Tax without design

Paul Johnson

15th CTA address

May 13 2014

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?

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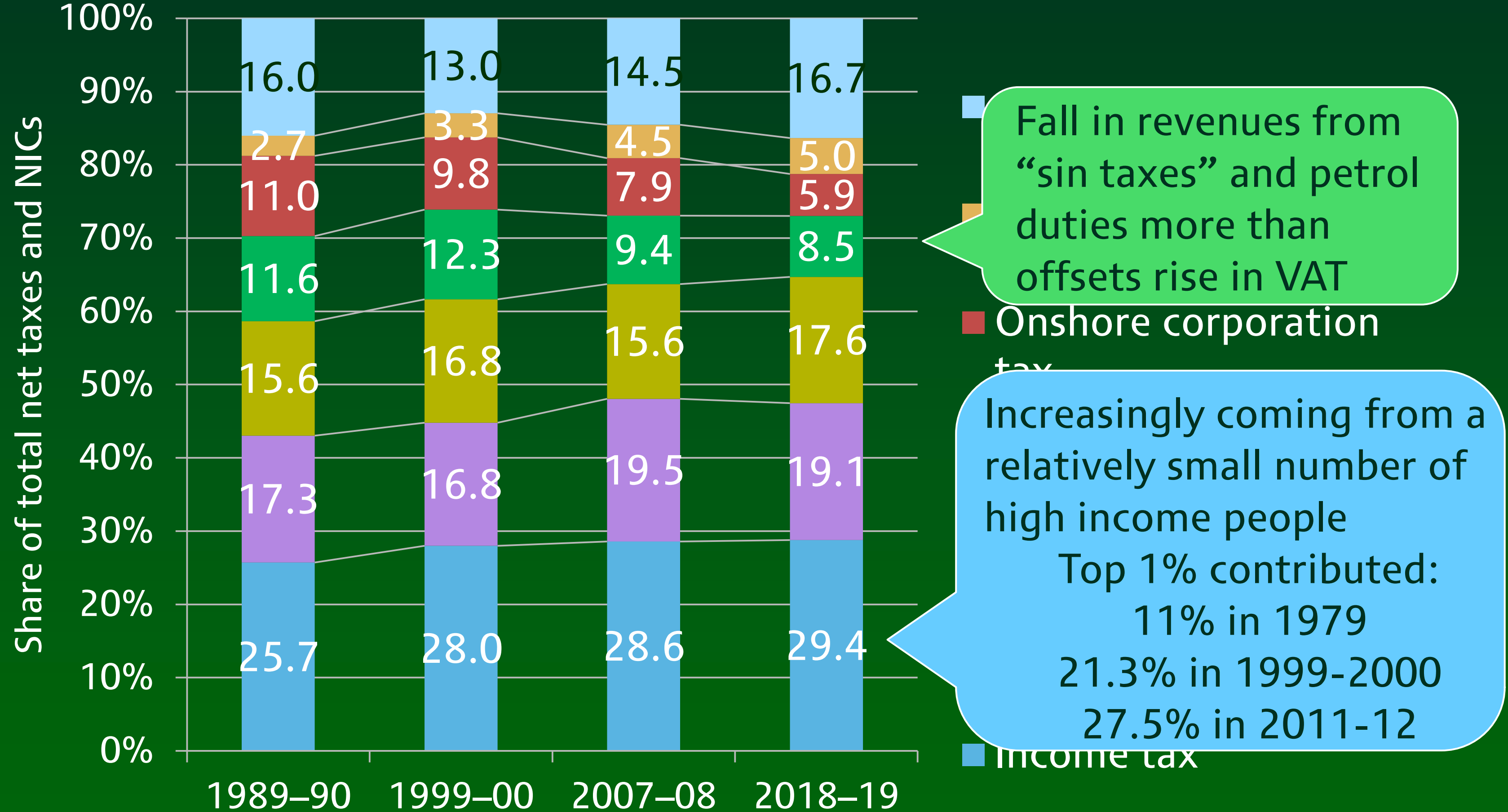
Composition of tax revenues



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

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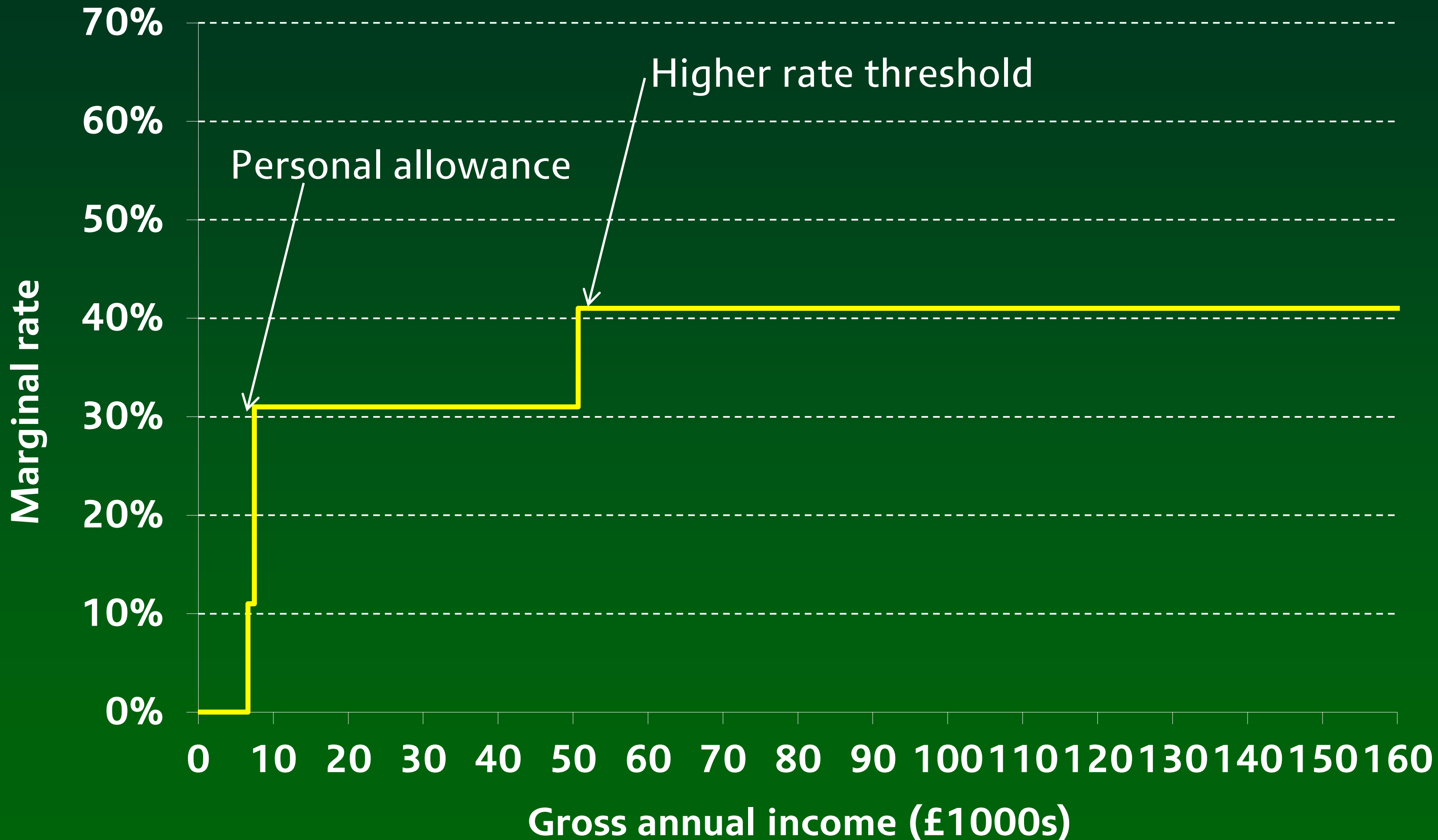
Direct taxes

- 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.

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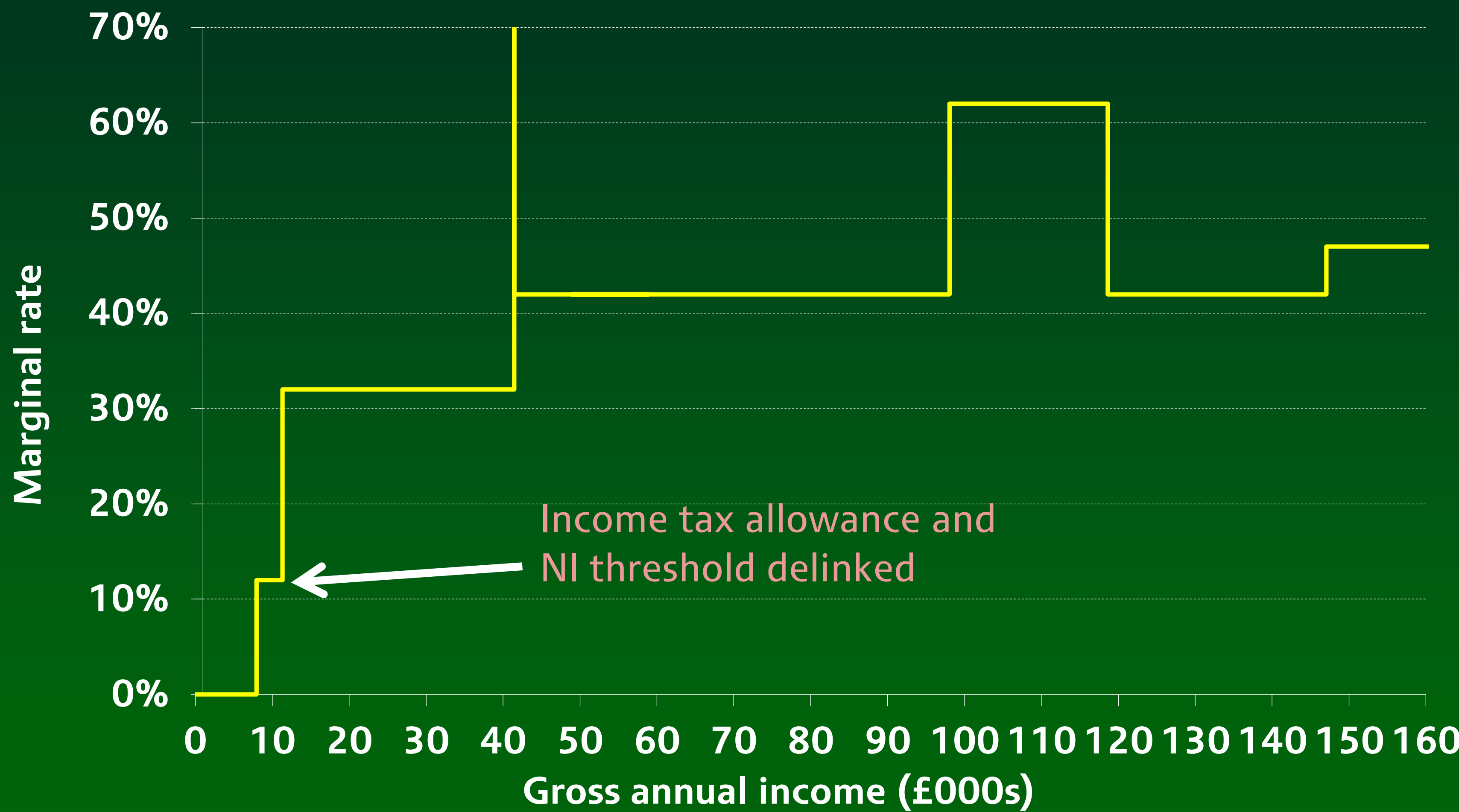
Income tax and employee NICS marginal rates 2015-16 (married, non-working spouse)



