WHAT IS FAIR AND RESPONSIBLE TAX?

October 2022

APPG on Anti-Corruption & Responsible Tax

PATRIOTIC MILLIONAIRES UK

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What is fair and responsible tax?

Dame Margaret Hodge
Labour Member of Parliament for Barking
Chair, APPG on Anti-Corruption & Responsible Tax

October 2022

The 2022 Conservative Leadership election was won and lost on the battleground of taxation. Rishi Sunak positioned himself as the fiscal realist in the race by lambasting the 'fairy tale' of lower taxes and higher public spending. But it was Liz Truss who emerged as the victor, and as Prime Minister, on the promise of tax cuts and economic growth. While the low tax argument may have won out on this occasion, the debate is far from over. Old ideological arguments on tax and spend have re-emerged as key political dividing lines in the run up to the next general election. Now, therefore, seems like the time to ask: what do we mean by "fair" or "responsible" tax?

The All-Party Parliamentary Group on Anti-Corruption & Responsible Tax recently partnered with Patriotic Millionaires UK and Tax Justice UK to host a roundtable in Westminster to address this vital question. The event brought together politicians from all major parties alongside voices from academia, think tanks, civil society and the tax industry to debate the purpose and role of tax in our society. In this new joint report we present written reflections from some of our attendees - including Conservative, Labour, Liberal Democrat and Green parliamentarians. And while there is often little consensus in the crucible of Parliamentary politics, what is gratifying is that so many shared themes do emerge from these contributions.

There are some basic principles that make a fair tax system. The way in which tax is collected can deepen inequalities and so fair taxation must strike the right balance between the revenue it raises from different groups within our society. Or in other words, tax must be fair between rich and poor; young and old; north and south; those that receive their income from wealth and those that earn through work. We must also consider the effective rate of tax paid by taxpayers, not just their absolute contribution. And we must acknowledge that our tax system is overly complex and acts in favour of taxpayers who can afford to pay for advisers that can help them avoid paying a fair share. Of course the political debate around all of these questions is, as ever, what balance do we strike.

When it comes to responsible taxation, the long-dominant view is that it is fiscally prudent for a government to fund day-to-day spending through taxation while capital investment can be funded through borrowing. Yet a more extreme view is held by Liz Truss and her Chancellor, Kwasi Kwarteng: that every penny extracted in the form of tax is a brake on our economy and, therefore, responsible taxation means cutting taxes to spur growth. Meanwhile, on the other end of the spectrum, others argue that taxing responsibly means the redistribution of money around the economy to fund government investment, improve public services and address inequality in our society – especially in the wake of the worsening cost of living crisis.

What does fair and responsible tax mean to me? Tax lies at the heart of the social contract. We must all pay into the common pot, for the common good, in order to fund the public services and infrastructure that we all rely on, including our NHS, our schools, and our roads. So a fair and responsible tax system is one in which all taxpayers – individuals and businesses alike – pay their fair share according to their circumstances and how much they earn or own. Any person or company that attempts to dodge paying their fair share – the tax avoiders and evaders – should be met with the full force of the law. And because tax belongs to all of us, the taxation system should be simple, transparent, and effective in raising the tax revenue that government relies on. Doesn't that sound like something we can all agree on?

Tackle the tax advisers to crack tax avoidance

Kevin Hollinrake

Conservative Member of Parliament for Thirsk and Malton

"If you went into Malton marketplace now and asked ten people whether they'd like to pay 10% income tax, 9 out of 10 of them would say, yes". The words of a local accountant who'd asked to see me to explain why I was wrong to support the Loan Charge, a device imposed by the Government to right the wrongs of highly contrived '*disguised remuneration schemes*'. These schemes reduced tax rates of up to 50% to less than a fifth of that. The further justification he offered was *"why should people pay high rates of tax when you lot let the Amazon, Google, Starbucks and Facebook get away with paying next to nothing"*. On that, he had a point.

The Government will rightly point out that it and previous governments since 2010 have gone further than any others to tackle corporate tax avoidance, including the General Anti-Abuse Rule, the Diverted Profit Tax and the Digital Services Tax, but there is so much more that can and must be done. We all know, or should know, that small businesses are the most dynamic part of a dynamic, competitive, free market economy, which in turn is the most important factor in driving down prices and driving up service for consumers. Yet, if the businesspeople behind them lose faith in the system through a belief that the game is rigged in favour of the big guys, then they won't even bother in the first place. As GK Chesterton once said *"Too much capitalism doesn't mean too many capitalists, but too few capitalists"*.

