The Taxing Wealth Report 2024

The full edition

Richard Murphy

The Taxing Wealth Report 2024

Richard Murphy

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The Taxing Wealth Report 2024

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Author's foreword

The Taxing Wealth Report 2024 happened because my Finance for the Future[1] colleague and partner, Colin Hines, suggested that it really was time that we wrote a report on how taxation could be used as a source of finance for the Green New Deal, on which we have worked together since 2007[2]. In writing this report I have built on previous work that we have undertaken on the use of quantitative easing and savings as sources of savings to be used for this purpose[3]. In completing our trilogy on this theme we have also completed our QuEST (quantitative easing; savings; taxation) for the essential sources of funding for the Green New Deal. Saying so, I am not sure that Colin anticipated a report of the scale that has flowed from his suggestion, but he has faithfully supported the work throughout its creation.

The time that I have spent on this project has been primarily funded by a grant from the Polden Puckham Charitable Foundation that was made available to the Finance for the Future partnership for the purposes of exploring how the Green New Deal might be funded. I am grateful to them for their support. They are not responsible for the recommendations made.

Nor is Sheffield University Management School, where I am professor of accounting practice. Some of the work on this project also took place as part of the activity for which Sheffield employs me.

Writing a report of this sort is a demanding occupation, but I cannot pretend that everything within it is making its first appearance as a tax reform idea within these pages. Some, albeit in earlier forms, has been published previously, particularly during the period when I worked most closely with John Christensen when we were together responsible for much of the output of the Tax Justice Network. This report builds on that foundation.

Finally, I must offer my thanks to my wife, Jacqueline, who has undertaken more of the editing and copy reading of this report than anyone. I thank her for her patience and comments, all of which I appreciated. Again, any remaining errors are mine: sometimes I made changes after she had finished her work.

I did not expect the Taxing Wealth Report 2024 to absorb so much of my time. I was finally motivated to respond to Colin's request for a report on tax when I heard Lucy Powell MP, a

[1] https://www.financeforthefuture.com/

[2] https://greennewdealgroup.org/

[3] See https://www.financeforthefuture.com/publications/

Labour Shadow Cabinet minister, say[4] in July 2023 that 'there is no money left'. She did in the process of doing so echo the notorious similar claim made by Liam Byrne MP, who was Labour Chief Secretary to the Treasury in May 2010 when he left office and left a note for his successor stating that same thing.

Liam Byrne was wrong in 2010. Lucy Powell was just as wrong in 2023. We have paid an enormous price for that erroneous belief, which they have shared in common with all the UK's Chancellors of the Exchequer who have served in successive Conservative Party lead governments since 2010. It has never been true that 'there is no money left'. As the notes in this report that explain the economics of money and taxation make clear, it is not even technically possible for this claim to be true. A government can no more run out of money than a football team can run out of goals: governments always have the capacity to create more money just as every football team can always score more goals. The collective claims made by leading politicians of all UK political parties to the contrary are not, in that case, statement of fact. They are, instead, at best, statements of belief. They could also be something much worse than that: they might be deliberately misleading, being offered to deny that choices are available to this country that they do not wish to consider.

Whatever the situation, my motivation, shared with Colin, in writing this report was to make clear that we really do have political choices available to us and money is not a constraint on what we might collectively achieve as a society and that there is always enough available to do whatever we are capable of actually achieving. That is why I have written the Taxing Wealth Report 2024. I hope that when you have read some or all of it that you might agree.

Finally, a technical point. The chapters that make up this report were written between July 2023 and March 2024. Some legislation changed during that period. All data refers to legislation as it existed at the time the chapter was originally published at www.taxwingwealth.uk .

Richard Murphy

April 2024
Finance for the Future LLP
Ely, Cambridgeshire

[4] See https://www.taxresearch.org.uk/Blog/2023/07/18/labour-claims-there-is-no-money-left/

About the author

Professor Richard Murphy is professor of accounting practice at Sheffield University Management School. He was a member or Fellow of the Institute of Chartered Accountants in England and Wales for more than forty years and is a Fellow of the Academy of Social Sciences.

After a career as senior partner of a firm of accountants and as an entrepreneur he co-founded the Tax Justice Network, the Fair Tax Mark and Finance for the Future. He founded and still directs Tax Research UK. He co-created the Green New Deal and remains an active member of the Green New Deal Group. He is founder-director of the Corporate Accountability Network.

Richard created the concept of country-by-country reporting, which is now in use in more than 80 countries around the world to identify tax abuse by multinational corporations as a result of backing for it provided by the Organisation for Economic Cooperation and Development. Richard has created the concept of sustainable cost accounting.

Richard has authored a number of books including The Courageous State and The Joy of Tax. He blogs, usually daily, at Funding the Future[5] and is a frequent commentator in the media on tax and accounting issues. In the last five years he has been named by the Institute of Chartered Accountants in England and Wales as the top social media influencer on accounting issues in the UK.

[5] https://www.taxresearch.org.uk/Blog/

Chapter 1

A summary of the Taxing Wealth Report 2024's proposals

The Taxing Wealth Report 2024 was written for one primary reason. Its aim was to demonstrate that the claim made by politicians from both the UK's leading political parties that there is no money left to support the supply of better public services in the UK is not true.

The Taxing Wealth Report 2024 shows that there is the potential to raise around £90 billion of additional tax revenue each year from fairly straightforward reforms to the UK's existing tax system.

All of these reforms would result in additional tax being paid only by those who are better off. Unless a person's income comes mainly from investments or rents, very little of what the Taxing Wealth Report 2024 suggests would have very much impact on them unless their income exceeded £75,000 per year. This would, however, be fair. As the Taxing Wealth Report 2024 shows, those with wealth in the UK are massively undertaxed compared to those who work for a living. Correcting this imbalance is entirely appropriate, simply in the interest of social justice.

Importantly, whilst the detailed workings underpinning the Taxing Wealth Report 2024 have required a lot of research, the ideas implicit in the recommendations made are quite straightforward. So, for example, it is suggested that pension tax relief should only be provided at the basic rate of income tax whatever the highest tax rate of the person making the contribution. If that change was made an additional £14.5 billion of tax would be paid in the UK each year.

It is also proposed that national insurance should be paid by anyone on their earnings from work at the same rate, and that the reduction in that rate that now applies for those earning more than about £50,000 a year should be abolished. This might raise more than £12 billion in tax a year, assuming national insurance rates used in 2023.

If an income tax charge equivalent to national insurance was also made on all those with income from investments and rents or capital gains exceeding in combination £5,000 a year, then that simple change might raise £18 billion in revenue each year whilst removing an obvious injustice within the tax system that has also been widely exploited by those seeking to avoid tax.

Aligning income tax and capital gains tax rates when there is no obvious reason why they should differ might raise a further £12 billion of tax year.

If only HM Revenue & Customs could be persuaded (or funded) to collect tax from all small companies that owe it when at least 30% of that revenue is lost each year at present due to under-investment in its collection, then maybe £6 billion a year of extra corporation tax might be collected, plus as much again in additional VAT and PAYE which is also likely to be lost from those companies not paying the corporation tax that they owe.

Charging VAT on the supply of financial services, almost all of which are consumed by those with wealth, might raise £8.7 billion a year, having allowed for existing insurance premium tax payments.

Numerous other, smaller, tax changes could also be made, whilst some inappropriate charges, like those for student loans that only raises £4 billion a year for what is, in effect a tax, could be abolished.

On top of all this, what the Taxing Wealth Report 2024 also shows is that if the conditions attached to tax-incentivised savings in ISA and pension fund accounts were changed then up to £100 billion of savings per annum could be transferred from their current speculative use to become the capital that is necessary to underpin the transformation of the UK economy. That money could either be invested in our crumbling state infrastructure, or in the transition that is necessary to beat the impact of climate change. Incentives for such tax-incentivised savings accounts now cost £70 billion a year, which is more than the UK defence budget. Almost no social benefit currently arises from this massive subsidy to wealth. In a country where there are £8,100 billion of financial assets, this transformation will not rock financial markets, but it will transform the future prospects of the UK.

That transformation might come in three ways.

Firstly, and vitally, inequality in the UK might be addressed. The tax owing by those on low pay has to be reduced and the benefits that they enjoy have to be increased if everyone is to have a chance of fully participating in the UK economy without the stress that millions now suffer.

Secondly, if the UK government undertook measures to tackle inequality and simultaneously spent more on recruiting suitably qualified people to supply UK government services of the standard that is now needed to meet our current health, social care, housing, justice and environmental crises then the boost to household incomes that would inevitably follow would provide the basis for the growth that every government claims to be necessary. Growth cannot come before that spending takes place. It would, as a matter of fact, follow it.

Thirdly, the UK has under invested in its own future for decades, having placed all its savings into the care of the City of London, who have used them for speculative activity rather than for the creation of real economic activity. Correcting that by redirecting tax incentivised savings into investment in the essential underpinning of the economy that we need might, yet again, generate new income for the UK's private sector and households, whilst ensuring that we are equipped for the very different future that we must face.

Having money available will not guarantee that the UK will have a better future. However, without there being money available, that future is not possible. The Taxing Wealth Report 2024 demonstrates that more than enough money is available to transform our society, to increase the incomes of those in need in the UK, to create growth, to stimulate employment, to increase the well-being of our companies, and to underpin the investment that we require. No politician can now say otherwise. The fact is that the choices that they can make are explained in this report. If they do not wish to use the options that it demonstrates are available, it is for them to explain why. However, what none of them can ever claim again is that there is no money left, because it is there for them to ask for whenever they wish to use it, and that is precisely why the Taxing Wealth Report 2024 matters.

Summary of proposals

The Taxing Wealth Report 2024 is made up of a series of proposals for the reform of taxes and the administration of tax in the UK, with some selected supporting explanatory notes also being added.

These proposals and the value of the reform that they suggest are as follows:

		Annual value of proposal £'bn
Income tax reforms		
1	Restricting pension tax relief to the basic rate of income tax	14.5

2	Recreating an investment income surcharge in the UK tax system	18.0
3	Capping the rate at which tax relief is given on charitable donations under Gift Aid	0.7
4	Capping ISA contributions in a lifetime	0.1
5	Reintroducing close company rules for income and corporation tax	3.0
6	Abolishing the domicile rule for tax purposes	3.2
7	Changing UK tax rates	-19.1
National insurance reforms		
8	Reforming national insurance charges on higher levels of earned income in the UK	12.5
Capital gains tax reforms		
9	Aligning capital gains tax and income tax rates in the UK	12.0
10	Abolishing capital gains tax entrepreneur's relief	2.2
11	Reducing the annual exempt amount of capital gains a person might enjoy a year to £1,000	0.4
12	Charging capital gains tax on the final disposal of a person's main residence	10.0
Corporation tax reforms		
13	Reforming the administration of corporation tax in the UK	6.0
14	Increasing the corporation tax rate for the UK's largest companies	7.0
15	Reforming Companies House	6.0
Inheritance tax reforms		
16	Abolishing the inheritance tax exemption on some funds retained in pension arrangements at the time of a person's death	1.3
17	Reforming inheritance tax business property relief	3.2

18	Reforming inheritance tax agricultural property relief	1.0
19	Reforming the rates at which inheritance tax is charged	0.0
20	Restricting charity tax reliefs to prevent their abuse	0.0
VAT reforms		
21	Abolishing the VAT exemption for financial services within the UK	8.7
22	Abolishing the VAT exemption for services supplied by private schools	1.6
Council tax reforms		
23	Council tax reforms	0.0
Student taxation reforms		
24	Student taxation reforms	-4.0
Tax incentivised savings reforms		
25	ISA tax relief reforms relating to required investments to qualify for tax relief	3.7
26	Pension tax relief reforms relating to required investments to qualify for tax relief	0.0
Administrative reforms		
27	Better estimation of the UK's tax gap might prevent the illicit accumulation of wealth.	0.0
28	The UK needs to undertake tax spillover assessments if tax abuse is to be beaten.	0.0
29	Creating on Office for Tax Responsibility	0.0
30	The reform of HMRC, its goals, and funding	0.0
Background notes		
31	Methodology notes	0.0
32	UK taxes in 2022/23	0.0

33	The political economy of tax and money	0.0
34	The UK's national debt: How to understand and interpret it	0.0
35	Tax and money flows in the economy	0.0
Next steps		
36	What the Taxing Wealth Report 2024 has not done and where taxes might go next if we are to have tax justice in the UK	
Total value of tax reforms		92.0
	ISA savings reforms - sums released for investments to qualify for tax relief	70.0
	Pension savings reform - sums released for investments to qualify for tax relief	35.0
Total annual value of funds released by reforms		197.0

A web version of this summary is available here:
https://www.taxresearch.org.uk/Blog/2024/03/04/the-taxing-wealth-report-2024-a-pre-budget-summary/

Chapter 2

The Taxing Wealth Report 2024

Introduction

The goals of the Taxing Wealth Report 2024

The Taxing Wealth Report 2024 is about three things.

Firstly, it is a response to all those politicians in the UK who suggest that there is no money left to spend on essential public services. This report comprehensively proves that this claim is wrong. What it shows is that there is enormous opportunity to raise additional money from taxes, and from tax incentivised savings, to fund both the ongoing routine expenditure that any UK government now needs to incur to improve the quality of our public services, and to provide the necessary capital that could underpin the transformation of our economy from its current poor state into being the sustainable economy that so many people want and everyone needs.

Secondly, this report demonstrates that the wealth of UK resident people has been under-taxed in the UK. It can, quite reasonably, be asked whether the scale of that under-taxation can ever be properly appraised, and it is accepted that the basis on which this suggestion is made in this report is open to challenge and reinterpretation. However, so great is the scale of that under-taxation of the increases in wealth in the UK compared to the level of charge imposed upon income in this country that the claim made in this Report that wealth is under-taxed is considered indisputable. The Taxing Wealth Report 2024 suggests that wealth is under-taxed by £170 billion a year when total tax revenues in the UK in the tax year 2022/23, ending in March 2023, amounted to £899 billion. The under-collection of tax from wealth does, in that case, amount to almost twenty per cent of potential total UK taxation revenues. If anyone wants to know why the UK appears to be an increasingly divided society, it is precisely because of the way in which our tax system has been constructed over many years, and even decades.

Third, what the Taxing Wealth Report 2024 shows is that there are pragmatic, practical and easily deliverable solutions to both of these issues. Over a wide range of suggested changes, totalling more than thirty in number, more than £90 billion worth of potential additional tax

revenues are identified. In addition, changes to tax incentivised savings arrangements that could release more than £100 billion of further funding for investment for social purposes in the UK are also detailed. Both of these sums are larger than any currently estimated costs of the transformations required within our society. In other words, choices are available to any government wishing to effect change in the UK. The idea that the UK might be constrained by a lack of funding when seeking to create the society that it wants is wrong.

Putting tax in its proper context

Saying this, it is stressed, that tax is not all about raising revenue. In fact, as this report makes clear, in a very real sense tax never does fund government spending, however counterintuitive that might sound to most people. Instead, tax is the mechanism that the government uses to withdraw the money that it has created and put into use in the economy as a result of its spending. This is explained in more detail in the sections of this report on the economics of tax, money and the national debt. This distinction might appear pedantic to some, but it is vital for a number of reasons.

Partly this is because the role of tax within the UK economy has to be properly understood, and very few of the UK's politicians, journalists, tax officials, or supposed tax specialists have any proper understanding of that economic function of tax within our society. This has considerably hindered the quality of debate on taxation issues in the UK and undermined the chance of creating the tax system that this country really requires.

That lack of understanding has also prevented it being properly understood that tax, when freed from the task of funding government spending, is instead an instrument for the delivery of any government's social, economic and industrial policy. This makes tax a public good[6], which is a fact little understood or acknowledged by our current politicians. Social, industrial and economic issues are all important within the context of the taxation of wealth, but of the three social policy is particularly important.

The UK is a wealthy country with estimated net financial wealth (i.e. excluding property, land and buildings) of £8,100 billion according to the Office for National Statistics despite everything that has happened within its economy since the global financial crisis of 2008, which impacted it so heavily. However, it is also a deeply divided society where millions,

[6] A public good is a service that is provided without intention of profit being made to all members of a society, whether by a government or a private sector organisation. In the context discussed here, the important point is that tax is not a mechanism used to impose a burden: it is, instead, a way to deliver a benefit for the good of society as a whole.

including too many children, live in destitution[7] whilst others live a life of luxury[8]. Any ethical approach to taxation should recognise that the role that taxation can have in addressing this issue is one of the most important tasks that it can be used for.

Importantly, in this context, when suggesting that up to £90 billion of tax might be collected from the wealthy, it is not necessary to presume that all of this will be used to finance, or financially compensate for, additional government expenditure. Instead, it should be presumed that a significant part of any additional revenue raised might be used for the purposes of reallocating resources from those with wealth to those in need, compensating for the fact that at present, the UK has one of the meanest benefits systems amongst OECD countries[9]. It also has one of the lowest state pensions in proportion to national income[10], which has consequence in the number of elderly people living in poverty, fear, isolation, hunger, and cold in inadequate property ill-suited to their needs.

The pragmatic approach of the Taxing Wealth Report 2024

Many of those who are aware of issues relating to the under-taxation of wealth in the UK and seek reform as a consequence base the proposals that they make on radical reform to the UK tax system. This will often include suggestions for the creation of wealth taxes, or land taxes, or both. The Taxing Wealth Report 2024 does not do this. Indeed, as will be noted, a section is included amongst the early chapters that suggests why the creation of a wealth tax in the UK is inappropriate at this point of time.

The argument is straightforward. This would be unnecessarily politically complex, involve protracted delay, and would create enormous difficulties with regard to identifying the ownership and valuation of wealth as well as agreeing the thresholds above which that wealth might be subject to tax. More pragmatically, the capacity to actually raise tax directly from wealth as a consequence of imposing a charge on it is remarkably limited. As the section on council taxation in the Taxing Wealth Report 2024 notes, the capacity to raise additional revenue from increasing tax charges on high value properties is actually very limited. There are just not enough of them. The same is true of the high wealth in general, most of which would be practically difficult to tax. Many of the same observations would apply to a land tax. As a consequence, the Taxing Wealth Report 2024 does not propose either course of action.

Nor does the Taxing Wealth Report 2024 suggest that any existing UK tax be abolished, or be replaced by any new tax. This is the case despite the obvious deficiencies in some taxes,

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[7] See https://www.jrf.org.uk/deep-poverty-and-destitution

[8] See https://www.thetimes.co.uk/sunday-times-rich-list

[9] See https://blogs.bath.ac.uk/iprblog/2022/10/28/how-generous-is-the-british-welfare-state/

[10] See https://commonslibrary.parliament.uk/research-briefings/sn00290/

including the inappropriateness of national insurance in a modern economy, the obviously outdated basis of charging used for council taxation, and the need for radical reform of inheritance tax. There is also a very obvious need for a progressive indirect tax in the UK to compensate for the regressive nature of VAT. It would, one day, be a great benefit if all these issues could be addressed. However, the Taxing Wealth Report 2024 does not think that day has arrived as yet. Instead, it is premised on the idea that when there are higher priorities, including the tackling of inequality, the need to improve UK public services, and providing the essential sourcing of funding for investment in the essential transition of the UK economy to a long-term sustainable basis in the face of climate change reforming existing taxes is the priority. Although there are structural faults in the UK tax system, remedying them is not as important as addressing these issues.

The logic of the Taxing Wealth Report 2024

As a consequence, having established that high income and gains from wealth are dramatically under taxed in the UK, what the Taxing Wealth Report 2024 seeks to do is to suggest how changes might be made to existing UK taxation so that these problems might be most pragmatically addressed with the expenditure of as little political capital as possible whilst delivering maximum impact. This logic underpins all the proposals made in this report.

Another logic is also present throughout this report. The Taxing Wealth Report 2024 presumes that all taxation is, eventually, imposed and collected by consent. There will, of course, always be those who object to taxation, and who will seek to evade and avoid it. Measures to address the activities of those people are noted in the sections of this report dealing with tax administration and, in particular, with regard to corporation tax abuse, but whilst those matters are of concern, it is more important that the consent of most voluntarily compliant[11] taxpayers is retained by the UK tax system. This is only possible if the UK tax system is seen to be just and equitable. It is very hard to describe the existing UK tax system as anything approximating to that.

There are, in essence, two standards for appraising fairness within any tax system. The first is described as horizontal tax equity, and the second as vertical tax equity.

Horizontal tax equity presumes that any source of enrichment that a person might enjoy should be taxed equally, whatever its source i.e., whether it comes from work or from wealth. The logic is not hard to understand. An additional pound in a person's pocket will always be worth £1 to them from wherever it comes. There is no tax justice if that additional pound is

[11] Tax compliance is defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

taxed less if it came from one source rather than from another. Not only is this obviously unfair, it also provides an incentive to abuse the tax system. As a consequence, the tackling of horizontal inequity within the UK tax system is a recurring theme of the tax wealth report, not least because very large parts of it lack horizontal tax equity at present.

Vertical tax equity has a different logic to it. This concept is based upon the idea that as a person sees their income or wealth increase then each additional pound that they accumulate from either source has decreasing net worth to them. It is obviously true that £1 is worth more to a person on the UK's minimum wage (let alone a person trying to survive on Universal Credit) than it is to a person who earns £100,000 or more a year, or who has savings of in excess of, say, £1 million. If that is the case, then it also logically follows that the perceived loss arising to a person as a result of tax paid is greater to the person on low income or with low wealth than it is to the person with higher income or wealth. There is, in that case, inherent and equitable logic to the idea of progressive taxation, where equality is achieved by ensuring that the approximate value of the loss suffered by a person out of each individual additional pound of income or wealth accruing into them is equivalent, whatever their source of income. This necessarily requires much lower rates of overall taxation on those with low income and wealth than it does on those with higher incomes or wealth.

As the Taxing Wealth Report 2024 makes clear, we are in nothing like that situation in the UK at present when those on the lowest income are likely suffering the highest overall tax rates in the UK, whilst those on moderate income see very little variation in their overall tax rate as their income increases. However, those on the highest incomes do, when taking into consideration their opportunities to reduce their taxes owing by taking advantage of the reduced rates of tax available on capital gains and in private companies, pay very much lower rates of tax, overall. In fact, this report suggests that whilst those in the lowest decile of income earners in the UK might pay overall tax rates of forty-four per cent per annum, those enjoying the highest levels of income and wealth might pay rates of less than twenty-two percent per annum, or half that of those on the lowest incomes. There is, as a consequence, nothing approximating to vertical tax equity within the UK tax system at present. This, in turn, justifies many of the proposals made within the Taxing Wealth Report 2024.

The largest tax reforms proposed by the Taxing Wealth Report 2024

Numbers always attract media attention, and there are some very large numbers in the Taxing Wealth Report 2024. Given that one of the goals of this report is to suggest how a UK government could raise additional revenue to support the essential public services that this country requires, these numbers are important. The smaller reforms that are also proposed within the Report are not insignificant, but within the context of revenue raising do inevitably contribute less than the larger reforms noted here. As a consequence, it is the bigger reforms to which attention is drawn at this moment. The detailed description of each of those reforms,

and the method of calculation of the estimated sums that might be raised, are included in this Report.

a. Income tax reforms.

One of the largest income tax reforms proposed in this Report is the recommendation that the tax relief provided to persons making contributions to qualifying pension funds be restricted so that everyone making such a contribution gets tax relief at the same basic rate of income tax, which is currently twenty per cent. This would reduce the level of tax relief available to those who currently make pension contributions and who enjoy tax relief upon them at rates of either forty per cent or forty-five per cent. The total saving from this simple change would amount to an estimated £14.5 billion pounds a year.

b. National insurance reforms

National insurance is a deeply unfair tax within the United Kingdom. Two major reforms are suggested with regard to this tax. The first of these reforms deals with an obvious anomaly, which is that when a person's income from an employment exceeds the equivalent of £50,270 a year, then the national insurance charge that they pay falls from 10% (when this written) to 2%. There is, admittedly, a corresponding income tax increase at the same time, but nonetheless, this reduction rate applies right across all income bands above this sum, meaning that those on high pay do, overall, get a substantial benefit as a consequence of paying much reduced overall national insurance charges in proportion to their income than are paid by those on lower incomes. This contravenes vertical tax equity, and it is therefore proposed that this reduced rate of national insurance is abolished. If this was to be done an additional £12.5 billion of national insurance revenue would be raised each year.

The second national insurance reform would actually be collected through the income tax system but is nonetheless motivated by a major design deficiency within the national insurance system. National insurance is only charged on income from work, whether by employed or self-employed people. It is not charged on any income from any other source, including all investment income of all sorts. This creates an enormous horizontal inequity within the UK tax system.

That inequity has given rise to significant effort on the part of many taxpayers to avoid national insurance charges by artificially recategorising their income as if it is from investment sources. This has been particularly commonplace amongst those who offer their employment by way of contract, many of whom have created limited companies for this purpose from which they pay themselves dividends and not a salary, so avoiding the national Insurance charges on that salary. However, other types of income also avoid a national insurance charge simply because of their nature, and with the rise of unearned income, e.g. from rent, within

the UK economy this inequity is now considerable. Until the 1980s, when it was abolished by Margaret Thatcher, the UK had what was described as an investment income surcharge within its income tax system. This was an additional 15% tax charge levied on income from investment sources above a limit laid down in law. This charge approximated to the national insurance paid by employees but was still considerably less than the combined rate of national insurance paid by employers and employees on income from work. The recreation of this investment income charge would make considerable sense at this time and restore fairness to the UK tax system as well as removing an incentive to avoid tax. It is estimated that an additional £18 billion a year could be raised by the recreation of this charge.

c. Capital gains tax reforms

Capital gains tax is a tax greatly favoured by those who wish to avoid tax liabilities that might otherwise be subject to income tax in the UK. Avoiding the recategorisation of income as gains was, in fact, the original motive for the creation of this tax in 1965. Little has changed since then. Because of the current substantial differential between income tax rates and capital gains tax rates in this country, where broadly speaking most capital gains tax rates are half those that would be paid on income of an equivalent sum (with no national insurance also being due). As a result, the attraction of being subject to capital gains tax instead of income tax still remains considerable. To avoid this obvious horizontal inequity within the UK tax system it is proposed that the tax charges on income and capital gains should be levied at the same rate, with anyone's capital gains tax liability being treated as the top part of their income for taxation assessment purposes subject only to a much smaller tax exemption than at present, meaning that a person's highest rate of income tax would be payable upon any capital gains. Undertaking this simple change to the tax system might raise an additional £12 billion of tax a year.

This Report also proposes one further significant change to capital gains tax. The largest single exemption within the UK tax system, excluding the personal allowance for income tax purposes, is the capital gains tax exemption provided on the sale of a person's main residence, or home. This relief is estimated to be worth more than £30 billion a year in total. Politically any attempt to change this relief would be unpopular, but there can be no doubt that disparities in wealth arising from differing access to homeownership have considerably increased inequality in the UK.

In part this is an age-related issue, with those who are now older having enjoyed the opportunity to acquire their homes at considerably lower prices in proportion to their income than do those who are now younger in the UK. Another element relates to the problems that younger people now have in saving for deposits to even begin a mortgage application to acquire a home. Overall, increased funding to secure additional social housing, plus funding

for enhanced investment in housing in general, would improve this situation. Therefore, tax reform in this area is required.

The Taxing Wealth Report 2024 addresses this issue by suggesting that, instead of a person's main residence being subject to inheritance tax on their death, when only a small number of these properties are ever subject to that charge, a capital gains tax charge should instead be imposed upon the lifetime gains by the last survivor of a spousal relationship that has owned a property when making disposal of it either because of death or because of simply ceasing to make use of it. This charge would be relatively straightforward to calculate in most cases, and approximations would be possible in the event that records were not available. The resulting additional taxation arising from this proposal, having allowed for the loss of inheritance tax payments owing, is estimated to be approximately £10 billion per annum, although this might increase over time.

d. Inheritance tax reforms

Inheritance tax is an enormously unpopular tax in the UK, not least because it lacks vertical equity.

The Taxing Wealth Report 2024 report does suggest reforming the single rate of tax used by this tax at present, suggesting that it be replaced with a much more progressive system. That said, this would not create additional revenue: it would simply redistribute liabilities more fairly.

The greatest cause of vertical inequity with regard to this tax arises because those with wealth in the UK tend to be able to use the exemptions and relief available within it to avoid many of the charges that they might otherwise owe. In this regard, no one has ever been able to provide any serious economic justification for the existence of the tax exemptions relating to business property or agricultural property within the inheritance tax regime, or their universal application to persons owning such assets. This Report recommends the reform of both these reliefs, with the substitution of tax deferral arrangements as an alternative and even then, potentially with regard to only a limited range of business assets. These reforms, which are essential if this tax is to be made fairer might together deliver an additional £4.2 billion tax revenue year.

e. Corporation tax reforms

Corporation tax has been subject to much press and other comment over many years as a consequence of abuses by some large companies, some of which made Amazon, Google, Apple and Starbucks, amongst others, notorious for a while. However, recent reforms with regard to international corporation tax need time to bed down at present to assess their

effectiveness, and therefore no further reforms in this area are recommended in the Taxing Wealth Report 2024.

Instead, the Taxing Wealth Report 2024 primarily focuses its attention on the UK's domestic corporation tax system, and particularly on the creation of appropriate mechanisms to ensure that the UK's smaller companies make settlement of the taxes that they might owe. When even HMRC estimates that almost thirty per cent of these liabilities might go unpaid each year[12], and with this Report suggesting that this estimate might be significantly understated, this is a matter of considerable priority within the UK. It is likely that much, if not most, UK tax evasion is undertaken through the medium of limited liability companies. This non-payment of tax undermines horizontal tax equity. The tax system itself is also undermined by the tolerance of this criminogenic environment. In addition, those who accumulate untaxed funds increase inequality within the UK, wholly inappropriately and criminally.

Four recommendations are made to address this issue. The first refers to actions required by HM Revenue & Customs. The simplest of these is that the UK tax authority require that every company in the UK file a corporation tax return each year. Surprisingly, this is not the case at present. Approximately half of all companies are exempted from this obligation with HM Revenue & Customs' consent because our tax authority accepts, without apparent enquiry being made, an unevidenced statement made by a company that it is not trading. It is then commonplace for HMRC to not require a corporation tax return from the company in question for at least five further years.

Then it is proposed that it should be required that the UK's banks be obliged to automatically provide our tax authority with information each year on the identities of all the companies to which they provide services during a year. This return of data should also specify the names and addresses of those people that the bank in question have identified to be controlling the company, and the total sum that they have recorded as deposited in its bank accounts during a specified twelve-month period. Systems to collect this information already exist with regard to foreign-owned companies operating in the UK, so extending this arrangement to UK-owned companies would be entirely straightforward and have minimal cost. However, the consequence of the provision of this data would be that HMRC would be able to check which companies that have not provided it with a corporation tax return might actually have a liability to that tax, and so in all likelihood to other taxes such as VAT and PAYE income tax, because they had been in operation during a period. This would then ensure that HMRC's resources could be properly focused on those companies where tax recovery is most likely.

[12] https://www.gov.uk/government/statistics/measuring-tax-gaps/5-tax-gaps-corporation-tax

The third element in this proposal is a suggestion that those controlling companies that do not make disclosure of their tax liabilities to HM Revenue & Customs, whatever the tax might be, should be made personally liable for the taxes owing by the companies that they control even if that company does enjoy limited liability. UK limited liability companies should not be used to create a criminogenic environment where horizontal and vertical tax equity are undermined, the rule of law is threatened, and wealth is criminally accumulated without tax charges arising, so increasing inequality within the UK. The removal of limited liability protection from those who are abusing the privilege would prevent this happening.

The last recommendation is that the UK's Companies House, which is the government agency responsible for collecting data from UK limited liability companies, be reformed. This agency, which has always taken what might be politely described as a lax attitude towards non-compliance with UK company law, currently fails to collect data from more than 400,000 UK limited companies a year, on average. This means that the information required by HMRC to collect tax from these entities is effectively unavailable to it, and as a consequence, tax evasion by these entities is effectively officially sanctioned at present, which must be unacceptable. Enhanced powers for Companies House to collect necessary data are, therefore, essential, which need to be used in association with the automatic information exchange from banks, noted above, so that tax owing in the UK can be collected.

These recommendations, taken together, might raise approximately £12 billion of extra tax in the UK each year from those who are largely seeking to evade it at present. An unknown sum of other taxes might also become payable as a result.

A final recommendation with regard to corporation tax is made in the Taxing Wealth Report 2024. This is that, whilst in the last two years, a differential in the tax rates applied to the profits of large and small companies has been re-introduced into the UK tax system after a period when it had been eliminated, it remains the case that this is a historically small differential at just 6%, with many large companies having opportunity because of tax relief and allowances available to them to largely eliminate this difference. There are good economic reasons why large and small companies should pay different rates of corporation tax, particularly relating to the differing ease with which they can access capital from banks and other financial markets, which are heavily biased against small companies. They also tend to pay significantly different interest rates on their borrowings, which rates are always higher in the case of small companies. If the UK wants its small companies to thrive it is appropriate that a differential of at least 10% exist between these corporation tax rates, which was a commonplace historical differential. Reinstating this differential would raise approximately £7 billion per annum of additional tax.

f. VAT reforms

There are many reasons to be concerned about the inequity of the UK VAT system, which is inherently regressive, and therefore vertically inequitable. However, within the context of the Taxing Wealth Report 2024, it is unlikely that any major reforms would be possible to this tax and therefore only a few detailed recommendations are made.

The only such recommendation that would create substantial revenues is with regard to the current VAT exemption available upon the provision of financial services by banks, insurance companies, and other such financial services providers. VAT exemption means that VAT is not charged on the supply of these services, reducing the effective price that consumers pay as a consequence. Since most financial services products are consumed by those with wealth, because those without wealth have little reason to use them or the means to do so, it follows that this exemption within the UK tax system is vertically inequitable and should be removed. Even allowing for reductions in insurance premium tax that might result as a consequence of the removal this exemption, it is estimated that more than £8 billion of additional tax revenue might be raised a year by making this change.

g. Council tax reforms

Many tax campaigners point to the differing council tax systems that exist in England, Wales and Scotland (but not Northern Ireland, which has a quite distinctly different system altogether) as evidence of the inequity of the UK's tax system, and they have an obvious point. Council taxes are very obviously not vertically equitable because of their charging structures. However, those who suggest that reforms are essential by creating higher charges on the most valuable properties presume that this change will raise significant revenues. Unfortunately, they have failed to notice that just 0.6 per cent of all properties actually fall into the existing top band of council tax charge within the UK. It is, therefore, unlikely that any significant reform of this sort will raise any significant additional revenue.

As a consequence, and consistent with the overall spirit of the Taxing Wealth Report 2024 to promote pragmatic ideas, no significant reforms to council tax in any of the UK's nations that make use of it are proposed in this report. It is, however, suggested that the following reforms are made:

- Property revaluation should take place so that current values are in use. Given advances in information technology and AI it is likely that this would be a very much less complicated affair than has always been assumed to be the case in the past.

- The number of council tax bands should increase, particularly at the top end, but also potentially at the bottom end.

- The fixed differential between top and bottom rate council tax charges should be eliminated, with a much greater diversity of charges being permitted, particularly at the top end.

- Additional tax charges on second properties and on empty properties should be made mandatory, and increase in proportion to those charged on main residences.

All these changes having been noted, if the current inappropriate level of charges on low value properties are reduced as vertical taxation equity would appear to require, then it is unlikely that any of these proposals would increase the net taxation revenues resulting from any UK council tax system.

h. Student taxation

The UK does not, officially, have a student taxation system, but in practice it does. Anyone who has graduated in the UK since 1998 could have been made a loan that was intended to cover their tuition fees and (since 2006) part of their maintenance costs while studying at UK universities, with a slightly differing arrangement applying in each of the UK's separate countries.

Again, subject to some slight variations, repayment of liabilities owing on these loans, including the quite high levels of interest charged upon all outstanding balances, is made through the UK's tax system, with charges now being commonly applied in England at a rate of 10% on all income exceeding a threshold depending on the loan made available of between £21,000 and £27,660 per annum at the time of writing.

This charge creates considerable horizontal and vertical inequity within the UK tax system, particularly because the charge imposed is very obviously a tax and is in no way related to the total liability that the person might have outstanding for their education. The system is also potentially a contributor to wealth inequality in the UK because the children of wealthy parents rarely have reason to take out a student loan whereas those not in that fortunate position will have had to do so.

Almost every recommendation made in the Taxing Wealth Report 2024 with regard to horizontal and vertical taxation equity is distorted by the existence of this student tax. The absurdity of that situation is exacerbated by that charge rarely having much chance of ever recovering most of the cost incurred in providing education to those who have been to UK based universities during the period when such loans have been created. To date, more than £200 billion of student loans have been created, but the total tax liabilities recovered by HMRC in the year 2022/23 with regard to such loans was just £4 billion.

Not only are student loan charges now a significant impediment to bright young people going to university at a time when the UK is desperate to improve its skills base, this tax is unjust because it does not in any sense relate to the liabilities owing by a person but does instead impose a tax purely because of a person's choice of career path when it has been national policy to encourage up to 50% of young people to go to university.

Given the small sums of revenue collected each year it is proposed that the student tax in the UK be abolished and that the government deal with the resulting consequences for the UK national debt however it thinks is appropriate. What is clear is that the UK tax system can no longer be distorted by this charge if it is to be just and equitable.

i. The administration of tax

Creating new tax laws, or changing those already in existence, does not guarantee that additional tax revenues are collected. Doing that requires that the UK has an effective tax authority, and very few people are currently persuaded that this is the case.

Most certainly, the House of Commons Public Accounts Committee, which undertakes the most rigorous scrutiny of the activities of HMRC, persistently reports on the weaknesses within HM Revenue & Customs and the need for it to reform itself. This is an issue on which the author of this report has long being engaged. The Taxing Wealth Report 2024 makes four fundamental recommendations which regard to the reform of the administration of HMRC.

First, it is recommended that the governance of our tax authority be transformed. The present governance arrangements of HM Revenue & Customs copies that which might be appropriate for a large public corporation, which it very clearly is not. The use of inappropriate governance structures that presume that an organisation is a business when it is not, meaning that its management think that its costs must be minimised and its directors must be protected from criticism, has become particularly apparent in the wake of the Post Office sub-postmaster scandal, where similarly inappropriate governance structures to those used by HMRC were in use.

It is also particularly inappropriate that many of the senior civil servants responsible for the management of HMRC have limited tax experience. It is even more inappropriate that the so-called non-executive directors of the agency are drawn from the ranks of large firms of accountants and big businesses, many of whom have represented organisations that have been subject to significant scrutiny for their own tax compliance arrangements.

Adoption of this governance approach has led to HMRC abandoning the idea that it is the provider of a public good[13]. It has, instead, assumed that its responsibility is to minimise the cost of recovering tax due and it has been willing to compromise horizontal and vertical tax equity and the need to ensure compliance with the rule of law to achieve this goal. It has also closed almost every tax office in the UK's communities over the last decade or so, and has sought instead to concentrate all services online, with the result that considerable taxpayer dissatisfaction with the quality of service received has arisen.

That has been exacerbated by the fact that since its creation as a result of the merger of the Inland Revenue and HM Custom and Excise in 2005, HMRC has reduced the number of staff it employs from just under 100,000 people, to just over 60,000 people. Unsurprisingly, as a result phone calls go unanswered, correspondence is not replied to on a timely basis, the number of tax investigations undertaken has fallen significantly, tax debts have risen substantially, and the chance of a person being provided with the help that they might require to make payment of the proper tax that they might owe if they require assistance to calculate this sum has almost entirely disappeared.

The tax reform recommendations made in the tax administration section of the Taxing Wealth Report 2024 take all the above factors into account and suggests:

- Putting an entirely new management structure for HM Revenue & Customs in place that reflects its obligation to everyone in the UK, and not just those with significant wealth or who are multinational corporations.

- That HMRC should have the objective of restoring its status as the supplier of a public good reimposed upon it. Its objective should be to assist every taxpayer to be tax compliant, where that is defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

- That HMRC's objective should, as a consequence, be the collection of as much tax as possible, including from those who are reluctant to make payment, recognising that this will require investment in significant additional resources to achieve that goal, including the reopening of its local office network so that taxpayers can access the

[13] A public good is a service that is provided without intention of profit being made to all members of a society, whether by a government or a private sector organisation. In the context discussed here, the important point is that tax is not a mechanism used to impose a burden: it is, instead, a way to deliver a benefit for the good of society as a whole.

face-to-face help that they need to ensure that they can comply with their obligations to pay tax.

- That HMRC should be subject to significantly more scrutiny than it has been to date, and that an independent Office for Tax Responsibility (OTR) should be created to undertake this work, subject to strict conditions on the personnel that it might employ. This OTR should be primarily responsible to parliament, with the Public Accounts Committee being able to set terms of reference for the audits that it should undertake.

- The Office for Tax Responsibility should become the agency responsible for calculating the UK's tax gap, which is the differences between the tax revenues that the UK should be able to collect and the tax revenues it actually recovers during the course of a period. This should include estimates of tax loss because tax bases, such as wealth, are not subject to taxation and annual audited estimates of tax lost because of the granting of tax exemptions, allowances, and reliefs, the appropriateness of which should be subject to constant review.

- The OTR should also be responsible for the preparation of an annual tax spillover assessment for the UK. Tax spillover assessments identify the ways in which one part of a tax system undermines another part of that same tax system, or that of another country, meaning that the expected amount of tax is not paid as a result. Tax spillover assessments do, as a result, complement proper tax gap assessments by highlighting why it is likely that anticipated tax revenues are not paid. The current low rate of capital gains tax in the UK is an example of a tax spillover that undermines the UK tax system. The low capital gains tax rate encourages abuse of income tax and inevitably reduces the UK's tax yield in ways that undermine horizontal and vertical tax equity as a consequence.