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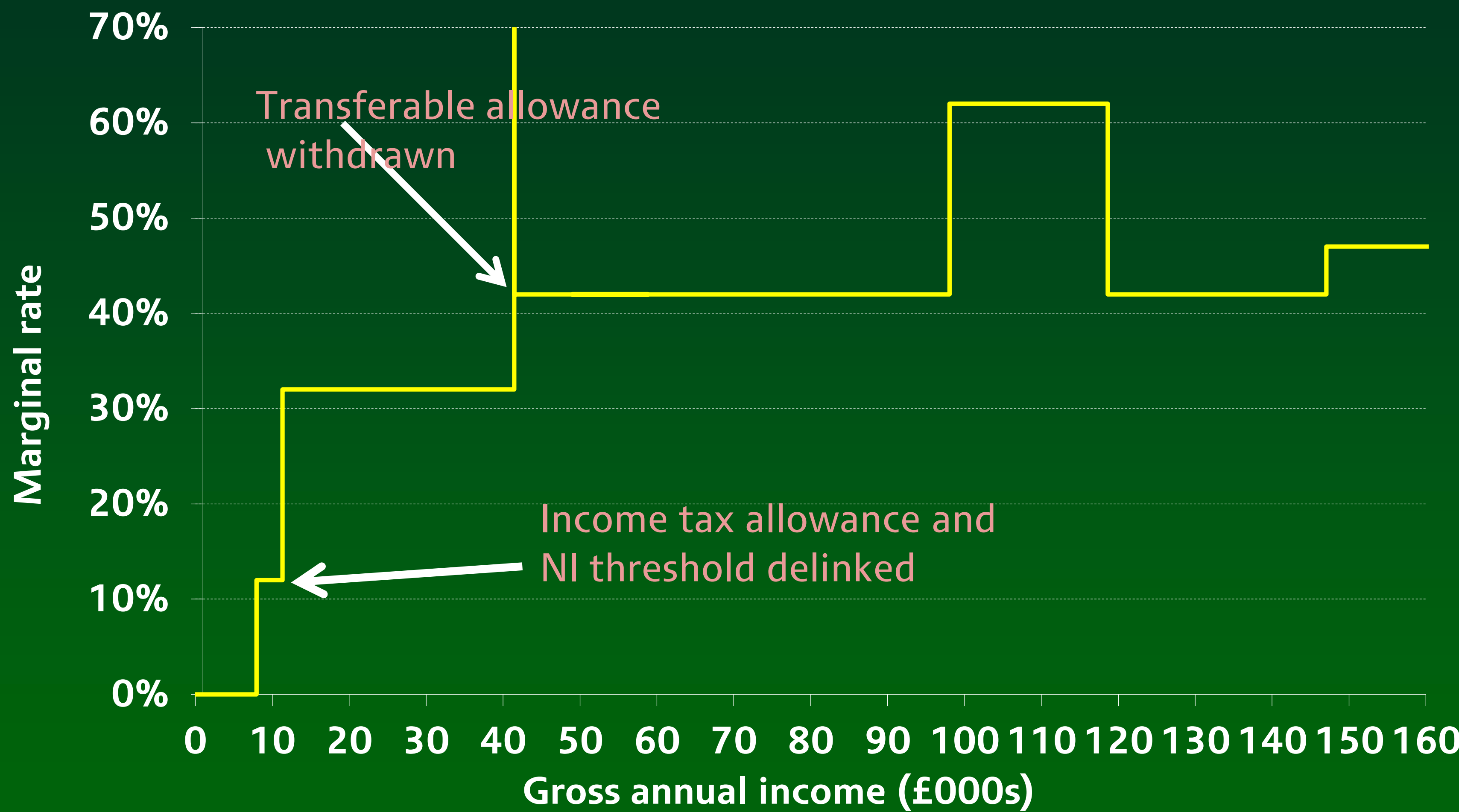

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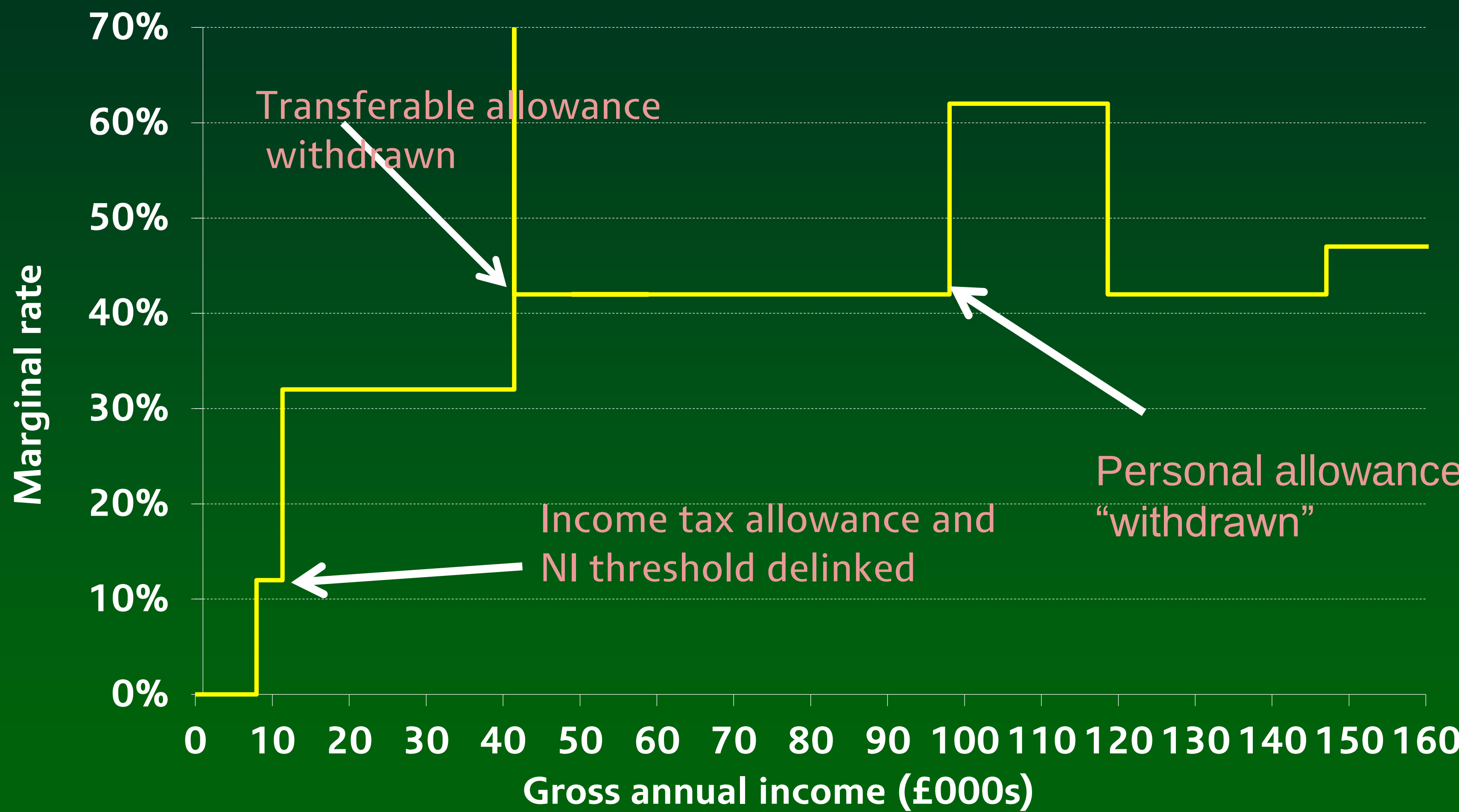