So, more measures are needed, but first and foremost, we should focus on enforcement. HMRC Chief Executive, Jim Harra, recently told the Treasury Select Committee that it collects £26 for every £1 spent on enforcement, so why don't we spend a lot more? And whilst we're at it, spend more on prosecutions, particularly of the advisors. Some years ago, once our business started to make decent profits, it was our accountants that suggested we should consider a tax avoidance scheme, even producing a barrister's opinion that confirmed its legality and efficacy. Thankfully, we declined. You might think then, that HMRC would have prosecuted the many advisors who catastrophically damaged thousands of lives whilst attempting to rob the revenue of over £2 billion. Thus far, not a single advisor has been charged in connection with these schemes, despite it appearing to be a clear case of *"cheating the public purse".*

A clue to why can be found in the words of Treasury ministers. Former Financial Secretary to the Treasury, Jesse Norman told the All-Party Group on Anti-Corruption on Responsible Tax that *"HMRC's job is to collect the money not to pursue long and expensive court action"*. Isn't this like saying to a shoplifter, *"just put the stuff back and we'll forget all about it"*. Where is the deterrent? If it's currently too difficult to prove that they've broken the law then then we should follow the APPG's recommendation of applying a *"double reasonableness"* test to criminal prosecutions of enablers of tax avoidance, in other words, would it be reasonable to view the avoidance scheme as reasonable? If not there should be a prosecution. The long-standing Treasury/HMRC position of rarely going after them at all must surely change.

Perhaps even more incredibly, any adviser who has been sanctioned by HMRC for tax fraud can still practice as a tax adviser as there is no licensing regime or requirement to be a member of a professional body. Immediate change required here also.

There are several other legislative changes that we also need, such as:

- Making VAT a place of consumption tax to prevent Google and co. billing a zero rate from Dublin.

- Tracking of parcels sent by overseas independent retailers to make sure VAT has been paid (making marketplaces like Amazon responsible for this has raised over £1.3bn per annum, over £1bn more than expected, but retailers who sell directly to UK consumers can easily avoid it).

- Ban the use of royalties that allow Starbucks and others to transfer revenue derived from UK consumers to lower tax jurisdictions.

A fairer and more level playing field, more confidence and belief of fairness in the system, more revenue for the public purse and as a consequence a lower tax burden for the public. A bit of a no-brainer if you ask me.

Reform property tax to bridge inequality and boost business

Sarah Olney
Liberal Democrat Member of Parliament for Richmond Park

Taxation divides political opinion. MPs and commentators from across the political spectrum agree that tax must be fair and responsible. However, the definition of these terms is what sets tax policies, and political parties, apart.

At the centre of the struggle to formulate national tax policy are the great wealth divides present in our country, which in turn inform definitions of *"fair"* and "responsible" tax. Our nation is fast becoming split into two economic halves, with the ability to accumulate wealth determined by factors such as asset ownership and pension provision, alongside generational wealth. Over the course of the pandemic, the rich got richer. There are now 171 billionaires in the UK – 24 more than a year ago – whose combined wealth grew by over one fifth during the pandemic. At the same time, the UK is entering a cost-of-living crisis with an additional 1.3 million families set to fall into absolute poverty next year.

Our current tax system is unbalanced and unfair: it is too easy for tech giants and large monopolies to avoid tax, and income from employment is taxed more harshly than income generated by wealth. Rather than bridging economic divides, taxation policy in the UK serves only to further exacerbate negative impacts of inequality. Taxation of property, the most common form of appreciating asset, sparks one of the most heated debates, as it represents one of the greatest divides. Those who own a home will not be taxed when they dispose of it, yet those who don't own a home are increasingly unlikely to be able to afford one.

The binary nature of our economy also extends into the sphere of business. Therefore, to combat economic division, we must also address business taxation, of which a crucial aspect is reform of business rates. The current business rates system reinforces an unhelpful binary in our retail and services sectors by unfairly taxing traditional bricks and mortar businesses that use property intensively, whilst providing a tax advantage to online-only enterprises. To bridge this divide, the Liberal Democrats propose to scrap business rates altogether and to replace them with a *'Commercial Landowner Levy'* (CLL). This levy would be paid by landlords, not tenants, and would be based purely on land value of commercial sites. It brings the following benefits:

Supporting SMEs

Reform of business rates is vital to support SMEs. Small businesses are the engine of our economy and require a tax system which fosters entrepreneurship. Only 39% of SMEs in England own their own main premises. By taxing landowners rather than occupiers, over half a million SMEs currently paying rent would be spared the burden of also paying business rates.

Boosting town centres

Businesses based in town centres have long regarded the current business rates system as an unfair burden which leaves them struggling to compete against digital enterprises. Throughout the pandemic, internet giants have raked in record-breaking profits whilst high street businesses depleted at a rate of around 50 closures per day. The time for business rates reform has therefore never been more necessary if we wish to preserve the character of town centres for future generations amidst an ongoing shift to online retail. The CLL would provide some much-needed relief by cutting taxes for most businesses and alleviating tenants of the tax burden, thereby also reducing barriers to entry for new businesses.

Bridging regional inequalities

'Levelling Up' has been top of the political agenda in recent years. However, the current business rates system does nothing to target regional disparity. Under the CLL, businesses in the most deprived areas would see the biggest fall in their bills, paying a rate of tax which is representative of land values in their local area. In over 90 local authorities, average taxes would be cut by 25%, with some areas set to see reductions of up to 46%.