- Finally, the OTR should make recommendations on the budget that should be made available to HMRC so that it might undertake the tasks required of it when at present it is clear that the UK's tax authority is significantly underfunded to achieve the tasks that society expects that it fulfil.

The technical background to the Taxing Wealth Report 2024

Much of the Taxing Wealth Report 2024 focuses upon detailed recommendations for change within the UK tax system. However, when making such suggestions the Taxing Wealth Report 2024 recognises that the tax system has much broader implications for society than the simple raising of revenue for the government.

In particular, a tax system has to be an integral part of the overall macroeconomic management system of a jurisdiction. This requires that the relationship between tax paid and government expenditure, and the consequent deficits and surpluses that arise must be understood by anyone making suggestions for change within the tax system since that relationship means that the manner in which the tax system operates has, in itself, implications for the overall effectiveness of that macroeconomic management system.

In addition, as is apparent from much of the discussion within the Taxing Wealth Report 2024, no tax system is neutral as to its impact on society. This necessarily requires that those responsible for making decisions on tax fully understand the way in which government money creation and taxation interact and the way in which tax might be used as a tool in economic, social and industrial policy. The Taxing Wealth Report 2024 includes three chapters explaining these issues so that they might be properly understood.

The Report as a whole only makes sense within the context that they describe because its intention is not just to explain how additional government revenues and funding for capital expenditure might be raised, although succeeds in doing that. It also seeks to explain how the UK's tax system both can and should be used as a tool to help the creation of a better and fairer society for all who live in the UK. Recommendations made seek to achieve this goal. In that context understanding how and why they can do this is important. Tax is a matter that impacts on a great many aspects of everyone's lives. That is why this report is important.

A web version of this summary is available here:
https://taxingwealth.uk/2024/03/20/the-introduction-to-the-taxing-wealth-report-2024/

Chapter 3

The under-taxation of wealth in the UK

Brief summary

This chapter suggests that, based on a review of taxes paid, UK national income and changes in UK wealth from 2011 to 2020:

1. The UK has a tax system on income that is regressive at the lowest levels of income, broadly flat over the middle range of UK incomes, and is only slightly progressive at the upper end, without however replicating on highest incomes the tax rates paid by those on lowest income.

2. Has a very generous system of taxation on wealth that means that whereas income was on average taxed at 32.9 per cent over this period, increases in wealth were only taxed at 4.1 per cent.

3. The combined average tax rate on income and increases in wealth over this period amounted to 25.6 per cent per annum.

4. Because of the way in which wealth is distributed in the UK, with most being owned by the top ten per cent of the population, this differential in tax rates means that the UK actually has a deeply regressive tax system.

5. Those with lowest income in the UK were likely to have a combined tax rate on income and increases in wealth of approximately 44 per cent per annum during this period whilst those in the highest decile of earners in the UK were likely to pay no more than 21.5 per cent per annum on their combined income and increase in wealth.

6. If the tax rates on income and increases in wealth were equalised then additional tax revenue of £170 billion a year might be raised in the UK as a result.

What this suggests is that:

a. There is significant additional capacity to tax in the UK, although only from those with most income and wealth.

b. A strong case for reducing the tax paid by those on lowest incomes can be made.

c. On balance, so long as additional sources of tax revenue are charged only (or almost entirely) on those with the highest income in the UK then there is no reason for any UK government or political party seeking power to suggest that there is no additional capacity to tax in the UK: that capacity very clearly exists.

The Taxing Wealth Report 2024 will explore about thirty ways in which this additional revenue might be raised in ways consistent with these findings.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/06/wealth-is-undertaxed-by-170-billion-a-year-in-the-uk/

Background to this note

There has been much discussion of wealth taxation in the UK in recent years[14] [15]. The prospect of taxing wealth more has appeared increasingly attractive, most especially since the onset of the Covid crisis. Even the editorial board of the Financial Times has suggested that the issue requires further investigation[16]. More recently however, as a cost-of-living crisis has engulfed the country, politicians of all parties appear to have backed away from the issue, suggesting that they have no plans to increase taxation on wealth, let alone to introduce a wealth tax in the UK[17]. It is against this background that this report has been written.

[14] https://www.theguardian.com/commentisfree/2023/aug/28/wealth-tax-britain-labour-general-election

[15] https://www.lse.ac.uk/News/Latest-news-from-LSE/2020/L-December/Wealth-Commission-report#:~:text=The%20Commission%20concludes%20that%20a,society%20in%20times%20of%20crisis.

[16] https://www.ft.com/content/7eff769a-74dd-11ea-95fe-fcd274e920ca

[17] https://www.theguardian.com/politics/2023/aug/27/rachel-reeves-rules-out-wealth-tax-if-labour-wins-next-election

The debate on wealth taxes in the UK has lacked three things. The first is a broader perspective, because far too much attention has been given to wealth taxes rather than undertaking how we might better tax income and gains derived from wealth. The second is data on what is actually achievable within the current UK political climate. The third is focussed policy proposals. These are what the Taxing Wealth Report 2024 will add to debate.

However, before any of those issues can be addressed the capacity to charge additional tax on wealth in the UK needs to be established. It is this issue that this note addresses.

More detailed summary

This note seeks to appraise available data on whether or not there is capacity for those with wealth to pay more tax in the UK, or not. Having appraised data from the Office for National Statistics, HM Treasury and HM Revenue & Customs four main conclusions are reached.

The first is that in the period 2011 – 20 the national income of the UK was £15.8 trillion whilst in that same period the increase in net wealth was £5.8 trillion. It is stressed, that this last figure is not for total wealth, but the increase in the value of that net wealth in that period.

Second, the overall effective tax rates on all income during this period were likely to have averaged 32.9 per cent, but those on wealth increases did not exceed 4.1 per cent.

Third, if these rates had been equalised it would, at least in principle, have been possible to raise an additional £170 billion in tax revenue per annum from the owners of wealth.

Fourth, because there has been no attempt at equalisation of these tax rates and because the distribution of the ownership of wealth is heavily concentrated in the UK's population, the effective tax rate of the 10 per cent of those in the UK who are in the lowest earning group of taxpayers is likely to exceeds 44 per cent of their combined income and increases in wealth during a year, but the equivalent effective tax rate for those in the highest ten percent of UK taxpayers ranked by earnings is less than half that at just over 21.5 per cent.

It is, as a result, suggested that there is considerable additional capacity for tax to be raised from those who own most of the wealth in the UK, many of whom are in that top ten per cent of income earners.

Whether or not it would be desirable, or even technically feasible, to raise £170 billion of additional tax from additional tax charges on wealth is not the primary issue addressed by this note. Instead, the issue of concern being addressed here is that those most vulnerable to precarity within the UK are those who are paying the highest overall effective rates of tax.

Whether that is appropriate is the first question raised.

The second is whether, if that is not the case, any tax increases that might arise in future should have any impact upon those with lower income or gains in wealth.

The evidence in this chapter suggests that those with substantially higher income and wealth should bear the majority, or all, of the cost of additional taxes that might be required if additional public services are to now be provided.

That same evidence suggests that if additional taxes are required in the future to meet the costs of controlling inflation by withdrawing spending power from within the economy then that too should be met by imposing those additional charges on those with substantially higher than average income and wealth in UK society.

One further conclusion is reached, and that is that if there is to be a cost to be paid as a result of the essential transition that must now take place to a sustainable economy then this too must fall on those best able to make payment, which the evidence in this chapter makes clear are those with substantially higher than average income and wealth in UK society.

So clear is the evidence on this issue that another conclusion emerges, which is that so great is the disparity in the relative tax payments made by those on high and low earnings in the UK that there is prima facie evidence that this should be addressed whether or not overall net additional tax revenue is required. That is because there is now ample evidence that inequality creates significant social costs within any society, and it is apparent that the UK tax system is contributing to this problem.

Introduction

During the Covid crisis a consensus appeared to emerge that suggested that taxes on wealth should increase. Both the Pope and Archbishop of Canterbury appear to share this view[18] for example. They did so with the objective of reducing inequality in society. They were not alone. For example, the Financial Times said in an editorial comment that[19]:

Radical reforms — reversing the prevailing policy direction of the last four decades — will need to be put on the table. …. Policies until recently considered eccentric, such as basic income and wealth taxes, will have to be in the mix.

In the aftermath of that crisis and the supposed return to 'normality' that so many were desperate for some of those calls have been forgotten.

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[18] https://www.taxresearch.org.uk/Blog/2020/04/13/the-need-to-rid-ourselves-of-neoliberal-thinking/

[19] https://www.ft.com/content/7eff769a-74dd-11ea-95fe-fcd274e920ca

There are, however, a number of good reasons to think that they should be revived. These include:

1. To tackle the consequences of the cost-of-living crisis that has emerged as the UK and other countries have emerged from Covid lockdowns in 2021, and thereafter.
2. To alleviate the pressure on government financing that has been a feature of the post-Covid era.
3. To add tax into the armoury of tools available to tackle inequality.

The last point is particularly relevant when it is understood that tax is one of the most powerful instruments available to a government to shape the society and economy for which it is responsible in the way that it thinks those who elected it might desire.

There are in essence only four bases on which tax can be charged:

1. Income (e.g., income tax, corporation tax, capital gains tax, national insurance)
2. Transactions (e.g., value added tax, excise and customs duties, specialist taxes e.g. on waste, air traffic and such like)
3. Land use (e.g., council tax)
4. Wealth (e.g., inheritance tax).

Of these, taxation of wealth is by far the least common in the UK. Only 3.7 per cent of UK estates currently pay this tax[20]. As a result it is appropriate to review the existing tax system that operates in the UK to see whether a demand for the increased taxation of wealth or of income derived from it is reasonable at this time.

The data used in this report to appraise this issue relates to the period 2011 to 2020, which is the last year for which suitable wealth data is available from the Office for National Statistics. The earlier date has been chosen to reflect the first year when some stability was restored after the global financial crisis of 2008.

[20] https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary#:~:text=The%20total%20number%20of%20UK,2021%20were%20%C2%A35.76%20billion.

Data sources for this note

Wealth data comes from the Office for National Statistics and in particular its wealth surveys[21] [and 22]. GDP data has come from HM Treasury[i23]. Tax paid data has come from HM Revenue & Customs[24] excepting council tax and business rates which have come from successive HM Treasury budget reports for the years in question. Wealth distribution data has come from the Office for National Statistics[25] and income distribution data and data on income taxes paid has come from HM Revenue & Customs for the relevant period[26]. The effective tax rates of households by deciles for 2019/20 is calculated from data published by the Office for National Statistics[27] Data has not been inflation adjusted: the analysis undertaken does not require that this be done.

The object of the exercise that has undertaken has been straightforward: it has been to compare national income over this period, and tax paid on it, with the increase in wealth in the UK over that same period, and the taxes paid on that increase in wealth. The aim has to been to determine whether the taxes paid on these two sources of financial wellbeing are equivalent, and if not to suggest who has benefited and by what approximate amount and with what possible potential consequence.

For the purpose of this exercise it has been assumed that all taxes except the following have been paid out of income included in GDP:

- Capital gains tax;
- Inheritance tax;

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21 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020

22 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/individualwealthwealthingreatbritain

23 https://www.gov.uk/government/collections/gdp-deflators-at-market-prices-and-money-gdp

24 https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk

25 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020

26 https://www.gov.uk/government/statistics/percentile-points-from-1-to-99-for-total-income-before-and-after-tax

27 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/theeffectsoftaxesandbenefitsonhouseholdincomefinancialyearending2014

- Stamp duties;

- Some special schemes e.g. the one-off Swiss bank charge.

Most people, of course, do not pay these taxes. For example, in 2019-20 just 301,000 people paid capital gains tax[28].

Findings

The resulting data suggests that gross domestic product over this period and the tax paid on it was as follows:

Table 1 UK gross domestic product and tax paid on it 2011–20

	GDP £'billion	Tax paid on income £'billion	Average tax rate %
April 2011 to March 2020	15,775	5,193	32.9%
Average per annum	1,753	577	32.9%

Gross domestic product is the estimated total national income of the UK in a year, and includes all wages and profits from self-employment, corporate profits, interest, rents and other similar sources of income. It is the usual measure used to reflect our national economic well-being. The noted figure for tax collected does not include taxes on wealth, which are separately accounted for in this exercise[29]. These taxes have been noted previously.

It is also important to note that over this period the Office for National Statistics, which is responsible for preparing this data for the UK, included in its estimate of GDP what it describes as imputed rentals for housing[30]. This figure is the deemed rent that people who are owner-occupiers of houses in the UK are considered to pay themselves each year. The sum is included in GDP to make the data for the UK comparable with that of countries like Germany where renting (which cost is included in GDP when mortgage payments are not) is much more commonplace. It is, however, the case that this deemed payment is never actually paid and as such it can never be taxable, and as such the figures for GDP included in this analysis have been stated net of this deemed rental payment so that the actual likely taxable

[28] https://www.gov.uk/government/statistics/capital-gains-tax-statistics

[29] Also excluded are what are described as the 'other' sources of revenue for the government in each year, including all the fees and charges that they make for services provided.

[30] https://www.ons.gov.uk/economy/nationalaccounts/satelliteaccounts/datasets/consumertrendschainedvolumemeasureseasonallyadjusted

income of the country is used as the basis for estimation of likely tax rates paid. The adjustment is significant: this deemed rental payment can make up ten per cent of GDP in each year in the UK.

The increase in wealth over this same approximate period was as follows (the periods not being absolutely identical because precisely matching official data has not been published):

Table 2 UK net wealth increase and tax paid on it 2010 – 2020

	Increase in wealth £'trillion	Tax paid on wealth £'trillion	Average tax rate %
July 2010 to March 2020	5,773	220	3.8%
Average per annum	592	24	4.1%

Note that because of the way in which this data is collected the increase in wealth is stated over a period of a little over nine years, whilst tax paid is noted for an exact nine-year period: the average data corrects for this. Also note that this data relates to increases in wealth during this period, and not its value. As such this data relates to a flow of increased value, and not to a stock of wealth.

The increase in wealth over the period was made up as follows:

Table 3 The composition of UK net wealth increase 2010 – 20

	Increase in wealth 2010-2020 £'billion	Annual average £'billion	Total wealth 2020 £'billion
Property Wealth (net)	1,930	198	5,458
Financial Wealth (net)	624	64	1,933
Physical Wealth	304	31	1,385
Private Pension Wealth	2,915	299	6,445
Total Wealth (including Private Pension Wealth)	5,773	592	15,221
Total Wealth (excluding Private Pension Wealth)	2,857	293	8,776

It should be noted that much of this wealth, e.g., people's homes and private pension schemes are at present largely exempt from tax, but this does not mean that they are outside the tax system: indeed, the fact that they are exempt from tax means that their relationship to the tax system is of some significance when considering issues related to the taxation of wealth. Their increase in value during the period was, in effect, tax subsidised. Consideration of whether the exemptions from tax that these assets enjoy is appropriate is a necessary part

of any discussion of the taxation of wealth and income derived from it. The status quo cannot be changed without some of its assumptions being challenged.

In addition, the fact that increases in the value of homes and pensions may not result in immediate cash benefits to those who own them does not mean that such increases do not contribute to the overall increase in the financial wellbeing of those who gain: both the sense of security that such increases in wealth provide, and the means that they afford to live in greater comfort at some time in the future have direct impact on the manner in which those enjoying them both feel in the present, and on their consequent actual behaviour with regard to consumption and lifestyle choices. As such they cannot be discounted in any discussion on current taxation, not least because they do provide greater capacity tax at present in the vast majority of cases[31].

Taking the annual averages for this combined data produces the following information:

Table 4 UK average income per annum, average wealth increase per annum and tax paid on both 2011 – 20

	£'billion	Average tax paid £'billion	Average tax paid %
Average income per annum	1,753	577	32.9%
Average wealth increase per annum	592	24	4.1%
Total increase in financial resources	2,345	601	25.6%

It is immediately apparent that wealth increases are taxed at substantially lower rates than income is. Without seeking to further finesse the assumptions made, if increases in wealth had been taxed at the same rate as income then an additional £170 billion of tax revenue might have been raised in the UK each year. Whether this is desirable is a matter for debate: that the difference in tax paid exists is a fact.

[31] The proverbial problem of the old person living in a valuable property but who has almost no income does not change this argument: it is always possible for taxes on wealth to be rolled up until death in such cases with a modest interest charge perhaps being applied. This is no more than a form of equity release arrangement and would be easy to deliver to overcome this issue.

The obvious question that then arises refers to who might pay this additional tax. To look at this issue earnings by decile[32] as reported by HM Revenue & Customs for 2019/20 have been matched with the likely allocation of the average wealth increase as noted above in that same year, assuming that the wealth increase is apportioned by decile in the same proportion as wealth holding by decile[33].

This results in the following apportionment of the income and wealth increases by decile:

Table 5 Average UK income of taxpayers and wealth increase of taxpayers per decile 2019-20

Decile	Average income within the decile 2019/20	Average wealth increase based on average wealth holding by decile	Total likely average increase in financial wellbeing in 2019/20 by decile
	£	£	£
1 (Lowest)	13,920	118	14,038
2	16,360	979	17,339
3	18,770	2,518	21,288
4	21,400	5,137	26,537
5	24,470	8,338	32,808
6	28,190	12,121	40,311
7	33,020	16,940	49,960
8	39,800	23,797	63,597
9	50,520	35,550	86,070
10	84,730	83,068	167,798

Those in the lower income deciles benefit very little from the increase in wealth in society at large: those in the highest income decile were however, likely to have seen their wealth increase by almost as much as their income in 2019/20.

The tax paid by decile has then to be considered. There are complications in doing so. Data on actual tax paid is only readily available by decile for income tax, and is notoriously misleading, as this table shows:

[32] A decile is simply one tenth of the population being studied: in this case there are 31.4 million taxpayers in 2019/20 and so there are likely to be a little over three million people in each decile.

[33] An assumption is made that the deciles for the two measures coincide: this is considered sufficiently plausible to be a reasonable assumption to make.

Table 6 UK income tax liability per taxpayer by decile 2019-20

Decile	Average income within the decile 2019/20	Expected income tax on income	Expected actual income tax rate	Cumulative proportion of income tax paid
	£	£	%	%
1 (Lowest)	13,920	240	1.7%	0.5%
2	16,360	660	4.0%	2.0%
3	18,770	1,090	5.8%	4.3%
4	21,400	1,630	7.6%	7.9%
5	24,470	2,190	8.9%	12.6%
6	28,190	2,860	10.1%	18.8%
7	33,020	3,750	11.4%	27.0%
8	39,800	4,950	12.4%	37.7%
9	50,520	7,030	13.9%	53.0%
10	84,730	21,640	25.5%	100.0%

It is easy to see how it can be suggested that the top ten per cent of income earners in the UK bear most of its taxes based upon this data, but the impression is in fact misleading because income tax is but one tax out of many that are paid in the UK.

For this reason, estimated overall effective tax rates per decile based on Office for National Statistics data for 2019/20 have been used to estimate actually tax liabilities paid out of income by decile[34]. Using this data as the most reliable available, the following estimated overall tax liabilities on income and wealth by decile can be estimated. The wealth tax due is estimated at the overall average rate of tax per annum of 3.4% previously noted, without allowing for the fact that many in lower deciles would appear to have increases in wealth lower than capital gains tax allowances, for example. This might overstate the tax that they actually pay, albeit only slightly given the sums involved.

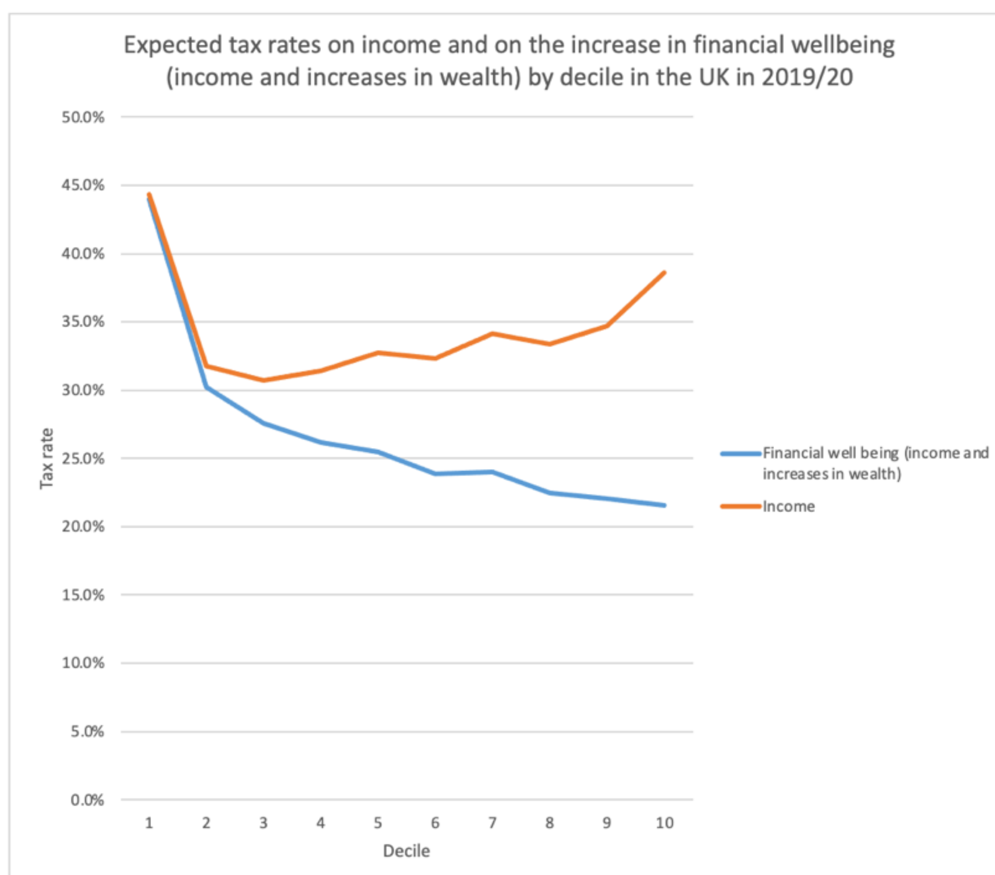
[34] It should be noted that because of slight statistical inconsistencies in the bases of estimation the overall tax rates estimated by the ONS are slightly higher than those previously noted here, but the impact is broadly equal across the range of all incomes.

Table 7 UK tax paid on income and wealth and the two combined by taxpayers by decile 2019-20

Decile	Average income within the decile	Average wealth increase based on average wealth holding by decile	Total likely average increase in financial wellbeing in 2019/20 by decile	Effective tax rate on gross income for the decile based on ONS data for 2019/20	Expected total taxes paid out of income	Expected tax on wealth	Expected total taxes	Expected tax rate on increase in financial wellbeing
	£	£	£	%	£	£	£	%
1 (Lowest)	13,920	118	14,038	44.3%	6,173	5	6,178	44.0%
2	16,360	979	17,339	31.8%	5,197	40	5,238	30.2%
3	18,770	2,518	21,288	30.7%	5,763	104	5,867	27.6%
4	21,400	5,137	26,537	31.4%	6,726	212	6,938	26.1%
5	24,470	8,338	32,808	32.8%	8,017	345	8,361	25.5%
6	28,190	12,121	40,311	32.3%	9,110	501	9,611	23.8%
7	33,020	16,940	49,960	34.2%	11,278	700	11,978	24.0%
8	39,800	23,797	63,597	33.4%	13,292	984	14,276	22.4%
9	50,520	35,550	86,070	34.7%	17,521	1,470	18,990	22.1%
10	84,730	83,068	167,798	38.6%	32,693	3,434	36,127	21.5%

The expected overall rate of tax on financial wellbeing in 2019/20 by decile, with the rate on income shown for the sake of comparison, was in that case:

Chart 1 UK expected effective tax rate for income taxes and income taxes and wealth increases when combined in 2019-20



Overall, the effective rate of tax on increases in financial wellbeing in the UK declines steadily as that financial wellbeing increases. The UK tax system is in that case deeply regressive.

In contrast, with regard to income the system is regressive at lower levels of income and is then broadly flat in middle income ranges, with rising rates returning for the highest decile who do, however, enjoy lower rates of tax paid out of income overall than some on much lower incomes.

This inequality is not just apparent in itself. Two further dimensions are important, one relating to gender inequality and the other to intergenerational inequality.

As the Women's Budget Group has noted[35], on average women own £101,000 less wealth than men and on average men have £51,000 more pension savings than women do. The distribution of income from savings also suggests that women have many fewer financial assets than men.

As Tax Justice UK has noted[36], in the tax year 2016-17, 614,000 people in the UK received over £100,000 in income from either property, interest, dividends or other investments, totalling £24.5bn, a little over 75 per cent of this was enjoyed by men, suggesting substantial gender inequality in financial wealth distribution. It is likely as a result that men pay lower overall effective rates of tax than women, exacerbating the inequality that already exists.

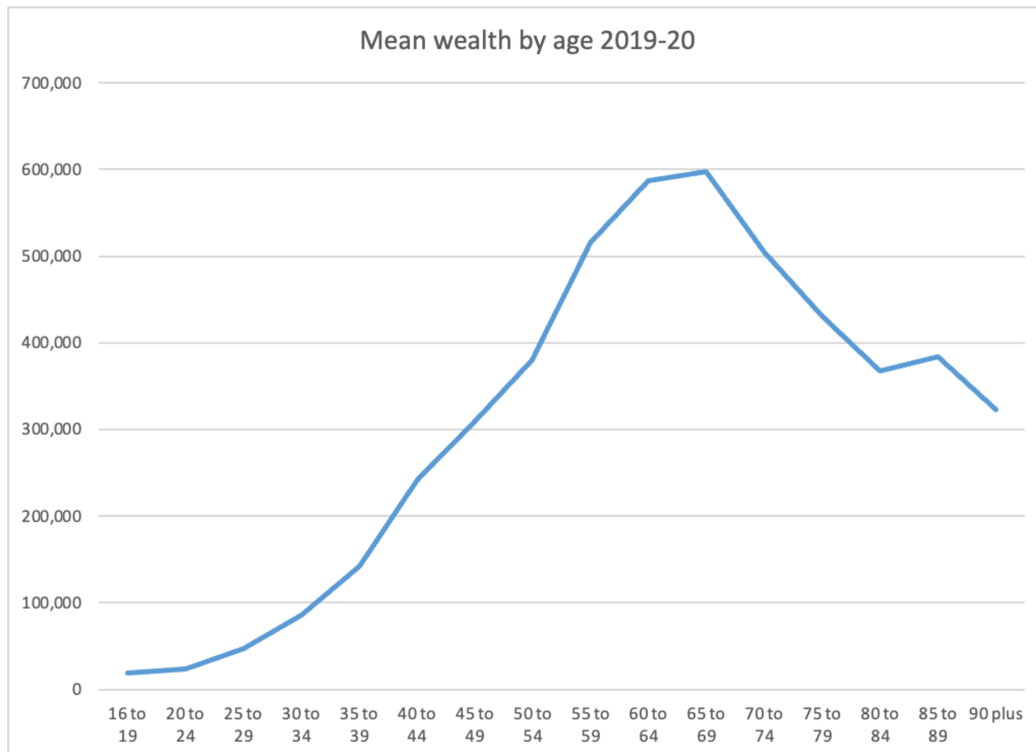
The intergenerational dimension of this has also to be considered. Based on 2019/20 wealth data the Office for National Statistics has estimated that mean wealth holdings by age of owner are as follows in the UK[37]:

[35] https://wbg.org.uk/analysis/why-wealth-tax-is-a-feminist-issue/#:~:text=The%20under%2Dtaxation%20of%20wealth,ripple%20effect%20on%20private%20pensions.

[36] https://www.taxjustice.uk/uploads/1/0/0/3/100363766/wealth_tax_and_gender_-_final_paper.docx.pdf

[37]

Chart 2 UK wealth by age of the owner 2019-20



Given this heavily skewed distribution it is likely that tax rates not only fall with increasing income and wealth but that they also fall steadily with age.

Conclusion

All estimates of the sort noted in the report are only as good as the underlying data permits, but it should be noted that the sources used in this report are the best currently available and are almost entirely drawn from official UK government data.

In addition, it should be noted that nothing about the use of that data in this report is of an unexpected, or unreasonable nature.

Furthermore, the suggestion made that increases in financial wealth are equivalent for the purposes of appraising well-being to the receipt of income by the wealth owner is considered appropriate and fair. That these two sources of well-being can be equated is a concept widely recognised in accounting theory and practice, for example, where all sources of financial gain are treated as having equal significance, whatever their origin.

The result is that some almost inevitable conclusions arise from the observations noted.

The first is that there have been quite exceptional increases in wealth in the period reviewed: the wealth increase in the period reviewed was 33.8% of all income recorded within GDP during the same years.

Secondly, given this disproportionate increase it is exceptionally unlikely that the increases in wealth in this period did all arise from what are conventionally called savings. Other factors must have influenced the increase in wealth, of which by far the most significant was the impact of government support for financial markets during this period as a result of its quantitative easing programmes. In addition, the support provided by the government to banks as a result of guaranteeing the deposits of many of those who held accounts with them sustained the wealth of many.

Thirdly, the tax subsidy the government provided for many savings arrangements such as ISAs and pension funds, all if which gave rise to multiplier effects in savings markets, are also likely to have increased wealth disproportionately. It can inevitably be concluded as a result that the owners of wealth have during the course of this period enjoyed the advantage of considerable financial support from the government that has greatly increased their financial wellbeing.

Fourthly, as has been noted throughout this report, this increase in wellbeing has not been evenly distributed throughout society. The owners of wealth also tend to be those with higher earnings, and both tend to be concentrated in a small part of society as a whole. They also tend to be older than average within the population as a whole whilst men will also be disproportionately represented amongst their number.

Fifthly, the perverse consequence of this subsidy is that the best off in the UK have enjoyed considerably lower overall effective tax rates on their increases in financial wellbeing over the last decade than have those with lower income and wealth.

Despite this it does not follow that increases in wealth should necessarily be taxed in the same way as income is. As is apparent from the nature of the wealth portfolios that have been noted, it has in particular been a consistent policy of successive governments of different political persuasions over long periods of time to subsidise the value of homes and pensions through the tax system. This is unlikely to change in the foreseeable future.

In that case what is required now is that the relationship between the tax systems on income and wealth be reimagined. If, as is likely in the case of a person with already adequate income, an increase in wealth contributes either as much or almost as much an increase to their wellbeing as an increase in income might do (which assumption is discussed in an appendix to this chapter) then it is apparent that the current tax system is heavily biased towards those

who are already well off. The precise degree of bias is not very relevant: the bias is so large at present that it very clearly exists.

Three things then follow from that observation. The first is that this disparity needs to be addressed to ensure that a fairer society is created.

Second, this issue has to be addressed because the subsidy given to saving is resulting in the withdrawal of large sums of money from the productive economy of the UK without any matching increase in investment taking place. That is because savings in housing, most of which is not new, or shares, most of which do not represent new share issues used to fund new corporate investment, or in commercial property, most of which is not newly constructed, might make sense to City based fund managers but they rarely provide new money for actual investment that creates new activity or employment in the UK economy. As a result, these subsidies to savers, most of whom are already wealthy, actually suppress growth at present, resulting in a loss of economic wellbeing to most people.

Third, if inequality is to be addressed a large part of any increase in taxes on wealth and income streams derived from it should be matched by reductions in the taxes paid by those on lower incomes to accelerate the process of creating equality and wider wellbeing within our economy as a whole, which will overall provide a significant boost to GDP as those on lower incomes tend to spend all that they earn, creating significant economic multiplier effects as a consequence.

Whether or not £170 billion of additional tax could be raised for redistribution as a result (as this chapter suggests might be theoretically plausible) is not the point. What does matter is that the inequalities that the existing system of providing subsidies to savings through the tax system be addressed for the wellbeing of society as a whole.

Appendix - Technical discussion on equating income and increases in wealth

In case of doubt as to the relevance of the approach used in this note, where increases in wealth in a period have been treated as being equivalent to the receipt of income in that same period, it is important to note that it is entirely consistent with the method of recording profit in UK and under international accounting standards.

The primary method of computing the income of any entity using these standards is to compare the net worth of a company at the end of a period (£A) with the net worth of that same company at the beginning of the period (£B) having allowed for sums withdrawn from the entity during the period by its owners, whether by way of dividend, share buyback or other means (£C), and the issue of new shares or other equity (£D).

In other words, profit (£Y) is calculated as:

£Y = £A - £B + £C - £D

This may come as a surprise to those who presume that the income of an entity during a period is the figure included as net profit after tax in the profit and loss account or income statement of the entity in question (£E). This is not the case. The movement in the value of the balance sheet at the end of a period (£A) is, instead, reconciled with the value at the beginning of the period (£B) by publication of three separate statements:

The income statement (or profit and loss account, as some might know it), which estimates the net sum earned from trading, having allowed for tax during the course of the period (£E).

The statement of comprehensive income for the period, which recognises the change in the market value of the assets and liabilities of the enterprise during the course of the period when stated at fair market value at both the opening and closing dates, some of which movements may be taxable. (£F)

A statement of the change in equity arising during the course of the year, which explains the sums withdrawn from the entity during the period by its owners, whether by way of dividend, share buyback or other means (£C), and the issue of new shares or other equity (£D).

As a result, and given that the changes in equity have already been included in the calculation noted above, earnings (£Y) can also be stated as:

£Y = £E + £F

To translate this to the context of this note, the earnings a person has during a period broadly equate to the earnings a trading entity records in its income statement (£E). It is this figure that most think represents their total income in the year. This idea is also implicit in most tax systems, largely because almost all of our taxes were created before modern theories of income and accounting were created.

This idea of income is, however, wrong: a person's total income in a period is their increase in net worth having allowed for what they have consumed and should therefore also include the change in the fair value of the assets that they own and sums that they owe during the course of period, as is reflected in modern accounting (£F). In that case the inclusion of the change in a person's net asset value during a period in income for determining effective tax rates as done in this note is not just appropriate, but theoretically required by accounting practice and the economic theory that it is based upon.

Chapter 4

Why we do not need a wealth tax in the UK

Many organisations on the left of UK politics are now calling for wealth taxes. The Taxing Wealth Report 2024 does not do so. It is appropriate to explain why that is the case.

As the Taxing Wealth Report 2024 has shown, because of the disparity between the tax rates applied to income and increases in wealth arising in each year it is possible that an additional capacity to tax of up to £170 billion per annum might be available in the UK. However, just because a potential tax base exists does not mean that it should be taxed. Nor does it mean that the tax base in question must be taxed in only one way.

It is my suggestion that it would not be wise or appropriate to introduce a wealth tax in the UK at this point in time. There are a number of reasons for saying so.

Firstly, whilst it is reported that there was personal wealth exceeding £15 trillion in the UK at the time that the last estimate was prepared in 2020 it is quite clear that a significant part of this might be unavailable as the basis for a wealth tax. The breakdown at that time was as follows:

	Total wealth 2020 £'billion
Property Wealth (net)	5,458
Financial Wealth (net)	1,933
Physical Wealth	1,385
Private Pension Wealth	6,445
Total Wealth (including Private Pension Wealth)	15,221
Total Wealth (excluding Private Pension Wealth)	8,776

Much of the UK's property wealth is tied up in private housing and there would be considerable political resistance to imposing a wealth tax charge on people's home, as past evidence has indicated. Whilst it is undeniable that some of that wealth is also second homes, buy-to-let property portfolios, commercial property, and land used for commercial and non-commercial purposes, and all of these might logically be within the basis for a wealth tax, this does not eliminate all the problems of imposing such a charge. There may well, in fact, be considerable difficulty in doing so, because of:

1. Establishing who owns a property, since by no means all land and buildings are registered within the UK.
2. Valuing these properties when those valuations might be deeply subjective in many cases, and therefore open to considerable (and costly) dispute.
3. Establishing a basis for re-evaluation of property values on a recurring basis to ensure that a tax remained relevant. In this context, it should be noted that property valuations for the purposes of Council Tax in England have not been updated since 1992, precisely because of this difficulty.

It would be a brave government that took on these issues. To do so, thinking that the basis for a wealth tax on property could be established within the lifetime of a single parliament, would be wildly optimistic.

Property is not the only area where such difficulties might arise. For example, whilst most physical property would fall outside the scope of a wealth tax because it comprises household effects and things such as cars, there are inevitable exceptions to this rule, including valuable collections, works of art, and so on, all of which could, in theory, be subject to wealth taxation. However, once again, establishing a basis for taxation for such assets and updating it on a regular basis would be exceptionally difficult.

The same problem is to be found with regard to financial wealth. Of the total sum of such wealth noted, it is very unlikely that any government would be willing to impose a wealth tax charge on savings in pension funds. Included in the sum of £1.9 trillion of financial wealth outside such funds is at least £600 billion saved in ISA accounts. It is, again, unlikely that any government would be willing to impose a wealth tax charge on these texts incentivised accounts. This leaves approximately £1.3 trillion of other financial wealth but by no means all of this will be saved in readily marketable assets. Some will, for example, be tied up in the value of private companies and businesses. These are notoriously difficult to value with such valuation exercises often being the subject of protected negotiation and dispute between taxpayers and HM Revenue and Customs, which the imposition of a wealth tax would only make it worse.

Taking all these factors into account it has to, firstly, be concluded that the potential basis for a wealth tax charge is much lower than the total financial wealth of people resident in the UK.

Secondly, it should be apparent that providing an adequate legislative base for such a tax charge would be extremely difficult without creating significant opportunities for loopholes to be exploited.

Thirdly, taking into consideration the need for consultations on all stages of this process, the time required to create such a tax would be considerable.

Fourthly, even if all these processes could be concluded, there would then be a considerable cost to administering this tax because of the inevitable high level of disputes that would arise as to the basis of charge to be made. The fact that those subject to this tax would also, most likely, have the means to engage accountants and lawyers to assist them in pursuing these disputes only increases the likely potential cost of collecting any tax owing.

For all these reasons, it is inappropriate for practical reasons to impose a wealth tax in the UK however appealing such an idea might be when considering the gross inequalities that exist within the country and the apparent disparities in tax paid that we note do arise on a persistent basis.

This does not, however, mean that there are no available taxation solutions to tackling the issues that the Taxing Wealth Report 2024 has noted arise as a consequence of the disparity between the tax rates now paid on income arising during a period and the average increase in wealth of UK households accruing during the same period. What that report suggests in place of a wealth tax are a wide range of reforms to existing taxes payable either on high levels of income, or upon income arising from wealth, or on the enjoyment of certain types of wealth. The breadth of these reforms is potentially quite significant, and include:

- Aligning capital gains tax and income tax rates.
- Reducing the capital gains tax annual allowance.
- Abolishing entrepreneur's relief in capital gains tax.
- Reforming inheritance tax.
    - Pensions
    - Business property
    - Agricultural property
    - Charities

  - Houses
  - Rates

- Reforming rates of income tax.

- Reforming national insurance charges on higher levels of earned income.

- Creating an investment income surcharge on unearned incomes.

- Restricting pension tax reliefs to the basic rate of income tax.

- Abolishing higher rate tax relief on gifts to charities.

- Abolishing the domicile rule.

- Reforming VAT to change tax rates on:

  - Private school fees
  - Financial advice

- Creating close company corporation tax rules.

- Companies House reform

- Reforming corporation tax admin

- Recreating large and small company corporation tax rates.

- Capping total ISA contributions.

- Council tax reform, including:

  - Higher rates of tax for high-value properties
  - Additional rates of tax on second and subsequent properties
  - Additional taxes on vacant properties.

These reforms are of varying complexity. Some, such as the alignment of income tax and capital gains tax rates, would be easy to implement and have historical precedent. This is also true for investment income surcharges and close company rules for corporation tax, for both of which there are precedents that create significant knowledge bases that would assist the

recreation of these charges. In the case of all the potential reforms of this type the creation of new charges should be a relatively straightforward matter, capable of implementation without significant time delays or the creation of substantial taxation disputes. This is the common characteristic to almost all these proposals: they are easy to deliver.

Importantly, however, because of the wide range of options available, it is obvious that not all these changes need to be implemented at the same time, and a rolling programme of reform could, instead, be undertaken. Critically, this suggests that the net outcome of this programme of reform would be significantly more successful than any attempt to impose a single wealth tax.

I offer an analogy by way of explanation. As any golfer knows, setting out to play a round of golf with just one club, whatever it might be, would result in a disastrous score. Golfers take a wide range of clubs because when doing so they have the range of tools necessary to address the wide range of scenarios that they will face whilst completing a game. I suggest that having a single wealth tax would be equivalent to playing a round of golf with, for example, a putter. Having the range of tax reforms proposed in the Taxing Wealth Report 2024 might instead be the equivalent to setting off with fourteen clubs in the golfer's bag, which considerably increases the chance of achieving a good score. So it is with taxation. Having a wide range of taxes imposed at relatively low rates on relatively easy to identify tax bases is likely to produce an overall taxation yield greater than a single tax on a peculiar tax base might ever achieve. It is on the basis of this logic that the Taxing Wealth Report 2024 has been written. Reforming existing taxes can achieve so much more than a wealth tax might.

A web version of this summary is available here:

https://taxingwealth.uk/2023/12/04/why-we-do-not-need-a-wealth-tax-but-need-to-tax-the-income-earned-from-wealth-a-great-deal-more/

Chapter 5

How the Taxing Wealth Report 2024's recommendation might be used

The Taxing Wealth Report 2024 includes more than 30 detailed recommendations for the reform of individual UK taxes as well as a whole range of recommended reforms of the management of that system as a whole. Every major tax is subject to at least one recommendation and some, like income tax, capital gains tax, inheritance tax, and corporation tax, are all subject to a range of recommended changes.