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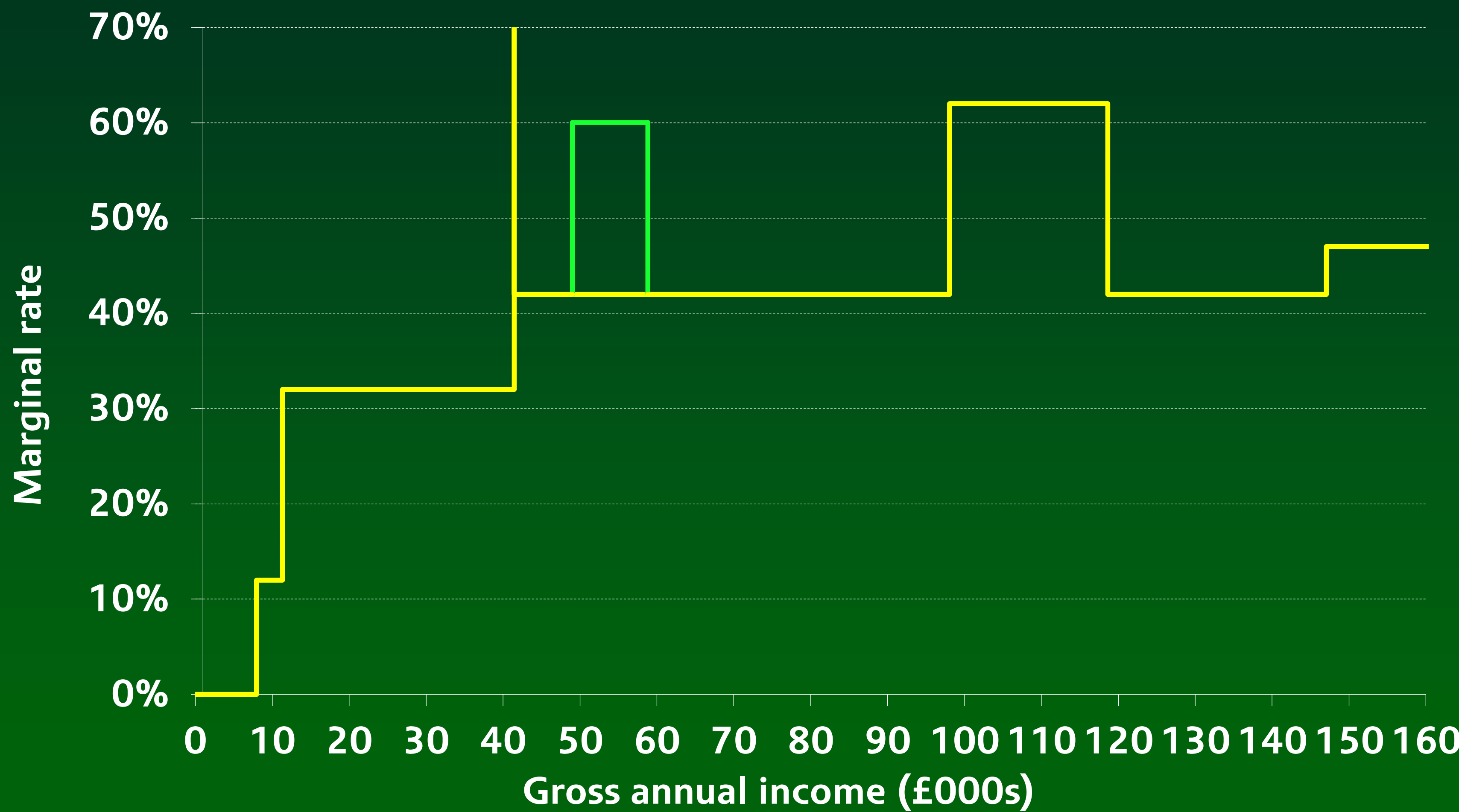
Income tax and employee NICS marginal rates 2015-16 (married, non-working spouse, 2 children)



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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
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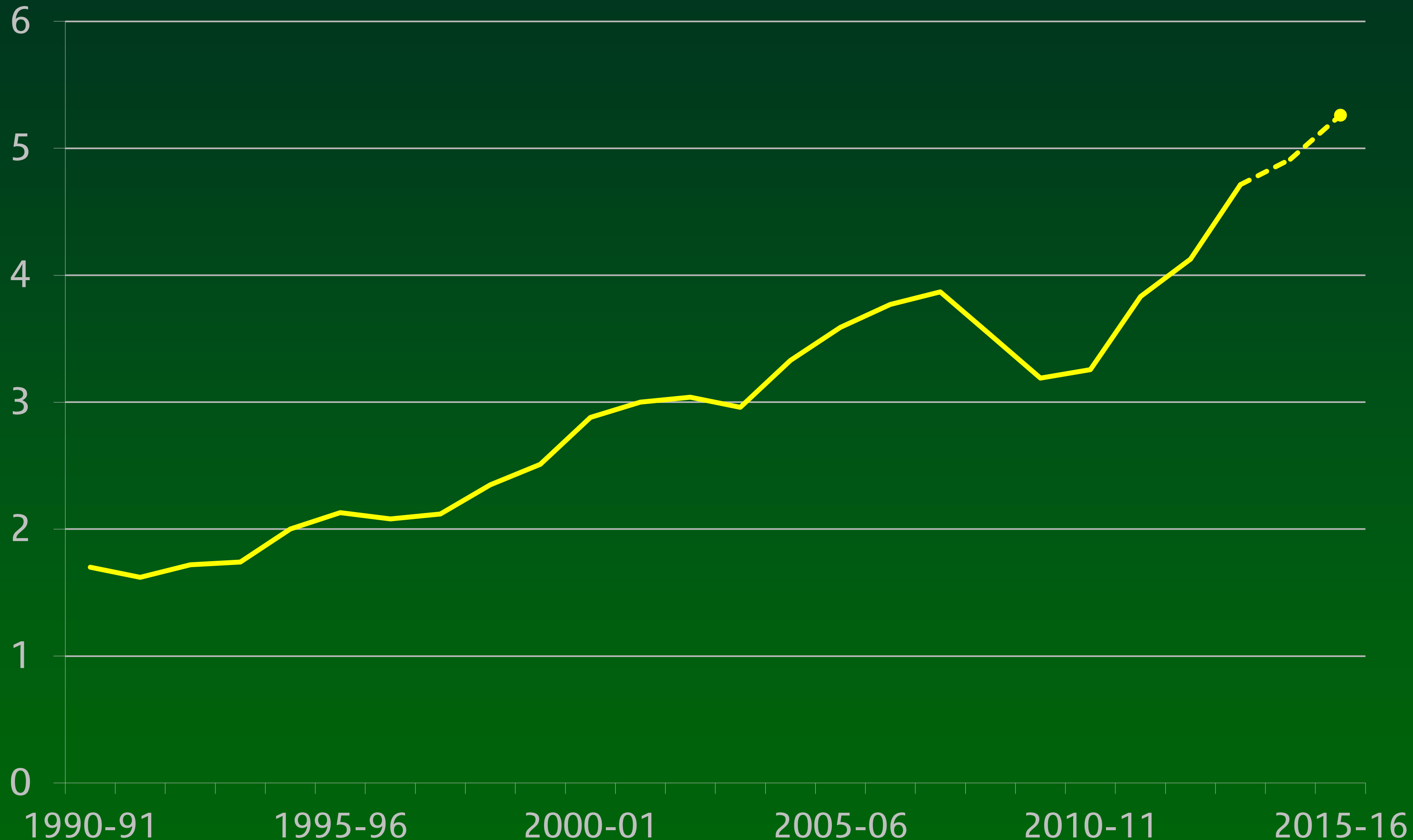
Number of higher-rate taxpayers (millions)



Note: includes additional-rate taxpayers

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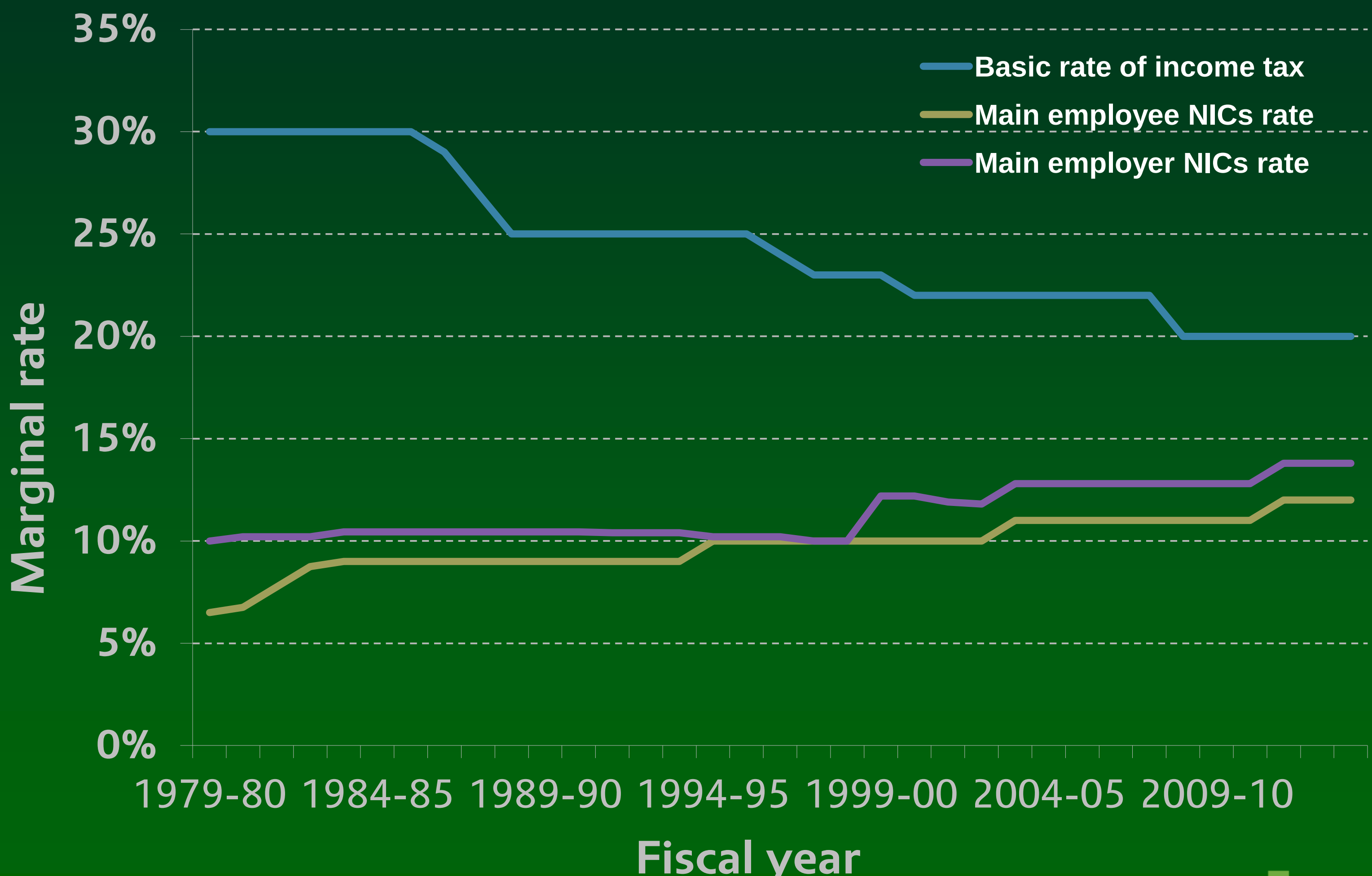
- One for the really nerdy:
  - Parameters in the employer NI system rise with the RPI
  - Parameters in the employee NI system rise with the CPI

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



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.