Tackling the climate emergency

Reform of business rates is also vital for reaching net zero goals. The current system has penalised businesses for going green by directly taxing capital investments in climate-friendly technologies. All such disincentives for green investment would be permanently scrapped by the CLL.

Boosting manufacturing after Brexit

The manufacturing sector is particularly hard hit by business rates, which consider investments such as machinery in tax calculations. With the introduction of the CLL, average tax bills for manufacturing premises would go down by 22% to reflect purely the land value of sites. Scrapping business rates would encourage manufacturers to invest in the UK, in turn increasing productivity and wages.

The tax cut provided by the CLL would also support exporting factories, many of which are struggling with post-Brexit trade rules. If the UK is to foster strong trading partnerships across the globe, our manufacturing industry must remain strong and competitive.

The Treasury's review of business rates, published in October 2021, did not propose to change the nature of the tax, nor the basis of valuation. The Liberal Democrats' proposals would change this basis of valuation to ensure that tax on business is fair and effective – unlocking investment and prosperity.

A Green perspective on "fair taxation"

Baroness Bennett of Manor Castle
Green peer

Decisions about taxation are a key part of fiscal policy, whose purpose is, to quote the IMF, *"to influence the economy"*. Discussion of its purpose, from the left and the right, often revolves around *"fairness"*, and very different ideas of what that looks like. But both the traditional left and right assume it is about creating a framework to encourage growth of the economy.

That's where the Green perspective is foundationally different. We know you can't have infinite growth on a finite planet, and that we've already – as Kate Raworth sets out so clearly in *Doughnut Economics* – exceeded this planet's boundaries in multiple directions, and are racing towards its limits in others.

One of those limits of course is the climate, already overheated by 1.1 degrees as a result of greenhouse gases pumped into the atmosphere since the Industrial Revolution, the world having agreed, although utterly failing to deliver, on plans to keep that figure below 1.5 degrees.

The tax system is one way to manage that, through carbon taxes, which we have in a very limited form now, but that need to be used across the board to ensure the externalised costs now borne by all of us through the climate emergency are carried by those creating them. Instead, we've now got subsidies for heating the planet, largely provided through the tax system. For North Sea oil and gas that totals £4 billion since 2015, money that could have provided a great deal of support for renewables and energy conservation.

More broadly and deeply, we could adjust VAT so that it reflects the environmental impact of the sale item, looking at the other planetary boundaries we're now nearing exceeding, such as chemical pollution, plastic contamination and soil destruction. That way we could be pushing in the direction of a circular economy, one that stops treating the planet as a mine and a dumping ground.

Growth has been, over the decades, profoundly damaging, not just environmentally, but also socially. Poorer communities, both in the UK and even more deeply in the Global South, have suffered horrendously – been impoverished – by the growth that benefits others. If we think of the economy as a pie, we can't keep making it bigger. It has to be of a size that fits within planetary limits, then slice it up so that everyone has enough for a decent life.

Taxation policy can be an important part of that, but far from the whole story. A frequently quoted figure in the UK is that the top 1% pay a third of tax. That's a measure of the deeply unstable and unsustainable inequality of our society, not a legitimate reason for a less progressive tax policy.

So the Green Party calls for the income tax threshold to be replaced with a universal basic income, and for a maximum ratio of 10:1 between the top paid person in a company and the lowest-paid, a real living wage for all. But even in a society with those conditions, and certainly in one moving towards them, other taxes are an important tool is delivering improvements in equity.

A wealth tax is crucial. And not hard to justify. If you put Bill Gates on a desert island, he wouldn't make a penny. Individuals become rich in our society now by relying on the infrastructure and services that our forebears created (all too often by robbing other peoples' ancestors), and that all of us continue to contribute to – roads, telecoms and power systems, policing etc. And they need customers and workers who need schools and hospitals.

A fair tax system recognises that corporation tax is collecting money from companies that put far less back into communities than do local small independent businesses. So the Green

Party 2019 manifesto promised to lift corporation tax back to 24 per cent (from the current historic low of 19%). Of course tax dodging means many firms fail to pay even the modest current level. There are technical answers to that – country-by-country reporting being one of the important ones – but at the foundation there's a simple one: have a government that actually wants to make companies pay their taxes. Freeing HMRC from government control and giving parliament oversight for its activities would be part of that process.

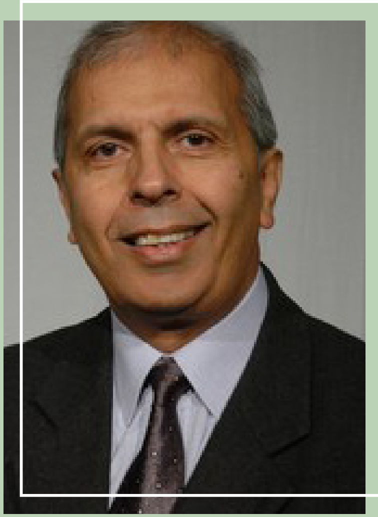
The taxation system we have now is one created by the decision-making of those who benefited from it. Simplification of the system – as the Green Party calls for – combining employees' National Insurance, Capital Gains Tax, Inheritance Tax, Dividend Tax and Income Tax into a single Consolidated Income Tax, bringing in an estimated £20 billion extra per year into the public purse – would increase fairness and block loopholes.