The purpose of the Taxing Wealth Report 2024 is to recommend tax reforms that would, in themselves, improve the functioning of the UK tax system if that system is to be considered a public good[38]. As a consequence, a government with concern for inequality in the UK might well wish to adopt many of the recommendations made in the Taxing Wealth Report 2024 not because they wish to use the funds that might be generated for revenue purposes, but because they wished to redistribute the incidence[39] of the tax burden in the UK so that those with the greatest capacity to pay have the highest overall tax demands imposed upon them as a progressive tax system would require. As the Taxing Wealth Report 2024 demonstrates, the UK tax system is a very long way from doing this at present[40].

It would also be possible for a UK government that wished to raise additional taxes to match additional spending that it might incur to improve the quality of public services currently available in the UK by taking advantage of the detailed tax recommendations made in the Taxing Wealth Report 2024. There is broadly based public demand that this might happen.

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[38] Public goods are a supply of goods (sometimes) and services (more commonly) that are provided without the intention of profit being made to all members of society, usually by a government, but also possibly by a private sector organisation.

[39] The term 'tax incidence' is used to describe who actually bears the economic cost of a tax. In this case the reference is to whom in the income strata of the UK is making contribution to the overall level of taxes paid in the country.

[40] https://taxingwealth.uk/2023/09/06/wealth-is-undertaxed-by-170-billion-a-year-in-the-uk/

The Taxing Wealth Report 2024 also suggests reforms to tax incentivised savings arrangements that might provide the capital for necessary long-term investment in the UK economy. Some of that investment might tackle the failing infrastructure in our public institutions, whether that infrastructure is in hospitals, schools, our transport and energy systems, or elsewhere. This additional capital might also fund clean water, flood defences and the necessary investment in the transition of the UK economy that we must make to become net–zero compliant by the legally required deadline of 2050.

The Taxing Wealth Report 2024 identifies tax reforms that could raise more than £90 billion of additional tax revenues a year. The proposed reforms to tax incentivised savings arrangements might assist the raising of more than £100 billion of capital for new infrastructure investment purposes per annum. Both these sums are significant. Together they amount to about eight per cent of UK national income, or gross domestic product (GDP) in 2024. Re-organising the use of human and material resources within the economy to make use of funding on this scale would take time, and it is, therefore, very unlikely that any government would wish to adopt all the recommendations made in the Taxing Wealth Report 2024 at one point in time, or potentially ever, as a result. It is actually possible that this much money might never be needed to effect the change that this country needs.

What this means is that the Taxing Wealth Report 2024 should be seen as a menu of options that any government could consider if it wished to achieve any of the three noted outcomes of redistribution, public service reform or capital investment for infrastructure noted above, or a combination of them. Given that many of the recommendations could, themselves, also be adopted in part as well as to the scale suggested in the Taxing Wealth Report 2024, that range of options available for consideration is very wide.

In that case, the Taxing Wealth Report 2024 should be seen as a way of encouraging debate on the ways in which the funding of the UK government and its infrastructure programmes might be changed to meet the social, political, economic, and environmental objectives of the 21st century. It puts options on the table. It is up to others to decide whether they wish to make use to them.

That said, the Taxing Wealth Report 2024 is intended to put an end to the claim that 'there is no money left' to fund programs that any UK government might wish to pursue. It is suggested that it succeeds in that goal.

It also, quite deliberately, is intended to provide the ammunition that politicians need when they are asked by journalists ''How will you pay for that proposal?' The Taxing Wealth Report 2024 makes it very clear that there is money left, and that any politician who wants to explain how they can fund their spending proposals has a very wide range of options available to them to answer that question. If, as a consequence, The Taxing Wealth Report 2024 broadens

the basis for debate on the future supply of government services in the UK, then it will have achieved its goal.

Chapter 6

Income Tax - Introduction

Background to income tax

Income tax is the biggest revenue raise in the UK tax system and has been for most of the last two centuries[41].

In the tax year 2022/23, which is the most recent for which there is confirmed data at the time of writing, income tax raised £250.2 billion of revenue[42]. This represented 27.8 per cent of total UK tax revenues in the year. Of this sum £212 billion (84.7 per cent) was collected via the Pay-As-You-Earn method of deducting income tax from employees working in the UK. The rest was collected on other sources of income subject to this tax via the self-assessment tax return system.

What is subject to income tax?

Income tax is charged on almost all sources of income arising to a UK resident person unless that income is:

- Subject to corporation tax because it is received by company.
- Subject to capital gains tax.
- Exempted from tax e.g. it is interest paid on an ISA (Individual Savings Account) or some forms of state benefit that are considered non-taxable.

This means that the following sources of income are subject to this tax, but please note that because of the comprehensive nature of income tax the list is not exclusive:

- Income from employment.

[41] Income tax was first introduced in 1799 and has been a persistent feature of the UK tax system since 1842, but due to historical anachronisms is technically reintroduced each year.
[42] https:/obr.uk/download/economic-and-fiscal-outlook-november-2023/?tmstv=1702908969

- Benefits in kind arising as a consequence of employment e.g. the benefit of being provided with a company car.
- Profits arising from self-employment.
- Rents if received personally.
- Income from savings and investments, including:
  - Interest
  - Dividends
  - Royalties
- Payments from estates.
- Distributions from trusts.
-
- Pensions, including:
  - The UK state pension.
  - Private pensions.
- Some, but not all, state benefits.
- The income of MPs.
- The income of ministers of religion.
- The salaries of company directors.

Problems with the UK income tax system

Every UK tax has some design deficiencies inherent within it. Income tax is no exception to this rule. The most important problems with UK income tax are:

1. The largest part of income tax, by far, is settled through the pay-as-you-earn (PAYE) system of tax deduction at source from employees. 84.7 per cent of income tax is paid in this way.

In contrast, the tax due on most of the above noted sources of income can only be charged to tax if those persons in receipt of that income make declaration of it on their self-assessment tax return. There is substantial evidence that very large numbers of people do not make declarations of all their income subject to income tax. HMRC estimate that 18.4 per cent of tax owed by self-employed persons might not be paid, for example (although that is better than their estimate for small companies, which they estimate do not pay 29.3 per cent of their tax owing)[43].

The scale of under the declaration is likely to be significantly underestimated by the UK's HMRC when preparing its estimate of tax gaps (see a separate note in this report regarding tax administration on this issue[44] and the section on reforming HMRC[45]). Until measures to both properly appraise, and then address the tax gap, which will be assisted by proper tax spillover analysis[46], are put in place this tax remains subject to the risk of significant abuse.

2. Income tax is, supposedly, the most progressive of UK taxes, but as is noted in this section of the Taxing Wealth Report 2024, significant relief and allowances reduce this progressivity, substantially cutting the tax liabilities of those who would otherwise pay higher rates of income tax. The economic benefits of granting these relief and allowances are not clear. The appraisal of the effectiveness of these reliefs could be a task for an Office for Tax Responsibility (see a separate section in the Tax Administration chapter).

3. The UK's income tax is substantially undermined by both its capital gains tax and corporation tax. This is because both those taxes provide opportunities for those with significant income or wealth to structure their tax affairs in ways that can significantly reduce the overall tax liabilities when compared to those that might be due if income tax was paid on all their income. For that reason, proposals are made to address these issues within this chapter.

4. Income tax is not the only tax charge due on income from employment and self-employment in the UK. National insurance is also payable on income rising from those sources. However, and problematically, national insurance is not paid on the other

[43] https://www.gov.uk/government/statistics/measuring-tax-gaps/1-tax-gaps-summary
[44] https://taxingwealth.uk/2023/09/19/the-taxing-wealth-report-2024-the-uk-needs-better-estimation-of-its-tax-gap-to-prevent-the-illicit-accumulation-of-wealth-2/
[45] https://taxingwealth.uk/2024/02/29/reforming-the-organisation-goals-and-funding-of-hm-revenue-customs/
[46] https://taxingwealth.uk/2023/09/29/the-uk-needs-to-undertake-tax-spillover-assessments-if-tax-abuse-is-to-be-beaten/

sources of income on which income tax is payable. This creates a considerable bias in favour of unearned income within the UK tax system. A recommendation to address these issues is included in this chapter.

5. Finally, there are serious problems arising with regard to tax and other liabilities owing on income within the UK tax system at present, where piecemeal, and often ad hoc, adjustments have been made to the tax system over time, particularly as they affect those with higher income. Those involving the withdrawal of various tax allowances are particularly. In addition, in combination the proposals made in the Taxing Wealth Report 2024 might create unfair tax rates on those earning between £50,000 and £75,000 per annum in the UK and a proposal for a reduced income tax rate over this income range is made as a result which would restore an appropriate balance to the proposed tax system. In the interest of tax justice, and to ensure that the other proposals made in this chapter are fair, these anomalies need to be eliminated from the tax system. Recommendations to achieve this outcome are noted. As is also noted these changes, which should only be considered if the other recommendations in the Taxing Wealth Report 2024 are implemented, would have a combined cost of £19.1 billion per annum.

The extensive proposals made in this part of the Taxing Wealth Report 2024 are designed to tackle the above noted issues. Between them they might raise £39.5 billion of additional tax revenues a year, albeit that in total reliefs of £19.1 billi0on are then recommended. This is why they are so important.

Future of income tax

The Taxing Wealth Report 2024 concerns itself with those pragmatic reforms to the UK tax system that might be undertaken by a government during the course of a single parliament. Given the number of recommendations made, the report does not suggest fundamental reform to the UK tax system as a whole. It should, however, be noted that there have been proposals made over many years to combine the income tax and national insurance systems. This report does not make comment on that proposal but does note that there are significant problems in doing so.

Merging these taxes (because national insurance is a tax) would create very high marginal tax rates on occasion, which might be harmful to tax morale. Such a proposal would also make the UK an outlier within international tax, where social security contributions tend to be more significant in comparable states than they are in the UK. UK income tax rates might then appear unattractive internationally as a consequence of this if this proposal were to be adopted.

The integration of income tax and employee's national insurance does also not overcome the fact that employer's national insurance contributes substantial revenue to HM Treasury each year (£103 billion in 2022/23[47]), and this contribution would either have to continue, or be replaced by another tax if there was an intention to eliminate national insurance as a whole.

These are issues that will need to be addressed in the future.

[47] https://assets.publishing.service.gov.uk/media/655af971544aea0019fb2fc9/NS_Table_workbook.xlsx

Chapter 6.1

Income tax – Recommendation 1

Restricting pension tax relief to the basic rate of income tax

Brief summary

This chapter suggests that:

1. The higher rates of tax relief on pension contributions made by those who are 40 per cent and 45 per cent taxpayers in the UK are inappropriate. Everyone should get tax relief on their pension contributions at the same rate of 20% that is now made available to basic rate taxpayers.

2. All such higher rate tax reliefs be abolished with some restriction on associated national insurance reliefs also being made.

3. As a result, £12.5 billion of tax reliefs might be withdrawn each year, plus maybe £2 billion of national insurance reliefs. As a result that much additional tax will be paid.

4. If this recommendation is adopted the cost of tax reliefs on pension contributions made by higher rate taxpayers in UK might still amount to approximately £24 billion a year, or £5,450 a year each, compared to approximately £8,750 a year each at present. The average basic rate taxpayer receives a subsidy of approximately £1,050 a year on their pension contributions at present.

5. Changing these reliefs will not seriously change the savings habits of the people impacted as pensions will remain by far the most attractive tax incentivised

savings arrangement available to them and more than eighty per cent of UK financial assets are held in tax incentivised savings arrangements.

The proposal	To restrict the rate of tax relief available on pension contributions to the basic rate of income tax, meaning that those on higher income will not enjoy additional tax relief as a result of the pension contributions that they make above the rate available to those paying tax at basic rate on similar sums. An additional suggestion is made to restrict national insurance tax relief on pension contributions for those earning in excess of £100,000 a year.
Reason for the proposal	1. To improve the horizontal equity[48] of taxation, which is currently undermined by the higher rate of tax relief enjoyed by those paying higher rates of income tax on the pension contributions that they make. 2. To increase the prospect of vertical equity[49] of taxation in the UK which is heavily undermined by the provision of higher rates of tax relief on pension contributions made by those liable to higher rates of income tax, which relief reduces their effective rate of tax paid by these people, impacting as a result on the progressive nature of the income tax system. 3. To reduce the tax spillover[50] effect that current rates of tax relief on pension contributions create within income tax rules.

[48] Horizontal tax equity requires that all incomes of similar amount be taxed the same sum irrespective of where that income comes from.

[49] Vertical tax equity requires that as a person's income increases, the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.

[50] Tax spillovers are the consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.

	4. To reduce the rate of tax avoidance[51] in the UK. 5. To consequently improve the rate of tax compliance[52] in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be small as pension arrangements will remain the most favourable tax incentivised savings arrangement in the UK even if these proposals were enacted. Assuming this to be the case then a sum of £12.5 billion of tax might be saved as a consequence of the proposal to restrict pension contribution tax relief to the basic rate whilst a further £2 billion or more of national insurance might be saved as a result of additional reforms.
Ease of implementation	Relatively straightforward. Tax relief at basic rate is already provided at source on many pension contributions. The changes to payroll and tax return systems that would be required would be quite straightforward. Changes to tax relief on national insurance contributions might be a little more complicated but the rules used for these contributions when made by company directors could easily be adapted for this purpose.
Likely difficulties that might result from implementation	Relatively few, although they will be politically unpopular.
Likely time required to implement the change	Months in the year preceding the year of actual change.

[51] Tax avoidance is the term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud). The practice may be summarised as 'seeking to get around the law'.
[52] Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

Consultation period required.	Relatively short. It is likely that the changes might be made within twelve months of any proposal being made.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/06/ending-higher-rates-of-tax-relief-on-pension-contributions-would-raise-14-5-billion-in-tax-a-year/

Background

The UK does, like many other countries, provide tax relief on the contributions that a person makes to a pension fund during their working life to provide them with an income in retirement.

The logic for providing this relief is fairly straightforward. In the first instance, a government wishes to encourage those within its population who are able to do so to make provision for the own cost of living in retirement, which, as a consequence, reduces the obligation on the state to do so. There is, as a consequence, a return to a government from providing this relief.

Secondly, there is a supposed economic logic to this relief. This logic is that if a person defers their consumption at the time that they make a contribution to a pension fund, which contribution will then provide a return to them in the form of an income in retirement, then they have, in effect, deferred recognition of their income for taxation purposes from the present until such time as they receive that payment during their retirement. However, this logic does presume that the pension paid in retirement will be taxed in broadly similar fashion and at broadly similar rates to those that the income that would have been subject to in the period when pension saving takes place and this is not guaranteed to be the case with regard to rax reliefs currently available in the UK.

Third, many governments still wish to promote economic growth. As such they also seek to promote investment and the creation of capital markets based upon savings and wealth, which market, they presume, will provide the source of funding for that investment activity. Governments then hope that this investment activity will generate returns that might provide the funds to make payment of the hoped for pension that will reduce their obligation to support ageing populations. In addition , they hope that the same capital markets will create capital assets that might deliver intergenerational transfers of wealth in due course that might

in turn support the payment of basic state payments pensions on a universal basis out of the income generated.

As data on the distribution of UK wealth shows[53], most of those taking advantage of the tax reliefs available upon contributions to pension funds are those with high income or wealth, or both. The following table breaks down pension wealth by decile in the UK in March 2020 (the most recent data available) and also provides average data from 2006 to 2020:

Table 1 - Aggregate private pension wealth in the UK 2006 - 2020

Great Britain, July 2006 to March 2020 — *£ million*

		April 2018 to March 2020	Average 2006 - 2020	Per cent 2020	Per cent average 2006 - 2020
Aggregate private pension wealth (£ millions)	Total Wealth Decile 1 (lowest)	3,982	2,689	0.06%	0.06%
	Total Wealth Decile 2	18,660	11,249	0.29%	0.24%
	Total Wealth Decile 3	64,609	45,672	1.00%	0.98%
	Total Wealth Decile 4	133,185	95,034	2.07%	2.03%
	Total Wealth Decile 5	199,385	143,937	3.09%	3.08%
	Total Wealth Decile 6	308,049	221,718	4.78%	4.75%
	Total Wealth Decile 7	514,231	358,572	7.98%	7.68%
	Total Wealth Decile 8	778,434	561,389	12.08%	12.02%
	Total Wealth Decile 9	1,346,107	975,122	20.89%	20.88%
	Total Wealth Decile 10 (highest)	3,078,409	2,255,487	47.76%	48.29%
	Total	6,445,051	4,670,868	100.00%	100.00%

Source: Office for National Statistics and author calculations.

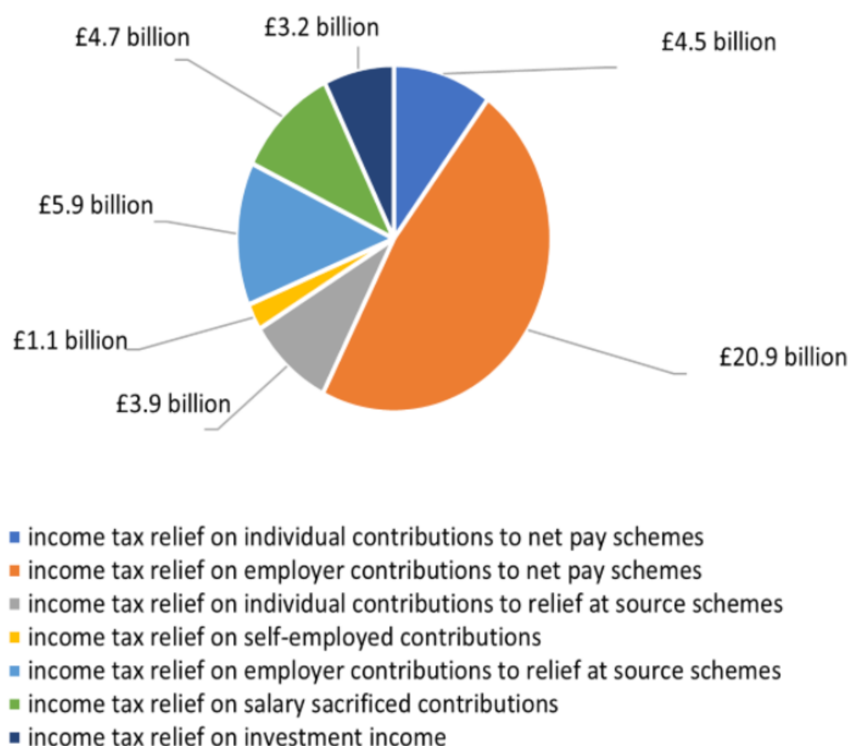
Those in the top decile of UK wealth owners in the UK own, on average, more than 48 per cent of the UK's pension wealth. It might, as a consequence, be presumed that those in this same decile enjoy 48 percent of total overall pension tax reliefs. That, however, is not the case as the reliefs that they enjoy are provided at higher tax rates than those made available to those who are subject to basic rate tax charges on their earnings.

[53] https://www.ons.gov.uk/releases/totalwealthingreatbritainapril2018tomarch2020

HM Revenue & Customs now suggests[54] that the cost of pension tax relief per annum was £67.3 billion in the tax year 2020/21, which is the most recent year for which data is available.

They suggest that the income tax element of this cost can be broken down as follows:

Chart 1 – Cost of pension tax reliefs



Source: As noted in text

These totals come to £44.2 billion, implying that national insurance reliefs arising as a consequence of pension contributions made cost £23.1 billion a year.

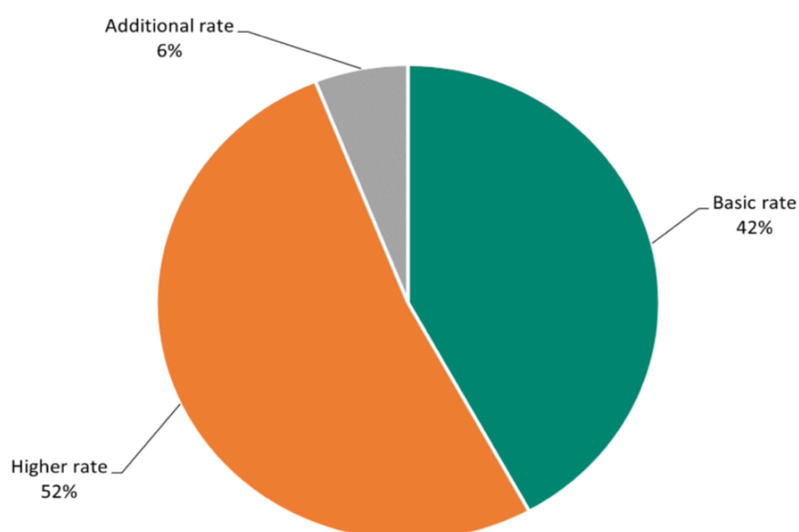
This data cannot simply be apportioned by decile on the basis of the wealth statistics. There is superficial appeal to doing so but this might not take into sufficient account the fact that the tax relief provided to those in the highest decile of income earners might be provided to them at their highest marginal income tax rate, which is likely to be at least 40 per cent (and maybe 45 per cent) in the year in question given the profile of UK earnings. This contrasts

[54] https://www.gov.uk/government/statistics/personal-and-stakeholder-pensions-statistics/private-pension-statistics-commentary-september-2022, section five

with the tax relief provided to all other contributors to such pension arrangements, who will also be provided with tax relief at their highest marginal tax rate, which rate is however likely in those cases to be at no more than 20%, again given the normal profile of income for taxation purposes within the UK.

HMRC have reviewed this issue and have suggested[55] that in the tax year 2020/21 the marginal rates of tax at which tax relief for pension contributions was claimed were as follows:

Chart 2 – Marginal tax rates at which pension tax relief is given



56

Source: As noted in text

In other words, whilst those with the highest levels of income in the UK are likely to own about 48 per cent of pension wealth, they claim 58 per cent of pension tax reliefs.

Taking these facts together, the likely cost of pension tax reliefs for those in the highest decile of income earners in the UK are likely to amount to at last £25.6 billion. Of this sum almost exactly £23 billion relates to higher rate (40 per cent) taxpayers, meaning that if their relief was restricted to 20% the saving would most likely be £11.5 billion per annum.

Because of the interaction of tax rates, a precise estimate of the saving as a result of restricting relief to the basic rate of income tax for those paying tax at 45% is harder to estimate but is likely to be not much less than £1.5 billion per annum, giving rise to a total saving of at least £12.5 billion.

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[55] https://www.gov.uk/government/statistics/personal-and-stakeholder-pensions-statistics/private-pension-statistics-commentary-september-2022 , section 6

[56]

It is also appropriate to question whether national insurance relief should be given on pension contributions for those on higher pay. It might also be appropriate to restrict that relief. Precise estimates of the sums saved cannot be made but given the remarkable proportion of income relief attributable to those with taxable earnings of more than £150,000 per annum it is likely that constraining national insurance relief on pension contributions for those earning over £100,000 per annum might result in savings of maybe £2 to £3 billion per annum.

When these savings in national insurance relief are combined with the saving in the tax cost of providing pension tax relief at rates above 20% for those with the highest earnings in the UK, total savings arising as a result of restricting pension tax reliefs for the highest earners in the UK might be not less than £14.5 billion per annum, and may be higher.

Discussion

In total tax and national insurance contribution relief on pension contributions by the highest earners in the UK are likely to amount to £38.6 billion per annum (£13 billion of national insurance and £25.6 billion of tax per annum). The remainder of the population enjoy a subsidy of £28.7 million between them. In other words, the wealthiest enjoy a subsidy of more than £8,750 per annum on average towards their pension savings each year and the rest of the population enjoy a subsidy of almost exactly £1,050 per annum each based on the number of taxpayers[57] in 2020/21.

To put these figures in context, the basic universal credit allowance a year is £4,416 per annum[58] in 2023/24 for a person over the age of 25 and the basic old age pension in that year is[59] £10,600 per annum, or not much more than the subsidy given each year to increase the value of the pension of the top income earners in the country, on average.

Recommendation

It is suggested that those paying the higher 40 per cent and 45 per cent income tax rates in the UK should not enjoy higher rate tax relief on the pension contributions that they make[60].

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[57] https://www.gov.uk/government/statistics/number-of-individual-income-taxpayers-by-marginal-rate-gender-and-age

[58] https://www.gov.uk/universal-credit/what-youll-get

[59] https://www.gov.uk/new-state-pension/what-youll-get

[60] It should be noted that some restrictions on relief for those with the very highest level of earnings in the country do already apply and that there is some logic to these restrictions given that the provision of tax subsidies to those already wealthy makes little economic sense.

Instead, it is suggested that the rate of tax relief on all pension contributions made by a person to a UK pension fund should be at the basic rate of income tax applicable at the time that the contribution is made. This would mean that higher rate income taxpayers would still get tax relief, but only at the basic rate of tax, like everyone else.

There are a number of compelling reasons for making this suggestion. Firstly, horizontal tax equity requires this. As far as possible, any tax relief must be available to all within the income tax system on an equal basis.

This is most, especially true when the vast majority of the pension income that will be taxed as compensation for this relief being made available at the time that the contribution was made will be taxed at the basic rate of income tax. That is because most people have lower income during the course of their retirement when compared to the income that they enjoyed during their working lives. It is in that case, wholly appropriate for the creation of horizontal tax equity that the relief given should match the most likely rate of tax payable on a pension in due course.

This proposal is also necessary for the purposes of creating vertical tax equity. Existing reliefs reduce the progressive nature of the UK's income tax and that is inappropriate.

There is also sound economic logic for restricting the amount of tax relief provided, most, especially when there is little economic evidence available to suggest that UK capital markets do in practice provide much of the necessary funding for investment in the UK economy. Almost all of that funding is now provided is by way of bank and other loan arrangements, few of which involve pension funds. It is, therefore, appropriate to restrict the scale of relief for this purpose. That is because most of the funds contributed to pension arrangements on which tax relief is claimed are in fact used for the purposes of financial speculation and not investment in real economic activity. There is no gain to society from that speculation, and as such the scale of tax relief provided should be restricted.

Finally, this change is suggested within the context of other proposals made as part of the series of proposed tax reforms of which this note forms a part. Another of those suggestions proposes that pension contribution tax relief should only be available in future if part of the sum contributed is used to directly generate new activity directly related to the development of a sustainable economy, preferably within the UK. Since that proposal is made for the benefit of all people within the UK economy, it is appropriate that the tax relief to be made available for that purpose is applied consistently to anyone making contribution, and that requires that tax relief on pension contributions only be made available at the basic rate of income tax.

The tax revenue benefits that might arise as a consequence of this proposal have already been noted.

Although there may be some behavioural response to this restriction in relief, they might also be small. Since over 80% of all financial assets within the UK economy are saved in tax incentivised arrangements of some sort[61], and presuming that recommendation made elsewhere in this series of potential tax reforms to restrict the level of ISA contributions on which tax relief might be available are accepted, then it is likely that pension savings will remain the favoured tax incentivised savings mechanism for those looking to make long-term arrangements to secure an income in retirement, meaning that the overall behavioural reaction to this restriction in the relief might be small.

Taking all the above factors into consideration it is likely that £12.5 billion of income tax relief will be saved as a consequence of making this change to pension tax relief whilst a further approximate £2 billion or more of national insurance might be saved.

[61] https://eprints.whiterose.ac.uk/153627/10/modern_monetary_theory_and_the_changing_role_of_tax_in_society.pdf

Chapter 6.2

Income tax – Recommendation 2

Recreating an investment income surcharge on unearned income

Brief summary

This chapter suggests that:

- It is inequitable that those with unearned income in the UK do not make a contribution equivalent to national insurance at present.
- Such a contribution could be made by recreating the investment income surcharge that was included in the income tax system and which was applied to unearned income at a rate of 15% until 1984.
- This charge could also be extended to capital gains.
- This charge would be collected via a person's self-assessment tax return for each year.
- This charge would only be applied to investment income and gains (excluding pensions) exceeding £5,000 in a year. This sum takes into account the fact that almost all those paying would have already had the benefit of a national insurance allowance in the year. A higher ceiling could be set for pensioners.
- This charge would raise approximately £7.1 billion in tax each year if capital gains were not taken into consideration. This sum would increase to approximately £18 billion per annum if capital gains were taken into account.

The proposal	To charge those in receipt of unearned income (i.e. income from savings such as interest or dividends, or from other sources such as rents and from capital gains and trusts, but not pensions) above an agreed level to an investment income surcharge on that excess unearned income. That investment income surcharge would be at the rate of 15%. It is suggested that it would only be applied to investment income of above £5,000 per annum. This liability would be collected as part of the income tax liability of those due to pay it, usually though their self-assessment tax return. This sum would be due because unearned income is not at present subject to a national insurance charge when income earned from work and self-employment is.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently seriously undermined by the differential between the tax rates due on earned and unearned income due to the absence of a national charge, or a charge equivalent to it, on unearned income. 2. To increase the prospect of vertical equity of taxation in the UK which the absence of this charge seriously undermines. 3. To reduce the tax spillover effect that the existing charge structures of national insurance create when compared to those charged under income tax rules. This has most especially been seen in tax planning designed to transform earned income into unearned income via the medium of limited liability companies and dividend payments to working shareholder / directors. 4. To help close the UK tax gap.

	5. To reduce the rate of tax avoidance in the UK. 6. To consequently improve the rate of tax compliance in the UK. 7. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this change is hard to predict, but since significant attempts have already been made by HM Revenue & Customs to reduce the rate of tax abuse via the use of limited liability companies it is likely to be smaller now than it might have been in the past. The inclusion of capital gains in the charge is vital if abuse via that tax is to be prevented. Some dividend and other payments to connected parties might be deferred as a result of this charge being introduced but the likelihood of this could be counter-acted via the use of close company apportionment rules (see separate recommendation). It is possible that such a charge might also defer the recognition of some capital gains. Overall, however, the impact on revenue is likely to be small and short term. The reality is that companies will still need to distribute dividends; that interest will still be paid on deposits and capital gains will be realised as a result of commercial transactions. Significant deferral of these in order to avoid a charge to this proposed investment income surcharge will, in that case, ultimately be hard to achieve. On investment income alone the yield from this charge would yield approximately £7.1 billion a year. If extended to capital gains that sum could exceed £18 billion per annum.
Ease of implementation	In essence this proposal is simple since such legislation has existed before. It was abolished in 1984. The principles are, therefore, known and could be revived.

	The equity of such a charge is obvious, making its passage easier. What is harder to predict is the scale of hostility any such proposal might create.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Up to two years planning might be required for a change such as this, even though it previously existed in UK law.
Consultation period required.	A significant consultation exercise would be required with regard to this change to win acceptability for it.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/13/an-investment-income-surcharge-in-the-uk-could-raise-up-to-18-billion-of-extra-tax-revenue-a-year/

Background

National Insurance is a complex tax. It was originally introduced by a Liberal government in 1911 as part of a range of measures that also saw the introduction of the first state old age pension in this country. It was, however, considerably expanded after the Second World War by the Labour government of that period that was seeking to provide a social safety net for the people of the UK as part of the new social contract that they were seeking to create between the working people of the UK and its government.

National insurance was created, as its name implies, as a state supplied insurance mechanism that guaranteed that in exchange for contributions made an employee or self-employed person might, depending upon their precise circumstances and contributions made, claim for unemployment benefits, some sickness and disability benefits and a state old age pension. It was also suggested that national insurance contributions should contribute to the cost of the National Health Service.

The pretence that national insurance contributions now make direct payment for any pension, benefit or health care provided by the UK state has effectively been abandoned, although

the entitlement to some such benefits is still dependent upon having made such contributions during the course of a working career. For all practical purposes, national insurance is now just one of many taxes within the UK. In the tax year 2023/24 it is likely that national insurance will raise total contributions of £172 billion[62]. This sum will represent approximately 18.1% of all anticipated tax revenues during the course of that year.

National insurance charges are complicated and differ for those who are employed and self-employed. There is also an option for a person to make voluntary national insurance contributions.

Importantly for the purposes of this recommendation, national insurance is not charged on a person's unearned income arising in a year, including:

- Interest on savings.
- Dividends on shares.
- Rental profits.
- Payments from trusts.
- Capital gains.

This creates considerable inequity in the UK tax system as a result since these sources of income are taxed at considerably lower rates than are those that are earned from work or self-employment.

Recommendation

It is recommended that an investment income surcharge be introduced that would be payable on the total unearned income of a person, including capital gains, arising in a year.

It is suggested that this be paid at 15 per cent, which was the rate last used when such a charge was included in the UK tax system before its abolition in 1984. The rate exceeds the national insurance charge but is much less than it when the national insurance contribution due by employers (13.2 per cent) is also taken into account.

It is suggested that an annual tax-free allowance equivalent be given for the purposes of this charge, largely to reduce the cost of administration of small cases. £5,000 would be sufficient

[62] https://obr.uk/economic-and-fiscal-outlooks/

for this purpose. In the event that a person did not have income subject to national insurance this could be increased to the lower national insurance threshold via the self-assessment tax return. A higher limit for pensioners could be considered.

Based on HM Revenue & Customs data[63] on taxable income arising from property, dividend, interest and other income for 2020/21 (the most recent year available), an investment income surcharge charged at 15% on income of this sort exceeding £5,000 per annum would yield approximately £7.1 billion per annum.

Extending the charge to capital gains would, based on HMRC data[64] increase the yield by more than £11 billion a year on top of other proposed increases in the capital gains tax rate noted in these proposals.

[63] https://www.gov.uk/government/statistics/income-tax-liabilities-of-starting-savers-basic-and-higher-rate-taxpayers-by-largest-source-of-income-2010-to-2011 table 3.5, other income.

[64] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1094358/Table_2_Size_of_gain.ods

Chapter 6.3

Income tax – Recommendation 3

Capping the rate of tax relief on donations to charity to the basic rate of income tax

Brief summary
This chapter suggests that: • The higher rate of tax relief on donations made to charity by those who pay higher rates of income tax in the UK should be abolished. • The existing relief is inequitable: it is inappropriate that those who pay higher rates of tax should be provided with a higher rate of tax relief when the action giving rise to that relief are the same whether a person is a basic or higher rate taxpayer. • It is inappropriate that the higher rate of tax relief provided to the higher rate taxpayer as a result of their donation to charity benefits them and not the charity they donated to. • This relief might distort the behaviour of charities within society. • Removing this relief might save £740 million a year, increasing tax revenues by that amount as a result. • Evidence collected by HMRC suggests that this relief has relatively little impact on the behaviour of higher rate taxpayers, who appear no more likely to use it than basic rate taxpayers, and that the behavioural consequence of the removal of this relief might be limited as a result.

The proposal	To cut the rate of income tax relief on donations to charities by higher rate taxpayers so that they only enjoy

	relief at the basic rate of income tax, which is the rate of relief available to basic rate taxpayers.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by higher rate tax relief that is available to those who gift to charity when only basic rate relief is available to a basic rate taxpayer. This issue is exacerbated by the fact that the taxpayer benefits from this higher rate relief: the charity does not. This adds to the inequitable impact of the relief. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that existing rates of tax relief on donations to charity by higher rate income taxpayers create when compared to the relief available to those who are basic rate taxpayers. 4. To reduce the rate of tax abuse in the UK, some of which has been associated with the availability of this relief. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known with certainty. What is known is that HM Revenue & Customs believe[65] that higher rate tax relief on gifts to charities under Gift Aid rules cost £740 million in the tax year 2022/23. The figure had increased from £480 million in 2014/25.

[65] https://www.gov.uk/government/statistics/uk-charity-tax-relief-statistics

	Basic rate tax relief costs £1,600 million (£1.6 billion), which figure is assumed to include the basic rate relief on the sums also subject to higher rate tax relief. It is assumed that the sum of £740 million will be saved by abolishing this relief as a result. HMRC is concerned that this relief is being abused at present and has opened a review on that issue[66]. It has also been found that numerous errors in making Gift Aid claims are being made by taxpayers. This change in the relief would reduce the cost of these[67].
Ease of implementation	Simple.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/14/capping-the-rate-at-which-tax-relief-is-given-on-charitable-donations-under-gift-aid-might-raise-740-million-in-tax-a-year/

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[66] https://www.gov.uk/government/consultations/charities-tax-compliance/consultation-charities-tax-compliance
[67] https://www.gov.uk/government/publications/charitable-giving-and-gift-aid-research

Background

In 2012 George Osborne suggested restricting the tax relief available to any taxpayer on the gifts that they might make to charity to the basic rate of income tax[68]. The result would have been that the higher rate tax relief on gifts to charity that those who pay tax at rates above the basic rate would have been eliminated. The reform was rejected after much protest, but it would appear timely to reconsider it.

A brief explanation of this relief is required. The government offers this explanation[69]:

You can claim back the difference between the tax you've paid on a donation [you have made to charity] and what the charity got back when you fill in your Self Assessment tax return. It's the same if you live in Scotland. Do this either:

- through your Self Assessment tax return;
- by contacting HM Revenue and Customs (HMRC) and asking them to amend your tax code.

Example

Suppose a higher rate (40%) taxpayer donates £100 to charity. They claim Gift Aid tax relief. As a result, the charity can treat the gift as being worth £125, having grossed it up to allow for the 20% basic rate tax that has been deemed to have been paid on the income of the donor that has now been deemed to have been diverted to the charity for its benefit. The charity reclaims the £25 basic rate tax paid on the donation from HM Revenue & Customs.

The individual making the donation can now refer to that fact on their tax return and claim tax relief at 40% on the gross donation made i.e., on the sum of £125. The £25 that represented basic rate tax relief cannot be repaid to the taxpayer because the charity has already had the benefit of that sum. However, the higher rate tax paid, which amounts in this case to £25 (or £125 at 40% less the £25 paid to the charity) can be claimed as a reduction in the tax bill of the higher rate taxpayer in the year in which the donation is made. They get the benefit of this relief: the charity is not involved in this claim and does not benefit from it.

Discussion

There are three consequences of this relief.

[68] https://www.theguardian.com/uk/2012/mar/21/budget-2012-charities-tax-cap
[69] https://www.gov.uk/donating-to-charity/gift-aid

Firstly, the overall tax rate of those with wealth is reduced by a greater sum if they give to charity than is the case if a basic rate taxpayer makes a gift of the same value. That is inequitable: there is no reason why tax rates should differ for this reason when the action undertaken is the same.

Second, this means that those with wealth can afford to give more to charity and so direct the use of the tax relief that a charity gets towards causes that matter to them more than most people can: this also appears inequitable.

Third, charities do not directly benefit from this tax relief, and that appears to make no sense when the relief is given to support charitable giving and not to reduce the tax rate of donors.

This tax relief at higher rates is poorly designed and increases inequality. It needs to be abolished for that reason.

That reform would not harm charities: they get the same relief either way, and it makes sense that taxpayers should be treated in the same way as well in that case. Equity does suggest as a result that reform is now timely and appropriate.

Behavioural responses

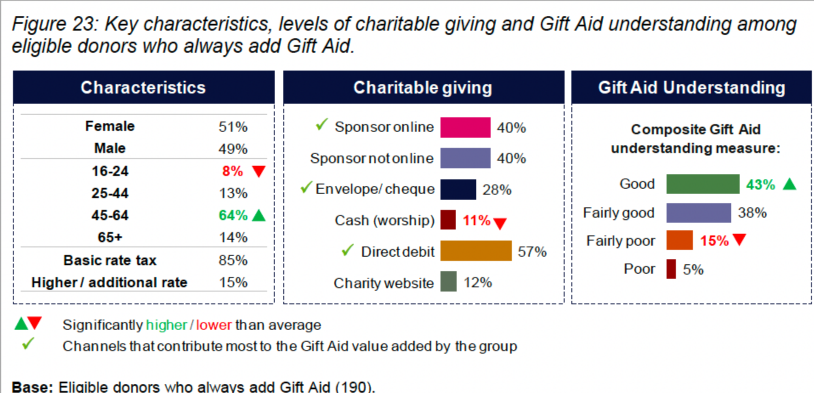
There is no clear evidence that there would be a behavioural response to the abolition of this relief. In 2018 HM Revenue & Customs published a paper[70] on the use of Gift Aid reliefs. Interestingly they noted this data with regard to those taxpayers who were the most likely to claim Gift Aid relief:

[70] https://www.gov.uk/government/publications/charitable-giving-and-gift-aid-research

A. Eligible and always add Gift Aid

Donors in this group are important to charities as their support for charitable causes generates a sizeable proportion of charities' income. They will consistently generate additional income for charities by adding Gift Aid to their donations, primarily via direct debit donations.

Figure 23: Key characteristics, levels of charitable giving and Gift Aid understanding among eligible donors who always add Gift Aid.



Base: Eligible donors who always add Gift Aid (190).

This group accounts for 12% of donors. They are likely to be aged between 45 and 64 years, suggesting financial stability from a steady income stream. Most (85%) are basic rate taxpayers, while 15% are higher or additional rate taxpayers.

Surprisingly, only twelve per cent of donors always add Gift Aid to their gifts to charity. More surprisingly still, of these only 15% are higher rate taxpayers, which is a figure only slightly more than their representation in the population of taxpayers as a whole. It does not as a result seem that this relief is of any great consequence to higher rate taxpayers or to their inclination to donate to charity.

As a result, it seems unlikely that there will be any significant behavioural response to this proposal, despite the protestations of those who might suggest otherwise, including charities.