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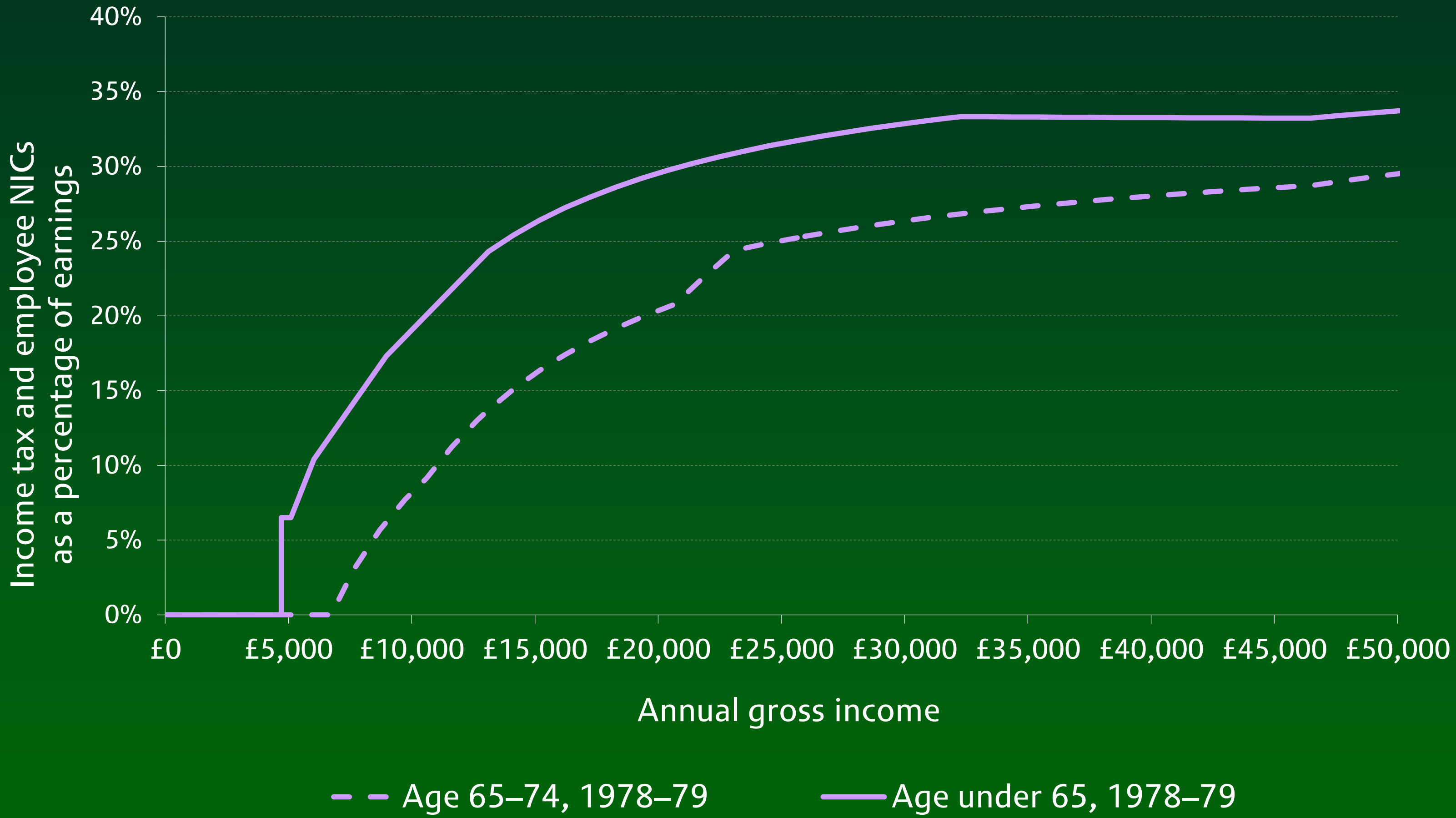
Total income tax and employee NICs rate by income in 1978–79 and 2015–16



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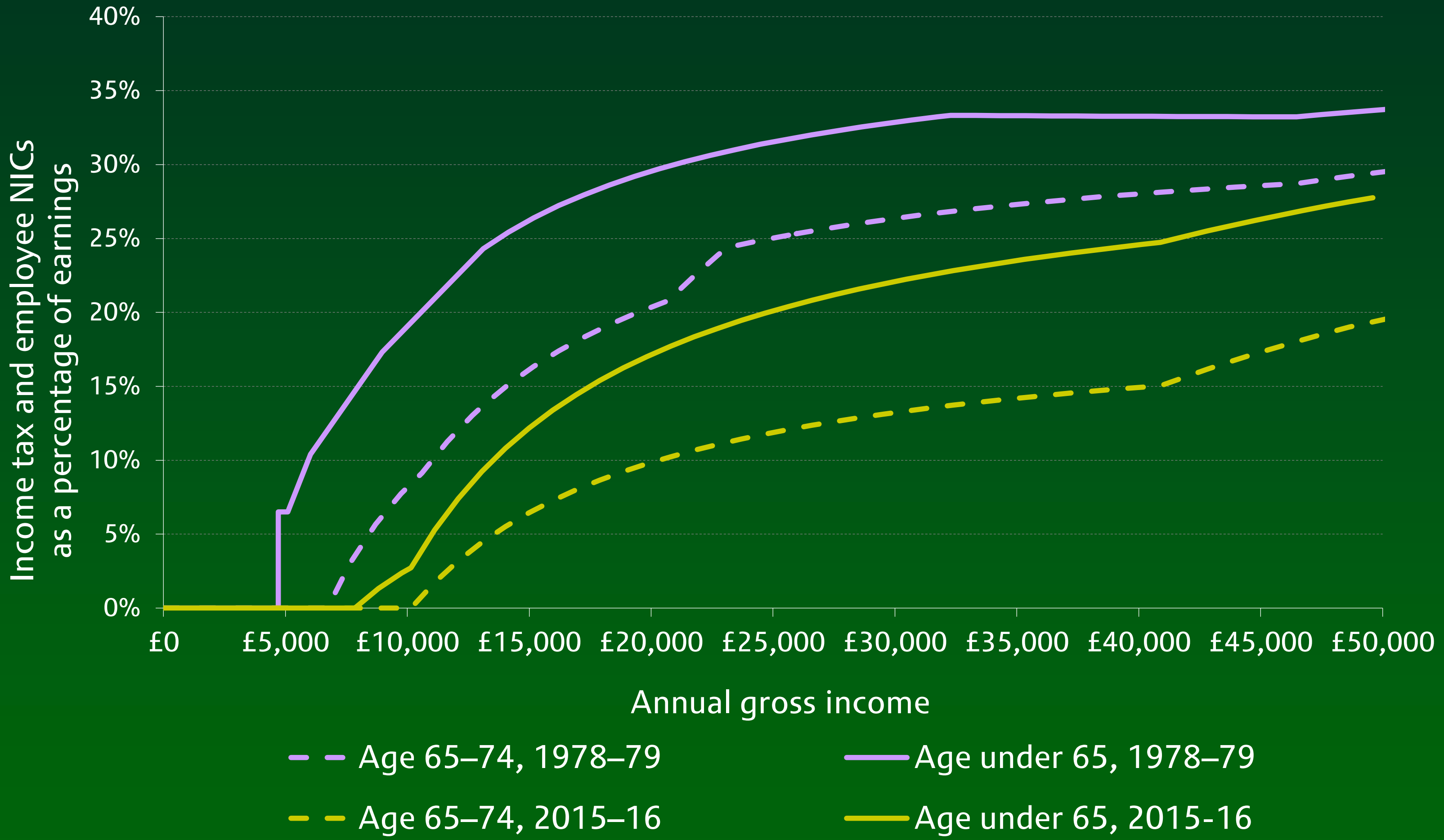

