Conservative and Labour tax proposals

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What’s coming up

• Discuss Conservative and Labour proposals on:
  – Income tax
  – Pensions tax relief
  – Taxation of housing
  – Tax avoidance

• Analyse policies as if in place in 2015–16, assuming all measures announced up to and including Budget 2015 already in place

• In each case, look at:
  – Winners and losers
  – Impact on incentives
  – Simplicity and efficiency

• Full report also looks at Liberal Democrat proposals
Income tax proposals

• Conservatives:
  – Increase personal allowance to £12,500 and higher-rate threshold to £50,000 by 2020–21. Overall cost: £5.9 billion per year

• Labour:
  – Abolish transferable personal allowance for married couples and introduce 10% income tax band. Revenue-neutral
  – Increase 45% additional rate of income tax to 50%. Yield: HMRC estimate £110 million per year, but highly uncertain
Conservative income tax proposals
2020–21 system in current prices

Gross income

Combined marginal income tax and employee NI rate

Increasing gap between employee NICs threshold and personal allowance

Basic-rate taxpayers gain £162 a year

Higher-rate taxpayers gain £539 a year

Note: assumes all income from employment, no pension contributions

Conservative proposals

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Personal allowance increase

• Both Conservatives and Liberal Democrats want to increase the personal allowance to £12,500 by 2020–21

• Biggest tax cut proposed by any of the three parties: £4bn
  – Follows £8 billion giveaway during last Parliament
  – Conservatives want to link personal allowance to minimum wage, which would increase the cost in the long run

• 44% of adults don’t pay income tax, so wouldn’t benefit
  – Up from 39% in 2010–11
  – Most taxpaying pensioners would benefit, unlike previous increases
Increasing higher-rate threshold: Cost £1.9bn

Number paying higher rates has risen from 3.3 million to 4.9 million under coalition

Would increase to 6.4 million without reform

Conservative reform would restrict growth: 5.2 million by 2020–21

1.2 million fewer paying higher tax rate
Distributional impact of the Conservative Party’s income tax proposals

Percentage change in net income

Income Decile Group

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Distributional impact of the Conservative Party’s income tax proposals

Percentage change in net income

Income Decile Group

Poorest 2 3 4 5 6 7 8 9 Richest All

Restriction of pensions annual allowance
Higher rate threshold
Personal allowance
Total

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Labour: abolish transferable personal allowance, reintroduce 10% income tax rate

- Transferable personal allowance allows a non-taxpayer to transfer part of their personal allowance to their spouse, if they are a basic-rate taxpayer
  - One third of married couples benefit by up to £212 a year from this
  - Single-earner couples and pensioners: tend to be in lower-middle of income distribution
  - Costs £675 million a year

- Would allow a 10% tax rate to apply to the first £260 of taxable income: all with incomes more than £11k gain £26/year
  - Tiny range: why not increase personal allowance?

- Both policies very small: replacing one complication of income tax system with another
Distributional impact of abolishing transferable personal allowance and Labour’s 10p income tax rate

- Abolishing married couples' TPA
- 10p income tax rate
- Both

Percentage change in net income

Income decile group

Poorest 2 3 4 5 6 7 8 9 Richest All
Labour: increase additional rate of income tax to 50%

- Labour (and SNP) would increase the additional rate of income tax that applies above £150,000 to 50%
  - Affects highest-income 313,000 adults
- Would raise £3.6 billion a year if no behavioural change
- But big behavioural response likely
  - HMRC estimated that cut from 50% to 45% would cost just £110 million a year (though much uncertainty)
- Previous evidence has shown much of response increased use of tax deductions and shelters
  - Labour’s anti-avoidance measures and restriction on tax relief on pension contributions may increase yield from this tax rise
- Even so, cannot rely on significant additional revenues from this
The tax schedule in 2020–21
2020–21 system in current prices, single-earner couple

Combined income tax and employee NI rate

Gross income

Note: assumes all income from employment, no pension contributions

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The tax schedule in 2020–21
2020–21 system in current prices, single-earner married couple with one child

Combined income tax and employee NI rate

Current plans
Conservative proposals
Labour proposals

Withdrawal of child benefit
Withdrawal of personal allowance

10% income tax rate applying over small income range

Note: assumes all income from employment, no pension contributions
Restricting tax relief on pension contributions

