Resolution Foundation reform ideas

Synopsis: The Resolution Foundation has put forward proposals for a modest tax reform. There are some aspects which could appeal to Rachel Reeves.

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As the Government will not need reminding, the UK's tax take has risen from an average of 33% of GDP in the first two decades of this century to around 37% now. By 2027/28 – the final year of the personal allowance and higher rate threshold freeze – the tax take is forecast to approach 38%, a seven-decade high.

In a new report, the Resolution Foundation has examined how that substantial tax increase has occurred and ways in which it could have been done better.

The starting point for the Foundation's report is the incoherence of the current tax regime...

- Long-term political competition to to lower income tax has led to repeated increases in National Insurance, biasing the tax system against salaried employment. The maximum effective tax rate for employed income (allowing for employer and employee NICs) is 53.4% against 47% for self-employment.

- Corporation Tax has been a great source of policy uncertainty for businesses, discouraging investment. The standard rate of 28% in 2010 fell to 19% in 2017 (with a pledge to go to 17%), only to rise back to 25% per cent in 2023. At the same time there have been frequent changes to investment allowances, of which the latest three-year 100% expensing is the latest example.

- Over the past decade Fuel Duty has been subject to a stated policy of raising it in line with inflation each year, but in practice there has been an annual ritual of a Budget announcement that the increase had been cancelled. Meanwhile there have been policy moves towards electrification of transport with no attempt to begin the long-term replacement of Fuel Duty.

- Short term fixes, such as the High-Income Child Benefit Charge, have distorted the tax system by creating high marginal tax rates.

- Political cowardice has meant necessary reform has been avoided. The classic example in England and Scotland is the Council Tax regime, which remains based on 1991 property valuations.

The report lists a revenue-neutral set of tax rises and tax cuts that cover five main areas.

The amount of tax involved is around 1% of GDP – a small slice of the 37% total...

<table>
<tr><th>Category</th><th>Tax Rises</th><th>Tax Cuts</th></tr>
<tr><td rowspan="2">Businesses</td><td>Cut the VAT registration threshold to £50,000 then £30,000.</td><td>Make Corporation Tax full expensing permanent.
No Business Rates on new structures/improvements.
Halve non-residential Stamp Duty rates.</td></tr>
<tr><td colspan="2">Extend full expensing to all capital but restrict debt interest deductibility.</td></tr>
<tr><td rowspan="2">Externalities</td><td>Create Road Duty for EVs.
Reform up-front VED.
Encourage local congestion charges.
End free carbon permits & introduce carbon
border adjustment.</td><td>Cut non-home EV charging VAT to 5%.
Scrap the Carbon Price Support.
Shift Climate Change Levy rates towards fossil fuels.
Shift other levies away from electricity bills.</td></tr>
<tr><td colspan="2">Uprate Fuel Duty by 2% pa with small monthly rises.</td></tr>
<tr><td rowspan="2">Homes</td><td></td><td>Keep current £250,000 Stamp Duty threshold.
Halve main home SDLT rates.</td></tr>
<tr><td colspan="2">Reform Council Tax.</td></tr>
<tr><td rowspan="2">Incomes</td><td>Apply CGT at death and exit from UK.
Reform non-dom taxation. Raise NI for higher self-employed incomes.
Introduce NI for rental income.</td><td>Cut the employer NI rate from 13.8% to 12.8%.
Scrap Child Benefit withdrawal (HICBC).
Scrap Personal Allowance withdrawal.
Lower the top two rates of dividend tax.</td></tr>
<tr><td colspan="2">Reintroduce CGT inflation indexing but raise marginal rates.</td></tr>
<tr><td rowspan="2">Pensions and inheritances</td><td>Extend employer NI to employer pension contributions.
Lower the pension tax-free lump sum cap.
Include pensions in IHT.
Abolish IHT agricultural/ business relief.
Abolish IHT residence nil-rate
Band.</td><td>Scrap personal NI on personal pension contributions.
Add 20% & 30% IHT bands below £1.5m</td></tr>
<tr><td colspan="2">Replace Inheritance Tax with a recipient-based tax.</td></tr>
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The mathematical logic of some of these proposals produces some surprising numbers. For example, to bring the total tax on dividends in line with the combination of tax and NICs on employed earnings implies the dividend rate for a basic rate taxpayer should increase from 8.75% to 20%, while for higher rate taxpayers the dividend rate should drop from 33.75% to 32%.

Comment

The menu of tax reforms set out by the Resolution Foundation are unlikely to appear in the next Labour Party manifesto, even though they would seem to be a good fit with some of the ideas that have emerged from the Party in recent times. Alas, given the state of the UK public finances there is a risk that it is the left-hand side of the table which will eventually receive more attention (and application) than the right.

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