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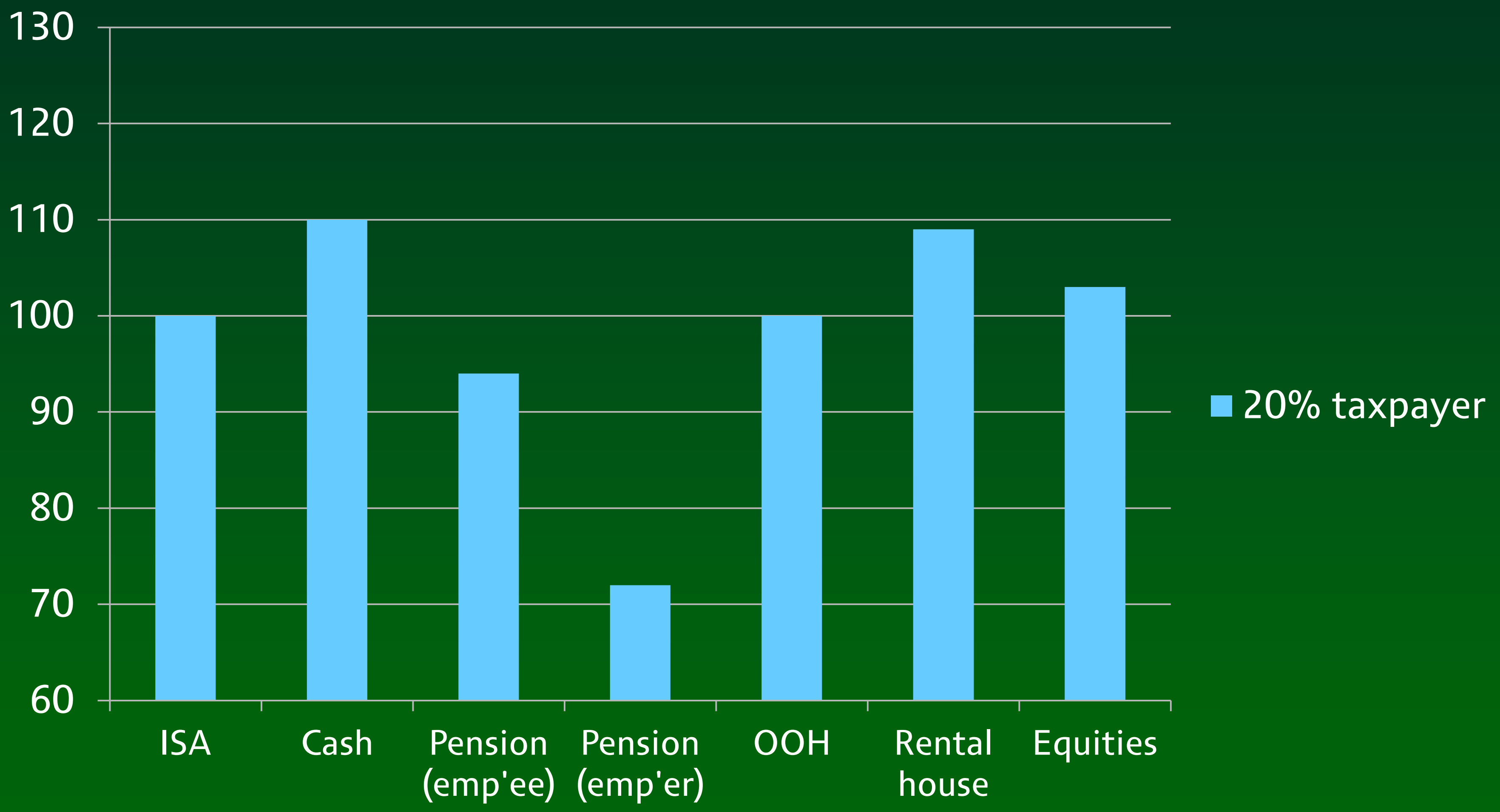
Taxation of savings and capital

- 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



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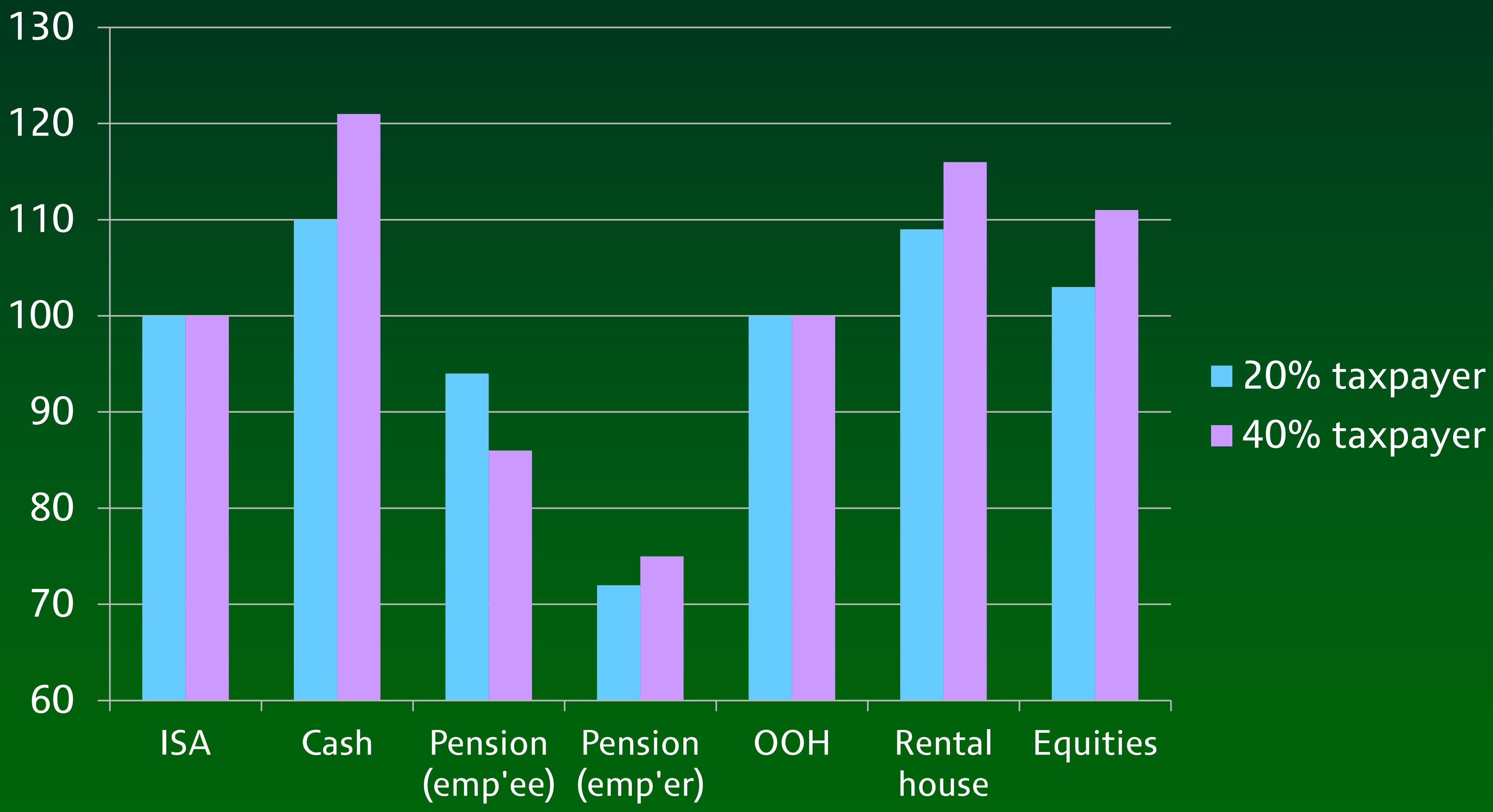

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Pensions

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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?

Products currently facing 20% VAT	Products currently facing 0% VAT
Cereal, muesli and similar sweet-tasting bars	Flapjacks
Potato crisps	Other roasted vegetable chips, tortilla chips
Marshmallow snowballs with no biscuit base	Marshmallow teacakes with a biscuit base
Chocolate bars that are ‘eaten with fingers’	Chocolate body paint
Sweet-tasting dried fruit for snacking	Sweet-tasting dried fruit for home baking
Chocolate buttons not for use in baking	Chocolate mini-buttons for use in baking
Frozen yoghurt and ice cream	Baked Alaska
Gingerbread men decorated with chocolate	Gingerbread men on which the chocolate amounts to no more than two dots for eyes

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  - At a cost of £5 billion a year relative to inherited plans

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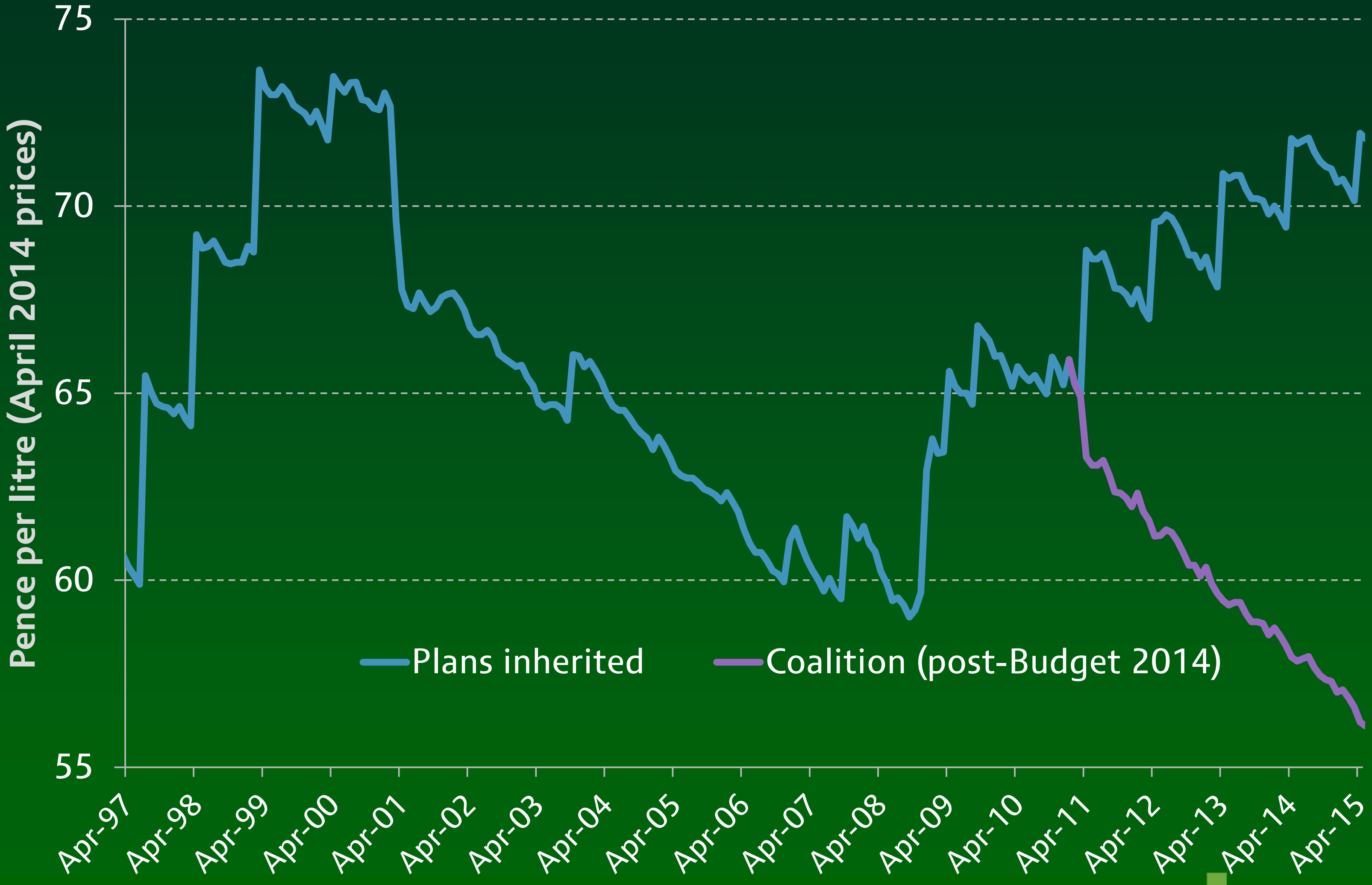
Real duty on a litre of petrol