Chapter 6.4

Income tax – Recommendation 4

Imposing a lifetime limit on ISA contributions

Brief Summary

This chapter proposes that:

- The current limits on ISA contributions are not working and are creating opportunity for some to accumulate considerable wealth in the UK in a tax-free environment when that was never the intention with regard to these accounts.
- That the contribution limit to ISA accounts should now be stated as a lifetime limit of £100,000. Transfers between ISA accounts would be ignored for this purpose. Withdrawals would not, however, reset the limit. Those who have now contributed this sum would not be able to make further contributions to ISA accounts.
- That any income or gains on ISA accounts where aggregate balances now exceed £200,000 should be subject to income tax and capital gains tax. If sums held in ISA accounts are not reduced below this level in a reasonable time period then exemption on all such accounts should be lost by the person owning them.
- Given that ISAs were always meant to encourage those with limited means to save more these changes are entirely consistent with the original intention of those who introduced these accounts. The significant increase in contribution limits in recent years has subverted the supposed economic reasons for the existence of these accounts, which are now a simple subsidy to those with wealth and considerable sums to save.
- This recommendation might save £100 million in ISA tax reliefs a year.

The proposal	To impose a limit on the total contributions that a person can make to an ISA during their lifetime to £100,000 and

	to limit the benefit of ISA tax reliefs to funds not exceeding £200,000 saved within ISA accounts. ISAs are Individual Savings Accounts, as defined by law. They exempt the income and gains generated by the sums saved in them from charge to income tax and capital gains tax. Subscriptions are at present capped by annual limits.
Reason for the proposal	To improve the horizontal equity of taxation, which is currently undermined by the excessive use of ISA tax reliefs that mean too large a disparity in rates of tax paid on savings income and gains has now developed between taxpayers within the UK tax system. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity, and which is undermined when the excessive use of ISA tax reliefs is permitted. To reduce the tax spillover effect that the excessive use of ISA tax reliefs has created. To raise additional tax revenues from those most able to make such payment.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be limited. The number of people it will impact is relatively small. They will not stop saving because of this change in ISA tax reliefs.
Ease of implementation	Relatively straightforward, not least much lower limits for permissible savings in ISA accounts existed relatively recently. An estimate of £100 million, or £0.1 billion, of revenue raised from this change might be fair without having access to more detailed information held by HM Revenue & Customs. The proposal is made to improve the equity of

	the UK tax system and to indicate that tax reliefs must be targeted to be effective in achieving their goals.
Likely difficulties that might result from implementation	Few. Some small technical issues with identifying funds in existing ISA arrangements that exceed £200,000 in value might arise but otherwise HMRC has all the available data to make this new arrangement work since ISA account usage is already tracked by them.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short, because the issue is straightforward.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/20/the-taxing-wealth-report-2024-capping-isa-contributions-to-100000-in-a-lifetime/

Background

As The Independent newspaper reported[71] in August 2023:

> *The number of "ISA millionaires" has surged to more than 4,000, according to HM Revenue & Customs (HMRC) figures.*
>
> *Some 4,070 savers were sitting on ISA pots worth more than £1m, as of April 2021, according to the data, obtained following a freedom of information (FOI) request on behalf of financial services network the Openwork Partnership.*
>
> *The number of ISA millionaires has nearly tripled year-on-year from 1,480 in 2019/2020, according to the HMRC figures.*

[71] https://www.independent.co.uk/news/uk/home-news/isa-millionaires-uk-business-b2385379.html

ISAs are properly termed Individual Savings Accounts[72]. Introduced in 1999 to replace a previous Conservative government-created tax-incentivised savings plan, ISAs were meant by their Labour Party sponsors to achieve three things.

First, they were meant to increase savings.

Second, they were supposedly targeted at those with more limited means to save because caps on the annual amount that could be saved were relatively limited at first, obviously with the obvious intention of restricting the opportunity for abuse.

Third, they were meant to do this by providing a subsidy in the form of tax-free income and capital gains for sums saved within the ISA.

Until 2010 the total annual subscription limit was at most £7,200, with half of that sum having to be held in shares. Since then, the limits have increased considerably. £20,000 may now be saved per annum, with all of that being capable of being held in cash if the saver so desires. However looked at, saving £20,000 per annum is not a normal economic activity when UK median household income is approximately £27,700 before tax per annum[73].

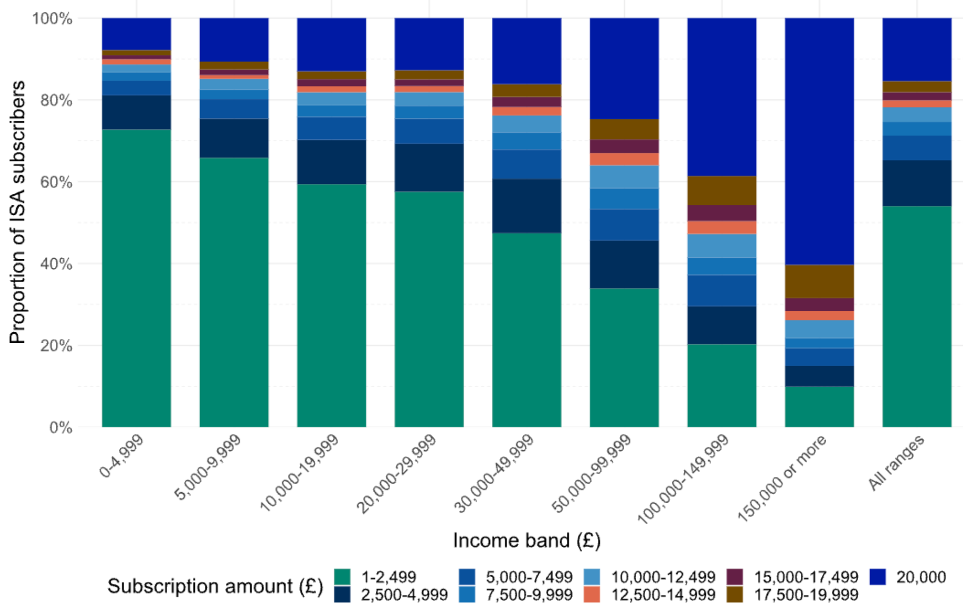
Recent data from HM Revenue & Customs[74] shows that the amount subscribed to ISAs varies considerably dependent upon the income of the person subscribing:

[72] https://www.gov.uk/individual-savings-accounts/how-isas-work

[73] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/earningsandemploymentfrompayasyouearnrealtimeinformationuk/latest#median-monthly-pay

[74] https://www.gov.uk/government/statistics/annual-savings-statistics-2022/commentary-for-annual-savings-statistics-june-2022#:~:text=Chart%201%20below%20shows%20that,ISAs%20increased%20by%20around%20860%2C000.

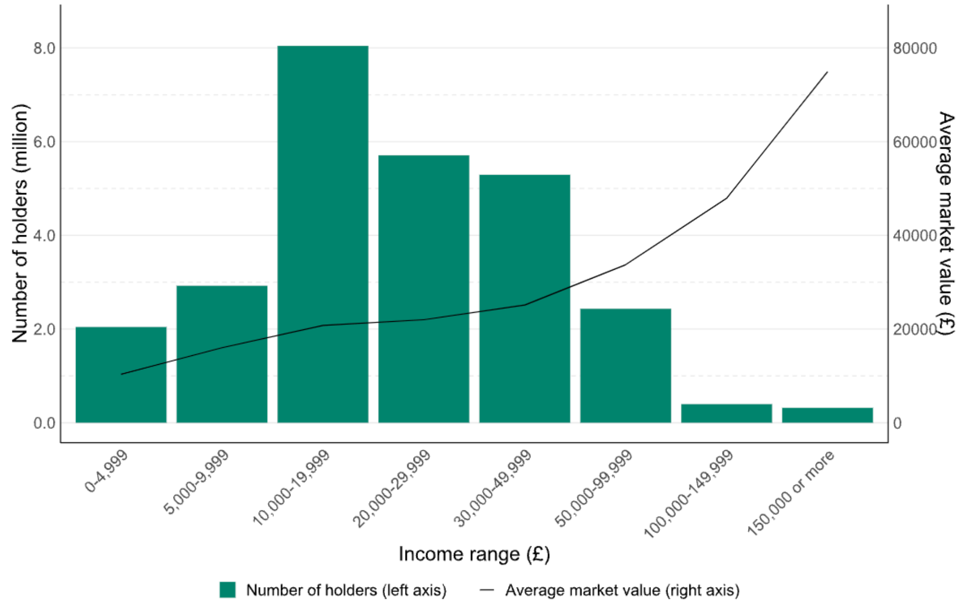
Chart 1: ISA subscriptions by income band and size of subscription in 2019 to 2020



Unsurprisingly, those with highest income make by far the largest contributions to their ISA accounts, with a deposit of £20,000 being commonplace amongst those earning £150,000 or more a year and frequently occurring amongst those earning £100,000 to £150,000 a year. In comparison, amongst lower income earners (and all those earning less than £50,000 a year) the most commonplace subscription per annum, by far, is of less than £2,500 a year. The benefit of ISA tax relief is, therefore, likely to be heavily biased towards those with higher levels of wealth as a result. That is especially the case because those with higher levels of income also save both income tax and capital gains tax at higher rates when sheltering savings within ISA accounts.

The resulting estimated market value of ISA accounts is as follows:

Chart 2: Number of ISA holders and average ISA market value by income band in 2019 to 2020



As is apparent, most ISA accounts have a market value of less than £100,000. They are, therefore, likely to be unaffected by the proposals made here. A few thousand accounts may be and it would seem that they are most likely going to be held by those earning £100,000 or more a year.

So, how do ISA millionaires come about? That required good stock picking and saving in shares, probably to the maximum amount permitted in each year. The result is a considerable likely tax subsidy to those who have used the scheme in this way.

What is clear is that the spirit of this scheme, which was focused on smaller savers, is being abused as a result.

Both the horizontal equity and vertical equity of the tax system are being undermined as a consequence. Income of similar sorts is not being taxed in the same way (horizontal inequity), and progressive taxation is also being undermined (vertical inequity). At the same time, tax subsidies (ISA subsidies cost about £4.3 billion a year[75]) are not being used as intended.

[75] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

Recommendations

The actions required to address this abuse are threefold. First, there should be a lifetime maximum subscription to ISAs. £100,000 might be fair and is still well beyond the reach of most people as the above noted data shows.

Second, in exchange for the tax relief, the funds saved should be used for social purposes. They could, for example, be linked to a requirement to save in green bonds[76] issued by NS&I.

Third, if the funds in an ISA grow to more than a limit (£200,000 would appear generous), then it is suggested that funds in excess of that sum should be transferred to an account not enjoying tax exemption. A reasonable time limit for doing so should be provided but if not done then the ISA account holder should become taxable on all funds in ISA accounts.

As it is, this relief is being used to increase income and wealth inequality in the UK, and that is unacceptable and is not a purpose of tax relief. The suggested reforms seem to be an obvious step to take in that case.

The sum saved as a result of this change would be modest. An estimate of £100 million, or £0.1 billion, might be fair without having access to more detailed information held by HM Revenue & Customs. The proposal is made to improve the equity of the UK tax system and to indicate that tax reliefs must be targeted to be effective in achieving their goals.

[76] https://www.nsandi.com/products/green-savings-bonds

Chapter 6.5

Income tax – Recommendation 5

Reintroducing close company rules for income and corporation tax

Brief Summary

This chapter proposes that close company rules be reintroduced into UK taxation. It should be required as a result that:

1. The income of all close companies with retained investment income and gains exceeding £50,000 should be required to distribute such sums to their members or they shall be deemed to have done so for income tax purposes.

2. The retained profits of all close trading companies in excess of £200,000 not demonstrably being used for the purposes of a trade shall likewise be required to be distributed to the members of that company or shall be deemed to be so for income tax purposes.

For these purposes a close company is defined as a company:

- under the control of:
  - five or fewer participators, or
  - any number of participators if those participators are directors.
- Or companies where more than half the assets of which would be distributed to five or fewer participators, or to participators who are directors, in the event of the winding up of the company.

A participator is usually a shareholder or director, although loan creditors can occasionally count if they have influence over a company.

<table>
<tr><td>The proposal</td><td>To reintroduce close company rules into UK taxation to prevent those able to do so from accumulating wealth subject only to the low tax rates charged on the income and gains of companies when those income and gains are not used for the purposes of a trade but are instead retained in a company for the purposes of avoiding taxes.

These rules would require that:

1. The income of all close companies with retained investment income and gains exceeding £50,000 should be required to distribute such sums to their members or they shall be deemed to have done so for income tax purposes.

2. The retained profits of all close trading companies in excess of £200,000 not demonstrably being used for the purposes of a trade shall likewise be required to be distributed to the members of that company or shall be deemed to be so for income tax purposes.</td></tr>
<tr><td>Reason for the proposal</td><td>1. To prevent one of the most common forms of tax avoidance by those with income and gains in excess of their need for current expenditure, which funds can be sheltered from tax by retaining them in lowly taxed private limited companies.

2. To improve the horizontal equity of the UK tax system by preventing the abuse of private limited companies that currently create a massive imbalance in that form of equity.

3. To increase vertical tax equity.

4. To reduce the incentive to avoid tax.

5. To reduce the tax spillover effect that private limited companies create</td></tr>
</table>

	6. To raise additional tax revenues in a more progressive fashion.
Estimated tax that might be raised as a result of the recommendation made	The behavioural responses to this recommendation cannot be known for certain, but it is bound to lead to a considerable increase in the rate of distribution of profits from many privately owned companies, and so to the overall tax rate of the shareholders of those entities. It will as a result have a favourable impact on horizontal and vertical tax equity as well as in decreasing inequality. Given the number of variables involved it is hard to estimate the sums likely to be distributed, but if only £10 billion was distributed a year as a result of this policy (and that would appear to be a modest estimate) the likely increase in tax yield might be more than £3 billion a year at current tax rates, and somewhat more at the rates of tax proposed in the Taxing Wealth Report 2024, especially if an investment income surcharge was taken into account.
Ease of implementation	The changes proposed will be easy to implement. No technical difficulties should arise because this is already known legislation.
Likely difficulties that might result from implementation	There is likely to be significant opposition to these changes but that is the only difficulty that should be anticipated.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months. At least twelve months notice of the change might, however, be beneficial with few tax risks arising.
Consultation period required.	It is likely that at least a year's notice of these changes would be required.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/03/taxing-wealth-report-2024-reintroducing-close-company-rules-for-income-and-corporation-tax-could-raise-at-least-3-billion-of-tax-a-year/

Background

One of the most serious problems faced when tackling the shortfall of tax paid by those with wealth and associated high levels of income is the ability of those in that fortunate position to shelter both their income and wealth from taxation by recording it in companies that they, or trusts that they control, own. This issue was noted by the EU Tax Observatory in 2023, when they suggested[77] that this fact was, in isolation, one of the biggest reasons why this group in society pay such an overall low level of tax on their income and wealth.

This is not a new problem. The issue was anticipated in the UK from the time that corporation tax was introduced in 1965. So-called 'close company provisions' were created tackle this issue. In the USA and the UK's Crown Dependencies these rules are given different names. In the USA, they are described as 'flow-through' taxation based on the existence of 'flow-through' entities[78]. In the Isle of Man companies falling under a not-dissimilar regime are subject to what is called a 'distributable profits charge'[79].

Whatever name is used, the purpose of such rules is basically the same. What they require is that some or all of the income and gains that a private limited company might make are not taxed as if they are the property of the company that legally generated them, but are instead taxed as if they belong to the shareholders or members of that limited liability company.

In the UK, at present, this rule only usually applies to the income of what are described as limited liability partnerships (LLPs). As their name implies, these legal entities are structured as if they are partnerships, but unlike most organisations described as such they have an existence that is legally distinct from the partners themselves. However, when it comes to tax, all of the income and gains of these LLPs is recorded as belonging to the individual members, who then pay tax on them as if they are the highest part of their income for taxation purposes. As such, personal income tax is paid on the profit of these organisations, whilst any capital gains are taxed as if they belong to the members and not to the partnership.

In the case of limited liability partnership, this apportionment of the income of the organisation includes the trading profit. This, however, need not be the case. Under the UK's close company taxation rules that broadly existed from 1965 until 1984, the trading profits of close companies could be retained by it for its own use so long as the company could

[77] https://www.taxobservatory.eu/publication/global-tax-evasion-report-2024/

[78] https://www.investopedia.com/terms/f/flow-through.asp

[79] https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/business-and-corporations/distributable-profits-charge/

demonstrate that that were commercial reasons for doing so. Tests to achieve this were established at that time and could be revived.

The companies subject to this rule, and which are still defined as close companies, were according to HM Revenue & Customs[80]:

- Companies under the control of:
    - five or fewer participators, or
    - any number of participators if those participators are directors.
- Or companies where more than half the assets of which would be distributed to five or fewer participators, or to participators who are directors, in the event of the winding up of the company.

Participators are defined[81] as any person having a share or interest in the capital or income of the company, which can in some cases include the providers of loan finance. The reality is that the vast majority of UK companies are close companies using this definition. If, however, a de minimis test was to be applied on both trading profits and unearned investment income and gains, with a much lower limit for the latter, the vast majority of companies would also fall out of the scope of these provisions[82].

That said, if the income and gains of a close company arising from non-trading activities gave rise to retained profits above the de minimis limit then that company would either be required to distribute the retained profits to its members by way of dividends, meaning that the income in question would then become taxable in the hands of its members, or it would be deemed to have done so, giving rise to the same net outcome with the members of the company being taxed as if they had received the income in question.

Note that the calculation is with regard to retained profits, and not profits arising in a year.

The same would be true if a close company made trading profits giving rise to retained profits above the de minimis limit without being able to justify their retention for trading purposes. In that case they too would be required to distribute those profits in the way noted above, or be deemed to have done so.

Disputes did, of course, arise between companies and the UK's tax authorities with regard to the use of profits by trading companies, but the great advantage of that for current purposes

[80] https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm60060
[81] https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm60107
[82] Based on HMRC data at least 83% of UK companies have taxable income of less than £50,000 per annum and the de minimis might be set higher than that.

is that as a result guidance already exists that could guide the use of this legislation in future.

In practice, it is also the case that much of the close company legislation that might be required to reintroduce this charge to tax does still exists since close companies remain a concept within UK taxation, with the definition still being used as part of other tax law. The task of innovating this legislation should not, therefore, be onerous.

Recommendation.

It is recommended that close company rules be reintroduced to UK taxation.

It should be required as a result that:

1. The income of all close companies with retained investment income and gains exceeding £50,000 should be required to distribute such sums to their members or they shall be deemed to have done so for income tax purposes.

2. The retained profits of all close trading companies in excess of £200,000 not demonstrably being used for the purposes of a trade shall likewise be required to be distributed to the members of that company or shall be deemed to be so for income tax purposes.

Discussion

There will, inevitably, be objections to this proposal because it has direct impact on one of the most commonplace tax planning tools used by those with wealth in the UK.

The development of guidance for companies to follow so that they might indicate relevant and evidenced reasons for retaining profit within trading companies will be crucial to the overall acceptability of the scheme.

Fairly straightforward rules on the recognition of the makeup of retained profits of a company will also be required to make these close company rules work. They should allow for retrospective application in the event that a close company has significant retained and apparently unutilised reserves at the time of introduction of new close company rules.

The approach to be used by HMRC to the application of these rules on trading companies should be principles based. In other words, if it could be demonstrated that a close trading company has the clear intention to grow, requiring the retention of profit for investment in either fixed or working capital then, broadly speaking, a relaxed approach towards the application of this rule should be used by HM Revenue & Customs. In the absence of clear evidence on this issue, however, particularly over a period of time, HMRC must be

empowered to act to require that profits are distributed or are deemed to be so, and that they therefore become subject to tax in the hands of the shareholders of these companies.

Penalties for failing to distribute profits when required to do so by close company rules would have to be available in case of need to use them.

Ownership by trusts

In the event of a company is owned either directly or indirectly, via a trust, then profits required to be distributed should be attributed to those who might be beneficiaries of that trust. In the absence of apparent beneficiaries tax should be charged on the trustees as if they are UK tax resident with liability being due at the top rate of income tax with all other recommendations made in the Taxing Wealth Report 2024 applying, if they are adopted. The use of trusts should not be a way to avoid these charges.

Groups of companies

In the case of groups of close companies, distribution should be determined on the basis of group consolidated accounts, which must be made available for this purpose. In the case of there being minority interests inside such groups appraisal should continue to be made on an individual entity basis.

Chapter 6.6

Income tax – Recommendation 6

Abolishing the domicile rule for tax purposes

NB: This proposal was adopted by Chancellor Jeremy Hunt

in his budget in March 2024.

This proposal was first published during the autumn of 2023

Brief Summary

This chapter proposes that the use of the domicile rule for taxation purposes should be ended.

It is suggested that a temporary residence rule should be created in place of the domicile rule for those who come to the UK for a period of less than seven years.

The proposal is made to prevent people being able to secure a tax advantage based solely on their domicile being outside the UK and their ability to afford the fee to do so.

The proposal	To cease providing tax advantages to those who are tax resident in the UK but who can claim to be not domiciled in this country. To provide a temporary residence rule in place of the domicile rule for those who come to the UK for a period of less than seven years.
Reason for the proposal	1. To prevent people being able to secure a tax advantage based solely on their domicile being outside the UK and their ability to afford the fee to do so. 2. To improve the horizontal equity of the UK tax system by preventing the abuse that the use of

	domicile status for taxation purposes has permitted. 3. To increase vertical tax equity. 4. To reduce the incentive to avoid tax. 5. To reduce the tax spillover effects that the domicile rule has created, particularly with regard to the use of offshore tax arrangements. 6. To raise additional tax revenues in a more progressive fashion.
Estimated tax that might be raised as a result of the recommendation made	Academics at Warwick University and the LSE have estimated that abolition of the domicile rule for taxation purposes might raise £3.2 billion a year in additional tax revenue for the UK and this estimate is accepted here.
Ease of implementation	The changes proposed will be relatively easy to implement because the alternative basis of taxation is already well known. No technical difficulties should arise.
Likely difficulties that might result from implementation	There is likely to be significant opposition to these changes but that is the only difficulty that should be anticipated. They have broadly based political appeal.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months. However, at least twelve months' notice of the change might, be beneficial as this will require some people to change their tax arrangements and it is generally considered appropriate to allow time for them to do so.
Consultation period required.	It is likely that at least a year's notice of these changes would be required. The consultation period could be somewhat shorter.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/10/taxing-wealth-report-2024-abolishing-the-domicile-rule-for-tax-purposes-might-raise-3-2-billion-of-tax-revenue-a-year/

Background

The UK's concept of domicile is a legal, not a taxation, creation and has existed for centuries.

In essence, a person's domicile is their natural home. This is best interpreted as being the place to which they will return and live when they are best able to do so. The concept of domicile recognises the fact that there may be good reasons why this might be impossible, and that does not mean that a person's domicile changes as a result.

For most people, their domicile is acquired at birth from the father. If they do not have a known father then they acquire their mother's domicile at birth. This is called their domicile of origin.

A person needs not retain this domicile of origin for life. They can adopt a domicile of choice, although doing so is by no means straightforward. Changing domicile basically requires that a person indicates by their actions, rather than by statements made in words, that they have severed all, or almost all, of their connections with the place in which they were previously domiciled. So, for example, by making it clear through their actions that they have abandoned any intention to live in their previous country of domicile, a person can adopt a domicile choice in another place, including the United Kingdom.

Changing taxation law with regard to domicile will not change this element of more general UK law. The question of a person's domicile, which is quite independent of their nationality, citizenship, residence or ethnicity, has significance beyond taxation.

The taxation significance of domicile

A person's domicile is relevant for taxation purposes because a country like the UK has to know whether or not it has the right to charge tax upon a person who might have income or games, or who makes gifts, in this country.
Broadly speaking, two concepts are used to determine this. One, which is common to all tax jurisdictions, is the concept of tax residence. The rules with regard to tax residence vary from state to state, and are complex within the UK. That being said, HMRC notes on its website that[83]:

You may be resident under the automatic UK tests if:

- you spent 183 or more days in the UK in the tax year

[83] https://www.gov.uk/tax-foreign-income/residence

- your only home was in the UK for 91 days or more in a row - and you visited or stayed in it for at least 30 days of the tax year
- you worked full-time in the UK for any period of 365 days and at least one day of that period was in the tax year you're checking

You may also be resident under the sufficient ties test[84] if you spent a number of days in the UK and you have additional ties to the UK, like work or family.

These rules are broadly internationally consistent, and the UK has double tax treaties with many countries to make sure that their operation is fair and disputes can be resolved so that a person is not unfairly double taxed.

The second concept used in the UK is domicile. If a person can claim to be non-domiciled in the UK, then their income is considered to arise in two ways, broadly speaking. Income and gains and assets located in the UK are all considered to be subject to relevant UK taxes relating to these issues if the person in question is also tax resident in this country.

The big issue of concern is that if a person is not domiciled in the UK, but is resident here, then they can elect for their income and capital gains arising outside the UK to be taxed on what is described as a 'remittance basis'. The gift of assets located outside the country is also, broadly speaking, outside the scope of inheritance tax.

The remittance basis is complex, and unless a taxpayer is very diligent and has good tax advisors, is inherently risky as a basis for tax. What it suggests is that any source of income or gain arising outside the UK is only taxable here if remitted to the country. What that then means, by implication, is that income and gains earned outside the UK and left outside the UK are outside the scope of UK tax if owned by a non-domiciled person.

The potential for abuse within the domicile rule

Use of the UK's domicile rule grew considerably as worldwide financial liberalisation increased in the 1980s, and its abuse was subject to significant comment from that decade onwards.

The potential for abuse was obvious because if a person did not have to declare their income and gains, and so their wealth, outside the UK then the opportunity for those who could live in the UK, but claim to be non-domiciled, to make use of tax havens and other such arrangements to hide income from tax authorities around the world was very high. This has had a significant impact on the growth of illicit funds in London, and the rise in the number of oligarchs located in the UK.

[84] https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11500

On a smaller scale, the opportunity to abuse the domicile rule for those who were second and even third generation immigrants clearly opened up the opportunity for significant disparities in the tax bills paid by some people who were long-term resident in the UK, and whose situations were otherwise similar, creating obvious horizontal and vertical tax inequalities as a result. These differences were a natural course for resentment.

Gordon Brown promised that he would tackle this issue before he was elected to office as Chancellor of the Exchequer in 1997, but largely failed to do so.

More recent legislation, largely from the Conservative party, has been more progressive. The right to use the domicile rule for taxation purposes has been severely restricted.

First, since 2008 anyone not domiciled and who had more than £2,000 per annum of income arising outside the UK had to decide whether they wished to use the domicile rule or not[85]. Those who chose to do so have been subject to steadily more progressive charges for exercising that option. The current charges are either[86]:

- £30,000 if a person has been here for at least 7 of the previous 9 tax years
- £60,000 for being here for at least 12 of the previous 14 tax years

What this means is that anyone now wishing to make use of the domicile rule has, after a relatively short time period in the UK, to calculate the trade-off between making payment of the fee for doing so and paying tax on their actual income and gains arising on a worldwide basis. They can also only use the rule for a relatively short time period before being deemed to tb domiciled in the UK whether they like it or not. This is not now a status that can go on indefinitely.

Despite this, continued existence of the domicile rule is an anomaly found in the tax legislation of only a very few countries around the world (Ireland and Italy being other notable countries where something similar exists). The discrimination that it promotes on the basis of a person's national origin rightly offends current sensibilities. The domicile rule needs to be abolished, and to be replaced by an improved temporary residence rule for those who relocate to the UK for short periods of time, but with no favour being shown to those who might move to this country for periods of longer than, say, seven years.

Recommendation

That the domicile rule cease to have any relevance for taxation purposes in the UK.

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[85] https://commonslibrary.parliament.uk/research-briefings/cbp-8099/

[86] https://www.gov.uk/tax-foreign-income/non-domiciled-residents

All persons tax resident in the UK should be subject to the same taxation rules unless they apply for temporary residence status, which would not apply for a period of longer than seven years after their time of arrival in the country.

Revenue consequences

It has been estimated by academics at Warwick University and the LSE that abolition of the UK domicile rule might raise £3.2 billion in additional tax revenue per annum[87]. This estimate was based on an analysis of the tax returns of those claiming the status. The estimate has to be treated with caution because a temporary residence rule for those coming to the UK for short time periods, such as secondees or students, might reduce the tax raised. However, given the widespread recognition of this estimate it is used here as the best available estimate of the current likely taxation revenue arising as a consequence of abolishing the domicile rule, which abolition is long overdue.

[87] https://www.lse.ac.uk/News/Latest-news-from-LSE/2022/i-September-22/Abolishing-the-non-dom-regime-would-raise-more-than-3.2-billion-each-year-finds-new-report

Chapter 6.7

Income tax – Recommendation 7

Changing UK tax rates

Brief Summary

This chapter suggests that:

- Although the Taxing Wealth Report 2024 has identified many anomalous tax rates reliefs and allowances within the UK tax system that are in need of correction where doing so will raise significant extra tax revenues, there are other tax allowances and reliefs that would also need to be addressed if the recommendations within the Taxing Wealth Report 2024 are adopted so that a tax system that is in overall terms just might be created in the UK.

- In the three cases highlighted in this chapter, correcting anomalous tax rates reliefs and allowances within the UK tax system might reduce overall tax revenues because those in use do, at present, create tax injustice at cost to those with higher income and wealth. It is not possible to promote tax justice without taking these issues into account, presuming that the other recommendations within the Taxing Wealth Report 2024 are adopted.

- The first of these issues relates to the High Income Child Benefit Charge (HICBC). This withdraws a claim for child benefit from any person living in the same household as the child in respect of which that claim is made if that person is earning between £50,000 and £60,000. The tax collected as a result is estimated to be £1 billion a year, but marginal tax rates exceeding 70 per cent can arise as a result, and in combination with the changes in the Taxing Wealth Report 2024 these would be unacceptable and as such this charge needs to be abolished.

- The second charge relates to the phasing out of the personal income tax allowance for persons earning between £100,000 and £125,140 a year, meaning that in that

range an additional 20 per cent tax charge arises. On top of the other changes recommended in the Taxing Wealth Report 2024 that would result in unacceptable tax rates that also defeat the desired steady progressiveness of the tax system and as such this charge should be abolished, but only if the other recommendations in the Taxing Wealth Report 2024 are accepted. The cost would be approximately £5.6 billion per annum.

- The third change would be to the income tax rate on earnings and gains totalling between £50,000 and £75,000. Again, this change is only recommended if the changes suggested in the Taxing Wealth Report 2024 are accepted as otherwise there would be no need to do so. If the tax rates on national insurance, capital gains and investment income recommended in the Taxing Wealth Report 2024 were accepted the overall tax rate on people earning between £50,000 and £75,000 would become too high if sufficient overall steady progressivity is to be achieved within the tax system. Subject in that case to those other recommended changes taking place it is suggested that the income tax rate in this range be reduced to 30 per cent from the current 40 per cent rate. This would have a cost of approximately £12.5 billion per annum.

- Without these changes it is likely that the Taxing Wealth Report 2024 would be inappropriately targeted: it is meant to target those with higher income and wealth and should not penalise most of those with earnings of between £50,000 and £75,000 a year as a result unless that income comes from capital gains or other unearned sources.

- The overall cost of recommendations made in this chapter is:

	Recommendation	£'bn
1	High Income Child Benefit Charge (HICBC)	1.0
2	Withdrawal of the individual personal income tax allowance	5.6
3	Reduction in tax rate between £50,000 and £75,000 a year	12.5
Total		19.1

Of these recommendations the first should happen irrespective of the other changes suggested in the Taxing Wealth Report 2024.

The other two suggestions are conditional on the other reforms proposed in the Taxing Wealth Report 2024 being made or tax injustice would result.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2024/02/08/the-taxing-wealth-report-removing-existing-anomalies-within-the-uk-system-that-prevent-the-delivery-of-tax-justice-might-cost-19-1-billion-per-annum/

Background

There are a number of tax rate and reliefs within the UK tax system that create tax injustice, and which need to be addressed if the UK is to have an effective tax system. Many of these flaws within the current tax system are addressed within the Taxing Wealth Report 2024, including:

- The substantial reduction in national insurance charges on income over £50,270 a year.
- The absence of a national insurance charge, or an equivalent income tax surcharge, on any source of income other than that from employment and self-employment.
- The low rates of capital gains tax when compared to income tax, which rates encourage tax abuse whilst not recognising that the receipt of all additional income by a person is a matter of indifference as to its source and so should be taxed equally subject to rates determined solely by the overall level of income and gains.
- The limited disparity between small and large company corporation tax rates.
- The exemption of financial services and private education from VAT charges.

- The capping of council tax charges, meaning that high value properties pay disproportionately low sums to local authority tax administrations.

- The granting of income tax relief at desperate rates, with the bias of advantage within these arrangements being towards the wealthy, particularly with regard to pension contributions and gifts to charities.

Correction of the above biases within the tax system would, as the Taxing Wealth Report 2024 notes, result in significant additional tax revenues being raised which are likely to exceed £100 billion in all.

However, in addition to these anomalous tax rates, there are other tax allowances and reliefs that need to be addressed if an overall fair tax system is to be created. In these cases, correcting these matters might reduce tax revenues because they do, at present, create tax injustice at cost to those with higher income and wealth. It is not, however, possible to promote tax justice without taking these issues into account.

In particular, the following charges and changes to tax reliefs create injustices.

High Income Child Benefit Charge (HICBC)

(See important note, below[88])

Parents and others with children in their households (even if they are not their biological offspring and even if they are unrelated by marriage) with regard to whom child benefit is claimed (even if not by them) have those payments withdrawn as their income increases between £50,000 and £60,000 a year. As a consequence, it is a possible that a person with income in this range, which happens to coincide with the point when higher rates of income tax are charged on at least some of those involved, might suffer very high marginal tax rates.

As the House of Commons Library said[89] of this charge in August 2023:

The High Income Child Benefit Charge (HICBC) provides for Child Benefit to be clawed back through the tax system from families where the highest earner has an income above £50,000. The tax charge is equal to 1 per cent of the total Child Benefit received for every £100 earned over £50,000. This means that someone's Child Benefit payment will be withdrawn completely when their income reaches £60,000.

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[88] The bands at which this charge operated were increased in mar h 2024, with the charge not beginning until income reaches £60,000. This will reduce the cost of the noted reform.

[89] https://commonslibrary.parliament.uk/research-briefings/cbp-8631/

Child benefit is in 2023/24 £1,248 per year for the first child and £827 for each additional child. The amount of relief foregone is in that case dependent upon the number of children for whom child benefit is claimed, but as Tax Policy Associates has noted[90], if claim had been made for three children the marginal tax person suffering this withdrawal of relief would be 71 per cent i.e. for each £1,000 earned in this range just £290 of net income would be enjoyed. The impact is lower if fewer children are claimed for but is still material.

This marginal tax rate is clearly penal and exceeds that on many persons with much higher income and is therefore inappropriate.

The charge also fails to recognise the fact that child benefit is paid for the benefit of the child, and not its parent, and is a recognition of the obligation that any parent takes on with regard to provision for their children. It is discriminatory to not provide this as a universal benefit in that case.

There is no logic to the perpetuation of this charge. It has only ever been justified by the imposition of austerity measures with a particular penalty arising on some parents, many of whom are working in middle management roles. As a consequence, it is suggested that this clawback of child benefit should end irrespective of any other changes in the Taxing Wealth Report 2024, and that this benefit be provided to all parents automatically on application without consideration of income, because of the serious tax injustice that otherwise arises.

Before it was abolished the Office for Tax Simplification looked at this charge and noted[91] in March 2022:

HICBC raises over £1 billion each year but is hard to administer as it is hard for many families affected to know about the charge, and complying with it involves filing a Self-Assessment tax return.

The government's policy has been not to increase the threshold at which the HICBC applies. This has had the effect that - according to the Institute for Fiscal Studies - it will by now be affecting more than one in five of the families eligible for the benefit.

HMRC no longer send an annual child benefit statement to recipients, in which they could remind people about the charge. Neither is the HICBC mentioned in the personal tax account, although there is a child benefit 'tile' which makes other points about the benefit.

[90] https://taxpolicy.org.uk/2023/09/24/70percent/

[91] https://www.gov.uk/government/publications/ots-evaluation-paper-on-the-high-income-child-benefit-charge

The £1 billion cost estimate made by the House of Commons Library is used as the best available for the consequence of abolishing HICBC but given the scale of inflation since they reported may now be a little low.

Withdrawal of the individual personal income tax allowance

When a UK tax resident person has taxable income in excess of a year of £100,000 a year the personal individual personal allowance to which they were entitled when their income was lower than this sum is progressively withdrawn. This withdrawal is tapered so that, as HMRC explain[92], the personal allowance goes down by £1 for every £2 by which a person has income above £100,000. The consequence is that the allowance is reduced to zero if income exceeds £125,140 a year.

Given that most people with this level of income pay tax at the 40 per cent tax rate the consequence is that, at the time of writing, the benefit of the £12,570 personal allowance is withdrawn over this range, meaning that a maximum of an additional £5,028 of tax is paid at an effective additional tax rate of 20 per cent when a person reaches the top of this band making the marginal tax rate over this income range 60 per cent, which is much higher than the current higher, 45 per cent, rate of income tax paid on larger incomes, which makes no sense.

This additional charge was intended to increase the progressivity of UK taxation. However, it does so in a crude fashion that creates considerable disincentives to work over a significant income range, which has been known to have impact upon, for example, the willingness of some doctors to undertake additional shifts. There is also a considerable incentive on those who might face these charges to try to avoid them, by, for example, making additional pension contributions. This approach to progressivity is, therefore, not just crude and unjust but also unproductive.

There is also a philosophical objection to this withdrawal of an allowance which until this change was introduced in April 2010 was universal, and always presumed to be akin to a basic right within the tax system. The presumption that a person should enjoy an element of their income tax-free, whatever their circumstance, is withdrawn by this arrangement with unfortunate and inappropriate consequences.

The Taxing Wealth Report 2024 recommends significant increases in income tax, national insurance and other tax rates, including on the income and gains of people currently impacted by this withdrawal of relief. It would be inappropriate to propose the increases recommended in the Taxing Wealth Report 2024 and not note the problems that this

[92] https://www.gov.uk/income-tax-rates/income-over-100000

withdrawal of the personal allowance creates. Accordingly, it is suggested that the personal allowance be made universally available once more to all tax resident people in the UK irrespective of their level of income, assuming (importantly) that the recommendations made elsewhere in the Taxing Wealth Report 2024 are adopted.

It is not possible to calculate the precise cost of this change. HMRC data is insufficiently granular to permit that. However, it is likely that 1.1 million people in the UK have income of more than £100,000 a year at present[93]. Of these about 650,000 will pay at 40 per cent and the balance (450,000) at 45 per cent. The proposed regranting of personal allowances to these person (which would only be appropriate if the other recommendations of the TWR are accepted, which would then mean that overall, these persons would pay significant additional income tax, capital gains tax and national insurance) would be approximately £5.6 billion per annum. Without this change the other tax rate changes proposed in the Taxing Wealth Report 2024 would not, however, be credible.

Student loan charges

A separate Taxing Wealth Report 2024 chapter has been written on this issue.

The reform of some income tax rates

The Taxing Wealth Report 2024 has proposed that the reduction in the national insurance rate paid by employees and self-employed people earning in excess of £50,270 per annum should be withdrawn, effectively increasing the national insurance rate for these people by 8 per cent per annum (using the rate applying from January 2024).

The income tax rate increases from 20% to 40% on incomes above the same value i.e. £50,270 per annum.

This means that marginal tax rates on income of £49,000 per annum in the spring of 2024 were, accordingly (assuming student loan charges do not apply) 30 per cent, with this increasing to 42 per cent on income above £50,270, given that the existing national insurance rate on income above that sum is 2 per cent. The proposals made in the Taxing Wealth Report 2024 would increase this marginal tax rate to 50 per cent unless there was a change to income tax rates above £50,000. This increase might be too significant if perverse tax incentives to either not declare income or to seek to reduce income are to be avoided. This would be especially true if these rates were also applying to investment income and capital gains, as the Taxing Wealth Report 2024 recommends.

[93] https://www.gov.uk/government/statistics/income-tax-liabilities-by-income-range

As a consequence, it is appropriate to suggest that the increase in the tax rate from 20 per cent to 40 per cent at approximately £50,000 of income, which has always appeared to be an overly large single step, should be reviewed if (and this point is critical to the suggestions that follow) the other recommendations of the Taxing Wealth Report 2024 are adopted.

In that case it is suggested that the income tax rate between approximately £50,000 per annum and £75,000 per annum should become 30 per cent, rather than the existing 40 per cent. This would reduce the marginal tax rate on income in this range, if the other recommendations in the Taxing Wealth Report 2024 were taken into consideration, from 50 per cent to 40 per cent (which is near enough where it is at present), allowing a smoother upward transition through tax rates as a consequence.

The acceptability of the proposed changes in the Taxing Wealth Report 2024 would be increased if this recommendation were adopted. This Report does not seek to increase tax on those making normal levels of income in the UK, and it is not abnormal for a person to now make £75,000 per annum. As a result, making sure that much of the impact of the report would be removed from those in this income range would be important to its acceptability.

HM Revenue & Customs do not publish information on the number of people whose income falls within the range £50,000 to £75,000 per annum. The latest date that they do supply[94] relates to the tax year 2023/24. This implies that maybe 6.5 million people might have income impacted by this change, although it is likely that at least 3 million of those people will have income of less than £75,000, but more than £50,000, and therefore would not benefit in full from the 10 per cent reduction in the tax rate over the range of £25,000 over which it is proposed.

Taking this fact into account, and accepting that there is a degree of approximation in this estimate, it is likely that this reduction in the income tax rate between £50,000 and £75,000 might reduce annual tax revenues by approximately £12.5 billion. This is considered a price worth paying to remove opposition to the imposition of higher rates of tax on income and gains above £75,000 per annum.