• Much instability over last five years
• Would continue under both Conservatives and Labour
• Conservatives: reduce amount of contributions that attract income tax relief for those with incomes above £150,000
  – Sliding scale from £40,000 at £150,000 to £10,000 at £210,000
  – Expect this to yield £1.4 billion a year
• Labour: reduce annual allowance to £30,000 and give relief at 20% rather than marginal rate for those with high incomes
  – Income above £130,000 and incomes + employer pension contributions of more than £150,000
  – Together expected to yield £2.3 billion a year
Problems with Conservative and Labour proposals on pensions tax relief

• Moving away from sensible system
  – Tax relief on contributions, returns untaxed, pay tax on withdrawals
• Conservative proposal would create strong disincentive for those with incomes £150-£210k to increase earnings
  – Why allow £40k of contributions at £150k but only £10k at £210k?
• Labour proposal creates ‘cliff-edge’ at £130,000
  – Why is relief at marginal rate ‘fair’ for 40%, but not 50%, rate taxpayers?
• Are better alternatives: remove genuine subsidies that exist in the current system:
  – Tax free lump sum: get up to £250,000 tax-free
  – Employer contributions not subject to NICs at any point: £14 billion a year exchequer cost
Taxation of housing: Conservatives’ inheritance tax proposal

• New transferable £175,000 main residence allowance in IHT

• Increases effective IHT threshold to £1 million for married couples
  – If main residence worth at least £350k

• Gradually withdrawn from estates worth more than £2 million, creating effective 60% IHT band

• Leaked HMT advice said ‘not strong economic arguments’ for this policy
  – Creates incentive to hold wealth in main home rather than downsize
  – Tax system already favours owner occupation
Taxation of housing: ‘Mansion tax’

• Labour: ‘Mansion tax’ on properties worth more than £2 million
  – Lib Dems and SNP have similar policy
• Banded structure similar to council tax
• Annual charge of £3,000 for properties worth £2 million-£3 million
• Revenue target of £1.2 billion will determine liabilities above that
• No one knows how many properties would be affected
• If 95,000 between £2 million and £3 million and 55,000 above £3 million, those above £3 million would pay £16,600 each on average
• Basic-rate and non-taxpayers will be able to defer payment (with interest) until sale or death
Taxation of housing: ‘Mansion tax’

• Strong case that high-value properties under-taxed at present
  – Council tax does not rise proportionally to property values

• Mansion tax at best only partly corrects for this

• But falls far short of solving all problems with property taxation
  – Council tax still based on 1991 values in England & Scotland
  – Better to solve problems with council tax than introduce new tax
Anti-avoidance measures

• All three main parties rely on raising significant revenues from reducing tax evasion and avoidance
  – Conservatives £5bn, Labour £7bn, Lib Dems £10bn

• Some detail from parties, e.g.
  – Strengthened General Anti-Abuse Rule, OECD’s BEPS proposals, non-don dom taxation, ending ‘shares for rights’

• But nowhere near enough to meet targets
Other Labour policies

- Increase corporation tax from 20% to 21%. Yield: £1.0 billion
- Cut business rates by 3.8%. Cost: £0.2 billion
- Levy on tobacco firms. Yield: £0.2 billion
- Increase bank levy. Yield: £0.8 billion
- Stamp duty holiday for first time buyers. Cost: £0.2 billion
- Reintroduce stamp duty on collective investment schemes. Yield: £0.2 billion
- One-off bankers’ bonus tax. Expected yield: £1.5-£2 billion
- One-off tax rebate to firms who raise all employees’ wages to the ‘Living Wage’
Summary

- Conservatives propose small overall tax cut
  - Income tax & IHT giveaways just offset ‘takeaways’ from pensions tax relief and (unspecified) anti-avoidance measures
  - Biggest winners those with incomes between £50,000 and £150,000
- Labour propose £12.2 billion tax rise
  - More than half of this from unspecified anti-avoidance measures
  - Most of the rest from ‘the rich’ and companies
- Neither would do much to deal with fundamental problems of tax system and some measures would complicate further
- Both relying on anti-avoidance numbers plucked from thin air