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

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Fuel duties: to uprate or not to uprate, Acts I to VI

Dates due before Budget 2011	Budget 2011	AS 2011	June 2012	AS 2012	Budget 2013	AS 2013
Apr 2011	Jan 2012	Aug 2012	Jan 2013	Cancelled	Cancelled	Cancelled
Apr 2012	Aug 2012	Cancelled	Cancelled	Cancelled	Cancelled	Cancelled
Apr 2013	Apr 2013	Apr 2013	Apr 2013	Sep 2013	Cancelled	Cancelled
Apr 2014	Apr 2014	Apr 2014	Apr 2014	Sep 2014	Sep 2014	Cancelled
Apr 2015	Apr 2015	Apr 2015	Apr 2015	Sep 2015	Sep 2015	Sep 2015
Apr 2016	Apr 2016	Apr 2016	Apr 2016	Apr 2016	Apr 2016	Apr 2016

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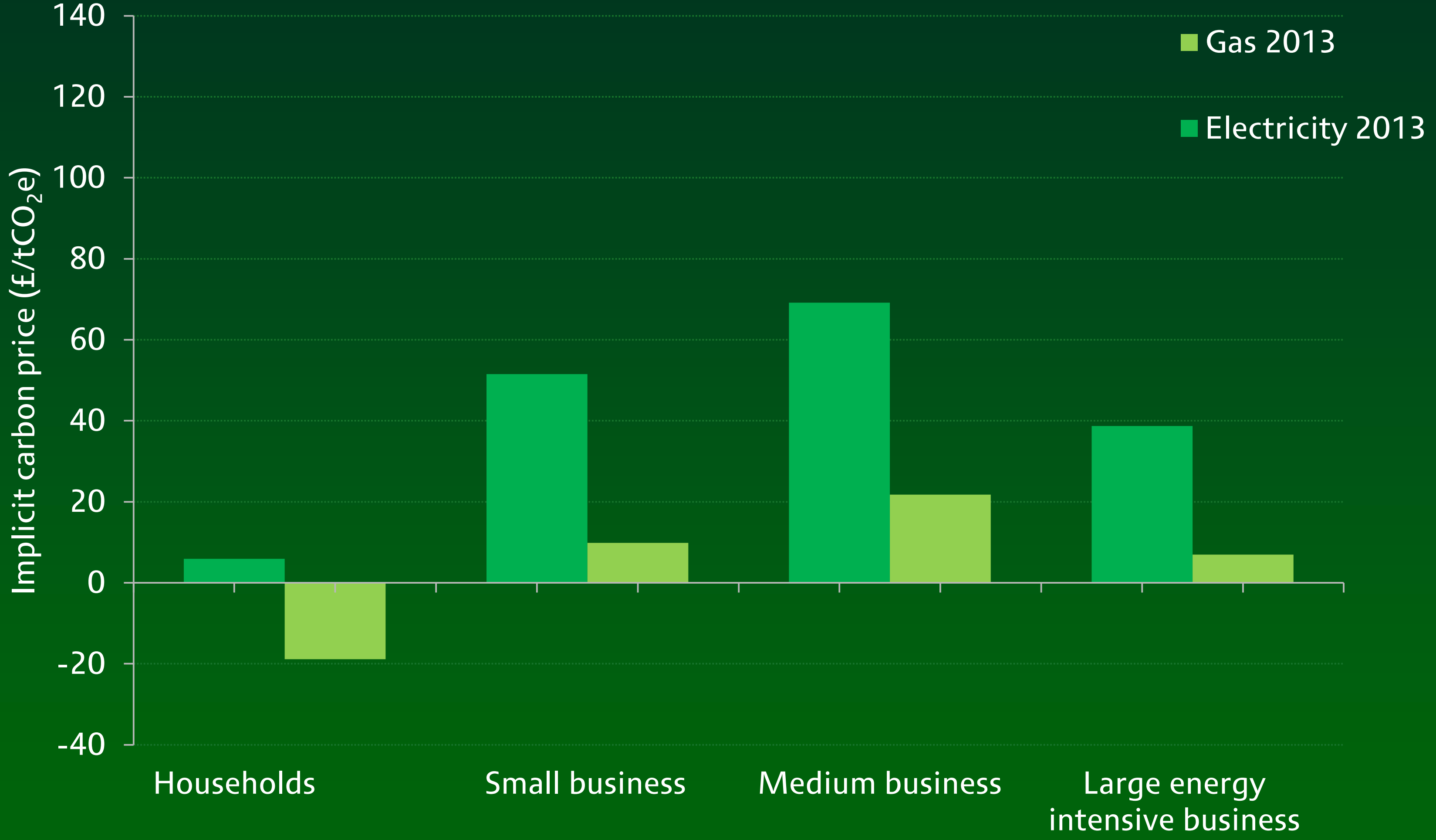
Environmental taxes

- May be newer but they are just as messed up as the rest of the system

Implicit carbon prices in 2013 and 2020



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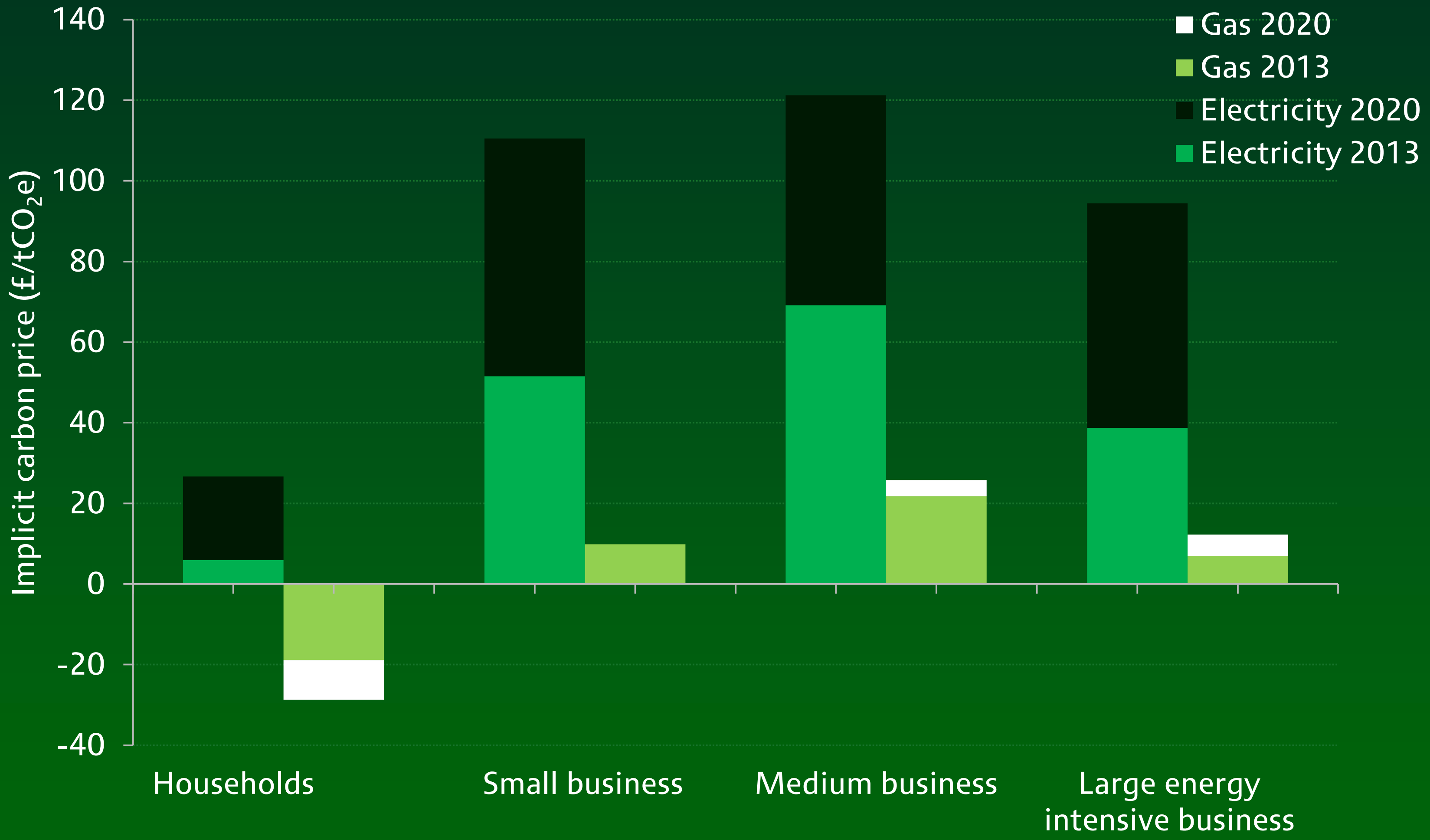