Overall cost

The overall cost of recommendations made in this chapter is:

		£'bn
1	High Income Child Benefit Charge (HICBC)	1.0

[94] https://www.gov.uk/government/statistics/income-tax-liabilities-by-income-range

2	Withdrawal of the individual personal income tax allowance	5.6
3	Reduction in tax rate between £50,000 and £75,000 a year	12.5
Total		19.1

Of these recommendations the first should happen irrespective of the other changes suggested in the Taxing Wealth Report 2024.

The other two suggestions are conditional on the other reforms proposed in the Taxing Wealth Report 2024 being made or tax injustice would result.

Chapter 7.0

National Insurance – Introduction

Background

The UK's national insurance system was introduced at the beginning of the twentieth century at the time that the very first UK state pension was created. It was, however, transformed and expanded in the aftermath of the Second World War. The Labour government elected in 1945, promised the creation of a much-enhanced social safety net to those who had endured that war. The result was an improved state pension, unemployment and sick pay benefits and the creation of the National Health Service. These new commitments required that additional taxation be paid. The current form of contributory system of payment giving rise to an entitlement to benefits was created as a consequence.

This system of taxation was largely based upon payments made via a person's employer through what became known as the pay-as-you-earn (PAYE) system, which also applied to income tax due on employment income. Post 1945 this was particularly suited to the structure of UK society. For example, in the 1940s and for some time thereafter, most employees were male, which fact was heavily reflected within this new taxation system, which was overall prejudicial to women, and especially married ones. In addition, most people were employed, with self-employment being surprisingly rare at the time, and the vast majority of those employees stayed with their employer for long periods whilst having no other sources of untaxed income of any note, meaning that the PAYE taxation system was highly likely to capture most income within it and tax it appropriately.

As it developed, national insurance became payable in several ways:

1. **Class 1 national insurance** was payable by employees, but in two parts. Part was due by the employee themselves and was therefore seen by them on their payslip. In addition, a second part, which currently exceeds in total tax collected that part paid by employees, was paid by employers. Employees did not recognise this as a taxation liability paid on their behalf, even though most economists agree that the impact of this payment was to reduce the level of net wages paid in the UK economy.

2. **Class 2 national insurance** was a basic contribution paid by those who were self-employed. It entitled them to credit for a few of the benefits that employees enjoyed,

and in particular an old age pension. Unemployment and sickness benefits were generally excluded. This contribution was abolished in the autumn statement of 2023. Because in its early days those who are self-employed secured this benefit by purchasing stamps that were suck onto a contribution card that a self-employed person had to submit to tax authorities to prove their entitlement to benefits for a year this class of contribution was for a long time called "the stamp".

3. **Class 3 national insurance** contributions were a voluntary contribution paid by person not in employment who wished to preserve their entitlement to an old age pension.

4. **Class 4 contributions** were additional contributions made by a self-employed person depending upon the level of income that they earned. These were originally considered the equivalent of an employer contribution but have never been paid at a rate that brought the contribution made by the self-employed to anything like the level paid by employees. This was a situation defended on the basis that self-employed people had significantly reduced entitlement to benefits payable as part of the social security safety net.

Over the years a number of variations on the above basic charges have risen, including the creation of Class 1A national insurance contributions, which are payable by employees and employers on the value of their benefits in kind provided by an employer.

The significance of national insurance in the UK tax system

In 2022/23 national insurance raised a total of £176.9 billion of taxation revenue[95]. This made it the second largest UK tax, behind income tax but ahead of VAT. Of this sum just over £100 billion was paid by employers and the balance by employees and the self-employed. The significance of national insurance as a source of government revenue is not, as a result, as apparent as it might be to most of those who pay it.

The rates at which national insurance is paid

Since the majority of national insurance contribution payments are made by those who are employed, or their employers, the rates for these people payable under what is called class one national insurance are summarised here:

	2023-24		
	Weekly	Monthly	Yearly

[95] https://obr.uk/efo/economic-and-fiscal-outlook-november-2023/

Primary threshold	£242	£1,048	£12,570
Upper earnings limit	£967	£4,189	£50,270

The rates of tax payable are as follows:

	2023-24
Employees' main rate (payable between the primary threshold and the upper earnings limit)	12.0%
Employees' lower rate (payable on earnings above upper earnings limit)	2.0%
Employers' rate	13.8%

In practice, what this combination of rates and thresholds means is that an employee starts paying national insurance when they earn more than £242 a week (£12,570 a year). The contribution due is payable at 12% on the excess over that sum. However, the rate of national insurance rate due falls to 2% when weekly earnings exceed £967 per week (£50,270 a year).

These rates have, it should be noted, been co-ordinated with income tax rates for the first time in 2023-24. Income tax rates in that year are:

Personal allowances	2023-24	Cumulative bands
Personal allowance (PA)	£12,570	£12,570
Basic rate band:	£37,700	£50,270
Higher rate band:	£37,701-£125,140	£50271 to £137,710
Additional rate band:	£125,140 or more	In excess of £137,711

What is clear from comparing these tables is that:

1. When the income tax rate increases from 20% to 40% the national insurance rate on employees falls from 12% to 2%, mitigating that income tax increase for those in employment.

2. Whereas the income tax rate then increases again, albeit at significantly higher levels of income, the national insurance rate never does.

It is also worth noting that:

At no time is there a national insurance charge on anything but income from work. All other income is exempt from this change.

Problems with the UK's national insurance system

The UK national insurance system might have had merits in the era post-1945. It is, however, anachronistic in 2023. in particular:

1. The system has failed over time to reflect the changing role of women in society, and there have been some significant problems that have risen as a result.

2. Self-employment is now substantially more commonplace than it was in 1945.

3. People change employment much more often now than they did when national insurance was first introduced, and many people also have multiple employments, which the national insurance system is ill-equipped to handle.

4. National insurance is not charged on anything, but income from work, meaning that the overall rate of tax paid on income of work is much higher than the overall rate of tax paid on any other source of earnings, most of which are derived from wealth. This contributes significantly to the growing inequality of incomes and wealth in the UK.

5. National insurance ceases to be paid by an employee or self-employed person (but not by their employer) when that person reaches the state retirement age (66, at present), which makes little sense when many people now work beyond that age. This creates a distortion in the employment market.

6. The scale of the employer's national insurance contribution has encouraged many employers to treat their staff as self-employed, even when that is not the case, meaning that both the employer and the employee save national insurance cost as a result. This has seriously undermined the horizontal equity of the UK tax system. Much

of this false representation of employment status has also been akin to tax evasion activity that undermines the integrity of the tax system as a whole.

7. Many people claiming be self-employed have during the course of the current century created limited liability companies to record their income. They have paid themselves a minimal salary out of the profits that company has recorded as a result of charges it has made for the supply of their labour. This means that they have kept their national insurance record intact for benefit purposes. They have then paid themselves dividends out of those profits, seeking to avoid both employers' and employee's national insurance liabilities on the sums they claim to have converted into what tax law recognises as investment income and therefore outside the scope of a national insurance charge. There have been many attempts by HM Revenue and Customs to address this issue, but they have still found no proper solution. As a result, horizontal tax equity has been seriously distorted in such cases. The cost of this abuse has never been estimated by HM Revenue and Customs, which is one of the many deficiencies in its tax gap estimate. So widespread has the abuse been that many government departments have been guilty of engaging consultants on this basis.

8. In the long-term national insurance is a tax that clearly discourages the employment of people in the UK when the creation of full employment remains an objective for most governments. This tax creates wholly perverse economic disincentives that are implicit in its construction and design. When most benefits and pension payments to those in need are not now dependent upon having a complete contribution record this is particularly perverse.

9. The requirement that people have many decades of contribution record to automatically qualify for a state old age pension in the UK is deeply discriminatory in an era when the UK is already, and will increasingly become, dependent upon migrant workers to undertake significant roles within the UK economy.

Approach to tackling the issues that national insurance creates

The Taxing Wealth Report 2024 is not meant to be a programme for tackling every deficiency in the UK tax system. It is instead intended to suggest how taxation revenue might be increased from those with significant income and wealth who are resident in the UK. So significant are the immediate changes that are required for this purpose as noted in the Taxing Wealth Report 2024 that no attempt is being made to tackle more fundamental failures in some parts of the UK tax system. The weaknesses in the national insurance system fall into this second category. Whilst recognising many of the above note problems exist, the recommendations made in this section and others that are related to it are at best partial and

a fuller consideration of the future of the national insurance system will have to await further consideration.

Recommendations made

The following recommendations are made in this and other sections of this report to address some of the failings that the national insurance system has created and to create additional tax revenues as a result:

1. To charge national insurance at a single rate across all levels of income earned, abolishing the reduced rate that now applies on income over £50,270 per annum as a consequence. It is estimated that this might raise £12.5 billion in tax a year.

2. To create an investment income surcharge on incomes from investment income (including capital gains) of more than £5,000 a year. This sum, which would be charged as income tax, would be broadly equivalent to national insurance and would raise £18 billion a year. It would end much of the incentive to tax avoid with regard to national insurance noted previously.

These two changes would end two of the most egregious tax abuses built into the UK tax system at present and might raise more than £30 billion in revenue in the process.

Chapter 7.1

National Insurance – Recommendation 8

Reforming national insurance charges on higher levels of earned income.

Brief summary

This chapter suggests that:

- The reduced rate of employee's and self-employed person's national insurance contribution payable by those earning more than £50,270 per annum from either of these sources can no longer be justified when the pretence that national insurance contributions are specific payments made to provide insurance cover for specified risks is no longer tenable and this charge is now a tax like any other within the UK tax system.
- This reduced rate of tax seriously undermines the vertical equity of the UK tax system by being explicitly regressive in nature.
- Along with other undesirable features within the national insurance system this reduction in rates for those on higher incomes undermines the integrity of the UK tax system and has encouraged tax avoidance and even abuse.
- Revenue of maybe £12.5 billion a year might be raised as a consequence of removing this reduced rate of contribution for higher earners, £11 billion of this sum coming from employees and maybe £1.5 billion from the self-employed. Because the data used to prepare these estimates was out of date these figures may be understated, a risk that is increased by the very cautious basis of estimation used.

The proposal	To charge employee's and self-employed people to national insurance at a single rate on all their earnings above the lower threshold at which such charges apply. This would remove the significant drop in the rate at which

	national insurance is charged that now happens when income from these sources reaches £50,270 per annum.
Reason for the proposal	1. To increase the prospect of vertical equity of taxation in the UK which the reduced national insurance contribution rate for those earning more than £50,270 a year in the UK clearly undermines. 2. To reduce the tax spillover effect that existing rates of national insurance create when compared to those charged under income tax rules. 3. To reduce the rate of tax avoidance in the UK. 4. To consequently improve the rate of tax compliance in the UK. 5. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural consequence of this proposal is likely to be small, most especially if the opportunity to avoid national charges by the creation of an investment income surcharge, which will also be recommended in this report, is enacted. Few people will willingly reduce their contractually due incomes to avoid a tax charge despite the claim made by microeconomists that this is likely. The fact that most people have fixed financial commitments and lifestyles that they wish to maintain does in fact suggest that the opposite might well be the case. It is, therefore assumed that an overall neutral reaction to this change is likely. Assuming this to be the case then a sum of between £10.5 billion and £12 billion might be raised from those in employment as a result of this change, with a further £1.5 billion (or thereabouts) a year likely to be raised from the self-employed. An overall yield of £12.5 billion is, therefore, suggested to be likely to arise as a result of this change.

Ease of implementation	Simple. The change is technically straightforward.
Likely difficulties that might result from implementation	Few. The change is no more complicated than any other change in national insurance rate, and these are commonplace.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/08/abolishing-the-lower-rate-of-national-insurance-for-high-earning-employees/

Background

National Insurance is a complex tax. It was originally introduced by a Liberal government in 1911 as part of a range of measures that also saw the introduction of the first state old age pension in this country. It was, however, considerably expanded after the Second World War by the Labour government of that period that was seeking to provide a social safety net for the people of the UK as part of the new social contract that they were seeking to create between the working people of the UK and its government.

National insurance was created, as its name implies, as a state supplied insurance mechanism that guaranteed that in exchange for contributions made an employee or self-employed person might, depending upon their precise circumstances and contributions made, claim for unemployment benefits, some sickness and disability benefits and a state old age pension. It was also suggested that national insurance contributions should contribute towards the cost of the National Health Service.

The pretence that national insurance contributions now make direct payment for any pension, benefit or health care provided by the UK state has effectively been abandoned, although the entitlement to some such benefits is still dependent upon having made such contributions during the course of a working career. For all practical purposes, national is insurance is now just one of many taxes within the UK. In the tax year 2023/24 it is likely that national insurance

will raise total contributions of £172 billion[96]. These will represent approximately 18.1% of all anticipated tax revenues during the course of that year.

National insurance charges are complicated and differ for those who are employed and self-employed. There is also an option for a person to make voluntary national insurance contributions when they are not working and to secure credits as if they were working in some situations.

Since the majority of national insurance contribution payments are made by those who are employed or their employers the rates for these people payable under what is called class one national insurance are summarised here:

	2023-24		
	Weekly	**Monthly**	**Yearly**
Primary threshold	£242	£1,048	£12,570
Upper earnings limit	£967	£4,189	£50,270

The rates of tax payable are as follows:

	2023-24
Employees' main rate (payable between the primary threshold and the upper earnings limit)	12.0%
Employees' lower rate (payable on earnings above upper earnings limit)	2.0%
Employers' rate	13.8%

In practice, what this combination of rates and thresholds means is that an employee starts paying national insurance when they earn more than £242 a week (£12,570 a year). The contribution due is payable at 12% on the excess over that sum. However, the rate of national insurance rate due falls to 2% when weekly earnings exceed £967 per week (£50,270 a year).

[96] https://obr.uk/economic-and-fiscal-outlooks/

These rates have, it should be noted, been co-ordinated with income tax rates for the first time in 2023-24. Income tax rates in that year are:

Personal allowances	2023-24	Cumulative bands
Personal allowance (PA)	£12,570	£12,570
Basic rate band:	£37,700	£50,270
Higher rate band:	£37,701-£125,140	£50271 to £137,710
Additional rate band:	£125,140 or more	In excess of £137,711

What is clear from comparing these tables is that:

1. When the income tax rate increases from 20% to 40% the national insurance rate on employees falls from 12% to 2%.

2. Whereas the income tax rate then increases again, albeit at significantly higher levels of income, the national insurance rate never does.

It is also worth noting that:

At no time is there a national insurance charge on anything but income from work. All other income is exempt from this change.

The consequence is that however well motivated national insurance charges were when first introduced they now create considerable problems within the UK tax system and for the concepts of both horizontal and vertical tax equity. In particular:

a) There is no horizontal equity[97] with regard to national insurance charges on income below £50,270 per annum when earnings from employment and self-employment are subject to those charges and those from anything else are not.

[97] Horizontal tax equity requires that all incomes of similar amount be taxed the same sum irrespective of where that income comes from.

b) The vertical equity[98] of the combined income tax and national insurance charge is distorted by the impact of a fall in the national insurance rate on income above £50,270 per annum.

c) There is no logic to the cut in the national insurance rate at £50,270 per annum on the basis of vertical equity when this tax is considered in isolation.

d) The interaction of national insurance and income tax now creates misleading impressions of overall tax rates whilst appearing to deliver a subsidy to those on higher levels of income earned from work.

e) There are strong tax spillover effects[99] in favour of income arising from unearned sources and from capital gains as a result of national insurance not being charged on these sources. This has been particularly seen in the growth of the one-person consulting limited liability company that supplies a person's labour on a contractual basis, seeking to turn the status of that profit from earned into unearned income by the payment of dividends out of profits with the sole aim of avoiding national insurance charges as a result.

Issues with regard to the spillover effects arising from national insurance charges only arising on earned income are dealt with in a separate recommendation. The issue addressed here relates to the reduction in the national insurance contribution charge from 12% to 2% on incomes earned from employment or self-employment exceeding £50,270 per annum.

Recommendation

It is recommended that the rate of employee national insurance contribution be fixed at 12% on any rate of income from employment or self-employment exceeding £12,570 per annum.

The reasons for this recommendation are:

1. Vertical tax equity requires that there be no cuts in tax rate on higher rates of income once a rate has been charged on a lower rate of income.

[98] Vertical tax equity requires that as a person's income increases the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.

[99] Tax spillovers are the consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.

2. Given that national insurance is now just a tax like any other the argument that additional contributions from those on higher incomes are not required for insurance purposes cannot be justified.

3. Those with higher incomes have greater capacity to pay this tax than do those with lower incomes and yet a lower rate is asked of them.

4. The charge might raise significant tax revenues.

Analysis of the potential additional income that this change might generate is hindered by the lack of recent data on which to base the calculation from HM Revenue & Customs. That is used here is based on data[100] from 2020/21 and might as a result significantly understate the additional tax that might be raised.

That data suggests that in 2020/21:

a) Around 18.3 million people had employment income of less than £50,000 a year.

b) Approximately 3.3 million people had employment income of more than that sum in that year.

c) Between them those with earnings of less than £50,000 a year enjoyed combined income of approximately £402 billion at an average of £22,000 of taxable income each (people not paying tax are not included in these figures).

d) Between them those with earnings of more than £50,000 a year enjoyed combined income of at least £268 billion at an average of £82,000 of taxable income each, which figure is likely to be a serious underestimate because a very cautious basis of extrapolation of data has been used.

e) If those earning more than £50,000 were required to pay an additional 10% national insurance contribution on their incomes from employment that charge might come to £10.4 billion a year. It is stressed that this is estimated using out of date data (which is nonetheless likely to be the best currently available) and on a very cautious basis of calculation. Because of inflation since 2020/21 it is possible that this sum might easily exceed £12 billion now.

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[100] https://www.gov.uk/government/statistics/income-tax-liabilities-of-starting-savers-basic-and-higher-rate-taxpayers-by-largest-source-of-income-2010-to-2011 which despite its web page address does include more up to date information.

f) This change would also have impact on the self-employed from whom it is likely that another £1.5 billion in tax revenue could be raised as a result of broadly equivalent changes.

Chapter 8.0

Capital Gains Tax – Introduction

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be re-categorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

In the tax year 2022/23, which is the most recent for which there is confirmed data at the time of writing, capital gains tax raised £16.9 billion of revenue, which was a record[101]. This represented 1.9 per cent of total UK tax revenues in the year.

The capital gains tax rate in operation from April 2020 to April 2024 were as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		

[101] https://obr.uk/download/economic-and-fiscal-outlook-november-2023/?tmstv=1702908969

Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates of tax are shown the lower one is the rate charged on the disposal of all assets except properties and the higher one is that due on property.

What is subject to capital gains?

Capital gains tax is charged on capital gains earned by a UK resident and domiciled person wherever those gains might arise in the world. A resident but non-domiciled person can be subject to different rules.

A capital gain is the measure of the increase in the value of an asset between the time of its acquisition and the time of its disposal. Disposal does not necessarily mean that a sale must take place as capital gains tax can be charged when some gifts are made.

The types of assets on which capital gains tax might be charged in the UK include:

- Shares and other investments.
- Land and buildings.
- Businesses.
- Artwork and other collectible items (although rules exist to take small value items out of consideration).
- Foreign currency and cryptocurrencies.

If a person trades in assets of these types they can be subject to income tax on their gains.

Many of the assets are subject to complex valuation rules that significantly increase the complexity of this tax.

The UK's tax system includes some significant exemptions from capital gains tax charges, including:

- Gains on the disposal of a person's principle private residence.
- Gains arising on gifts made at the time of death.

There are also problematic reductions to tax rates, for example on the disposal of some business assets.

The rules for calculating capital gains have changed greatly over the years. In particular, for an extended period an 'indexation allowance' that supposedly eliminated gains attributable

to inflation from charge was included within the tax calculation, but no such provision is included at present.

A generous annual exempt allowance has always been a feature of this tax, although this has been reduced recently.

The problems with the UK's capital gains tax system

There are considerable problems with capital gains tax when it comes to the taxation of wealth. Examples include:

a) The fact that those individuals who make capital gains have an additional personal allowance above that provided for income tax purposes, even after the reduction in 2023 noted above. This reduces their overall tax liabilities, inequitably.

b) Capital gains are charged to tax at approximately half the tax rate used on the income of the same person in the same year. This encourages tax abuse.

c) There are major exemptions from capital gains tax. This most especially applies to a person's principal private residence, which is exempt from tax. This has caused considerable distortion within the UK housing market and with regard to the distribution of wealth in the UK.

d) Capital gains tax is not charged on death and the gifts resulting from it, although it is on lifetime gifts.

e) Some exemptions from capital gains tax, such as business asset disposal relief, which is still popularly known as entrepreneur's relief, make no economic sense.

The recommendations made in the Taxing Wealth Report 2024 are designed to tackle some of these issues.

Recommendations

Capital gains tax was always meant to discourage tax avoidance and tax planning, and yet it has become the epicentre of a major tax planning industry precisely because of the issues noted above. The disparities in tax rates, allowances, and exemptions noted have created what are technically called significant tax spillovers[102], which are themselves the subject of a

[102] https://www.taxresearch.org.uk/Blog/glossary/T/#tax-spillover-assessment

separate chapter within the tax administration section of the Taxing Wealth Report 2024. The recommendations made in this report are intended to reduce these tax spillover effects.

The recommendations made include:

- Charging capital gains at income tax rates. This might raise £12 billion of tax a year.

- Making capital gains subject to an investment income surcharge for income tax purposes. The estimated revenue for this charge is included in the income tax section of the Taxing Wealth Report 2024 and so is not duplicated here.

- Reducing the annual exemption for gains not subject to tax to bring that exemption into line with similar exemptions offered for the purposes of creating administrative ease within the income tax system. This might raise £0.4 billion of tax a year.

- Abolishing capital gains tax entrepreneur's relief. This might raise £2.2 billion of tax a year.

- Creating a capital gains tax charge on the lifetime gains that a person has made on their principal private residence, with that charge to be paid on their final disposal of the principal private residence, whenever that might arise. This might raise £10 billion of tax a year.

Future work

In the case of some of the taxes refer to in the Taxing Wealth Report 2024 there would be obvious long-term benefit to replacing the tax with one that is socially, economically and administratively more efficient. Taxes where this might be appropriate, include:

- national insurance,

- council tax, and

- inheritance tax.

There is not, however, an alternative to having a capital gains tax within the comprehensive range of taxes that any modern democracy requires if a jurisdiction is to impose fair taxation upon the people to whom it is responsible. As a result, there is no suggestion made here for a future programme of work with regard to capital gains tax because the most desirable reforms are already noted, above.

Chapter 8.1

Capital gains tax – Recommendation 9

Aligning capital gains tax and income tax rates

Brief summary

This chapter suggests that:

- The tax owing on capital gains should in the future be taxed as if they represent the top part of the income of the person making those gains in the year that they arise.
- This proposal is made to end the current situation where capital gains are charged at rates that are very often half those applied to earned income.
- This change to the tax system would be easy to implement since the tax rate at which a gain is charged does at present require that the income of the taxpayer in the year in which the gain arises already be taken into account.
- The change in taxation that this proposal creates would be fair from the perspective of horizontal and vertical tax equity[103].
- This change would also eliminate a major tax spillover effect in the UK economy, as a result of which the credibility of the UK's income tax system is undermined by the existence of capital gains tax rates that are usually about half those due on equivalent income.

[103] These terms and the nature of tax spillovers are explained here. https://ww.taxresearch.org.uk/Blog/2023/09/07/the-taxing-wealth-report-2024-methodology/

- There would be a significant reduction in the amount of time wasted on tax avoidance activity in the UK as a result of this change to the overall advantage of society at large as this activity makes no useful contribution to the wellbeing of society as a whole.

- The proposed change is fair because the increase in the wellbeing of a person as a result of an additional pound of wealth is the same whether derived from income or capital gains, meaning that it is appropriate that they be taxed at the same rate.

- The calculated estimated additional sum owing as a result of this change is in excess of £16 billion per annum. In case of potential behavioural changes it is assumed that a lower sum of £12 billion might be raised for the sake of prudence.

The proposal	To align the rates of tax charged on income and capital gains by assuming that the chargeable capital gains of a UK resident taxpayer form the top part of their income for taxation purposes in a year.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the reduced rates of tax payable on capital gains in the UK. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that existing rates of capital gains tax create when compared to those charged under income tax rules. 4. To reduce the rate of tax avoidance in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be small as most capital gains arise as a consequence of transactions undertaken in the normal course of economic activity and the number

	actually planned for tax reasons on which a tax liability might arise might be quite small. Assuming this to be the case then a sum of between £12 billion and £16 billion a year might be raised as a result of this proposal. The lower sum is used as the estimate for the additional revenue to be raised from this proposal to allow for possible behavioural changes.
Ease of implementation	Simple.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	As short as possible to prevent abuse in advance of the change.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/11/aligning-capital-gains-tax-and-income-tax-rates-might-raise-more-than-12-billion-in-tax-a-year/

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be re-categorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

This is good news since the tax raises relatively little revenue, suggesting that overall it has achieved at last some of its design objectives.

In 2020/21, the last year for which detailed statistics for capital gains tax data is available, capital gains tax raised £11.1 billion in tax revenue[104], which was just 1.9% of total tax income of HM Revenue & Customs. However, in the next two years revenues rose significantly to £15.3 billion in 2021/22 (2.1% of total revenues raised in that year) and £16.9 billion in 2022/23 (2.15% of total revenues in that year)[105]. It is clear that the returns to wealth are growing.

Total gains and the number of taxpayers making them in 2020/21 were as follows[106]:

Range of gain (Lower limit £)	Number of individuals	Amounts of gains for individuals	Amounts of tax for individuals
0	2	2	9
10,000	96	1,680	85
25,000	73	2,621	304
50,000	53	3,708	582
100,000	40	6,234	1,076
250,000	16	5,575	938
500,000	10	6,782	1,085
1,000,000	5	7,437	1,252
2,000,000	3	10,737	2,011
5,000,000	2	30,706	6,161
All	301	75,481	13,503

[104] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1171979/NS_Table.xlsx

[105] Based on HMRC data for total tax revenues raised and not just capital gains tax https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk

[106] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1094358/Table_2_Size_of_gain.ods

Note that since an additional £811 million of capital gains tax was also paid by trusts in this year according to this data it does not reconcile by some way with the more recent data from HM Revenue & Customs for overall capital gains tax paid in the year as noted above. These differences cannot be explained and add to the difficulty of working with HMRC data on tax yields.

The tax rate in operation from April 2020 to April 2024 have been as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic income tax rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate income taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		
Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates of tax are shown the lower one is the rate charged on the disposal of all assets except properties and the higher one is that due on property.

Now that the annual exemptions for this tax were reduced from 6 April 2023.

Note too that the rate of tax a person pays is determined by their income in a year, and not (at least in the first instance) by the total of their capital gains in the year.

To determine whether a person is a standard or higher rate taxpayer for the purposes of this tax their income tax liability has to be computed on the basis of the following allowances, rates and reliefs:

Personal allowances	**2023-24**	**2022-23**
Personal allowance (PA)	£12,570	£12,570
Income Tax bands and rates	**2023-24**	**2022-23**
Basic rate band:	**£37,700**	**£37,700**
Savings rate	20%	20%
Non-savings rate	20%	20%
Dividend rate	8.75%	8.75%
Higher rate band:	**£37,701- £125,140**	**£37,701- £150,000**
Savings rate	40%	40%
Non-savings rate	40%	40%
Dividend rate	33.75%	33.75%
Additional rate band:	**£125,140 or more**	**£150,000 or more**
Savings rate	45%	45%
Non-savings rate	45%	45%
Dividends rate	39.35%	39.35%

If the capital gain less the capital gains tax allowance for the year is a positive sum i.e. there is a chargeable gain on which tax is potentially due, then if that net gain when added to income subject to income tax in the year is less than £50,270 (£12,570 personal allowance plus the basic rate income tax band) then the tax due is charged at the lower capital gains tax rates. If it exceeds that sum, then to the extent that it does the higher rates of capital gains tax apply.

It will be noted that in effect the capital gains tax annual allowance did effectively almost exactly double the available tax-free sum that a person might enjoy until 5 April 2023. This has now been reduced. This has increased the number of people to whom the higher rates of capital gains tax might now apply.

In the last year for which data is available (2020/21) 301,000 people paid tax on gains that they had made. Of these at least 129,000 had gains that in themselves guaranteed that they were higher rate taxpayers for capital gains tax purposes. If, as it would be reasonable to assume, all of these capital gains taxpayers had income of at least £25,000 subject to income tax in that year then the number likely to be paying tax at higher rates would increase to 202,000.

Reform recommendation

If a government is to address the apparent under taxation of wealth then it is apparent that the rates of tax due on income and capital gains must be equalised.

There are a number of reasons for suggesting this. First of all, it should be noted that unless the rates of capital gains tax and income tax are equalised then capital gains tax fails to stop tax avoidance, which is its purpose. Instead, it actually encourages tax avoidance[107] by the creation of a deliberate spillover[108] effect. As a result, it reduces tax compliance[109]. These perverse situations must be brought to an end.

Secondly, by offering a lower rate of tax on a return from wealth the significant disparity in the overall tax contribution made by those with wealth and higher incomes when compared to those with lower incomes noted in this report will continue.

Third, this disparity in rates will continue to encourage perverse behaviour in the economy, including the encouragement of the recognition of capital gains rather than dividends in the returns from companies.

Fourth, the effort expended on tax planning, which is wholly unproductive for the economy as a whole, will be reduced if these rates are equalised.

Fifth, in the short-term the churning of gains to minimise tax might end, to the advantage of investment management of portfolios where long-term views should be taken.

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[107] Tax avoidance involves an activity deliberately undertaken by a taxpayer in a way that they know might not be tax compliant.

[108] Tax spillovers are the consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.

[109] Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

Finally, and most importantly of all, people will be seen to be equal within the economy. When, as a matter of fact, a pound received is indifferent in worth as to its source[110] it should be taxed at the same rate taking into consideration the situation of the recipient whatever that source might be, and unless it is the tax system is obviously discriminatory. This should cease to be the case.

The recommendation made is that capital gains should always be taxed as if they are the top part of a person's income with income tax rates applying to that gain.

This change would be easy to implement: it is already necessary to treat capital gains as if they are the top part of income to work out the tax capital gains tax payable at present.

Importantly, the declaration process for capital gains need not change at all.

Using the assumptions noted previously on the number of taxpayers likely to be liable to basic, higher and additional rates of tax noted above and presuming that none of the capital gains tax due related to property gains, then the increased tax yield in 2020/21 using the data noted previously for that year assuming no behavioural change in the recognition of capital gains took place might be[111]:

Range of gain (Lower limit £)	Number of individuals	Amounts of gains for individuals	Amounts of tax for individuals	Additional tax due at basic income tax rate	Additional tax due at higher rate of income tax	Additional tax due at additional rate of income tax	Total additional tax due
0	2	2	9	9			9
10,000	96	1,680	85	85			85
25,000	73	2,621	304		304		304
50,000	53	3,708	582		582		582

[110] For a discussion of this issue see https://www.taxresearch.org.uk/Blog/2023/09/07/the-taxing-wealth-report-2024-methodology/

[111] The additional sum owing is the original sum owing multiplied by the ratio of the new rate owing to the original rate owing e.g. assuming, as noted, that all gains are payable at 20%, the extra sum owing at the additional rate is the original sum owing multiplied by 45/20, less the original sum paid. In case this is an overestimate a lower range estimate of approximately 75% of the calculated additional sum owing is used as the estimate for likely additional revenues from this change.

100,000	40	6,234	1,076			1,345	1,345
250,000	16	5,575	938			1,172	1,172
500,000	10	6,782	1,085			1,356	1,356
1,000,000	5	7,437	1,252			1,565	1,565
2,000,000	3	10,737	2,011			2,514	2,514
5,000,000	2	30,706	6,161			7,701	7,701
All	301	75,481	13,503	94	886	15,653	16,633

It cannot, of course, be guaranteed that there will be no behavioural change on the part of taxpayers as a result of this alignment of tax rates. However, since most capital gains that were artificially created in the past were intended to use the higher rate of annual allowance available until April 2023, which allowance has now been reduced, and most actual chargeable gains will therefore now be the unavoidable consequence of transactions that really arise in the course of normal trading and investment, the scale of this change in behaviour might well be modest.

Prudently, to allow for uncertainty about this behavioural response and to allow for uncertainty referred to in footnote nine it is assumed that approximately seventy five per cent of this forecast additional tax might be collected, resulting in potential additional income of around £12 billion per annum whilst recognising that this sum might actually be higher in practice.

Chapter 8.2

Capital gains tax – Recommendation 10

Abolishing entrepreneur's relief

Brief summary

This chapter suggests that:

- Capital gains tax business asset disposal relief, which is still popularly known as entrepreneur's relief, should be abolished.

- This relief does at present offer a 10% tax rate on the first £1 million of gains made by a person during their lifetime when disposing of relevant business assets, which will usually be an interest in a private business.

- The relief is claimed by relatively few people a year and the vast majority of the relief by value usually goes to a relatively small number of claimants. In 2020 just 4,000 claimants enjoyed 73 per cent of the total relief provided by value.

- The relief makes no economic sense. It does not encourage entrepreneurial activity because it provides relief when a business is sold i.e., when the person making the claim has ceased entrepreneurial activity. As a result, the relief does not encourage entrepreneurial activity but does instead encourage short-termism within the UK economy. This is sufficient in itself to justify abolition of this relief.

- HM Revenue & Customs estimate that at current rates of capital gains tax this relief now costs £1.1 billion per annum. However, this report suggests that current capital gains tax rates be abolished and that capital gains should be taxed at in come tax rates. That is likely to increase the cost of this relief, and so the amount that might be saved by its abolition, to approximately £2.2 billion per annum.

The proposal	To abolish entrepreneur's relief within UK capital gains tax.

Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the availability of capital gains tax entrepreneur's relief. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that having entrepreneur's relief within capital gains tax creates. 4. To reduce the rate of tax avoidance in the UK which this relief encourages. 5. To consequently improve the rate of tax compliance in the UK[112]. 6. To raise additional sums in additional tax revenues. 7. To reduce wealth inequality in the UK which capital gains tax entrepreneur's relief increases.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known but is likely to be beneficial by encouraging longer term business development before disposals take place. The impact on tax yields might also be beneficial in that case as gains might be larger if business assets are held for longer. The current estimated cost of this tax relief provided by HM Revenue & Customs is £1.1billion per annum, but that estimate assumes that the applicable tax rate is 20%. If that tax rate was increased to a person's marginal income tax rate the amount that might be raised by abolishing this allowance might increase to £2.2 billion a year.
Ease of implementation	Simple. The sum relieved was reduced without difficulty in 2020.

[112] Many of the terms used in this summary are explained in more depth at https://www.taxresearch.org.uk/Blog/2023/09/07/the-taxing-wealth-report-2024-methodology/

Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/12/abolishing-capital-gains-tax-entrepreneurs-relief-might-raise-approximately-2-2-billion-of-tax-a-year/

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be re-categorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

The tax rate in operation from April 2020 to April 2024 have been as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		
Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates are shown the first refers to gains in general and the second to gains on the sale of land and buildings.

Other proposals in this report address the rates of tax at which capital gains are charged and the appropriate rate of annual exemption that should be available for the purposes of this tax, suggesting changes in both. The current recommendation relates solely to the abolition of what is technically called business asset disposal relief, but which is however still popularly known as entrepreneur's relief.

Entrepreneur's relief was introduced by a Labour government in 2008. It announced in the Budget documents for that year[113] that:

A new entrepreneurs' relief will also be available on the disposal of a trading business or shares in a trading company, provided the seller is an officer or employee of the company and has a minimum 5 per cent stake in the business. This will reduce the effective tax rate to 10 per cent for up to the first £1 million of gains made over a lifetime.

The lifetime limit on qualifying gains was raised to £2 million in the March 2010 budget. It was increased again just three months later, to £5 million by the new Conservative/Liberal coalition government and yet again in 2011 to £10m. In the March 2020 budget, the lifetime allowance for this relief was reduced to £1m and the relief was renamed to Business Asset Disposal Relief but otherwise little changed.

In 2023 HM Revenue & Customs estimated[114] that this tax relief cost £1.1billion a year, a reduction from £2.8 billion in 2020 before the lifetime limit was cut.

The recommendation

It is recommended that this relief be eliminated.

In 2023 HM Revenue & Customs estimated that the relief was likely to be claimed by 47,000 people in that year, at most. Each claimant would, in that case, benefit by £23,400. However, in 2020 it was noted[115] that data then current showed that the total cost of the relief was £2.36 billion per annum but of this £1.73 billion went to just 4,000 people giving them a tax savings

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[113] https://www.gov.uk/government/publications/budget-2008-stability-and-opportunity-building

[114] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

[115] https://www.taxresearch.org.uk/Blog/2020/02/10/entrepreneurs-relief-an-exercise-in-the-tax-system-redistributing-wealth-upwards/comment-page-1/

of more than £430,000 each, on average. It remains very likely that the distribution of the benefit of this relief remains as skewed in favour of a small number of claimants.

The impact of the relief is to provide a boost to the wealth of the already wealthy. Anyone claiming it has, after all, already made a significant capital gain that is, in effect, delayed payment for the work they have undertaken for a company in which they have been involved. Not only is this horizontally inequitable in tax terms, it also makes no economic sense. That is because the relief does nothing to encourage entrepreneurial activity because it provides a tax saving when a person ceases to undertake entrepreneurial activity by selling a company rather than when they commence it, which is when entrepreneurial activity occurs. The entire logic underpinning the relief is, in that case, illogical.

What this relief actually encourages is short-termism and an inclination to sell out from an activity rather than to develop it, both of which are the opposite of what the UK needs. As such this relief should be abolished.

The estimated cost of this relief provided by HM Revenue & Customs assumes existing tax rates, which would charge a maximum of 20% on gains of the sort subject to Business Asset Disposal Relief. Increasing rates to income tax levels, as recommended in this report, would at least double the cost of this relief. That means that abolishing it might save £2.2 billion a year.

Chapter 8.3

Capital gains tax – Recommendation 11

Reducing the annual exempt amount for capital gains tax

Brief Summary

This chapter suggests that:

- The capital gains tax annual exempt amount should be reduced from £6,000 per annum to £1,000 per annum.
- Since the exempt amounts that might be earned from trading and property activity within income tax law are now £1,000 per annum it makes sense that the same limit be used for capital gains tax purposes.
- The administrative burden on a person making capital gains exceeding £1,000 a year can be no higher than those on the person making trading or property income exceeding £1,000 a year when it comes to preparing a tax return and as such this request is administratively reasonable.
- It is likely that this proposal will not only promote horizontal and vertical tax equity but that it will also reduce the incentive to avoid tax and increase tax revenues by £0.4 billion per annum, and potentially somewhat more.

The proposal	To reduce the capital gains tax annual allowance or exempt amount to £1,000 per annum to match the equivalent exempt sums allowed for trading and property income within income tax.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the availability

	of an additional exempt amount or allowance for capital gains enjoyed by UK resident taxpayers. 2. To increase the prospect of the vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that having an annual exempt amount for capital gains tax creates. 4. To reduce the rate of tax avoidance in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise modest sums in additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known. The recommendation should end the practice of tax planning to make use of the annual exempt amount for capital gains tax purposes which has been commonplace until recently and which will not be worthwhile once this change has taken place. Based on HMRC data it is suggested that this change might raise additional revenue of £0.4 billion a year but it has to be accepted that the true impact cannot be known in advance and may be significantly higher.
Ease of implementation	Simple.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/26/reducing-the-annual-exempt-amount-of-capital-gains-a-person-might-enjoy-a-year-to-1000-might-raise-at-least-0-4-billion-of-additional-tax/

Background

Capital gains tax was introduced in the UK in 1965. As was made clear by the Rt Hon James Callaghan MP, the Chancellor of the Exchequer at the time, the aim was to ensure that income could not be re-categorised as capital gains and so escape from either the income tax system or fall out of taxation altogether. The tax was as a consequence always as much an anti-avoidance measure as it was a revenue-raising tax.

The tax rate in operation from April 2020 to April 2024 have been as follows:

	From 6 April 2023	From 6 April 2020 to 5 April 2023
Standard rate (basic rate taxpayers)	10% / 18%	10% / 18%
Higher rate (higher and additional rate taxpayers)	20% / 28%	20% / 28%
Business asset disposal relief (Entrepreneur's relief) effective rate	10%	10%
Annual exemption:		
Individual	£6,000	£12,300
Trusts	£3,000	£6,150

Where two rates of tax are shown the lower one is the rate charged on the disposal of all assets except properties and the higher one is that due on property.

Another proposal within the Taxing Wealth Report 2024 addresses issues relating to the rates of tax at which capital gains are charged. This recommendation relates to the annual exemption made available for the purposes of this tax.

It will be noted that the annual exemptions for this tax were reduced from 6 April 2023. In the Autumn Statement of 2022, the following was noted[116] (references to other measures having been edited out):

> **5.21** Capital Gains tax Annual Exempt Amount - The government will reduce the Capital Gains Tax Annual Exempt Amount from £12,300 to £6,000 from April 2023 and to £3,000 from April 2024. These measures will raise over £1.2 billion a year, from April 2025. The government will legislate for these measures in Autumn Finance Bill 2022.

It is not clear how these sums were estimated.

The reduction in this exempt amount was welcome: it helps achieve the objectives noted above. However, it remains the case that each person also has a personal allowance for income tax as follows, and that this capital gains tax allowance is additional to this.:

Personal allowances	2023-24	2022-23
Personal allowance (PA)	£12,570	£12,570

That said, the income tax system does provide an exemption from a charge to that tax in the case of any person making less than £1,000 a year from either trading or property income (rent)[117]. If it is assumed that it is administratively worthwhile collecting tax on trading and property income exceeding £1,000 a year, then it must also be the case that it is administratively worthwhile collecting capital gains tax on gains above the same limit. That is the reason for the adoption of that limit in this proposal.

