Tax measures

Stuart Adam
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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Statutory corporate tax rates in the G20, 2015

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
Annual investment allowance

- Before Budget
- After Budget

£0
£50,000
£100,000
£150,000
£200,000
£250,000
£300,000
£350,000
£400,000
£450,000
£500,000
£550,000

Apr-08, Apr-09, Apr-10, Apr-11, Apr-12, Apr-13, Apr-14, Apr-15, Apr-16, Apr-17
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• Companies making profits ≥£20m must pay tax 3 months earlier
  – Raises one-off £7.8bn
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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• 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
UK headline corporation tax rate

- Before Budget
- After Budget
- After Budget - banks

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

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
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?
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
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