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- Carbon Price Support Rate (CPSR)
  - CPSR introduced in April 2013 to 'top up' the EU Emission Trading Scheme carbon price to meet the Carbon Price Floor (CPF) set by the government
  - applies to all UK generators of fossil-fuel-based electricity
- Introduced in Budget 2013 with a clear trajectory to create certainty for investors
  - Which was undone in Budget 2014

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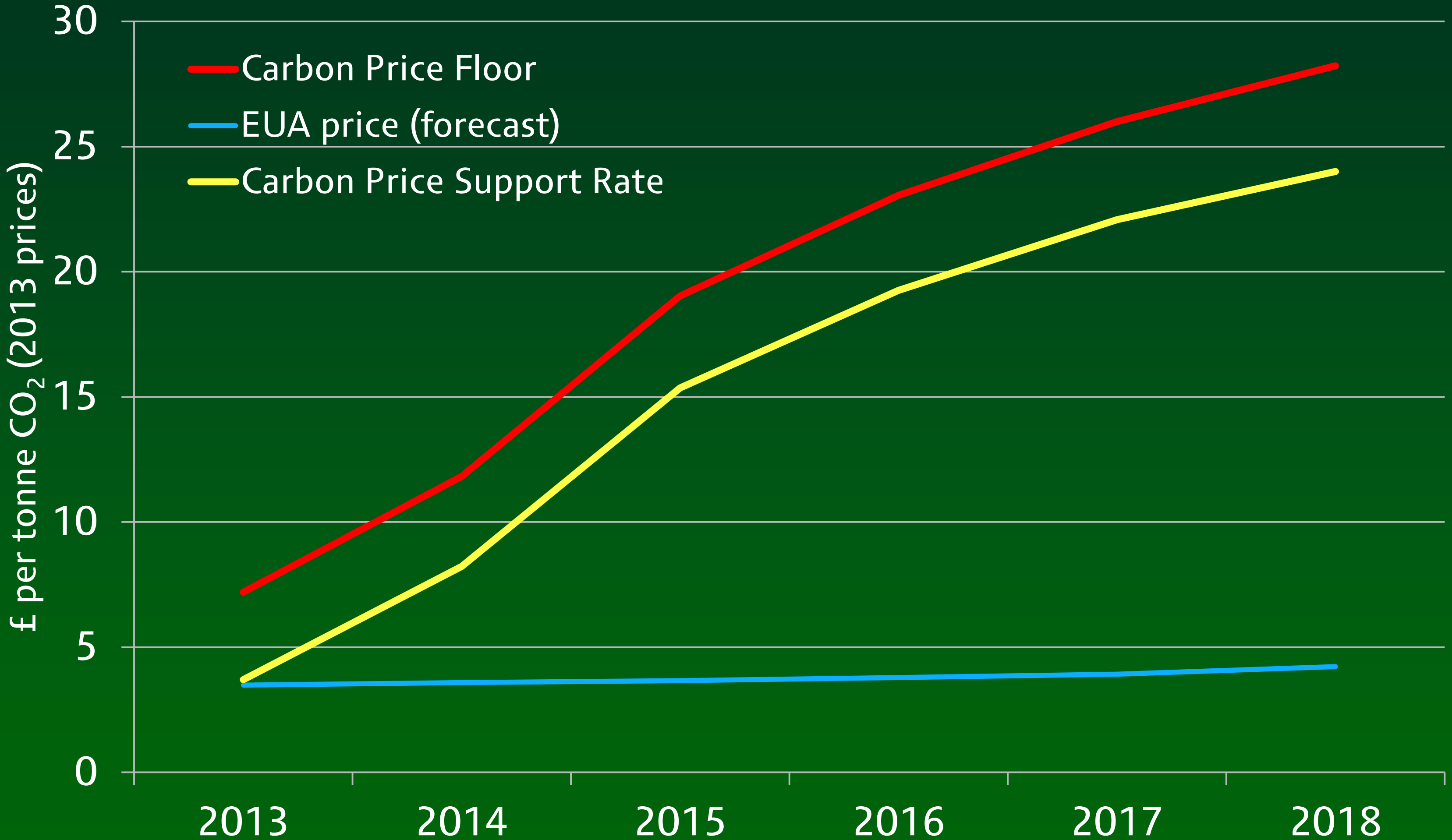

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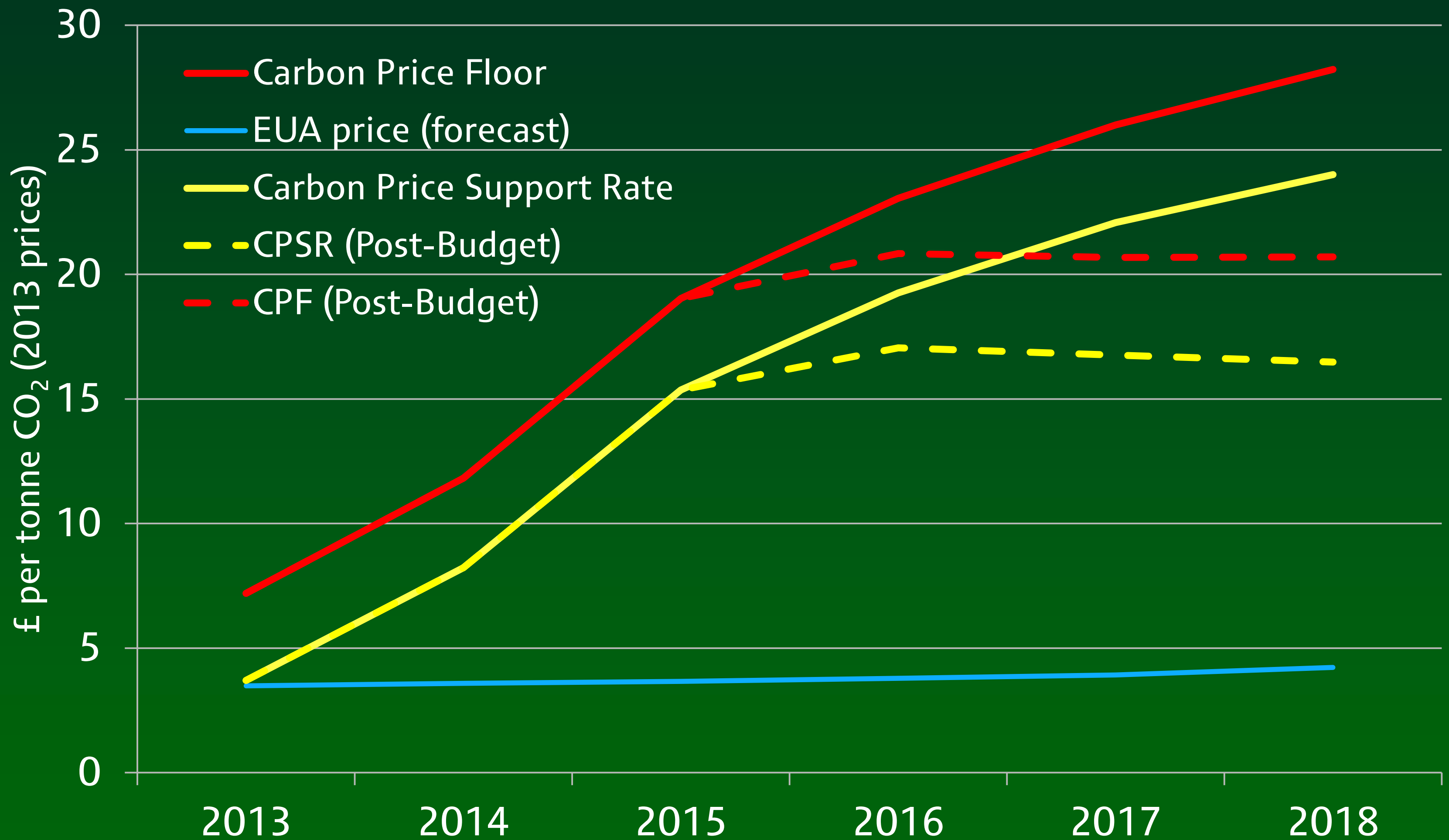

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- Stamp duty is one of the worst and most distorting of all our taxes
  - Its slab structure means a £1 increase in sale price can add £40,000 to the tax bill
  - It discourages transactions
  - Yet it has been ratcheted up time and again