As for council tax and business rates – current systems that almost no one defends – the Green Party calls for a land value tax (also incorporating national non-domestic rates, stamp duty on land, annual tax on enveloped dwellings, capital gains tax on land sales, inheritance tax on land and income tax on land for owner-occupiers). This would help to redistribute wealth and help fix our broken housing market.

And student fees now operate as a kind of tax – a very ineffective, regressive one. Even with the latest further weight laid on young shoulders, most of the supposed loans will never be paid back, and those with high incomes will pay less than those with middling wages. The Green Party regards education as a public good, which should be paid for from general taxation.

There's a lot of change in that short account – something many might find shocking in its scope. But there's no doubt that economically, socially, environmentally, educationally we are now in a profoundly unstable place. Radical change is inevitable in the next few years. Like our constitution, our tax system has been created through centuries of historical accident, short-term expediency and essential fixes and is now deeply dysfunctional and destructive. Change will occur.

Principles for a fairer and more equitable tax system



Lord Sikka
Labour peer

A key requirement of any system of taxation is that it should be fair and equitable. It should be used to redistribute and help the less well-off. However, the UK tax system does the opposite. It penalises workers and families, rewards rentiers and overloads the less well-off with taxes.

An example would help to illustrate the issues.

For the tax year 2022/23, recipients of earned income receive a tax free annual allowance of £12,570. A basic rate of 20% tax is paid on taxable income between £12,571 and £50,270; 40% (higher rate) on income between £50,270 and £150,000; and 45% (additional rate) on income above £150,000. In addition, national insurance is payable at the rate of 12% on annual income between £12,570 and £50,270.

In contrast, unearned income, such as capital gains arising from the sale of second homes, businesses, speculating on stock market, commodities and investments are taxed at marginal rates ranging from 10%-28%. The recipients of capital gains receive a tax-free annual allowance of £12,300. No national insurance charged.

The system may appear to be progressive, but it is loaded against workers and favours the rich and speculators.

Consider the case of two individuals with identical gross annual income of £30,000. One is a worker and the second is a speculator who has generated £30,000 through clever bets.

	Worker (£s)	Speculator(£s)
Gross Income	30,000	30,000
Personal Allowance	(12,570)	
Capital gains allowance		(12,300)
Taxable Income	17,430	17,700
Chargeable Gain		
Income tax at 20%	(3,486)	
Capital Gains Tax at 10%		(1,770)
National Insurance at 12%	(2,092)	NIL
Total tax and NI	(5,578)	(1,770)
Net Income	24,422	28,230

The worker pays £4,000 more in tax and national insurance deductions and has a lower take-home pay, compared to a speculator, an owner of shares or business assets.

The 2020-2021 tax data[1], most recent available at the time of writing, shows that 323,000 individuals had chargeable capital gains of £80bn. On this, they paid capital gains tax of £14.3bn. This is an effective rate of just under 18%, considerably lower than the marginal rates on earned income.

The beneficiaries of the capital gains tax regime use the NHS and social care, but do not pay any insurance. Thus, they have a free-ride, effectively a wealth transfer from salaried workers to rentiers and speculators.

Relatively few working or middle-class taxpayers have any capital gains or other forms of unearned income. Its main beneficiaries are wealthy people and the tax regime increases inequalities. Most of the benefits of the tax regime accrue to individuals resident in London and the South East of England. Thus, the tax regime also generates regional disparities.

Any government interested in reducing inequalities and regional disparities needs to tax capital gains at the same rates as earned income. There is no economic difference between earned and unearned income. Both generate identical purchasing power and provide access to goods and services. Some argue that lower capital gains tax rates incentivise entrepreneurs and risk-takers. Firstly, there is little empirical evidence to back that up. US research suggests that there is no correlation between economic growth and lower capital gains tax rates2. The UK research shows that low rates of capital gains tax on business income lead to large tax savings for wealthy elites but do not boost investment3. Indeed, these tax savings have a capacity to increase the national pool available for investment in productive assets, but interest on savings, subject to tax reliefs, is taxed at a higher marginal rate than capital gains.

Secondly, there is no economic logic in rewarding investors of finance capital whilst punishing those who invest human capital to generate economic surpluses, which form the basis of capital gains.

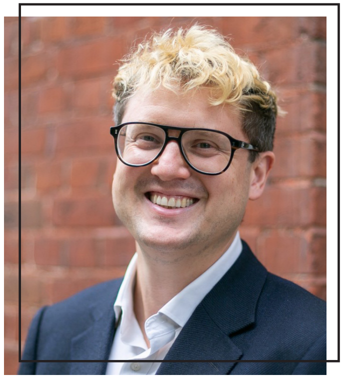
Thirdly, the lower capital gains tax rate is a boon for the tax avoidance industry which continues to craft avoidance schemes to enable their rich clients to convert earned incomes to capital gains and dodge taxes. This leads to inefficiencies as resources are wasted in constant exploitation of tax differentials. HMRC resources are also wasted on scrutiny of ingenious tax avoidance schemes and tax administration.