Recommendation

The annual capital gains tax exempt amount still remains additional to the annual exempt amount provided to any person for income tax purposes. Although the capital gains tax exemption has been reduced recently the disparity between the exempt amounts made available for income tax and capital gains tax purposes is illogical and as such still provides a person who enjoys the benefit of capital gains with a tax advantage over the person whose income is entirely derived from sources subject to income tax.

[116] https://www.gov.uk/government/publications/autumn-statement-2022-documents
[117] https://www.gov.uk/guidance/tax-free-allowances-on-property-and-trading-income

Because an exemption of £1,000 is provided for trading and property income in income tax law it is now proposed that a similar sum be provided as the annual exempt amount for capital gains tax purposes. There can be no logical reason for a bigger difference.

It is not possible to provide a precise estimate of the taxation benefits arising from this change, which is anyway motivated more by a desire for tax equity and to reduce tax avoidance than it is by a desire for additional revenue.

According to HM Revenue & Customs[118], increasing the exempt amount for capital gains tax by £500 a year might at present cost approximately £40 million in lost tax revenue a year. Extrapolating the number tenfold and in the opposite direction may not provide a very good estimate of additional revenue, but it is the best basis for estimating available. As such estimated revenue of £0.4 billion is suggested.

[118] https://www.gov.uk/government/statistics/direct-effects-of-illustrative-tax-changes/direct-effects-of-illustrative-tax-changes-bulletin-january-2023

Chapter 8.4

Capital gains tax – Recommendation 12

Charging capital gains tax on the final disposal of a person's main residence

Brief Summary

This chapter suggests that:

- A capital gains tax charge should be made on the final disposal of a former residential home by a person or their spouse or civil partner.
- This capital gains tax charge would usually arise on the death of a person or on the death of the last surviving member of the marriage or civil partnership of which they were a part, but it could also arise on the merger of households, on a sale before moving into a care home or on disposal of a property before emigrating. A partial charge could also arise on downsizing.
- Residential properties would be taken out of the scope of inheritance tax if this charge was made.
- This charge would be considerably more equitable and predictable than current inheritance tax charges, which create considerable regional tax injustice.
- The charge is fair: it only arises when a person ceases to have use of their main residence.

- Without suggesting that the tax be hypothecated it is suggested that it is likely that it would be considerably more acceptable if a commitment was made to invest the proceeds in social housing.

- The proceeds that might arise from this suggestion are hard to estimate because the current level of gains of this sort arising on death are not known, not least because capital gains tax is not chargeable on death at present.

- It is known that the exemption of people's main residences from capital gains tax charge is thought by HM Revenue & Customs to cost £35.2 billion of tax foregone each year at present.

- Depending on the rates of capital gains tax chosen (and the Taxing Wealth Report 2024 generally suggests that those in use for capital gains tax are too low and should be subject to an investment income surcharge, which might be waived in this case) the amount of tax that might be raised could vary considerably. However, it would not be unreasonable to think that at least £10 billion of additional revenue could be raised a year, having taken into consideration the loss of inheritance tax on such properties.

- This proposal would require considerable consultation and great care in drafting to ensure that tax justice was delivered.

The proposal	To charge capital gains tax on the last occasion that a person, or a person connected to them, makes disposal of a residential property previously used as their main residence without reinvesting the proceeds in a new main residence. This is most likely to happen on death.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the exemption from capital gains tax of the main domestic residence of a UK taxpayer when no equivalent relief is available to a person who rents their main residence.

	2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that this exemption from capital gains tax creates in the UK housing market and in UK wealth profiles. 4. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this charge is hard to predict. As a matter of fact, people will still dispose of properties that were previously their main residence, either during their life or on death. This charge will, then, be unavoidable. This fact will be assisted by the charge applying equally to those properties that are gifted (where the market value of the property gifted will be taxed) as well as to those that are sold. It is exceptionally unlikely that people will be dissuaded from owning their own main domestic residence as a result of this charge. Again, this suggests only a very limited scope for behavioural response to this charge. There may be minor behavioural issues to deal with on disposals taking place during life which do not result in the reinvestment of proceeds in another main residence. These are most likely when merging households, going abroad or selling in old age but before death. Careful drafting will be required in the first two cases, most especially if reinvestment does then subsequently occur within a reasonable time period of the earlier disposal, and in the last case to ensure no unforeseen interactions with inheritance tax arise within a reasonable time period of disposal. Likely proceeds from this charge should exceed £10 billion, therefore considerably exceeding the current inheritance tax charge on such properties whilst being considerably more equitable with regard to the basis of charge across the UK population as a whole. Since the

	largest gains likely to be subject to this charge will be those on the most valuable properties, which are by definition owned by the wealthy, this charge will inevitably reduce wealth inequality in the UK.
Ease of implementation	Not straightforward because of the sensitivity of the issues and because of issues referred to in the preceding paragraph.
Likely difficulties that might result from implementation	Technically few. Practically, a lot of taxpayer preparation might be required, as might also be the case with regard to systems required for reporting a potential tax liability, especially if it arises during life rather than on death.
Likely time required to implement the change	Several years for the reasons noted in the next section.
Consultation period required.	This is, in effect, a new tax on a tax base that has previously been considered sacrosanct from charge, and as such is bound to require an extensive consultation process to ensure that the tax is fair and charged appropriately. Implementation is, therefore, likely to take 2 to 3 years from the time proposal is made.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/28/charging-capital-gains-tax-on-the-final-disposal-of-a-persons-main-residence-might-raise-10-billion-of-tax-a-year/

Background

By far the largest exemption by value for capital gains tax purposes is that provided to people on the gains arising from their use of a property as their main residential home. In 2022/23 it

was estimated by HM Revenue & Customs[119] that this relief cost £35,200 million (£35.2 billion) having cost £31,700 (£31.7 billion) on average over the six preceding years.

This exemption, which has existed ever since the introduction of capital gains tax in 1965, has now contributed to a growing wealth divide within the UK economy as a whole. At one time, there was a joke that said that the UK could be divided between the haves and the have yachts, but that division is now much more commonly represented by the division between those who have secured ownership of their own domestic residence and paid for it over their lifetime, and those who have not been able to do so and have, instead, rented accommodation throughout their lives.

UK estate agents now suggest that the total value of the UK's housing stock amounts to £8,700 billion[120] before the offset of mortgage loans to produce the net wealth figure for such property included in data on UK wealth produced by the Office for National Statistics[121].

That gross figure apparently increased by 5.1% in 2022 or approximately £420 billion, which is a sum equivalent to about one sixth of UK gross domestic product (or national income) in the year in question. This makes it apparent that there is an issue that needs to be addressed concerning the resulting wealth inequality in the UK.

That is especially true when it is becoming increasingly difficult for young people to buy properties for use as their homes without considerable financial assistance from their parents, which fact perpetuates this problem. However well-motivated this tax exemption might have been when introduced there now appears to be good reason for reconsidering whether it should be retained in its existing form.

The purposes for this tax exemption have always been clear. There were three primary justifications for it:

1. There was no desire to charge tax on gains arising to a person if they were to move to secure employment. The obvious impediment to labour mobility that this would

[119] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

[120] https://www.savills.co.uk/insight-and-opinion/savills-news/340229-0/uk-housing-value-hit-a-record-high-of-%C2%A38.68-trillion-in-2022-with-gains-favouring-owner-occupiers-rather-than-landlords#:~:text=The%20total%20value%20of%20all,year%2Don%2Dyear%20increase.

[121] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/totalwealthwealthingreatbritain

create was always considered a reason for not charging capital gains tax on the sale of domestic properties used as a person's main residence tax during their lifetime.

2. There was no desire to charge tax on inflationary gains arising when a person moved during the course of their lifetime when it was assumed that they would have a continuing need for a residential property after any sale giving rise to such a gain.

3. It was assumed that any desire to tax gains arising on residential properties of significant value at the time of death would be captured through the inheritance tax system.

The first of these assumptions remains entirely valid. It remains the case that the imposition of any tax that might reduce labour mobility might be harmful to the economy. For that reason, the gains arising on most lifetime sales of property should continue to fall outside the scope of a capital gains tax charge.

However, the widespread expansion of home ownership and the considerable increase in the value of homes, even having taken inflation into consideration, suggests that some aspects of the second assumption do now require reappraisal.

That reappraisal has to, necessarily, be linked to the third assumption. That is because there can now be little doubt that the interaction between capital gains tax and inheritance tax with regard to main residences can produce unfair outcomes. In particular, because of the widespread variation in average house prices across the UK and in their increase over time there is considerable potential regional tax injustice that might arise because residences of apparently similar style in different parts of the country might be subject to considerable variation in the inheritance tax charge that might be payable upon them.

The recommendation made here takes all these factors into account.

Recommendation

It is proposed that lifetime gains on the ownership of residential property should become liable to capital gains taxation on the death of its owner, or of their spouse, civil partner, or other connected person to whom they might have transferred that ownership upon their ceasing to use it during their own life, which person, or their estate, should then be liable for the gain arising on that residential property at the time that they die or cease to use it as their main residence, which last provision shall also apply to any person making a disposal of a property without buying a replacement main residence during the course of their lifetime.

For example, suppose that Jo bought a property in 1972 for £10,000. They sold it for £22,000 in 1982, buying another property for £35,000 at that time. They then moved again in 1993, selling that second property for £89,000 and buying another for £115,000. They then remained resident in the property with their spouse until they died in 2022, their spouse having predeceased them having left their share in the property to Jo meaning that the entire gain on the properties owned during life is due by Jo's estate. Jo spent £12,000 on a new kitchen in 2003 and £19,000 on a conservatory in 2007. The property was valued at £485,000 at the time of death.

The total capital gain is:

	£	£
Sales proceeds or value of final property		485,000
Less: cost of final property	115,000	
Cost of new kitchen	12,000	
Cost of conservatory	19,000	
Total cost of final property		(146,000)
Gain on final property		339,000
Add: Gain on first property		
Sales proceeds	22,000	
Less: cost	10,000	
Gain on first property		12,000
Add: Gain on second property		
Sales proceeds	89,000	
Less: cost	35,000	
Gain on first property		54,000
Total lifetime gain on main residences:		£405,000

This can be rationalised as being the disposal value less the actual sum paid for the properties, which totals £80,000 in all. This is made up of £10,000 for the first property; £13,000 for the second property (being the cost less the proceeds on the first property); and

£57,000 on the third property, being £115,000 spent less £89,000 from the proceeds of the previous property, making £26,000, plus £31,000 on improvements.

It is suggested that this sum should be subject to capital gains tax on death but that there be no inheritance tax charge on that gain as a result.

It is also suggested that this charge should arise during Jo's lifetime if they made a disposal of this value and then did not reinvest the proceeds for any reason, e.g. because they went abroad, or because they moved into a care home, or they merged their household with that of another person which other house then became their main residence for capital gains tax purposes.

The amount of capital gains tax due on this charge would depend on the rate chosen. This need not be at the same rate as other capital gains tax charges, at least during a transition period. It might also be exempt from the investment income surcharge proposed elsewhere amongst the Taxing Wealth Report 2024 proposals. It could also be subject to progressive rates specific to this charge depending upon the amount of gain made. These variables clearly make it harder to estimate the likely revenues arising from this proposal.

Any estimate of the tax to be collected does also depend upon an estimate of the number of gains on the sale of properties that might fall within the scope of this charge. This does require that an estimate be made of the number of disposals that a person makes on average during their life. Whilst estimates that a person might live in ten or more properties during their adult life appear commonplace it also seems likely that a majority of these will be rental properties that they live in before acquiring their first own main residence. Three or four main owned residences seems to be a commonplace estimate.

Given that the tax exemption for capital gains arising on the disposal of domestic residences is now estimated by HM Revenue & Customs to cost £35.2 billion a year[122] what is clear is that there is considerable scope for raising revenue from this charge. This is most especially true because the proposal made is that the charge be on the lifetime gain made on a person's final disposal of a main domestic residence and not on the capital gain arising or disposal of the last such residence. As a consequence, a disproportionate part of the total cost of the £35.2 billion cost of this exemption might be brought within the scope of a charge to tax as a result of this recommendation.

[122] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

That said, there will be a reduction in the amount of inheritance tax payable as a consequence of removing a person's principal private residence from the charge to that tax on death. Appropriate measures would also be required to allow for a reduction to an inheritance tax charge on disposal proceeds arising from the sale of a property in a reasonable time period before death.

It is suggested that the political feasibility of this charge would be considerably increased if the proceeds were to be used to build new social housing, even if not directly hypothecated for that purpose.

The proceeds to be raised would depend upon the rate of tax charged. If charged at a person's highest marginal rate of income tax rate in the year of death many such gains would be subject to tax at 40% or 45%. The former is the current inheritance tax rate, which does not take into consideration the cost of acquiring the property. As such these rates may be appropriate. However, to make this charge both progressive and fair it is likely that this gain might need to be subject to its own scale of charges. It might also need to be exempted from any investment income surcharge otherwise proposed in the Taxing Wealth Report 2024.

Given all these variables, suggesting the annual yield from this tax is difficult, but a sum in excess of £10 billion per annum is entirely plausible even allowing for the loss of current inheritance tax charges on these properties.

Chapter 9.0

Corporation tax reforms - Introduction

Background

The UK's corporation tax was introduced in 1965 at the same time as the country also saw the introduction capital gains tax. Both taxes were introduced by a Labour government that was anxious to both modernise the UK's tax system and to remove from it opportunities for abuse that existed in the system that they had inherited from the previous Conservative government.

Corporation tax is a tax that is primarily charged on the income, gains and profits of private limited liability companies and public limited companies (PLCs). It can also be charged on the income of some unincorporated bodies, but this is incidental to its main function.

Corporation tax is, when ranked by revenue, the fourth largest tax in the UK, raising £78.6 billion in the tax year 2022-23, which sum represented 8.8 per cent of all UK tax revenues[123].

Corporation tax is also one of the most abused taxes in the UK. It is estimated by HM Revenue & Customs that at least 13.3 per cent of all corporation tax revenues were evaded or avoided by taxpayers in the tax year 2021-22, with that figure increasing to 29.3 per cent in the case of smaller companies that pay approximately half of all UK corporation tax. Both these figures are on rising trends: this is a tax that appears to be out of control in the UK[124].

Corporation tax rates

When corporation tax was first introduced all companies paid tax at the same rate of around 40% on their profits arising during the course of a year.

In 1973, that changed. Companies that were defined as being small paid tax at a rate that was usually 10% less than that imposed on large companies.

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[123] Based on table A5 here: https://obr.uk/download/economic-and-fiscal-outlook-november-2023/?tmstv=1701349270

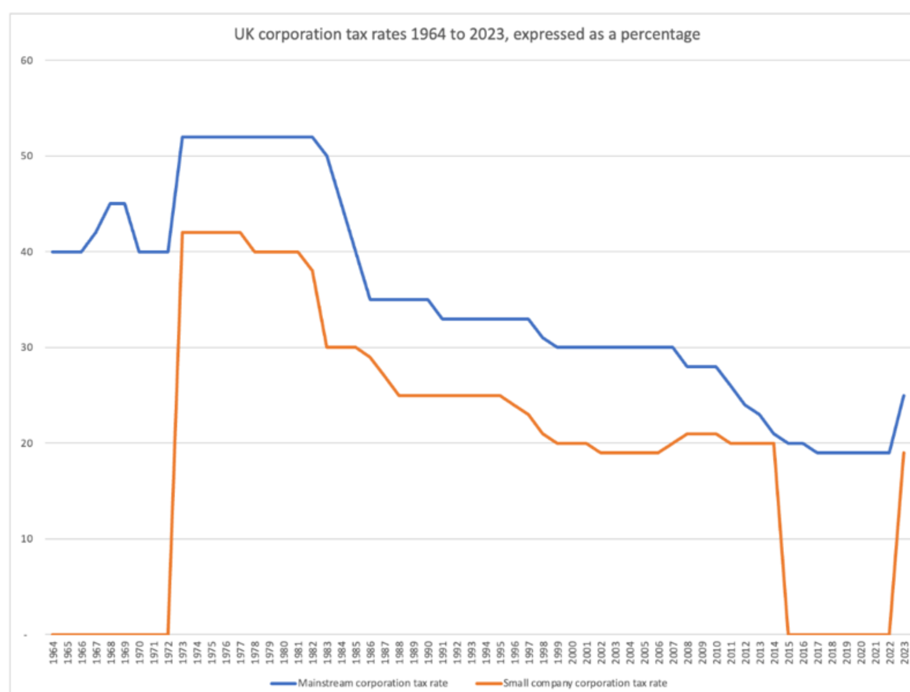
[124] https://www.gov.uk/government/statistics/measuring-tax-gaps/5-tax-gaps-corporation-tax

It should be noted that the difference between a large and small company was based upon the level of profit that was generated by a company for corporation tax purposes during the course of a year. As a consequence, a company with a low turnover but with very high profitability could be defined as a large company, whilst a very large company that made a very small profit could be defined as a small company. Groups of companies were treated as single entities for this purpose to prevent abuse. This definition has persisted to date.

As will be noted from the chart below, opportunity was taken when the small companies rate of corporation tax was introduced to increase the rate of tax charged on the profits of large companies, which in the 1970s exceeded 50 per cent.

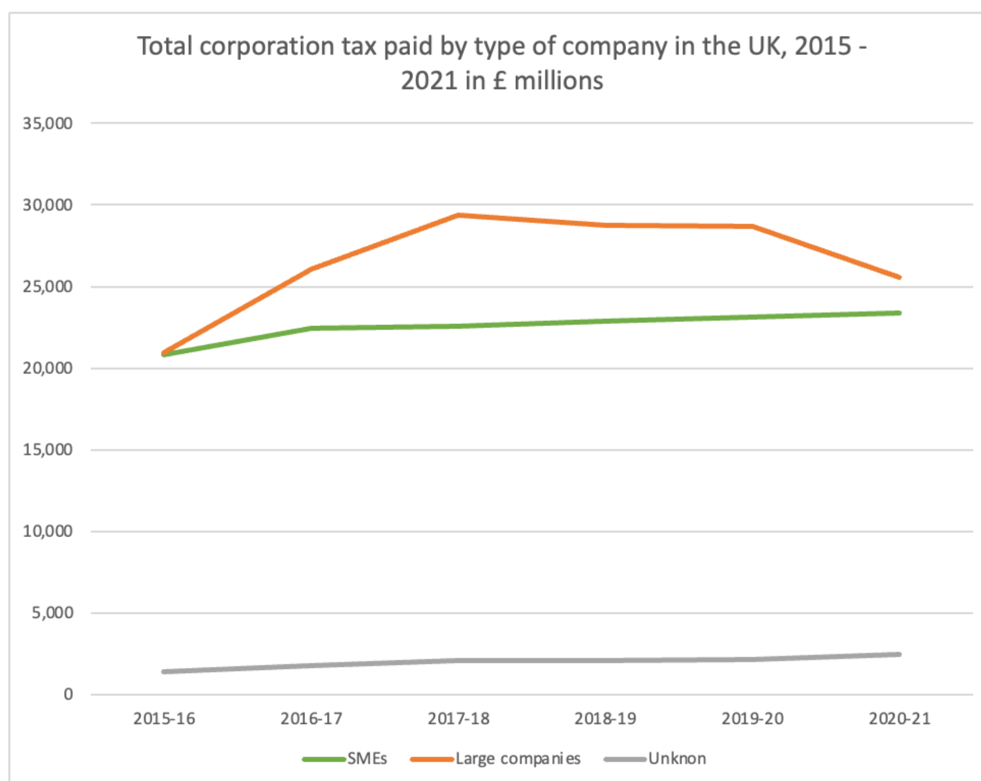
Corporation tax rates fell steadily during the early years of Margaret Thatcher's administration in the 1980s. They then broadly flatlined at between 35% and 30% for more than two decades, until a further steady decline started just before the global financial crisis in 2008, with corporation tax rates reaching their lowest ever level at 19% from 2017 onwards, only recently having been raised again.

It will be noted that from 2015 to 2022 small companies paid corporation tax at the same rate as large companies, i.e. at 19% for most of this period. In 2023 corporation tax rates for large companies have been raised to 25%, but small companies still pay tax at 19%.



Sources: various from data collected by the author over time

In recent years, the estimated amount of corporation tax paid by large and smaller companies, as identified by HM Revenue and Customs to the best of their ability given that these terms had little relevance to liabilities owing during the course of this period, were as follows:



Source: HM Revenue & Customs and author calculations[125]

To put these numbers in context the number of large and small companies and the average tax liabilities that they settled in each of the years noted were as follows:

	Number of large companies	Total tax paid by large companies	Average tax paid by each large company	Number of SMEs	Total tax paid by SMEs	Average tax paid per SME	Multiple: large to small company tax payments
	Number	£'million	£'million	Number	£'million	£	Ratio
2015-16	18,911	20,960	1.108	1,293,868	20,843	16,109	68.80
2016-17	18,982	26,032	1.371	1,384,777	22,435	16,201	84.65
2017-18	19,576	29,396	1.502	1,434,347	22,561	15,729	95.47
2018-19	19,147	28,733	1.501	1,453,288	22,866	15,734	95.38
2019-20	17,886	28,678	1.603	1,512,888	23,154	15,305	104.77
2020-21	18,432	25,552	1.386	1,461,466	23,365	15,987	86.71

[125] https://www.gov.uk/government/statistics/corporation-tax-statistics-2022 table 10

Source: HMRC and author calculations[126]

As this table shows, in most years more than half of all corporation tax payments in the UK are made by a small number of very large companies. This is because of the massive imbalance in their profitability when compared to that of small and medium sized companies that pay tax[127].

Problems with the UK's corporation tax

Corporation tax has been subject to considerable attention from tax specialists, tax justice, campaigners, governments, international organisations such as the Organisation for Economic Cooperation and Development, and journalists over the last two decades as a consequence of the perceived abuses of corporation tax by companies based in the UK and elsewhere, and most particularly the abuse perpetrated by those multinational corporations that have made use of tax havens to reduce their corporation tax liabilities.

As a result of this focus of attention considerable changes to the international aspects of this tax have occurred in recent years including:

1. The introduction of country-by-country reporting[128] by the OECD[129] requiring that multinational corporations report their results to their tax authorities based on the jurisdictions where they make their sales, employ their staff, engage their assets, record their profits and pay their taxes. This makes the artificial relocation of profits between high and low tax jurisdictions harder to achieve.

2. Automatic information exchange from many tax havens to countries like the UK of data on companies located in those places controlled by people who are UK tax resident, again making the use of tax haven locations much harder for tax abuse purposes.

3. The introduction of minimum global corporation tax rates for a limited range of very large multinational corporations by the Organisation for Economic Cooperation and

[126] https://www.gov.uk/government/statistics/corporation-tax-statistics-2022 table 10

[127] See https://taxingwealth.uk/2023/09/22/reforming-the-administration-of-corporation-tax-in-the-uk-might-raise-at-least-6-billion-of-tax-a-year/ This information is based on the companies that do pay tax: evidence suggests that HM Revenue & Customs do not know how many should.

[128] First designed and then campaigned for by the author of this report. https://www.internationaltaxreview.com/article/2a690uzo3gga4tnxell34/no-9-richard-murphy

[129] https://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.htm

Development in 2024, again reducing the risk of artificial profit relocation to low tax jurisdictions[130].

As a result of these significant changes, it is likely that the rate of such abuse has reduced significantly, even if this fact has yet to be acknowledged by many tax justice campaigners. As a consequence, little focus is given to the international dimensions of corporation tax in this report. Existing changes to the international corporation tax system need to take affect and be properly appraised before further recommendations should be made in this area. Instead, attention is given to three particular issues of concern with regard to domestic corporation tax within the UK. These are now considered to be of much higher priority if the obvious failings of this tax within the UK taxation system are to be properly addressed.

Recommended reform to UK corporation tax.

Three major reforms are suggested in this section of the Taxing Wealth Report 2024.

Firstly, the administration of UK corporation tax requires substantial reform. Although there are more than five million companies in corporation in the UK only about half of these submit a corporation tax return to HM Revenue & Customs each year, and a very large number of these report that they make no profit, with no enquiry being made of them as a consequence. There appears to be an extraordinary assumption within the UK tax system that those who have incorporated UK based companies are inherently tax compliant and so do not need to report their activities. Nor are they already worthy of much investigation.

This is despite the fact that the evidence of tax losses, particularly from smaller companies, very clearly indicates that these companies are widely used for the purposes of tax abuse, as is noted in HM Revenue & Customs' own tax gap reporting, as noted above. In this case the Taxing Wealth Report 2024 recommends that:

- Every company registered in the UK be required to submit a corporation tax return each year.
- If it fails to provide that information then those personally responsible for that failure – including all company directors - should be automatically held personally liable for any tax losses arising to HM Revenue & Customs by the company.

[130] https://www.oecd.org/tax/inclusive-framework-releases-new-multilateral-convention-to-address-tax-challenges-of-globalisation-and-digitalisation.htm

- Automatic information exchange should take place between the UK's banks and HM Revenue & Customs so that information is provided by those banks, and maybe other financial services providers on:

    - Every UK company for which they maintain a bank account.
    - The level of deposits received in that account in an annual period.
    - The company's bank balance at the close of any nominated accounting period.
    - The names and addresses of those whom the bank thinks runs the company.
    - The address from which the bank thinks the company trades.

- Based on this information, and assuming that the company does not provide alternative data, HM Revenue & Customs will be able to work out the approximate tax liability owed by a company in the absence of other data and then assess that sum upon those responsible for the administration of that entity, who would then be personally liable for settlement. It is suggested that this would massively reduce the scale of tax abuse taking place through the use of UK limit to companies and raise potential revenues of at least £6 billion per annum. The arrangement would also save HMRC considerable time by confirming which companies are also really likely to be dormant and so not worth the effort of investigating.

Secondly, in a related recommendation, it is proposed that the UK's Companies House should be reformed to improve the quality of the data that it collects from companies in the UK. Although some changes in this respect have been enacted at the beginning of 2024 there is a serious concern, based on behaviour in response to past reforms, that the requirements to file additional information now put in place will be ignored by many companies, their directors and shareholders, and those who represent them, and that information to ensure the taxes collected will not be recovered from those who are responsible to make such payments. This deficiency in company law administration in the UK has been a major impediment to effective tax collection and has facilitated tax abuse in the UK over a significant period of time and does now need to be addressed. It is estimated that the proposed reforms of Companies House will raise £6 billion of corporation tax per annum.

Finally, although there has been a recent, and welcome, re-introduction of the differential in corporation tax rates between large and small companies that current differential remains relatively modest at just six per cent, with many incentives that are available to large companies considerably reducing the effective differential. There are very strong economic arguments for re-creating a differential in these rates of at least ten per cent, which differential existed between these rates over many years throughout the history of corporation tax in the UK. It is suggested that if this differential of 10% was created then an additional £7 billion of corporation tax per annum might be collected in the UK.

Other related reforms

The above being noted, those sections of this report dealing with tax gaps, tax spillovers and the administration of HM Revenue & Customs should also be noted as each has a significant bearing on the administration of corporation tax in the UK. The use of limited companies has almost significantly contributed to tax losses arising from tax evasion and avoidance in the UK, and the under-resourcing of HMRC has facilitated this process. If corporation tax losses are to be properly addressed, then the issues noted in this report with regard tax of administration also need to be taken into consideration.

It is also appropriate to note the recommendation for the reintroduction of an investment income surcharge made in the income tax section of this report as this will impact the use of limited companies in the UK.

Chapter 9.1

Corporation tax – Recommendation 13

Reforming the administration of corporation tax

Brief Summary

This chapter proposes that:

- The administration of corporation tax by HM Revenue & Customs needs to be substantially reformed if the abuse of limited liability companies to illicitly accumulate untaxed wealth is to be prevented.

- The current lax regime for the requesting of a corporation tax return by HM Revenue & Customs should be replaced by a mandatory obligation that a company file such a return with attached accounts each year.

- That the directors and principal shareholders of a company should be required to prove their identities and current address to HM Revenue & Customs and Companies House annually.

- That the directors and principal shareholders of a company failing to supply a corporation tax return should be liable for the penalties due as a result of that failure. The latest available research on this issue suggests that 99 per cent of those penalties are unpaid at present.

- The directors and principal shareholders of a company should be liable for any tax of any sort owing by it if unpaid by the company itself unless they can demonstrate a clear commercial reason for which they were not responsible that explains the inability to pay.

- Any banker, lawyer, accountant or other person in the financial services industry acting on behalf of a company who is required by law to prove the identity of that company's directors and principal shareholders shall be required by law to provide an annual declaration to HM Revenue & Customs and Companies House confirming those identities, or a statement as to why they are unable to do so.

- Any bankers and accountants supplying services to or acting on behalf of any company in a year should be required by law to supply details of the total payments received in that company's bank accounts during each of its financial years within nine months of the end of that period so that in the absence of a corporation tax HM Revenue & Customs can raise an estimated assessment of those taxes that they think it might owe for which the directors and principal shareholders shall be liable unless they can disprove that claim.

- That these proposals should considerably reduce the amount of tax evasion in the UK, which HM Revenue & Customs estimates to be £19 billion per annum, but which might be very much higher, most of which will be undertaken through limited liability companies. A revenue estimate of £6 billion is estimated to arise as a result of these changes.

- These proposals might also considerably reduce the scale of fraud perpetrated on the government each year, which is estimated to be between £33 billion and £58 billion per annum excluding Covid related issues. No revenue estimate is made for the likely gain resulting.

- The illicit accumulation of wealth in the UK that contributes significantly to inequality might be reduced as a consequence of these changes.

The proposal	To reform the administration and enforcement regimes of corporation tax in the UK when there is considerable evidence that these are insufficiently robust at present, resulting in the trading activities of many companies going undetected with significant loss of tax almost certainly arising as a result. This can lead to the untaxed

	accumulation of wealth which is deeply destructive of social and tax justice within the UK economy as a whole.
Reason for the proposal	1. Reduce the risk of the abuse of limited liability status to avoid taxation obligations. 2. Reduce tax gaps, and so increase tax paid by those with wealth in the UK who take most advantage the opportunities provided by the incorporation of companies within the UK. 3. Increase the effectiveness of resource usage by HM Revenue & Customs in the management of tax risk arising from the operation of limited liability companies. 4. Improve taxpayer accountability and compliance, most especially with regard to the use of limited liability entities. 5. Increase horizontal tax equity, which can be undermined by the abuse of limited liability companies. 6. Increase vertical tax equity, which can be increased by the use of limited liability companies by those with wealth. 7. To reduce the tax spillover effect that existing rates of capital gains tax create when compared to those charged under income tax rules. 8. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be significant, which is why it is being made. The amount of tax abuse, including significant tax evasion, that is being undertaken through the medium of limited

	liability companies cannot be known, but is likely to be very significant for reasons noted below. Reducing the abuse of limited liability companies to prevent the accumulation of untaxed wealth must be a significant objective of any programme with regard to the taxation of wealth. Unlike almost all the other recommendations made in the Report of which this note forms a part, the issue addressed here focuses on tax evasion and unpaid tax, which even in the estimate of HM Revenue & Customs might amount to at least £19 billion a year this is significant[131]. When they also estimate that 56 per cent of the tax gap relates to the activities of smaller business, most of which will be operated via limited liability companies, the scope for tax recovery amounts to many billions of pounds per annum[132], most especially when it is considered likely that the majority of tax abuse in the UK is undertaken through the medium of private limited companies. A target of at least £6 billion of additional revenue is proposed.
Ease of implementation	The changes proposed will take some time to implement and will require the expenditure of significant political capital by any government seeking to implement the proposed changes since opposition is likely to be significant.
Likely difficulties that might result from implementation	As noted above, there is likely to be significant opposition to these changes although they should be relatively easy to legislate and implement at a technical level.

[131] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx table 7.1 interpreted by author.

[132] Table 1.4 interpreted by author from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx

Likely time required to implement the change	A process likely to take a number of years.
Consultation period required.	At least a year as opposition is likely and will have to be noted.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/22/reforming-the-administration-of-corporation-tax-in-the-uk-might-raise-at-least-6-billion-of-tax-a-year/

Background

Corporation tax is charged on the profits and gains made by limited liability companies and some other entities in the UK.

Like most UK taxation liabilities, corporation tax is charged on the basis of self-assessment. In other words, a company that has a tax liability arising as a result of its trading activity has an obligation to report this fact to HM Revenue and Customs and to then compute its tax liability owing and to supply accounts to support that computation.

As data from HM Revenue and Customs shows[133], the number of companies making declaration of tax liabilities in the UK has arisen over time:

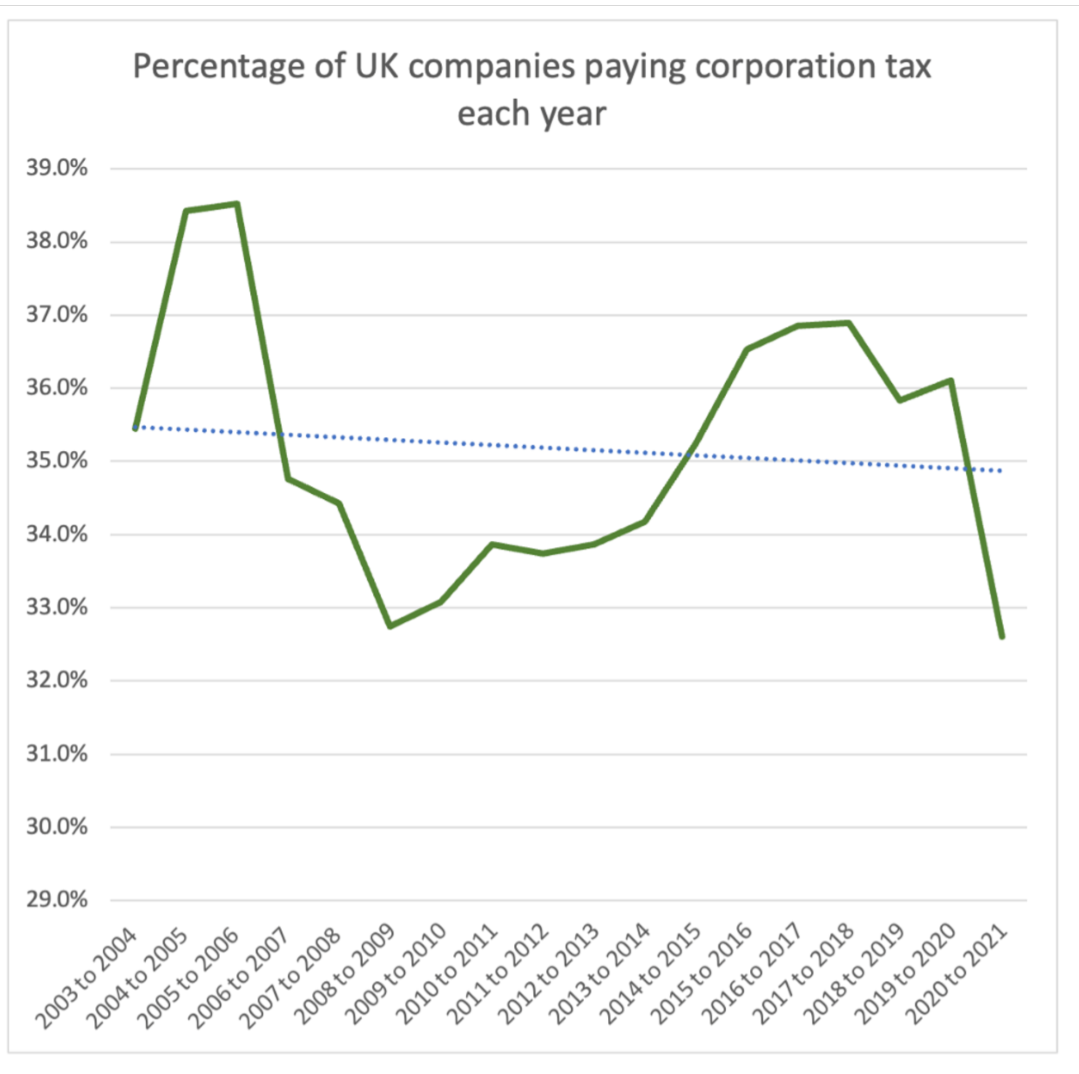
Number of companies making corporation tax payments

Financial Year	Corporation Taxpayers
2003 to 2004	715,000
2004 to 2005	830,000
2005 to 2006	895,000
2006 to 2007	885,000
2007 to 2008	925,000
2008 to 2009	890,000

[133] https://www.gov.uk/government/statistics/numbers-of-taxpayers-and-registered-traders

2009 to 2010	870,000
2010 to 2011	910,000
2011 to 2012	965,000
2012 to 2013	1,031,000
2013 to 2014	1,111,000
2014 to 2015	1,221,000
2015 to 2016	1,344,000
2016 to 2017	1,436,000
2017 to 2018	1,488,000
2018 to 2019	1,506,000
2019 to 2020	1,571,000
2020 to 2021	1,538,000

As a proportion of the total number of companies in the UK each year, the number declaring a tax liability is, however, surprisingly small as this chart demonstrates:



Sources, HMRC[134] and Companies House[135] and author's calculations

Whilst this data is slightly distorted by the steady increase in the number of companies in the UK over time, (this being a factor because companies do not pay corporation tax in the first year of their existence), this is insufficient by self to explain this very low proportion of the overall number of companies in existence that are not paying tax.

That increase in the number of companies not making corporation tax declarations in the UK is marked:

Number of companies not making a corporation tax declaration

2003 - 2021

Financial Year	Number of companies not paying tax
2003 to 2004	1,301,700
2004 to 2005	1,330,200
2005 to 2006	1,428,100
2006 to 2007	1,661,200
2007 to 2008	1,761,500
2008 to 2009	1,828,200
2009 to 2010	1,759,884
2010 to 2011	1,776,902
2011 to 2012	1,894,666
2012 to 2013	2,013,710
2013 to 2014	2,139,325
2014 to 2015	2,243,155
2015 to 2016	2,334,860
2016 to 2017	2,460,755
2017 to 2018	2,545,355
2018 to 2019	2,696,044
2019 to 2020	2,779,913
2020 to 2021	3,178,126

Sources: as previously noted

Whilst it is undoubtedly true that there are a significant number of companies in the UK that can be a technically described as 'dormant', meaning that the do not trade, it is also unlikely

[134] https://www.gov.uk/government/statistics/numbers-of-taxpayers-and-registered-traders

[135] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023

that there are sufficient such companies to explain the low number apparently making declaration of corporation tax liabilities.

Dormant companies include those companies incorporated to protect a trading name, or to protect an intellectual property right, or because liabilities that might arise as a result of their being dissolved cannot be reliably estimated, or because somebody simply had a bright idea which never happened, but the company formed to undertake it has yet to be dissolved.

All of these are entirely honest explanations for the existence of such companies, but given the ease with which companies can be both incorporated and dissolved in the UK, and in the absence of any effective form of regulation on their activities, (which issues are noted elsewhere in the series or notes making up the Taxing Wealth Report 2024, when considering the relationship between the activities of Companies House and HM Revenue & Customs) it is also very likely that a significant number of companies are incorporated in the UK each year for the purposes of undertaking fraudulent trades.

Discussion

The failure to detect this fraudulent trading is largely due to failings on the part of HM Revenue & Customs. Research undertaken in 2014 (since when there have been no major changes in HMRC practice) suggested that[136]:

- HMRC did not requested corporation tax declarations from approximately 25 per cent of all companies because those companies had stated at some time in the previous five years that they did not trade.
- HMRC accepted that claim at face value in almost every case.
- HMRC also appears to accept the claim made by the 19 per cent of all companies that submitted a corporation tax return who said that they had not traded in a period at face value in almost every case.
- On average 25 per cent of all corporation tax returns requested by HM Revenue & Customs were not submitted without them making any further inquiry.
- More than 99 per cent of the penalties imposed by HM Revenue & Customs for failing to submit corporation tax returns were not paid, suggesting that the companies not

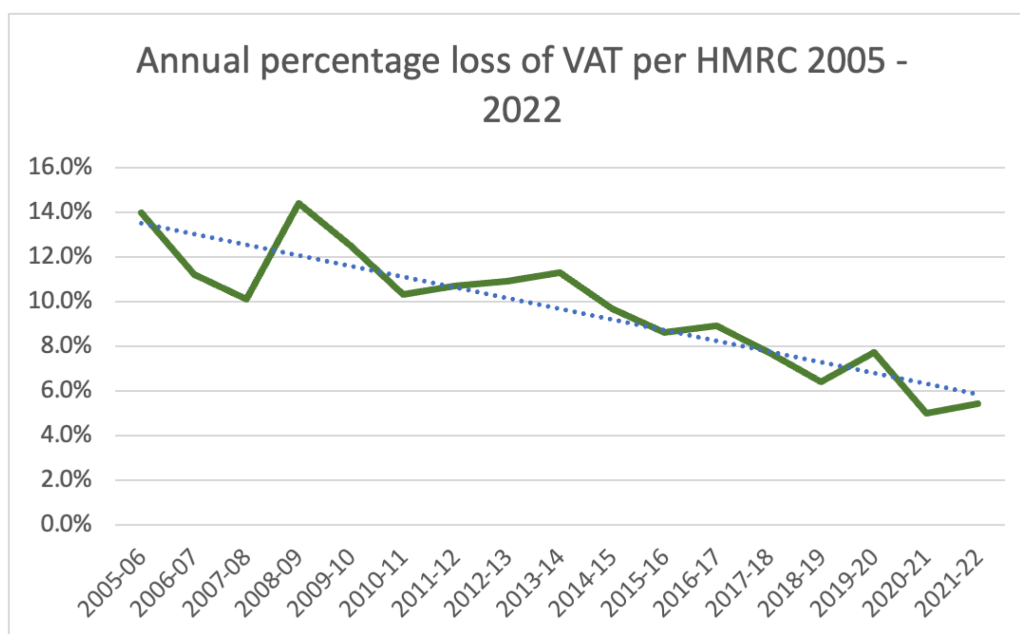
[136] http://www.taxresearch.org.uk/Documents/Intheshade.pdf

doing so had, in effect, been abandoned by their directors who had no further intention of complying with their legal obligations.