The increase in stamp duty rates

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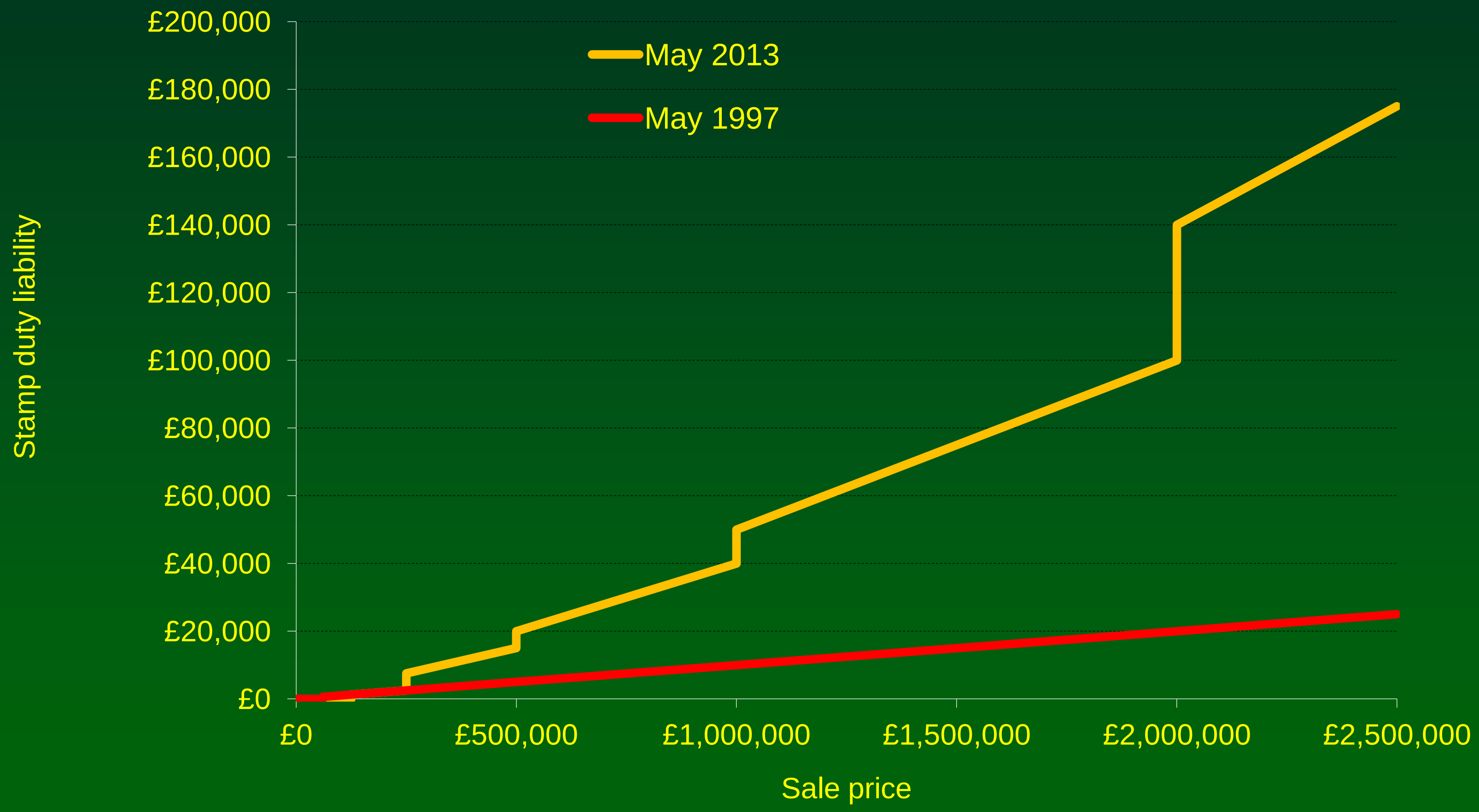

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Business taxation

- 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
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  - Absurd degree of inconsistency in Annual Investment Allowance

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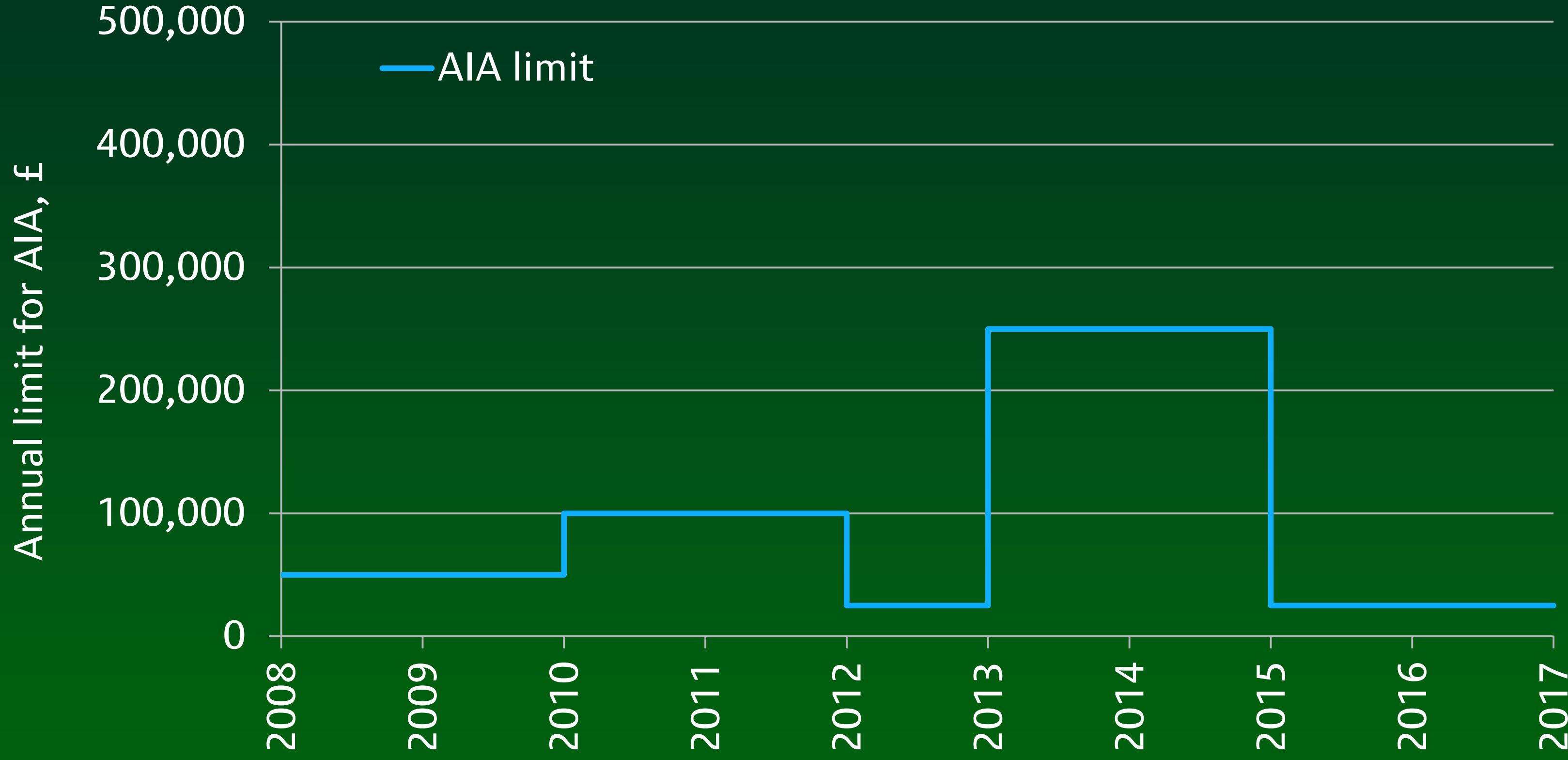
Annual Investment Allowance (AIA)



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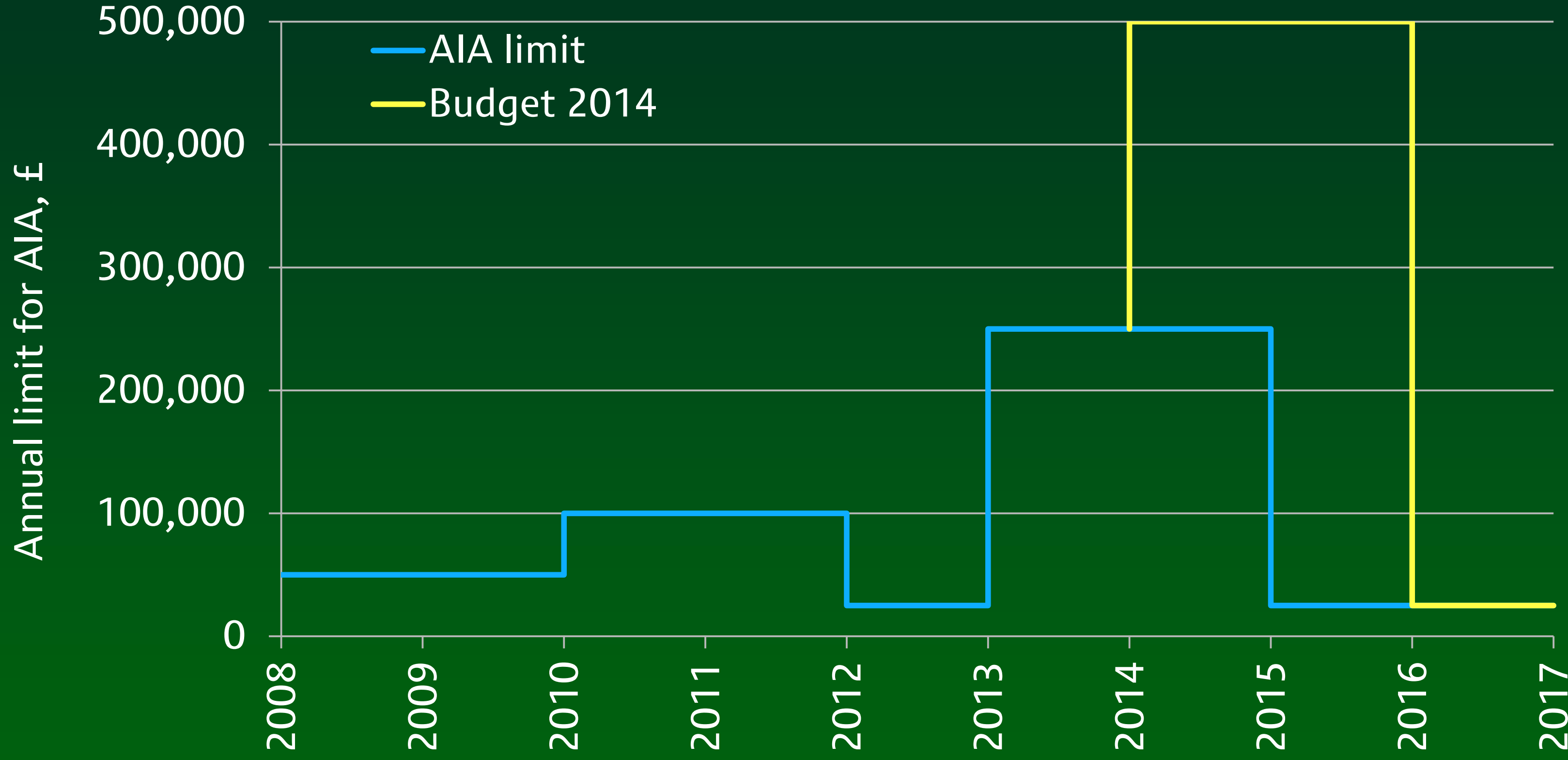

- AIA set at £250,000 for 1 Jan 2013 – 31 Dec 2014. Would have returned to £25,000 in January 2015. Now £500,000 from April 2014 to end of 2015

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  - Problems in design of the Patent Box

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Lord Lamont:

> [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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- We can do better