In 1988, Conservative Chancellor Nigel Lawson4 aligned the capital gains and income tax rates and said that there is "little economic difference between income and capital gains". However, subsequent Chancellors succumbed to lobbying and reintroduced the differential rates.

A 2021 report, estimated that by taxing capital gains at the rates applicable to earned income, around £17 billion a year of additional tax revenues could be raised5. National insurance on the same could raise another £8bn or more i.e. a total of £25bn. The sum raised would provide resources for redistribution and can make a qualitative difference to the lives of the people.

This article has provided example of the inequities generated by the preferential tax regimes for capital gains. However, the same inequities are also generated by preferential treatment of other forms of unearned income too - for example, taxation of dividends. The principles outlined here should apply to them too.

Responsible tax reform means combatting the climate crisis



Robert Palmer
Executive Director, Tax Justice UK

The IPCC's report makes for difficult reading. The independent panel of climate scientists has outlined "*the urgency of immediate and more ambitious action to address climate risks. Half measures are no longer an option.*" The UK government must use every lever to head off this existential threat, and meet its own targets for a 68% reduction in emissions by 2030. This includes our tax system.

The few positive steps the former Chancellor Rishi Sunak made- reducing taxes on household renewable energy for example - have to date been outweighed by tax cuts to fuel and air passenger duties. Overall, carbon taxes are being pushed in the wrong direction by Sunak's Treasury.

It seems likely that Truss' new Conservative administration will continue this trend, not least through the major subsidies to traditional energy companies already announced through the Energy Price Guarantee, for example.

These political choices are made under the cover of the cost of living scandal that is forcing millions of households to sacrifice heating for eating. Meanwhile the major oil and gas producers are generating mega-profits - BP and Shell alone *have made billions in profits already* this year[2] .

A windfall tax on oil and gas profits was announced, but at a rate that has so far failed to put sufficient cash into the pockets of those struggling, and invest in green transition measures. It was brought in alongside a *huge, new oil and gas tax relief* that perpetuates our reliance on the fossil fuel industry[3].

The tax system also has a much *wider role to play here*[4] . It can raise revenues for transformative green policies such as retrofitting our housing stock, or taxes can increase the cost of carbon intensive activities such as frequent flying. We can incentivise a rapid and just transition by cutting the costs of green alternatives, and build public support for climate action by ensuring that all members of our society are seen to contribute.

So far the government has *barely acknowledged these vast opportunities* that tax offers in tackling the *climate crisis*[5]. The narrow scope of the proposals made in the Treasury's *Net Zero Review paper*[6] failed to make full use of this tax and climate toolbox. Their final report was limited to a few concrete proposals on tackling carbon emissions: carbon pricing, carbon leakage and replacing the revenues lost from existing carbon taxes. The courts have since *judged these to be insufficient*[7] in meeting the government's stated aims.

Perhaps the most obvious gap in the approach taken over the last twelve years is addressing the links between climate crisis and wealth inequality. Study after study has shown that the wealthiest are disproportionately responsible for carbon emissions, both in the UK and across the globe.

One found that the wealthiest 1% in the UK emit *11 times someone in the bottom half of the distribution*[8]. This is driven by *high consumption lifestyles*[9], and *the environmental impact of their investments*[10]. The Treasury recognised that in the UK *"higher income households consume three times more carbon than lower income households in absolute terms."* Action to tackle wealth inequality is essential to meeting our climate commitments.
This could mean support for a frequent flyer levy, action to bring capital gains into line with taxes on earnings, or higher taxes on private jets and super yachts. These would tackle some of the extreme carbon lifestyles of the super-rich.

But they wouldn't reflect the fact that much of this wealth is derived from active commercial interests. The super-rich have personal wealth accumulated through carbon-intensive production, which is then spent on carbon-intensive consumption. One idea being proposed by New York academics is a *Carbon Wealth Tax*[11], which looks to increase the price of high-carbon investments that underpin personal wealth. This would not only shift capital flows away from destructive industries towards green alternatives in the green economy, but any revenues generated could be re-invested back into the green transition, generating a virtuous circle of productive green investment.

It is clear from these multiple proposals that there is much more work to be done to build a tax system fit for the age of climate crisis. We can't wait for another IPCC report to get on with the job of green tax reform.

A first, big step towards a fairer tax system

Arun Advani
Assistant Professor of Economics, University of Warwick

Tax may not be exciting, but it is important. It is how we pay for schools, hospitals and roads, how we support people when their incomes are low, and how we provide for people in their retirement. Doing this doesn't come cheap: the government will spend more than £1 trillion this year, a bit more than 43% of all income in the country. Most of this money is raised through taxation, so it is important that we raise it well.

