ‘inappropriate ways are found round these new rules’.

When, if ever, is retrospective legislation justified? The government has some form on this issue. It was only last month that the Exchequer Secretary announced retrospective changes to the loan relationship rules to counteract ‘outrageous’ schemes to allow companies to buy back debt at a discount to its face value without incurring a tax charge on the deemed release that would otherwise occur. In that case, the government could point by way of justification to the fact that the scheme in question would otherwise have allowed a solvent bank, that had signed a code of conduct in relation to tax planning, to buy back its own debt at a discount without paying tax on its commercial profit. But the same planning was also used by debt-laden companies to restructure their debts and avoid insolvency. Were those schemes so ‘outrageous’ as to justify retrospective legislation?

As the Exchequer Secretary himself recognised, when he was an opposition Treasury spokesman, retrospective legislation threatens to undermine the reputation for certainty in our taxation system (remember deductions for employee liabilities in Finance Bill 2009). And a reputation for retrospective legislation will only serve to undermine the government’s efforts – through the tax system or otherwise – to promote the UK as an attractive location for business.

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The view from LITRG

Robin Williamson
Technical Director, LITRG

The rise in the basic personal allowance and the tax credits changes bring mixed benefits, depending on income levels and individual circumstances, while the age allowance changes will cost pensioners in the medium term. For people on middle incomes, the rise in the personal allowance is good news. But those on means-tested benefits will keep comparatively little of any tax saving, as means-tested benefits are based on net, after-tax, income. So a person receiving, say, housing benefit and council tax benefit may only keep a mere 15% of what they save in tax. And of course people with incomes below the level of this year’s personal allowance will see no benefit at all from the increase.

Tax credits are a vital component of the household budgets of those with low paid jobs or responsibility for children, and changes here must be balanced against the tax measures announced in the Budget. In particular, many low-income couples with children will find themselves a lot worse off from April because of the new rule that they must work 24 hours a week, not 16, to qualify for working tax credit. One positive development is that, following persuasive pre-Budget representations by a number of charities led by LITRG, couples where one partner is entitled to carer’s allowance were added to the list of exceptions from this new rule.

For pensioners, the increase in the State pension has to be balanced against far less generous rises in the higher personal allowances for those aged 65 and over. This phasing out of age allowances has been dubbed a ‘granny tax’.

In reality it is not a tax, merely the ending of an expectation that older taxpayers will always be entitled to a higher personal allowance than the under-65s. No doubt this will achieve simplification in the longer term, but at a cost to pensioners in the interim, not least in terms of added complexity over the next few years.