In essence, submitting a corporation tax return had as a consequence all the appearance of being a voluntary activity on the part of those doing so.

The number of companies that might be abusing this situation cannot be known for certain. However, when it is known that in the year to March 2023 there were 585,807 companies dissolved in the UK[137] and that of these 557,096 were 'struck off' the register of companies i.e. they were dissolved either because the company applied for this to happen, suggesting in the process that they had no liabilities owing (to secure which striking off they pay a fee of £8), or they were removed by Companies House because of the company's failure to file either an annual confirmation statement or annual accounts, the risk that a significant number of the companies that are dissolved without any form of inquiry as to their activities prior to dissolution being made might have been engaged in illicit activity is likely to be high.

This is a concern reinforced by the scale of VAT loss in the UK as evidenced by the UK tax gap:



Source: HM Revenue & Customs[138]

[137] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023

[138] https://www.gov.uk/government/statistics/measuring-tax-gaps-tables

As the data shows, over the period for which UK tax gap data is available, the total likely VAT lost through what is recognised by HM Revenue & Customs to be very largely fraudulent or criminal activity has exceeded ten per cent per annum on average at a total cost of £180 billion, which is a sum in excess of £10 billion per annum.

The latest fall in losses is claimed to be due to better detection and changes in methodology, although whether this is true is open to some doubt given that (as noted elsewhere in the Taxing Wealth Report 2024) HM Revenue & Customs has now almost entirely ceased on-site reviews of VAT registered person's books and records and relies almost entirely on digital audits. The apparent improvement in the tax gap might simply be due to the fact that this methodology does not identify the rate of error that tax inspectors sitting in company premises once did.

It is important to note that even if the current VAT gap is correct and just £7.6 billion of VAT is currently lost per annum per annum for this reason, this inevitably means that the gross income that would generate this loss, which amounts to at least £38 billion per annum, would also give rise to other tax losses. Assuming that this £38bn should have had income tax and national insurance paid on its transfer to the persons who benefit from that illicit sum then an amount likely to be not less than 45 per cent of this gross value might also be lost for tax purposes, meaning that a further £17 billion of tax might be unpaid. HM Revenue & Customs do not make this obvious extrapolation in their estimates of VAT gaps, which is one of the reasons why their accuracy is open to doubt.

Given that it highly likely that most of this fraudulent activity will take place through limited liability companies it is clearly worth investing more in the administration of the UK's corporation tax system, and the related activities of Companies House with whom these companies are registered.

Recommendations

There are a number of very obvious solutions to this problem of failing to properly identify those companies that have traded in the UK and that might as a result have an undeclared liability to pay a range of UK taxes, including VAT, PAYE (encompassing both income tax, and national insurance) and corporation tax. All of the following are recommended:

1. Requiring that no company be registered in the UK without its directors and controlling shareholders having first proved their identities to the UK's Companies House for money laundering purposes, with that proof of identity being required to be renewed annually.

2. That every company in the UK be required to submit a corporation tax return annually with the directors and principal shareholders[139] having joint and several liability for penalties owing if the company does not fulfil this obligation.

3. Making the directors and principal shareholders of a company jointly and severally liable for any tax, interest and penalties owing by it unless those persons can demonstrate that:

    a. The failure arose for reasons beyond their control such as a commercial failure of the business that could not have been anticipated, or
    b. The company has made payment.
    c. HM Revenue & Customs shall be required to use best endeavours to recover such sums owing, including on those occasions when the company shall fail to make returns when the information referred to in the following paragraphs might be used to raise estimated assessments of such liabilities owing, which estimates sums the directors and principal shareholders shall have the legal obligation to disprove if they wish to reduce the sum due by them.

4. Requiring that any bank or professional accountant or bookkeeper in private practice who might be engaged to deal with the affairs of a company shall each year, within nine months of the accounting reference date of that company, file a return with HMRC, with regard to its affairs declaring at least one of:

    a. Its turnover for accounting purposes, as reconciled with its bank records.
    b. The sum deposited by the company in each of the accounts that it might maintain with the bank in question.
    c. A statement that this return cannot be made, with reasons given.

5. Requiring that any bank, accountant, bookkeeper, lawyer, or registered financial advisor, who is required to prove the identity of their clients for the purposes of money laundering regulations shall file annually with both HM Revenue & Customs and Companies House a statement of those persons whose identities they have verified as a consequence of them being directors or principal shareholders of every entity that they have advised during the course of a year, or they shall provide a statement saying why they are unable to do so, with detailed reasons being given.

Supporting notes

[139] It is suggested that anyone with a holding of more than 10 per cent be a principal shareholder.

It is likely that many company directors, banks, accountants, bookkeepers and other financial advisors will object to the demands made of them by these proposed regulations. It would be inappropriate for them to do so for two reasons.

Firstly, limited liability was never granted as a right to an individual. It was, and remains, a privilege that affords a company considerable advantages if used honestly, which will remain the case despite these proposals. Preventing the abuse of limited liability by those who use it with fraudulent intent is to the benefit of all honest traders by reducing the risk to them from competition from dishonest traders. The benefit of that protection is worth the costs imposed by these suggested regulations.

Secondly, the proposed data to be supplied by those in the financial services industry in the UK imposes an obligation no more onerous than that now imposed by international automatic information exchange regimes. These require that those in the financial services sector in tax havens and other places supply extensive data to the domestic tax authorities of those persons to whom they provide services, whether directly or as a result of their association as directors, principal shareholders or indirect beneficiaries with the operations of limited companies registered in such places. If this data can be required from tax havens there is no reason why it cannot be required domestically to tackle what is, almost certainly a much bigger loss of taxation arising within the domestic UK economy.

Potential tax saving

It is aways hard to estimate the tax benefit that might arise from measures designed to prevent tax evasion. However, assuming that the total losses from tax abuse of the type identified is not less than £25 billion per annum (approximately £8 billion of VAT and £17 billion of other taxes) then it is quite reasonable to target a yield of at least 25 per cent of this sum, or at least £6 billion) given the scope of the proposed regulations to improve the administration of corporation tax, although not all of this will be corporation tax.

More might be achievable given time, whilst a secondary benefit will arise from a reduction in fraud, which the National Audit Office[140] has estimated costs the government between £33.2 billion and £58.8 a year in lost government spending and income. Almost all of that fraud will be undertaken by limited companies that might not be declaring their incomes at present. No estimated gain is attributed to this potential benefit at present. However its importance in the context of the Taxing Wealth Report 2024 cannot be overstated since it will reduce the illicit accumulation of untaxed income in the UK which makes a significant contribution to inequality in this country.

[140] https://www.nao.org.uk/press-releases/tackling-fraud-and-corruption-against-government/

Chapter 9.2

Corporation tax – Recommendation 14

Recreating a significant differential between large and small company rates of corporation tax

Brief Summary

This chapter suggests that:

- The rate of corporation tax payable by smaller companies in the UK should be aligned with the basic rate of income tax, which is 20 per cent at present. This would increase their current tax rate by 1 per cent.

- That larger companies in the UK should pay corporation tax at a rate 10 per cent higher than smaller companies because:

    - They have higher rates of profitability than their smaller rivals, usually because of their ability to extract monopoly profits from consumers because of their market strength.
    - They have lower costs of capital than smaller companies because they tend to be able to borrow more at lower cost than smaller companies, which ability also allows them to invest more than their smaller rivals which in turn tends to reduce the tax rates that they might otherwise pay.
    - The cost of proper tax compliance is proportionately higher for smaller companies than larger ones, meaning that they should enjoy at least one lower tax rate as a result to compensate them for this.
    - Smaller companies need to retain more of their profits than their larger rivals if they are to invest, and the rate of return on investment

by smaller companies tends to be high for the benefit of the UK economy as a whole. o Larger companies are larger polluters and pose a greater threat to biodiversity than smaller companies and so should pay more corporation tax as a result when there is at present no other tax to reflect this fact. • There would be only limited behavioural responses to this proposal because it only applies to UK generated profits and it is increasingly difficult to relocate profits to other countries or tax havens for taxation purposes. • As a consequence, it is likely that this proposal might raise an additional £6 billion per annum from large companies and more than £1 billion from smaller companies, providing total additional revenues of £7 billion per annum as a result.

The proposal	To change the UK's corporation tax system so that the rate of tax paid by a company, or group of companies, depends upon the rate of profit that it makes, with a progression in the rate paid as the amount of profit increases.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the low rates of corporation tax payable by larger companies in the UK. This then become a source of subsidy for the growth in the wealth of those with the means to own shares in these larger companies. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that existing rates of corporation tax create when compared to those charged under income tax rules.

	4. To reduce the rate of tax avoidance in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be small: UK corporation tax rates only apply to the UK profits of UK based groups of companies and as such there will be little incentive for them to relocate as a result of the proposed changes, whilst measures to prevent profit shifting by multinational corporations are now considerably more sophisticated than they were even a decade ago. It is likely that, taking into account the recent increase in the corporation tax rate for larger companies, that this proposal will raise £6 billion of additional tax from larger UK resident companies and more than £1 billion from smaller companies because of the suggested alignment of their tax rate with the basic rate of income tax. Total estimated additional tax revenues are, in that case, £7 billion per annum.
Ease of implementation	Relatively straightforward, not least because the UK had tiered rates of corporation tax until 2015 and they have, to some extent, already been reintroduced meaning that there is considerable familiarity with such a system.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short, largely because of the familiarity that already exists with multiple rates of corporation tax.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/25/increasing-the-corporation-tax-rate-for-the-uks-largest-companies-could-raise-7-billion-a-year-in-tax/

Background

The UK's corporation tax was introduced in 1965 at the same time as the country also saw the introduction capital gains tax. Both taxes were introduced by a Labour government that was anxious to both modernise the UK's tax system and to remove from it opportunities for abuse that existed in the system that they had inherited from the previous Conservative government.

Corporation tax is a tax that is primarily charged on the income, gains and profits of private limited liability companies and public limited companies (PLCs). It can also be charged on the income of some unincorporated bodies, but this is incidental to its main function.

Rates of corporation tax

When corporation tax was first introduced all companies paid tax at the same rate of around 40% on their profits arising during the course of a year.

In 1973, that changed. Companies that were defined as being small paid tax at a rate that was usually 10% less than that imposed on large companies.

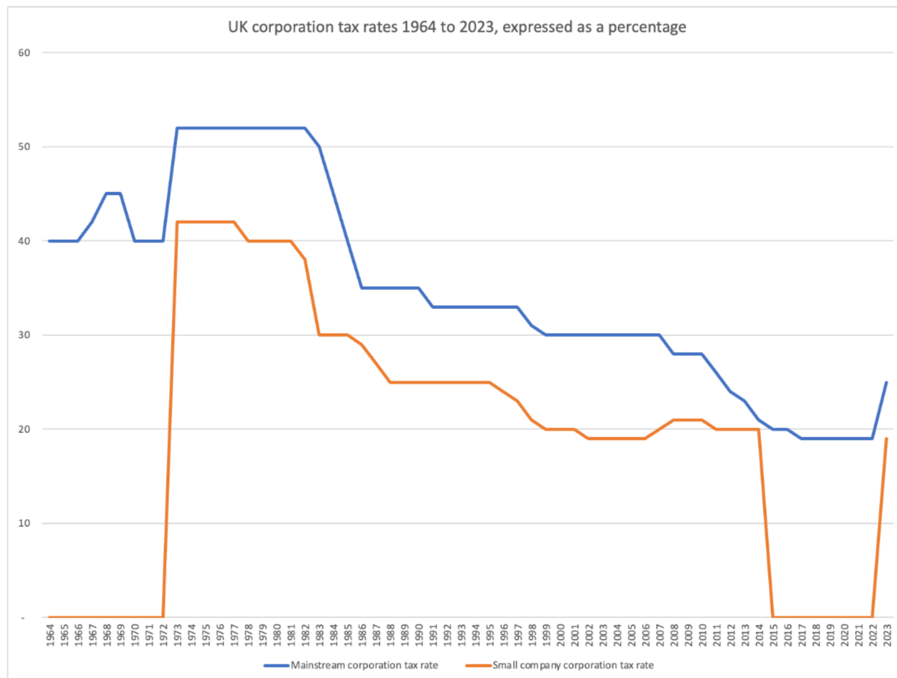
It should be noted that the difference between a large and small company was based upon the level of profit that was generated by a company for corporation tax purposes during the course of a year. As a consequence, a company with a low turnover but with very high profitability could be defined as a large company, whilst a very large company that made a very small profit could be defined as a small company. Groups of companies were treated as single entities for this purpose to prevent abuse. This definition has persisted to date.

As will be noted from the chart below, opportunity was taken when the small companies rate of corporation tax was introduced to increase the rate of tax charged on the profits of large companies, which in the 1970s exceeded 50 per cent.

Corporation tax rates fell steadily during the early years of Margaret Thatcher's administration in the 1980s. They then broadly flatlined at between 35% and 30% for more than two decades, until a further steady decline started just before the global financial crisis in 2008,

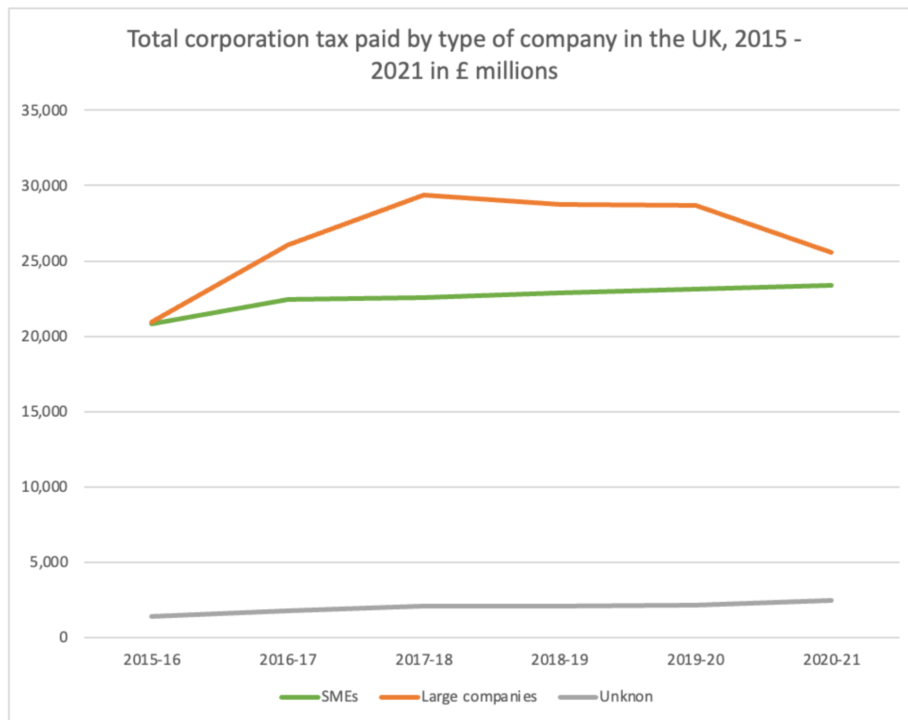
with corporation tax rates reaching their lowest ever level at 19% from 2017 onwards, only recently having been raised again.

It will be noted that from 2015 to 2022 small companies paid corporation tax at the same rate as large companies, i.e. at 19% for most of this period. In 2023 corporation tax rates for large companies have been raised to 25%, but small companies still pay tax at 19%.



Sources: various from data collected by the author over time

In recent years, the estimated amount of corporation tax paid by large and smaller companies, as identified by HM Revenue and Customs to the best of their ability given that these terms had little relevance to liabilities owing during the course of this period, were as follows:



Source: HM Revenue & Customs and author calculations[141]

To put these numbers in context the number of large and small companies and the average tax liabilities that they settled in each of the years noted were as follows:

	Number of large companies	**Total tax paid by large companies**	**Average tax paid by each large company**	**Number of SMEs**	**Total tax paid by SMEs**	**Average tax paid per SME**	**Multiple: large to small company tax payments**
	Number	**£'million**	**£'million**	**Number**	**£'million**	**£**	**Ratio**
2015-16	18,911	20,960	1.108	1,293,868	20,843	16,109	68.80
2016-17	18,982	26,032	1.371	1,384,777	22,435	16,201	84.65
2017-18	19,576	29,396	1.502	1,434,347	22,561	15,729	95.47
2018-19	19,147	28,733	1.501	1,453,288	22,866	15,734	95.38
2019-20	17,886	28,678	1.603	1,512,888	23,154	15,305	104.77
2020-21	18,432	25,552	1.386	1,461,466	23,365	15,987	86.71

Source: HMRC and author calculations[142]

As this table shows, in most years more than half of all corporation tax payments in the UK are made by a small number of very large companies. This is because of the massive

[141] https://www.gov.uk/government/statistics/corporation-tax-statistics-2022 table 10
[142] https://www.gov.uk/government/statistics/corporation-tax-statistics-2022 table 10

imbalance in their profitability when compared to that of small and medium sized companies that pay tax[143].

Discussion

The idea implicit in the removal of the differential between the tax rates for large and small companies from 2015 to 2022 was that all companies, irrespective of size, should be treated equally within the UK tax system. There are very good reasons for disagreeing with this suggestion.

As is apparent from the data noted above, large and small companies in the UK are very different in their size, as are their resulting tax liabilities.

There are also a number of substantial differences in their trading situations that justify a differential in the corporation tax rates that should be applied to their profits arising during the course of a period.

Firstly, large companies enjoy a number of significant trading advantages compared to their smaller rivals. In particular, many large companies will enjoy the benefits that result from having recognised brands or significant market control, meaning they tend to enjoy higher rates of profitability than lower companies because their trading situations provide them with opportunity to extract what economists describe as economic rent from their customers. That rent might also be described as monopoly profit in some cases because these enterprises often face only limited competition in the localities in which they operate because of their size or familiarity. These additional profits justify the imposition of higher rates of tax on these companies.

Secondly, larger companies also benefit from much lower costs of capital when compared to smaller companies. What this means is that they can borrow more easily and in proportionately larger amount than small companies and that they will usually pay significantly lower rates of interest on those borrowings than will their smaller arrivals. Not only does this increase the rate of profitability of larger companies, it also means that they have access to more funds for the purposes of investment than their small rivals. Given the incentives provided for investment within the tax system this means that larger companies can often reduce their actual tax rates quite considerably as a result of making such

[143] See https://taxingwealth.uk/2023/09/22/reforming-the-administration-of-corporation-tax-in-the-uk-might-raise-at-least-6-billion-of-tax-a-year/ This information is based on the companies that do pay tax: evidence suggests that HM Revenue & Customs do not know how many should.

investments, whatever the headline rate of tax. As a consequence, a tax differential between larger and smaller companies is justified.

Thirdly, the costs of tax administration in proportion to profits generated are likely to be higher in smaller companies than larger companies, particularly if diligently undertaken. For that reason, a lower tax rate should be applied to smaller companies to compensate them for their higher overall cost of tax compliance.

Fourthly, because of their difficulty in raising capital, and most, especially because it is hard for smaller companies to raise capital from third-party shareholders, most small companies in the UK are dependent upon retaining profits generated to fund their future development and growth. This is not necessarily the case for larger companies[144]. Given that this growth potential in smaller companies is essential to the long-term prosperity of the UK a lower rate of corporation tax for smaller companies is justified because of the potential overall increased return to society that might result from increased investment by smaller companies that are able to retain a larger proportion of their profits.

Finally, there is evidence to suggest that large companies emit proportionately more carbon and cause greater biodiversity loss than do small companies. As a consequence, if net zero is to be achieved it is appropriate that large companies make a more significant proportionate contribution to the costs of climate transition. This can be achieved by them making payment of a higher of corporation tax rate in the absence of other taxes to tackle this issue at present.

Recommendation

Taking all these factors into account, it is suggested that the corporation tax rate payable by small companies in the UK should be aligned with the basic rate of income tax at 20% and that the rate of corporation tax payable by large companies should be 10% more, as was often the case in the past, suggesting that the rate to be used for larger companies should be 30%, which is still comparable to that payable in many other countries, tax havens apart.

Likely revenue implications

Whilst there would be significant objection from large companies to this proposal, in reality, the UK rate of corporation tax is only applied to their profits that arise in the UK in most cases. Since the majority of large companies based in the UK generate most of their profits outside this country this proposal will not reduce the attractiveness of the UK as an international location.

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[144] See https://productivityinsightsnetwork.co.uk/app/uploads/2021/06/PIN-Report-29-6-21-FINAL.pdf

It is also the case that very few large companies pay corporation tax at the headline rate at present because so many tax reliefs and allowances are available to them. This means that in the vast majority of cases their overall tax rates are quite several percentage points below the headline rate, meaning that this suggestion will only leave the effective rate of corporation tax due by these companies at rates comparable to those payable in many competitor nations, tax havens apart.

For these two reasons, it is unlikely that there will be significant behavioural responses as a consequence of this proposed change. In that case, it is reasonable to cautiously extrapolate existing tax yields for both large and small companies for the proposed additions in rate that are suggested in this chapter. In the case of large companies, this will increase the rate from 25 per cent to 30 per cent, and in the case of small companies it will increase the rate from 19 per cent to 20 per cent. Plausible estimates of revenues arising might be £6 billion in the case of large companies and at least £1 billion in the case of smaller companies. A total of £7 billion is, as a consequence, suggested as the combined revenue yield arising from these proposals.

Chapter 9.3

Corporation tax – Recommendation 15

Reforming the administration of Companies House

Brief Summary

This chapter proposes that:

- Companies House is an almost wholly ineffective regulator of limited liability companies in the UK, many of which might be used to facilitate tax abuse and fraud.

- This is profound concern to the operation of markets in the UK, most especially when there are more companies incorporated in the UK each year than there are live births.

- There are numerous reasons for this failure on the part of Companies House, including:

    - The ease with which companies can be incorporated without proof of the identity of those doing so necessarily being required.
    - The incredibly cheap regulatory fees payable in the UK, which deny resources to Companies House to regulate companies.
    - The failure of Companies House to require accounts complying with either company law or accounting standards on public record, and their failure to address failures in this regard when they are drawn to their attention.
    - The lax attitude that Companies House has towards the striking off of companies from the register that they maintain when companies are in default of their legal obligations, which failure on their part

facilitates the use of limited liability companies by fraudsters, whether with regard to tax or otherwise.
  - The failure of Companies House to prosecute in the case of most corporate failures to provide information that should be submitted to them by law.

- The cost of this failure in terms of tax lost and in terms of fraud facilitated cannot be known, but when the former is conservatively estimated to cost £19 billion a year and the latter has been estimated to have a further cost to the government exceeding £30 billion per annum and to the private sector of in excess of £150 billion per annum[145] the scale of abuse facilitated by almost wholly unregulated limited liability companies within the UK economy is so large that it is hard to avoid the conclusion that Companies House is the facilitator of a criminogenic environment within the UK economy, even if inadvertently.

- To address this issue a series of radical reforms are proposed including:

  - Annual checks on the identities of all directors and significant shareholders involved with UK companies.
  - A requirement that UK companies have a share capital commensurate to their level of trading and that shareholders should have unlimited liability to the extent that this capital is not made available by them.
  - That the full details of all directors of a company should be available to Companies House on all occasions and should be on public record unless a case for withholding information can be proven.
  - That the full trading addresses from which the company operates should be recorded on public record.
  - That the full accounts of all companies as due to its shareholders should always be available on public record.
  - That the directors and principal shareholders of a company that is dissolved without filing full accounts to the time when application for dissolution is made, including a creditors list, shall lose the right to limited liability with regard to any debts owing at that time.

[145] https://issuu.com/petersandpeters.com/docs/annual_fraud_indicator_report_2023

- That although the Taxing Wealth Report 2024 has already estimated that maybe £6 billion of additional tax might be collected a year as a result of tackling deficiencies in the administration of the UK's corporation tax system a further similar sum might be raised by these proposals because of the limitations in other frauds that they might facilitate.

- The cost of these extra safeguards should be covered by increasing the currently minimal fees charged by Companies House.

The proposal	To reform the administration and enforcement regimes of the UK's Companies House and to require the supply of additional data concerning the commercial activity of companies to Companies House by the UK's commercial banks and others in the UK's financial services sector.
Reason for the proposal	1. To reduce the risk of the abuse of limited liability status to avoid and evade taxation obligations and other regulatory obligations. 2. To reduce tax gaps, and so increase tax paid by those with wealth in the UK who take most advantage the opportunities provided by the incorporation of companies within the UK. 3. To increase the effectiveness of resource usage by HM Revenue & Customs in the management of tax risk arising from the operation of limited liability companies. 4. To improve taxpayer accountability and compliance, most especially with regard to the use of limited liability entities. 5. To increase horizontal tax equity, which can be undermined by the abuse of limited liability companies.

	6. To increase vertical tax equity, which can be undermined by the use of limited liability companies by those with wealth. 7. To help close the tax evasion and tax avoidance tax gaps. 8. To reduce the tax spillover effect that existing arrangements fort the regulation of companies in the UK create. 9. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be significant, which is why it is being made. The amount of tax abuse, including tax evasion, that is being undertaken as a result of the abuse of limited liability companies cannot be known, but is likely to be very significant for reasons noted below. HM Revenue & Customs estimate the tax loss to be at least £19 billion per annum[146]. Other fraud against the government might exceed £30 billion per annum, of which at least half might well be committed by limited liability companies. In the private sector economy fraud might exceed £150 billion per annum, which will in turn contribute to the UK tax gap, which may well be much bigger than HM Revenue & Customs estimate because of limitations in the methods that they use to estimate that figure as noted elsewhere in the Taxing Wealth Report 2024. Not all of this will be facilitated by those using limited liability companies, but a significant part will be.

146 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx table 7.1 interpreted by author.

	Reducing the abuse of limited liability companies to prevent the accumulation of untaxed wealth must be a significant objective of any programme with regard to the taxation of wealth. Unlike almost all the other recommendations made in the Report of which this chapter forms a part, the issue addressed here focuses on tax evasion and unpaid tax. When HM Revenue & Customs estimate that 56 per cent of the tax gap relates to the activities of smaller business, most of which will be operated via limited liability companies, the scope for tax recovery as a result of the enhanced regulation of limited liability companies amounts to many billions of pounds per annum[147]. This is most especially the case when it is considered likely that the majority of tax abuse in the UK is undertaken through the medium of private limited companies.
Ease of implementation	The changes proposed will take some time to implement and will require the expenditure of significant political capital by a government seeking to implement the proposed changes since opposition to them is likely to be significant. The costs of the proposed changes can easily be covered by increasing the current exceptionally low fees charged by Companies House, where the annual fee for maintaining a company is currently no more than £13 a year in most cases.
Likely difficulties that might result from implementation	As noted above, there is likely to be significant opposition to these changes although they should be relatively easy to legislate and implement at a technical level.
Likely time required to implement the change	A process likely to take a number of years.

[147] Table 1.4 interpreted by author from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx

Consultation period required.	At least a year as opposition is likely and will have to be noted.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/10/18/taxing-wealth-report-2024-reforming-companies-house-might-raise-6-billion-of-tax-a-year/

Introduction

Companies have existed in the UK since the 15th century. Most early companies were associated with the exploitation of monopolies. As such they have been linked to economic abuse for as long as they have existed. The East India Company is an example of one such early entity.

In the UK the company as we now know it is associated with the growth of industry, starting with the development of canal companies in the eighteenth and early nineteenth centuries. The popularity of incorporation grew with the rise of railways in the early nineteenth century. These companies from the early industrial era were incorporated by separate acts of parliament. The Joint Stock Companies Act 1844 first permitted incorporation by registration. From 1855 this was possible with limited liability. As a consequence, the modern company that exists because of its registration by the UK Registrar of Companies (now usually known as Companies House) was born.

In March 2023[148]:

- The total UK company register recorded the existence of 5,116,743 companies, an increase of 4.5% compared with March 2022.

- There were 801,006 company incorporations in the year ending March 2023, an increase of 6.4% compared with the previous financial year.

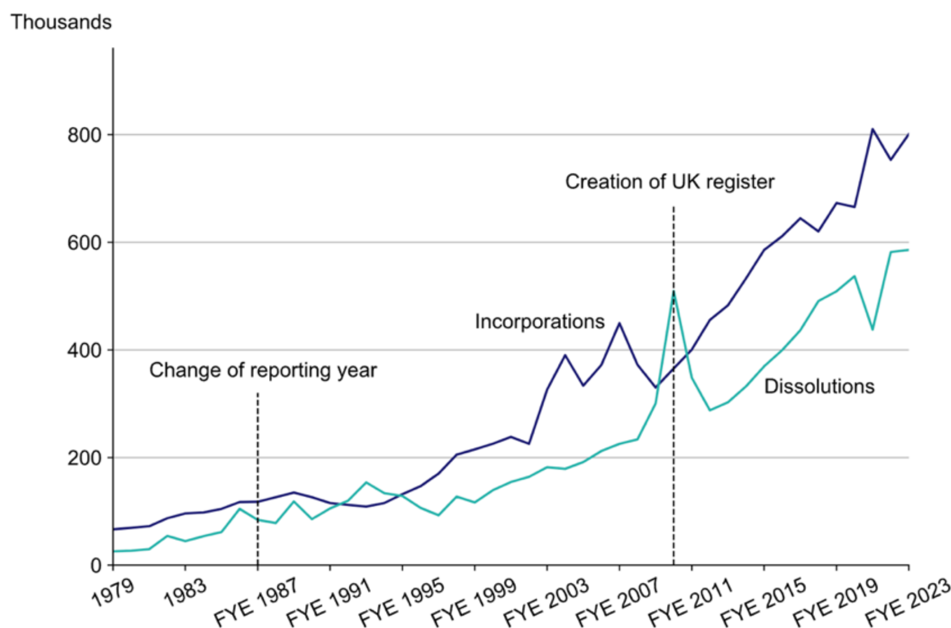
- In that same year there were 585,807 dissolutions, an increase of 0.7% compared with the previous year.

[148] Data from https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023

- The average age of a company on the register at the end of March 2023 was 8.6 years.
- Private limited companies accounted for over 95% of all companies on the register.

To put these figures in context, there were 605,479 live births in England and Wales[149] in 2022. Whilst the figures for companies cover the whole UK, what is apparent is that there are more companies created in the UK at present than there are live births. Thankfully, the life expectancy of children is longer.

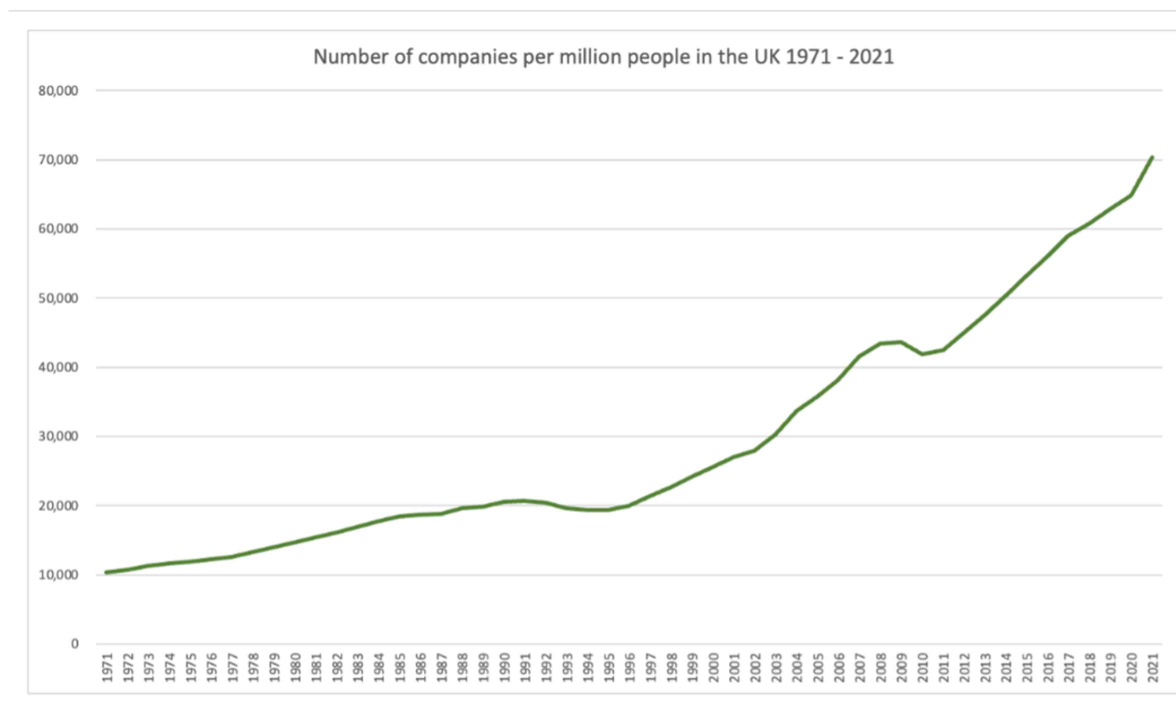
The growth in the number of companies is demonstrated by this chart published by the UK's Companies House[150]:



149 https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/livebirths/bulletins/birthsummarytablesenglandandwales/2022#:~:text=3.-,Live%20births,compared%20with%202021%20(624%2C828).

150 https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023

To put these figures in context, this chart shows that the number of companies per head of population grew seven-fold between 1971 and 2021:



Sources: Companies House[151], the Office for National Statistics[152] and author's calculations

As is apparent, the growth in company numbers has been extraordinary.

Several phenomena have contributed to this:

- The relaxation of audit requirements for most companies during the 1990s, so that in this century fewer than five per cent of companies require an audit, significantly reducing the cost of managing a company.

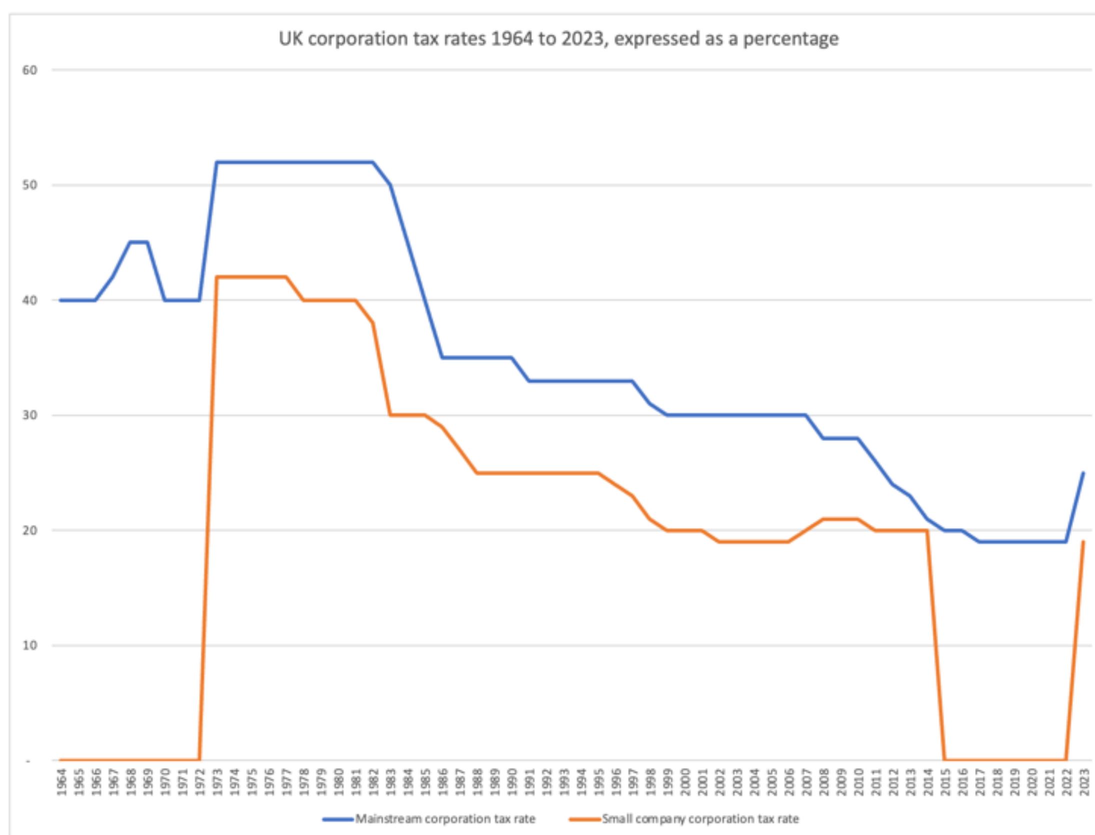
- Since the audit requirements on limited companies were removed there have been no quality control checks on the accounts filed by UK limited companies. Companies House is specifically a registrar of companies, and not a regulator of them. Accounts bearing little or no relationship to the requirements of company law can be, and are,

[151] Table A8 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1165559/Companies_Register_Activities_FYE_2023.xlsx

[152] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/timeseries/ukpop/pop

filed at Companies House without comment from them arising. The checks that they perform are decidedly limited e.g., the company number on the accounts must be correct; as must the date be appropriate; the accounts must be signed (at least electronically); and the balance sheet must balance. It seems that few other checks are made and complaints on deficient accounts are rarely addressed. As such there is no effective regulation of UK accounting law.

- The significant reduction in corporation tax rates over time, demonstrated by this chart:



Sources: Author's accumulated data sources

As is apparent, the rate of corporation tax has fallen considerably, and most especially since the mid 1990s, since when the use of companies has increased considerably.

Note that when no small company tax rate is shown it is the same as that for large companies. Large is defined by profits, not the scale of a company's activities, with the cut off changing over the period noted.

It will be noted that in some recent years the rate of corporation tax has, for all companies, been lower than the basic twenty per cent income tax rate.

- The ease of incorporation of companies in the UK. The UK is now notorious for this ease, based on these facts:
  - It usually costs just £12 to form a company in the UK[153].
  - Those incorporating a company in the UK still do not need to prove their identity for money laundering purposes.
  - The annual recurring registration fee for a company is £13.
  - The fee to have a company voluntarily struck off the UK register of companies is £8.
  - No evidence of the identity of newly appointed directors or major shareholders is required.

Legislation before parliament at the time of writing may require that proof of identity might be required by Companies House in the future and that some fees will increase as a result, but the move still leaves the UK well behind other countries when it comes to the regulation and control of new company creation.

Not surprisingly, this fact has been noticed by many outside the UK. UK company formation agents have often marketed their services to persons outside the UK, including to Russians until recently.

- UK companies can be disposed of with ease:
  - In the year to March 2023 there were 585,807 companies dissolved in the UK[154].
  - Of this number 557,096 were 'struck off' the register of companies i.e. they were dissolved either because the company applied for this to happen, suggesting in the process that they had no liabilities owing (to secure which striking off they pay a fee of £8), or they were removed by Companies House because of the company's failure to file either an annual confirmation statement or annual accounts. The remainder (28,711, or 4.9 per cent of the total) were formally dissolved as required by company law.

[153] https://www.gov.uk/government/publications/companies-house-fees/companies-house-fees

[154] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023

- Companies House do not provide an analysis within their statistics of the number of companies dissolved at their own choice and the number struck off by Companies House for failing to comply with regulatory requirements. When the author of this note last investigated this issue[155] in 2014, around 45 per cent of all companies struck off the register were removed by Companies as a result of a company's failure to supply documentation required by law. Assuming that the ratio remains the same now, around 250,000 companies a year might be removed from the register each year because of their failure to comply with regulatory requirements.

The ease with which UK companies can be disposed of with few, if any, questions being asked compounds the problems created by the absence of any effective company law enforcement regime with regard to accounting and creates a criminogenic environment in the UK which some can use to facilitate the abusive accumulation of wealth. This is why this matter requires action.

Recommendations

The key problems being faced as far as the regulation of Companies House, company law and tax are concerned are:

- Not knowing who owns and manages companies and which people are, therefore, responsible for taxes payable.

- The ease with which companies can be created and dissolved very often with no data of any sort with regard to their activities being filed with any relevant authority, including HM Revenue & Customs, which might permit the illicit accumulation of wealth.

- The absence of any quality control data over accounts filed by limited companies.

- The ability that companies have to avoid settlement of their tax liabilities, a fact exacerbated by the fact that HM Revenue & Customs is very often one of the largest creditors of failing companies as a result of the deliberate choices made by their directors, who might profit from this decision.

There are also matters relating to other frauds to consider, abating which might also raise tax revenues.