Raising tax well means four tests have to be met. First, the money should be raised efficiently. Taxes shouldn't distort the choices people make, like what to buy or how much to work, more than they absolutely need to. Second, they should be fair. This means treating similar people similarly, and – at a minimum – ensuring the tax rate does not fall with income. Third, taxes should be easy to pay and difficult to avoid. Finally, collectively we need taxes to raise the money necessary to fund those public services and provide for people in need.

While these tests seem fairly obvious, the present system fails all of these, across a range of taxes. A clear and costly example of this is in the way we tax capital gains. Capital gains are profits on the sale of assets. You might picture second homes or valuable paintings, but three-quarters of taxable gains are actually from sales of businesses. These business gains are growing. But rather than reflecting a boom in British entrepreneurship, they are driven by tax planning.

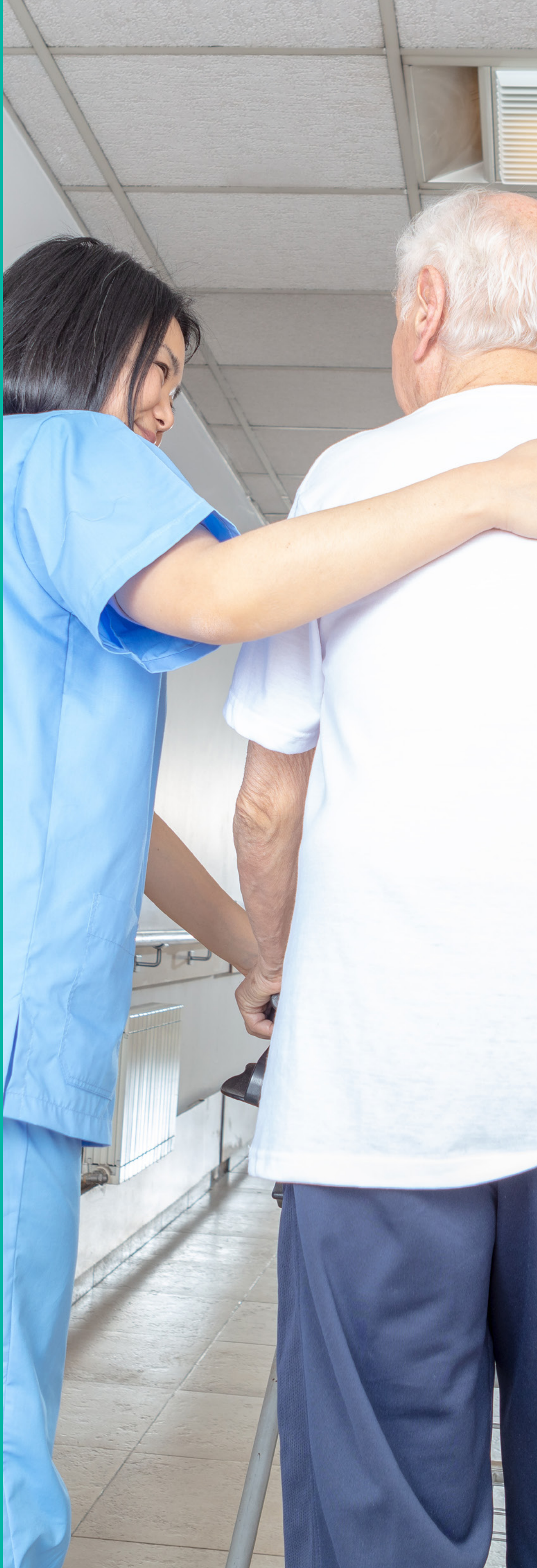
A top earner pays more than 48% in income tax and national insurance. By contrast, if their income can be paid into a company and taken out as a gain, they can take up to £1 million at only 10%. With a saving like that, it is little surprise that people use gains as a way to avoid income tax. And this problem isn't new: when Chancellor James Callaghan introduced capital gains tax in the 1960s, he explained that "…gains confer much the same kind of benefit on the recipient as taxed earnings… [and] the present immunity from tax of capital gains has given a powerful incentive to the skilful manipulator." Sixty years on, the only change is that you do not have to be particularly skilful.

As well as creating a clear opportunity for avoidance, the enormous difference between the tax on income and the tax on capital gains creates unfairness in two forms. First, there is a huge gap in the tax paid by people with the same remuneration, depending on how much they can convert into gains. Second, average tax rates actually decline with total remuneration. One in ten people taking home £1 million or more pay an effective tax rate below someone earning just £15,000.

The direct financial cost of this is a major revenue loss for government, revenue that has to be made up through other taxes. And there are consequences for productivity. Brilliant IT consultants, engineers and accountants who are working successfully in a big organisation, instead set up their own company, and waste time inefficiently managing their own diary and accounts, just to benefit from a low tax rate.

A straightforward solution to all four problems would be to equalise the capital gains tax rate with income tax. This is not a new or radical idea, in fact Nigel Lawson implemented this system in 1988, alongside an allowance for inflation, though it was replaced in 1998 by Gordon Brown. "More closely aligning" rates was also the top recommendation from the government's official tax advisors, the Office for Tax Simplification, in 2020, when it would have raised up to £16 billion. This is enough to reduce income tax or VAT by 2p, or send a cheque for almost £600 to every household. And at a time of rising inflation, an inflation allowance would ensure that people are not taxed on 'paper gains'.

Treating capital gains and income in the same way would be fairer, more efficient, reduce avoidance, and raise substantial cash. What's not to like?



Responsible tax policy should tackle economic challenges

Sam Robinson
Senior Research Fellow, Bright Blue

Tax reform is once again front and centre of political debate. In the wake of the pandemic, the UK's level of tax is set to reach its highest level, at over 36% of GDP, since the 1940s. As we grapple with the cost-of-living crisis and a stagnant economy, there is pressure to reform taxes to help struggling households and boost growth.

Beyond the immediate cost-of-living crisis, there are massive economic challenges the tax system needs to navigate over the next few decades: climate change, repairing the public finances, and 'levelling up' the country, to name a few. Tax reform will be needed; borrowing more and more to meet current spending demands, and thereby ladening future generations with unsustainable levels of debt, is economically and morally unacceptable. Bright Blue has recently concluded a multi-year project examining the principles and policies that should underpin a strategic programme of tax reform that can anticipate and address these challenges.

But to be successful at delivering these priorities, tax policy must also be fair, both protecting those on low incomes and giving equal treatment to people in similar circumstances.

The need for a responsible approach to tax reform is, arguably, nowhere clearer than when it comes to achieving net zero emissions by 2050. This is the defining policy goal of this century; if not controlled, climate change will result in catastrophic and potentially irreversible effects on the environment and society.

While the key policy drivers of this transition will be investment, innovation and spending, the tax system could and should play a much bigger role. Currently, the UK's system for carbon pricing under the UK Emissions Trading Scheme is insufficient to sufficiently change behaviour and reduce emissions. It is currently priced at around £50 per tonne of CO_2. But according to Government estimates, prices on carbon may need to rise as high as £125-300 per tonne of CO_2 to achieve net zero. The UK's ambition on taxing carbon needs to go much further.

The UK's carbon pricing across different economic sectors is also highly inconsistent. Overall, the effective price consumers and taxpayers pay for emitting a tonne of CO_2 can vary by as much as £700 depending on how it is emitted. In some sectors, such as aviation, agriculture and residential gas use, carbon emissions are not explicitly priced and the sector effectively receives subsidies, either directly or through reduced or zero-rated VAT.

A good first step to driving forward progress towards net zero, as we have recommended, would be setting a target price range for carbon taxes across the whole economy by 2030, with a 2030 'floor price' that each economic sector would have to achieve at a minimum. This would set a clear fiscal framework for action on net zero and deliver a clear signal to businesses and individuals of action on climate change. It would also reduce the large, and sometimes seemingly arbitrary, gaps in effective carbon prices between different sectors.

But the transition to net zero, which could cost the UK £1.4 trillion over the next three decades, risks being expensive for the poorest in society. The 'gilet jaunes' movement in France shows us the political consequences of failing to protect low-income households during such a transition. To ensure a just transition and achieve political buy-in, reforms to carbon taxes should be accompanied by a 'Green Dividend Framework' made up of the revenues from carbon pricing measures. This would allow for a total figure to be set for what has been delivered to the public purse by carbon taxation measures and increase transparency around green tax reforms. A specific portion of the funds from the Green Dividend Framework could be utilised to reduce the impact of rising prices on those on low incomes.

The Government's flagship 'levelling up' agenda is another example of where bold tax reforms can address long term economic challenges while delivering fairness. In some ways, the tax system actively holds back progress on levelling up. This is especially evident when looking at Council Tax, which has not been revalued since 1991. While properties in areas such as Hartlepool can, on average, pay over 1% of their current value in Council Tax annually, in areas such as Westminster this can be as low as 0.1%, according to the Institute for Fiscal Studies. Ultimately, given different rates of house price growth across the country since 1991, the main beneficiaries of static Council Tax valuations have been London and the South-East. The distribution of costs by house value translates to lower-income households, on average, paying more as a share of their income in Council Tax than higher-income households.

Council Tax is a rare example of a tax that is outright regressive, both on an individual and a regional level. It is surely not right that less well-off households pay proportionately more in tax than wealthier households. Nor should effective tax rates vary so wildly simply based on where you live.

At the least, Council Tax needs to be revalued to bring it back into line with today's housing market. But a bolder step would be to move towards a Proportional Property Tax that would tax homes on a set proportion of their property value. Such a system would reduce property tax liabilities in most constituencies, particularly those outside London and the South East, in so doing reducing the seemingly arbitrary connection between the level of tax someone pays and where in the country they live. And it would be more progressive on an individual level, helping those in less well-off households.

Now more than ever, we need responsible tax policy that sets out a clear plan for tackling economic challenges such as reaching net zero and levelling up, that will define the decades to come. But a strategic approach to tax needs to have fairness at its core. This should involve both protecting and enhancing the livelihoods of the poorest in society and making sure that similar activities, and people in similar circumstances, are taxed in a similar manner. Doing so will be crucial in ensuring the political success of major tax reform. But it is also morally fair that future tax measures ensure that those on low incomes do not bear disproportionate costs from societal projects such as net zero and levelling up.

Beyond the OTS – delivering meaningful tax simplification

George Crozier
Head of External Relations, Chartered Institute of Taxation

To be fair and responsible, tax needs to be able to be understood by those liable to pay it, as well as by wider society. The rationale behind tax rules needs to be visible, the tax consequences of decisions need to be foreseeable, and the effort involved in being tax compliant needs to be proportionate.

In other words, tax needs to be simple – or at least simpler than it is now.

The good news is that pretty much everyone across the political spectrum agrees with this.

The bad news is that delivering meaningful simplification in practice is proving somewhat harder. Despite the setting up of the Office of Tax Simplification (OTS) 11 years ago, most people think that in the period since then the tax system has got more, not less, complex.

So were the Government right to announce the abolition of the OTS in September's mini-Budget?

No.

The OTS has many achievements to its name. Its first report led to the abolition of more than 40 (admittedly mostly fairly niche) tax reliefs. Cash basis reporting has made compliance simpler for more than a million small unincorporated businesses. There have been useful reforms to employee expenses and inheritance tax reporting. In fact pretty much every Finance Act of the last decade has had measures in it which owe their genesis to the OTS, and which have made navigating the tax system easier for some group or other.

Where the OTS has failed is when it comes to its more ambitious suggestions – for example, two reports in 2016 making the case for closer alignment of national insurance (NI) with income tax.

Broadly the pattern has been that where the OTS has proposed technical or administrative tweaks the government has at least considered it. But where it has proposed to simplify the actual rules, its calls have usually fallen on deaf ears.

The recent OTS investigations into capital gains tax and inheritance tax are a case in point. The OTS produced two reports on each tax looking separately at the design of the tax and at technical and administrative issues around it. The government adopted more than half of the technical and administrative recommendations, but not a single one of the design proposals.

While ministers buy in to the principle of simplification whenever it comes up against political or revenue obstacles they seem to trump it. If a significant reform costs money (for example the 2017 recommendation of smoothing the VAT threshold) or produces losers who would make a fuss (as with aligning the NI and income tax bases) it goes nowhere.

Sadly not many substantial simplifications are cost-free and upset no-one.

So we should not be too surprised that the OTS has not made more progress towards simplifying the tax system. But rather than abolishing the OTS the government could have chosen to strengthen it.

It could have been given a greater role in scrutiny of new proposals. It could have taken on post-enactment review of new legislation, examining the actual impact of measures a few years on compared to that envisaged, and identifying 'lessons to learn'.

The government could have been required to respond formally to all its recommendations within a prescribed period, as they are obliged to do with select committees.

This is the direction the Chartered Institute of Taxation would have liked to see the government go in – giving the OTS a louder voice, a wider remit and greater resources.

But the government have chosen a different path.

The Growth Plan states that: "Instead of having a separate arms-length body oversee simplification, the government will embed tax simplification into the institutions of government… and set a mandate to the Treasury and HMRC to focus on simplifying the tax code."[12]

Okay. Let us take the government at their word and assume they are truly serious about simplification – and that they are abolishing the OTS because they regard it as insufficiently effective, rather than because it asked difficult questions and made suggestions they disliked. How then should they move forward?

First they need to put flesh on the bones of the words in The Growth Plan: set out what this mandate will look like in practice, identify how success will be measured.

The OTS itself produced a report in July identifying ways to better embed the principle of simplification in the general tax policy making process. This included a framework of questions for officials and ministers to consider when developing policy. Will ministers build this into their embedding process?

One thing the OTS has an especially good record on is effective consultation, meeting proactively with affected groups around the country to identify burdensome tax complexities and how they might be removed. Will HMRC and the Treasury be taking this on? If not this work will be missed. Similarly the OTS has been a valuable interface between policy officials in government and external experts in the private sector, professional bodies and academia. To be effective, embedding tax simplification must continue to engage external expertise and not simply allow a retreat into institutional – or political – group-think.

Moving forward is not just about government. In the absence of the OTS Parliament needs to take a closer interest in simplification. A select committee might usefully question ministers and officials, and produce an annual report on progress towards simplification. An annual debate on simplification on the floor of the House would raise the profile of the issue. Ultimately, of course, with or without an OTS, the success or otherwise of efforts to simplify the tax system depends on senior policy-makers, and above all, ministers. If ministers are serious about simplification they must be prepared to amend or drop otherwise attractive proposals if the complexity cost is too high.

There have been some praiseworthy moves towards simplification in recent years. The flow of tax legislation has reduced somewhat (as advocated by the 2017 *Better Budgets report*[13]). Aligning income tax and NI thresholds is a step in the right direction. But if we want a genuinely less complex tax system we need to 'think simple' at every stage of tax policy consideration. The government needs to remember this and, in the absence of an OTS, Parliament, the tax profession and other interested groups need to find ways to work together to challenge them and hold them accountable for delivering on their promises.

Endnotes

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