[155] http://www.taxresearch.org.uk/Documents/Intheshade.pdf

The recommendations that follow are meant to address these issues.

a) The identity of all company directors and persons controlling more than ten per cent of a company should be proved to Companies House by each company annually. The creation of registers of those holding such positions that could be updated for all appointments and shareholdings simultaneously would mean this should not be an onerous obligation. Linking this register to passport and driving licence data would make the process even easier and more reliable. The opportunity to save tax anonymously should be abolished.

b) Companies should have a share capital commensurate to their level of trading and those not doing so should be able to call on their shareholders to make good the deficiency in the event of an insolvency. Shareholding cannot be seen to be a risk-free activity when it clearly is not. This should mitigate the tax losses arising to HM Revenue & Customs annually as a result of unpaid tax.

c) All company accounts should be available on public record, in full, and accounting standards should ensure that they are designed to meet all shareholder needs[156].

d) Companies failing to file accounts on time should lose the benefit of limited liability until they do so.

e) Details of all directors and shareholders should be on public record. Those companies not filing correct data should lose their limited liability. Exceptions should only be made in the case of proven risk.

f) A full list of the trading addresses of all companies should be available on public record.

g) All companies must be required to file tax returns annually (many do not at present). Those that do not should have personal liability imposed on the directors for tax owing. For more information on this issue refer to the Taxing Wealth Report 2024 note on corporation tax administrative reform.

h) No company should be struck from the Register of Companies without filing accounts, including creditor lists, if insolvent. Failure to do so should result in unlimited liability for the debts of the company on the part of all its directors and principal shareholders

[156] Note that proposals to achieve this goal are now being legislated

(those holding more than 10 per cent of the equity). Failure to acknowledge any debt owing by the company should also result in unlimited liability to the unacknowledged creditor.

i) Banks must be required to share with Companies House and HMRC annually the details that they should on the company, its trading addresses, the shareholders and directors and must supply a figurine for sums deposited in all bank accounts that they holds for it. In the absence of company supplied data this information should be placed on company record in place of company supplied data. For more information on this issue refer to the Taxing Wealth Report 2024 chapter on corporation tax administrative reform.

These measures will be seen as tough, and there will be protest from 'free marketeers'. However, limited liability, as Adam Smith knew and did not like, creates the chance for free-riding, moral hazard and straightforward abuse that undermines all theories of market competition. As such, any such protest cannot actually be about support for free markets. They would, therefore, be more like a defence of freeloading, because that is what limited liability has become, and what it will remain unless action to end abuse is taken.

Chapter 10.0

Inheritance Tax – Introduction

Background

Inheritance tax is the only tax in the UK that is supposedly charged on wealth.

If reports from opinion pollsters are to be believed, it is also the most hated tax in the UK[157].

Paradoxically, inheritance tax is also one of the taxes that a person is least likely to pay in the UK. In the tax year 2020/21, which is the last for which reliable statistical data is available, just 3.73 per cent of all estates in the UK were subject to an inheritance tax charge[158].

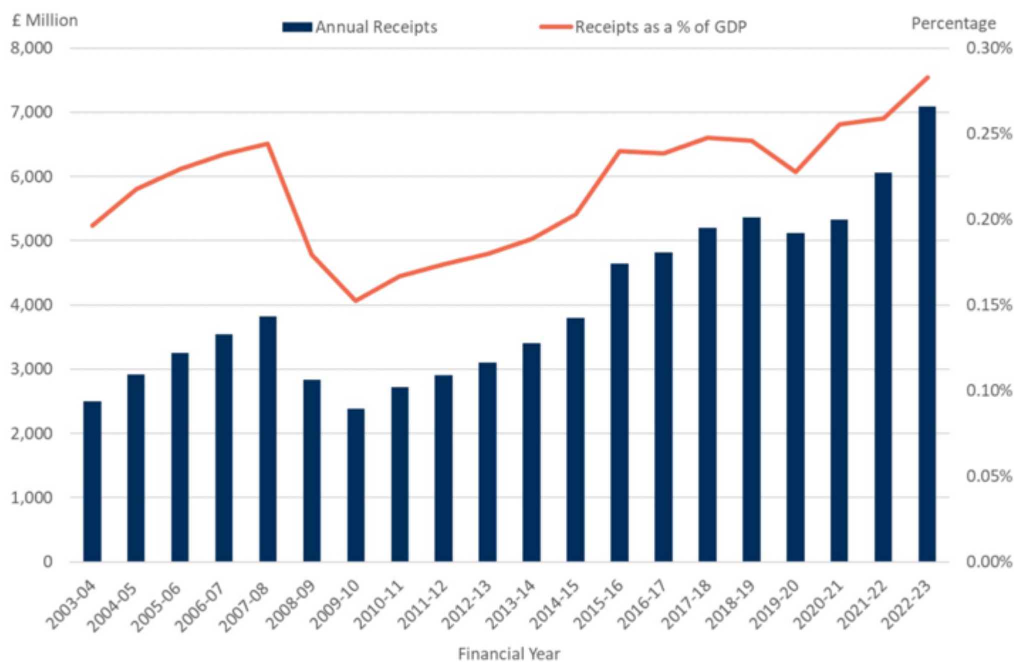
In the last year for which reliable tax collection data for this tax is available (2022/23) the tax yield from inheritance tax was £7.1 billion, which sum amounted to 0.8 cent per cent of UK tax receipts as a whole. Both amounts were, however, records, as the following chart indicates[159]:

[157] https://www.hl.co.uk/news/articles/archive/britains-most-hated-tax

[158] https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary

[159] https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk/hmrc-tax-receipts-and-national-insurance-contributions-for-the-uk-new-annual-bulletin

Annual receipts of inheritance tax and receipts as a proportion of GDP



HM Revenue & Customs has suggested that recent increases in yield are likely to be due to a combination of recent rises in asset values and the government's decision to maintain the inheritance tax nil rate tax band thresholds at their 2020/21 levels up to and including 2027/2028. Even so, revenue remains modest, overall.

Despite increasing revenues there are good reasons to think that inheritance tax is not working as it should.

What UK inheritance tax is charged on

The UK's inheritance tax system is complex, but most charges arise on:

- Gifts made by a person at the time of their death.
- Gifts made by a person in the seven years preceding their death.
- Transfers of assets into some sorts of trust, with recurring charges then arising if those assets remain in such trusts. This contributes a relatively small part of inheritance tax revenue.

UK inheritance tax rates

In the case of individuals inheritance tax is taxed at 40% on all gifts over an exempt sum, which is currently £325,000, which is a figure that has been fixed since 2009. This band can, however be enhanced[160] on the basis that:

- Transfers between spouses and civil partners are tax free, meaning that no inheritance tax need be paid on the first death of a couple related in these ways.

- The gift of a family home to a person's children (including adopted, foster or stepchildren) or grandchildren can increase the exempt sum to £500,000.

- A person who is married or in a civil partnership whose estate is worth less than their threshold can transfer any unused threshold to their partner who can then add it to their own threshold when they die, creating the possibility of a threshold of up to £1 million.

This tax is not, in that case, as penal as many think it is, but it does create a bonanza for tax planners feeding on people's prejudices.

The problems with the UK's inheritance

Firstly, it has to be made clear that as a proportion of UK wealth the amount of inheritance tax paid is miniscule. Current estimated UK financial wealth is, according to the Office for National Statistics and in particular its wealth surveys[161] approximately £15,221 billion. The failure of this tax to make any significant inroads into wealth or to tackle wealth inequality suggests that it is poorly designed, inappropriately targeted and highly avoidable by some. That means that the tax is failing to address issues with regard to vertical tax equity and inequality in the UK. It may also be creating horizontal tax inequity.

Secondly, inheritance tax's treatment of the taxation of former domestic residences, either on death or in the years prior to it, is inequitable. Since property prices vary enormously around the country applying a consistent tax rate of tax on the value of particular asset if above a fixed sum does appear to be particularly unfair. For that reason, a chapter in the Taxing Wealth Report 2024 series suggests that the inheritance tax charge on former domestic residences should be replaced with a capital gains tax charge on the final disposal of a former domestic residence by a person tax resident within the UK, with certain caveats and conditions attached. The inheritance tax anomaly relating to these assets would be removed as a

[160] https://www.gov.uk/inheritance-tax

[161] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020

consequence.

Third, there are significant reasons for concern when this tax appears to be quite effective in imposing charge upon the estates of those with smaller estates primarily made up of lifetime savings and domestic residences but appears to be particularly ineffective when taxing the estates of the wealthiest that are saved in other ways.

Inheritance tax is, in that case, in need of reform.

Recommendations

The obvious long-term solution to the problems within inheritance tax is to replace that tax with a lifetime gifts receipts tax, which would be substantially more equitable. However, in view of the wide range of other recommendations already been made in the Taxing Wealth Report 2024, a series of more modest recommendations will be made here. They will be:

- To take domestic residences out of the scope of inheritance tax and make them subject to capital gains tax on death or last disposal. This issue is addressed in the capital gains tax section of this report.
- To review inheritance tax business property relief.
- To review inheritance tax agricultural property relief.
- To review inheritance tax charges on personal pension funds.
- To review the use of inheritance tax reliefs on gifts to charities and related issues.
- To review the rates at which inheritance tax is charged to make the tax more progressive.

Each of these issues is addressed in a separate chapter within the context of The Taxing Wealth Report 2024.

Future work

Whilst the Taxing Wealth Report 2024 is limiting itself to reforms that might make sense in the short term and which can be adopted in isolation, this does not mean that future work cannot address the significant weaknesses within the structure of this tax, including:

- That the basic logic of a tax on death, charged irrespective of who inherits (charities and spouses apart) makes little sense. A tax on the receipt of gifts would make much more sense and promote greater equality.

- That the rates at which the tax is charged are too inflexible: a progressive scale would make much more sense.

- Arrangements for long established trusts still mean that some property falls beyond the scope of this tax.

These, however, are issues for further attention in due course and are, as a result, beyond the scope of this current review.

Chapter 10.1

Inheritance tax – Recommendation 16

Removing the inheritance tax exemption for funds retained in a pension fund on death

Brief summary

This chapter suggests that:

- The current inheritance tax provisions that exempt from charge to that tax sums left in personal pension arrangements that have been undrawn at the time of a person's death should be abolished.
- These arrangements have been abused with consequence for horizontal and vertical tax equity in the UK.
- This abuse is widely known about and advised upon by UK financial services providers.
- Despite forthcoming panned changes to pension tax laws, this arrangement is likely to offer continuing opportunity for abuse in the future.
- On the basis of reasonable estimates, abolishing this exemption could raise maybe £1.3 billion in additional tax revenue per annum.
- This change would be easy to implement.

The proposal	To remove the inheritance tax exemption for funds retained in a pension fund on death.

Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by this exemption which removes from an inheritance tax charge a sum that was itself accumulated in a pension fund on a tax-free basis, creating considerable imbalance within the tax system between those able to take advantage of this arrangement and those who cannot. 2. To increase the prospect of vertical equity of taxation in the UK which is currently undermined by the ability of some people to take advantage of this opportunity, undermining the vertical tax equity of inheritance tax. 3. To reduce the tax spillover effect that this exemption creates by encouraging the accumulation and retention of funds in tax free pension arrangements. 4. To reduce the rate of tax avoidance in the UK which this exemption encourages. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is hard to estimate because the extent to which the exemption is used is currently unknown because of a lack of data on the issue and some planned changed to pension rules might make it less attractive in the future for reasons unrelated to inheritance tax. Based on reasonable assumptions the exemption might cost more than £1.3 billion annum at present.
Ease of implementation	Relatively straightforward. The exemption was introduced with little fanfare and could be removed in much the same way.

Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short, largely because few realistic objections are likely to be capable of being made.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/10/12/the-taxing-wealth-report-2024-abolishing-the-inheritance-tax-exemption-on-some-funds-retained-in-pension-arrangements-at-the-time-of-a-persons-death-might-raise-1-3-billion-a-year/

Background

When George Osborne introduced significant changes to taxable pension arrangements in the UK during his time as Chancellor of the Exchequer[162], he introduced a particularly attractive quirk into those arrangements which has had a significant interaction with inheritance tax.

Broadly speaking, until Osborne changed the UK's pension tax regime, a person who had saved in a pension arrangement was required to purchase an annuity at the time that they took a pension from the fund to which they had contributed. That annuity then provided them with a guaranteed income for the remainder of their life.

The result of this was that the annuity provider took out a gamble with the retired person. They made that retiring person an offer of a pension that, based upon the that person's age, gender and health, they thought that they could afford to pay for the remainder of the annuitant's life. If the annuitant died early, then the annuity provider gained, and vice versa. What, however, was always the case was that the available funds at the time of retirement were always entirely used for the purposes of providing a pension payment. There was nothing left over on death.

[162] https://www.professionalpensions.com/analysis/1014826/pension-tax-relief-cuts-brief-history

Osborne removed this requirement that a person must acquire an annuity when they retired. Instead, he permitted a person who had made pension savings to draw down funds from the pension pot that they had accumulated over the remainder of their life. As a result the pensioner decided when such payments would be made, with them always being aware of the risk that there might be insufficient funds to provide them with an income for life if they took funds too early or lived beyond their anticipated life expectancy.

What these changes created was the possibility that a person might die with a part of their pension savings being left unused in their pension fund. Osborne's changes provided that this remaining capital sum did not then become the property of the pension provider but was, instead, available to the executors of the late pensioner to distribute to that person's heirs. No inheritance tax was, however, payable on the value of this distribution which was deemed to fall outside the estate of the deceased pensioner.

This arrangement is particularly egregious with regard to horizontal and vertical tax equity. The funds exempted from inheritance tax charge have already been subject to an income tax and national insurance (in some cases) exemption on the assumption that they will be subject to an exit tax charge from the pension fund in which they are saved, even if not of equivalent amount. This inheritance tax exemption does at least create the possibility that no tax charge of any sort might arise on the withdrawal of these funds from a pension savings arrangement, most especially if the person dying is under 75 years of age. This is deeply disruptive of horizontal tax equity and also disrupts the vertical tax equity of inheritance tax.

It is important to note that there have always been rules that, rather perversely, can make the receipt by a beneficiary of such a pension arrangement subject to income tax in the hands of the recipient if the person who died was of more than 75 years of age and that this chapter is being written with an awareness that further changes to pension rules should apply from 2024 which will, in most cases, reduce the likely value of these undistributed pension pots, particularly if the pensioner dies after reaching 75 years of age, but this does not mean that the opportunity for the abuse of inheritance tax that these arrangements has created will be eliminated. As a consequence, the advice now commonly provided by pension advisors to those with a choice as to how they will fund their earnings in retirement, which advice normally suggests that sums from a pension fund should be drawn-down last because any undrawn part of that fund will fall outside the scope of inheritance tax will, most likely, remain valid.

Analysis

There is no logic to this inheritance tax exemption. If it was meant to, for example, replicate the opportunity that any person has to withdraw up to 25% of their pension fund tax-free, then it fails to do so. That is because even if opportunity was taken to exploit that tax free drawn down those funds would still then fall within the scope of inheritance tax, meaning that

a charge to inheritance tax would be due, which is not the case under the arrangement that George Osborne created. The exemption does in that case make no sense.

Proposal

This relief should be abolished. Any residual funds remaining in a pension saving arrangement that a person has at the time of the death should be brought within the scope of an inheritance tax charge on their estate and be distributed on that basis.

Potential sum that might be raised

Estimating the tax yield from this reform is hard for three reasons:

- Pension rules are changing in 2024 and these changes may well impact this yield by reducing the sums left in pension funds on death.
- There is no data published on the sums subject to these arrangements.
- The current rules, especially given their change when a person reaches 75 years of age, make it hard to know to what degree this opportunity is exploited.

That said, given that the possibility of making use of this exemption is widely known to UK based financial advisers it is likely that it is commonly used by those with wealth.

Presuming that half of the estates subject to inheritance tax did take advantage of this planning opportunity and that there was a modest (by the standards of wealthy person's pension funds) £250,000 residual value in such pension funds at the time of death then the tax saving per person taking advantage of this opportunity might be £100,000 at the 40% marginal income tax rate on such estates. In that case the cost of this exemption might amount to £1.35 billion[163 and 164.]

[163] 27,000 estates were subject to inheritance tax charge in 2020, meaning that this estimate is for 13,500 estates at £100,000 per estate. No account is taken of the additional estates that would be brought into the scope of this tax as a result of this proposal, which might be significant in number.

[164] https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary

Chapter 10.2

Inheritance tax – recommendation 17

Reforming business property relief

Brief summary

This chapter suggests that:

- Inheritance tax business property relief currently costs £3.2 billion a year.
- The relief is open to abuse, which opportunity is well known and is advertised. Where that abuse is possible the relief should now be withdrawn.
- There is limited evidence of an economic need for this relief in other cases, although the provision of deferred payment arrangements to prevent business disruption at the time of the death of the owner of business assets is entirely appropriate.
- Payment deferral periods of up to three years might be permitted in those cases where 50% inheritance tax business property relief is provided at present.
- Payment deferral periods of up to five years might be permitted in those cases where 100% inheritance tax business property relief is provided at present, with the option for extension at the discretion of HM Revenue & Customs.
- Up to £3.2 billion of additional tax might be collected per annum over time as a result of the adoption of these recommendations.

The proposal	To abolish inheritance tax business property relief in cases where it is likely to be abused and to replace it in other cases with generous deferred payment periods so that the disruption that might result from making forced sales soon after death to settle inheritance tax liabilities is avoided, thereby protecting the ongoing business subject to this arrangement.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by this exemption which removes an inheritance tax charge at the time when a capital gains tax is also avoided in many cases. 2. To increase the prospect of vertical equity of taxation in the UK which is currently undermined by this relief. 3. To reduce the tax spillover effect that this exemption creates by encouraging the ownership of business property at death. 4. To reduce the rate of tax avoidance in the UK which this exemption encourages. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be small. The reasons for providing this relief are respected by the proposal made, which grant significant time to make payment of the inheritance tax payable on most business assets, so avoiding any serious business interruption that may result from the requirement to do so. At the same time the opportunity to abuse this relief is closed.

	There are unlikely to be few realistic objections to this proposal. Based on reasonable assumptions this relief might cost more than £3.2 billion annum at present and this sum is likely to be raised in future as a result of its cancellation.
Ease of implementation	Relatively straightforward.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Moderate because objections are likely to be made and will have to be heard.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/10/16/taxing-wealth-report-2024-reforming-inheritance-tax-business-property-relief-might-raise-3-2-billion-of-tax-a-year/

Background

Inheritance tax business property relief is a widely used exemption within the UK inheritance tax regime.

HM Revenue and Customs have the following to say about this relief[165]:

> *You can get 100% Business Relief on:*
>
> - *a business or interest in a business*
> - *shares in an unlisted company.*
>
> *You can get 50% Business Relief on:*

[165] https//www.gov.uk/business-relief-inheritance-tax/what-qualifies-for-business-relief

- *shares controlling more than 50% of the voting rights in a listed company*
- *land, buildings or machinery owned by the deceased and used in a business they were a partner in or controlled*
- *land, buildings or machinery used in the business and held in a trust that it has the right to benefit from.*

> *You can only get relief if the deceased owned the business or asset for at least 2 years before they died.*
>
> *Some restrictions do apply.*

Notably, and surprisingly, the ownership of shares quoted on the third tier of the London Stock Exchange (the Alternative Investment Market, or 'AIM'[166]) qualifies for 100% inheritance tax business property relief on death if the shares in question had been held for two years at that date. This is the case even if there is no other connection with the entity in which the shares are held, meaning that a portfolio of shares can be held to achieve the goal of reducing inheritance tax.

As one tax adviser put it on their website in 2022[167] when talking about investing in AIM shares for this reason:

> *If you need your money to receive an inheritance tax exemption quickly, these can be a great option. Significant lifetime gifts, whether made directly to a beneficiary or to a trust, typically take seven years to fall completely out of your estate, so it can become a bit of a gamble in later life. This is why investments that attract business relief are more commonly deployed for older clients who have greater clarity as to the level of assets they'll need to provide their income until death. There are few other options that provide full relief in as little as two years.*

It is not known how widely commonly structures of this sort are used but given that relief for share investments is the most common claim made it is quite possible that this arrangement is quite widely used. It is certainly well known. It is very obviously abusive of the principles inherent in the legislation.

The amount of inheritance tax business property relief claimed

[166] https://www.investopedia.com/terms/a/alternative-investment-market.asp

[167] https://www.saltus.co.uk/the-financial-planning-blog/business-relief-and-aim-an-option-for-reducing-inheritance-tax#:~:text=Investing%20in%20AIM%20shares%20can,tax%20relief%20within%20two%20years.

In the tax year 2020/21, which is the one for which most recent data is available[168], inheritance tax business property relief was claimed by 3,380 estates. The total relief sum claimed amounted to £3,200 million, or approximately £946,745 for each claim made.

Of the claims made, 2,350 were for shares in qualifying businesses. These claims had a total value of £2,550 million, or an average of £1,085,106 each.

The remaining 1,210 claims were for other business assets, with a value of those reliefs totalling £642 million (the figures do not quite total in the original data). These claims had an average value of £530,578.

The logic behind inheritance tax business property relief

The logic implicit in this relief is that it is important that a business survive the death of its owner or owners without business disruption arising from the need to realise capital to make payment of inheritance tax. As a consequence, interests in the most illiquid of businesses are provided with 100 pe cent tax relief, whilst those with greater liquidity are offered a lower, 50 per cent, rate of relief.

There are a number of very obvious problems with the supply of this relief on a universal basis without taking into consideration the particular circumstances of the business under review. These include:

- That in many cases there may be no significant disruption resulting from the death of the owner of a person owning assets qualifying for inheritance tax business property relief, or in raising capital to make settlement of any resulting inheritance tax liabilities. This might be most particularly true in the case of minority shareholdings. It will almost invariably be true in the case of AIM shareholdings held for the purpose of tax avoidance. This relief encourages abuse.

- That the preservation of capital amongst the heirs of those who created a business interest is not necessarily in the interests of the business itself. There are many examples where the second generation of owners of a business add no value (at best), whilst third generations frequently destroy it. The logic within this relief that the preservation of capital in a tight ownership group is beneficial has no obvious evidential support in the modern economy.

- That it is inappropriate that the owners of assets of this sort should have the opportunity to avoid inheritance tax in addition to avoiding capital gains tax on gains

[168] https://www.gov.uk/government/statistics/inheritance-tax-statistics-table-122-exemptions-and-reliefs

they might have made during their lifetime on the property in question, which charge is cancelled on death. This double taxation relief makes this relief particularly generous as well as open to abuse.

These situations all suggest that:

- The relief might be too generous.
- The relief is open to abuse.
- The assumptions underpinning the relief are inappropriate.
- An alternative is needed.

Recommendation

A number of recommendations flow from these observations and those in the background section:

1. No relief should be provided on assets only held for investment purposes in businesses qualifying for this relief. The opportunity to obtain inheritance tax relief by buying a portfolio of AIM shares should be prevented altogether in the future.

2. Relief for the assets now subject to 50% business property relief is inappropriate. Alternative funding for these assets should always be available given suitable time to make appropriate arrangements. The possibility of making an application for the deferment of payment of inheritance tax owing for a period of up to three years should be made available in such cases, whereafter it should be payable in full. Deferment should be allowed on a case-by-case basis. This would permit time for necessary arrangements to be made without disruption to the business resulting.

3. The inheritance tax due on the disposal of assets now subject to 100% inheritance tax business property relief should be deferred for a period of no more than 5 years, with extensions being permitted on a case-by-case basis. Capital gains rebasing at the time of rebasing should be permitted, but a charge should be placed over assets so that they cannot be sold without the liability to inheritance tax due being paid. Revaluation of liabilities owing to take into account changed market circumstances should only be permitted in the first two years following death.

These proposals withdraw inheritance tax business property relief altogether in cases where it is currently likely to be abused and turn it into a deferred payment arrangement in other cases to prevent the disruption that might occur by demanding payment soon after the time of death of the owner of a business or asset. The reasons for originally providing this relief are respected. The opportunity to save two taxes (i.e. both capital gains tax and inheritance tax) is, however, denied, creating much stronger vertical and horizontal tax equity as a result whilst raising £3.2 billion in additional tax revenue over time on an annual recurring basis.

Chapter 10.3

Inheritance tax – Recommendation 18

Reforming agricultural property relief

Brief summary

This chapter suggests that:

- Inheritance tax agricultural property relief currently costs just over £1 billion a year in tax foregone at present.
- The relief is open to abuse and that opportunity should now be denied.
- There is limited evidence of an economic need for this relief in other cases, although the provision of deferred payment arrangements to prevent business disruption at the time of the death of the owner of agricultural assets is entirely appropriate.
- A payment deferral period of up to five years might be permitted in cases where the estate of a person who actually used the assets in their farming business (some exceptions now being noted) has to sell assets to make payment of tax owing, with the option for extension at the discretion of HM Revenue & Customs.
- Up to £1 billion of additional tax might be collected per annum over time as a result of the adoption of these recommendations.

The proposal	To abolish inheritance tax agricultural property relief in cases where it might be abused and to replace it in other

	cases with generous deferred payment periods so that the disruption that might result from making forced sales soon after death to settle inheritance tax liabilities is avoided, thereby protecting the ongoing agricultural business subject to this arrangement.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by this exemption which removes an inheritance tax charge at the time when a capital gains tax is also avoided in many cases. 2. To increase the prospect of vertical equity of taxation in the UK which is currently undermined by this relief. 3. To reduce the tax spillover effect that this exemption creates by encouraging the ownership of agricultural property at death. 4. To reduce the rate of tax avoidance in the UK which this exemption encourages. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be small. The reasons for providing this relief are respected by the proposal made, which grant significant time to make payment of the inheritance tax payable on most agricultural assets, so avoiding any serious business interruption that may result from the requirement to do so. At the same time the opportunity to abuse this relief is closed. There are unlikely to be few realistic objections to this proposal.

	Based on reasonable assumptions this relief might cost more than £1 billion annum at present and this sum is likely to be raised in future as a result of its cancellation.
Ease of implementation	Relatively straightforward.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Moderate because objections are likely to be made and will have to be heard.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/10/17/taxing-wealth-report-2024-reforming-inheritance-tax-agricultural-property-relief-might-raise-1-0-billion-of-tax-a-year/

Background

Inheritance tax agricultural property relief is a widely used exemption within the UK inheritance tax regime.

HM Revenue and Customs has the following to say about this relief[169]:

> *You can pass on some agricultural property free of Inheritance Tax, either during your lifetime or as part of your will.*
>
> *Agricultural property that qualifies for Agricultural Relief is land or pasture that is used to grow crops or to rear animals. It also includes:*
>
> 1. *growing crops*
> 2. *stud farms for breeding and rearing horses and grazing*
> 3. *trees that are planted and harvested at least every 10 years (short-rotation coppice)*

[169] https://www.gov.uk/guidance/agricultural-relief-on-inheritance-tax

4. *land not currently being farmed under the Habitat Scheme*
5. *land not currently being farmed under a crop rotation scheme*
6. *the value of milk quota associated with the land*
7. *some agricultural shares and securities*
8. *farm buildings, farm cottages and farmhouses*

These do not qualify for Agricultural Relief:

- *farm equipment and machinery*
- *derelict buildings*
- *harvested crops*
- *livestock*
- *property subject to a binding contract for sale*

Location

A property may be owner occupied or let, but it must be part of a working farm in the:

- *UK*
- *Channel Islands*
- *Isle of Man*
- *European Economic Area*

Period of ownership or occupation

The property must have been owned and occupied for agricultural purposes immediately before its transfer for:

- *2 years if occupied by the owner, a company controlled by them, or their spouse or civil partner*
- *7 years if occupied by someone else*

Some restrictions do apply.

Notably, the period of required ownership can be remarkably short, whether the property is used the owner or by a company that they own or used by someone else (i.e. let to a tenant farmer). There is obvious opportunity for abuse in these arrangements, most especially when self-occupation does not require that the owner actually run the agricultural business in person, and when the ownership of tenanted land requires little more than rent collection on the part of the owner.

The amount of inheritance tax business property relief claimed

In the tax year 2020/21, which is the one for which most recent data is available[170], inheritance tax business property relief was claimed by 1,300 estates. The total relief sum claimed amounted to £1,020 million, or approximately £784,615 for each claim made.

No further analysis of these claims is available i.e. the number made for owner-occupation and for tenanted land is unknown.

The logic behind inheritance tax agricultural property relief

The logic implicit in this relief is that it is important that an agricultural business survive the death of its owner or owners without business disruption arising from the need to realise capital to make payment of inheritance tax.

There are a number of very obvious problems with the supply of this relief on a universal basis without taking into consideration the particular circumstances of the business under review. These include:

- That in the case of tenanted farms there is usually no reason why there should be any business disruption in the event of the death of an owner.

- That the relief is available for land outside the UK, for reasons that are not all apparent and which provides no return to the UK for the relief given.

- That in the case of the ownership of shares in a farm there is no reason why the death of an owner need necessarily disrupt the business of the agricultural property.

- To describe stud farms as agricultural property is surprising.

- The relief can be given for shooting estates and other land uses that are now considered environmentally harmful.

- That it is inappropriate that the owners of assets of this sort should have the opportunity to avoid inheritance tax in addition to avoiding capital gains tax on gains they might have made during their lifetime on the property in question, which charge is cancelled on death. This double taxation relief makes this relief particularly generous as well as open to abuse.

These situations all suggest that:

[170] https://www.gov.uk/government/statistics/inheritance-tax-statistics-table-122-exemptions-and-reliefs

- The relief might be too generous.
- The relief is open to abuse.
- The assumptions underpinning the relief are inappropriate.
- An alternative is needed.

Recommendations

A number of recommendations flow from these observations:

1. No relief should be provided on agricultural assets used by other persons. It should, however, be possible to apply for deferred tax payment in the event of sale of such property to raise funds to pay tax for a maximum of two years, but thereafter no further relief is required.

2. Relief for property outside the UK should be abolished.

3. Relief for stud farms should be abolished.

4. Relief for gaming estates should be abolished.

5. Relief for other personally owned assets used in an agricultural property should be abolished but any tax due should deferred for a period of no more than 5 years, with extensions being permitted on a case-by-case basis. The intention of this arrangement would be to prevent business disruption. This deferral should be sufficient to achieve that goal. Capital gains rebasing at the time of death should be permitted, but a charge should be placed over assets so that they cannot be sold without the liability to inheritance tax due being paid. Revaluation of liabilities owing to take into account changed market circumstances should only be permitted in the first two years following death.

These proposals withdraw inheritance tax agricultural property relief altogether in cases where it is currently likely to be abused and turn it into a deferred payment arrangement in other cases to prevent the disruption that might occur by demanding payment soon after the time of death of the owner of a business or asset. The reasons for originally providing this relief are respected. The opportunity to save two taxes (i.e. both capital gains tax and inheritance tax) is, however, denied, creating much stronger vertical and horizontal tax equity as a result whilst raising £1 billion in additional tax revenue over time on an annual recurring basis.

Chapter 10.4

Inheritance tax – Recommendation 19

Reforming the rates at which inheritance tax is charged

Brief Summary

This chapter proposes that:

- The rates at which inheritance tax is charged should be subject to review.
- The existing flat charge rate of this tax is inappropriate and might be one reason for its lack of political acceptability.
- The current charge structure of this tax also fails to deliver sufficient vertical tax equity within this tax.
- At the same time, that flat rate also results in insufficient wealth being redistributed by this tax when that is one of the objectives for using it.
- If new tax rates from 10 per cent to 60 per cent of the value of chargeable estates were introduced on cumulatively increasingly wide bands of chargeable estate, then whilst no additional tax might necessarily be collected the distribution of that charge would change considerably, with much more being paid by higher value estates.
- The suggested revised structure would reduce the inheritance tax due on almost all chargeable estates of less than £1 million, often by significant amounts.

- When this issue has been addressed, and when other recommendations in the Taxing Wealth Report 2024 relating to this tax have been considered, it may be appropriate to reconsider the size of the nil rate band for this tax.

The proposal	To reform the rates and allowances at which inheritance tax is charged so that: • The tax is more progressive. • Less tax is paid on smaller estates. • More tax is paid on larger estates (ignoring any other proposals made in the Taxing Wealth Report 2024).
Reason for the proposal	1. To improve the public perception of inheritance tax by: • Making it more progressive. • Reducing its impact on smaller estates. • Increasing the overall yield to tackle increasing wealth inequality in the UK. 2. To increase vertical tax equity. 3. To reduce the incentive to avoid inheritance tax. 4. To reduce the tax spillover effect that existing inheritance tax rates create. 5. To potentially raise additional tax revenues but in a more progressive fashion.
Estimated tax that might be raised as a result of the recommendation made	The behavioural responses to this recommendation cannot be known but are likely to be positive amongst most groups that currently view inheritance tax negatively. There will be negative reaction from those with significant wealth. Political capital will have to be expended to address this issue.

	An example calculation of additional tax that might be raised is included in this chapter. Whilst it suggests that no new tax might be raised by making inheritance tax significantly more progressive it does suggest that its redistributive qualities might be enhanced considerably.
Ease of implementation	The changes proposed will be easy to implement. No technical difficulties should arise.
Likely difficulties that might result from implementation	As noted above, there is likely to be significant opposition to these changes but that is the only difficulty that should be anticipated.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months.
Consultation period required.	A few months, at most.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/10/27/taxing-wealth-report-2024-reforming-the-rates-at-which-inheritance-tax-is-charged/

Introduction

It has long been the case that the structure of inheritance tax has been overdue for reform.

The nil rate band for this tax, which takes the vast majority of UK estates out of a charge to inheritance tax, has been set at £325,000 since 2009, although this sum can be increased in the case of the passing of former domestic residences. This sum is not expected to change until at least 2027.

The rate of tax has been subject to even less change. A few exceptions apart, once inheritance tax is charged it has been due at 40% for decades. It is stressed, that this rate only applies to the chargeable estate above the nil rate band, and not to the estate in its entirety.

For a tax that is so unpopular[171], according to public reports, the fact that there has been no serious review of its structure or rates for more than a decade is surprising. The changes that have been made have all tinkered at the edges of the tax, but not addressed issues of principle.

Some of the unpopularity of this tax does, almost certainly, result from the apparent bluntness of the charging structure. In particular, the use of one tax rate that was (and is still, in the minds of many) associated with the higher rate of UK income tax most probably implies a penal rate that encourages an adverse reaction to inheritance tax.

The Taxing Wealth Report 2024 suggests a number of changes to this tax including:

- Taking domestic residences out of the charge to inheritance tax and subjecting them to capital gains tax on lifetime gains instead[172].

- Removing the inheritance tax exemption for funds retained in pension funds at the time of death[173].

- Removing business property relief and providing tax deferral arrangements in its place[174].

- Removing agricultural property relief and providing tax deferral arrangements in its place[175].

These proposals are likely to significantly increase the tax revenues owing by larger estates, which are the ones most likely to be impacted. Although business property relief and agricultural floor property relief are only claimed by fewer than 5,000 estates in the UK each year according to the latest statistics available, they reduce the tax paid by each of those estates by approximately £1 million. What this makes clear is how distorted liability to this tax is because of inappropriate reliefs and allowances. Any consideration of general reforms has to take this into account.

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[171] https://www.hl.co.uk/news/articles/archive/britains-most-hated-tax

[172] https://taxingwealth.uk/2023/09/28/charging-capital-gains-tax-on-the-final-disposal-of-a-persons-main-residence-might-raise-10-billion-of-tax-a-year/

[173] https://taxingwealth.uk/2023/10/12/the-taxing-wealth-report-2024-abolishing-the-inheritance-tax-exemption-on-some-funds-retained-in-pension-arrangements-at-the-time-of-a-persons-death-might-raise-1-3-billion-a-year/

[174] https://taxingwealth.uk/2023/10/16/taxing-wealth-report-2024-reforming-inheritance-tax-business-property-relief-might-raise-3-2-billion-of-tax-a-year/

[175] https://taxingwealth.uk/2023/10/17/taxing-wealth-report-2024-reforming-inheritance-tax-agricultural-property-relief-might-raise-1-0-billion-of-tax-a-year/

The profile of tax paid by size of estate in 2021, which is the last year for which reliable information is available with regard to this tax was as follows[176]:

Net estate (lower limits)	2020 to 2021 number not taxed	2020 to 2021 number taxed	2020 to 2021 tax due (£ million)	2020 to 2021 average tax (£)	2020 to 2021 average effective tax rate of taxpaying estates (per cent)
Band limit					
0	9,750				
10,000	7,740				
25,000	5,890				
40,000	3,690				
50,000	3,790				
60,000	8,170				
80,000	10,000				
100,000	86,000				
200,000	63,900				
300,000	35,400	2,380	33	13,800	4%
400,000	20,600	2,460	105	42,800	9%
500,000	14,200	2,770	152	54,900	10%
600,000	7,080	2,300	178	77,600	12%
700,000	4,870	2,140	192	89,900	12%
800,000	3,320	1,800	201	111,000	13%
900,000	2,310	1,560	201	129,000	14%
1,000,000	1,110	6,330	1,020	161,000	13%
1,500,000	486	2,300	775	337,000	20%
2,000,000	145	1,560	888	570,000	24%
3,000,000	76	579	501	865,000	25%
4,000,000		248	271	1,100,000	25%
5,000,000		278	413	1,480,000	25%
7,500,000		114	197	1,720,000	20%
10,000,000		158	633	4,010,000	17%
Total estates notified	**289,000**	**27,000**	**5,760**	**214,000**	**13%**

Source: as noted in text footnote

The obvious reforms to consider are:

1. Changing the value of the nil rate band available within this tax.
2. Introducing tiered bands of tax payable as the size of estates increases.
3. Reducing the opening rate of inheritance tax to a level with which most taxpayers are more familiar.

[176] https://www.gov.uk/government/statistics/table-121-estates-notified-to-hmrc-numbers-and-tax-due

4. Increasing the rate at which inheritance tax is paid by the largest estates as a means of addressing the substantial wealth inequality that exists within the UK.

As example, it would be possible to change the rates at which inheritance tax is charged as follows:

Band of chargeable estate (£)	Size of band	Rate of tax (%)
0 - 325,000	325,000	0%
325,001 - 425,000	100,000	10%
425,001 - 525,000	100,000	20%
525,001 - 725,000	200,000	30%
725,001 - 1,025,000	300,000	40%
1,025,001 - 1,325,000	300,000	50%
Above 1,325,001	Unlimited	60%

If this were to be done then, assuming no other allowances and reliefs are claimed, liabilities by size of estate might change as follows (with numbers being approximations as the distribution of estates within bands is not known):

Net estate (lower limits)	2020 to 2021 number not taxed	2020 to 2021 number taxed	2020 to 2021 tax due (£ million)	2020 to 2021 average tax (£)	2020 to 2021 average effective tax rate of taxpaying estates (per cent)	Revised average tax due (£)	Change in tax due (£)	Total revenue in band £ million)
Band limit								
0	9,750							
300,000	35,400	2,380	33	13,800	4%	3,450	-10,350	8
400,000	20,600	2,460	105	42,800	9%	11,400	-31,400	28
500,000	14,200	2,770	152	54,900	10%	17,450	-37,450	48
600,000	7,080	2,300	178	77,600	12%	28,800	-48,800	66
700,000	4,870	2,140	192	89,900	12%	37,425	-52,475	80
800,000	3,320	1,800	201	111,000	13%	53,250	-57,750	96
900,000	2,310	1,560	201	129,000	14%	66,750	-62,250	104
1,000,000	1,110	6,330	1,020	161,000	13%	90,000	-71,000	570
1,500,000	486	2,300	775	337,000	20%	281,250	-55,750	647
2,000,000	145	1,560	888	570,000	24%	665,000	95,000	1,037
3,000,000	76	579	501	865,000	25%	1,107,500	242,500	641
4,000,000		248	271	1,100,000	25%	1,460,000	360,000	362
5,000,000		278	413	1,480,000	25%	2,030,000	550,000	564
7,500,000		114	197	1,720,000	20%	2,390,000	670,000	272
10,000,000		158	633	4,010,000	17%	5,825,000	1,815,000	920
Total estates notified	**289,000**	**27,000**	**5,760**	**214,000**	**13%**			**5,445**

As will be noted, for many smaller estates, where the imposition of this tax is most keenly felt, liabilities would fall if these bands were adopted.

This would also be true for all estates where the overall net estate is less than £1.5 million.

However, on higher value estates the overall liability increases, as it would also do if other recommendations in the Taxing Wealth Report 2024, e.g. with regard to agricultural and business property relief are also taken into account, given that most of the estates claiming those relief will fall into this category.

It is suggested that this overall redistribution of liabilities is just and equitable whilst also achieving the goal of redistributing wealth within the UK without imposing tax charges at rates that are uncommon within the rest of the economy.

It will be noted that this change is broadly tax neutral. Bands could be altered to achieve an increase in revenue raised. Those chosen here were instead picked to increase the degree of redistribution that the tax might achieve.

Chapter 10.5

Inheritance tax – Recommendation 20

Reforming inheritance tax charity tax reliefs

Brief Summary

This chapter proposes that:

- Tax reliefs available for gifts to charities should be restricted in all cases, including for inheritance tax, where any of the following arise:
  A material personal gain arises as a result of the gift, even if only by reason of overt publicity.
  - That some degree of control over the gift or the donated asset has been retained.
  - The charity favoured by the gift had not distributed more than 80 per cent of its revenues for charitable purposes in the five years preceding the donation or in the three years following it.
- That measures to achieve these goals should be put in place as a targeted anti-avoidance rule for tax purposes.
- That the purpose for making these changes is not to raise revenue (although some savings in relief given may arise) but is instead to:
  - Prevent tax abuse.
  - Prevent the tax system being used in combination with charitable structures to perpetuate the current unequal division of wealth within society.
  - Encourage good governance on the part of charities.

o Protect the charitable sector as a whole from abuse, meaning that all well-managed charities gain from these proposals.

The proposal	To restrict the tax relief due on gifts to charities, whether for inheritance tax, income tax or capital gains tax purposes, in cases where: • A material personal gain arises, even if only by reason of overt publicity. • That some degree of control over the gift or the donated asset has been retained. • The charity favoured by the gift had not distributed more than 80 per cent of its revenues for charitable purposes in the five years preceding the donation or in the three years following it.
Reason for the proposal	1. To reduce the incentives to avoid inheritance tax and other taxes by using the reliefs available for gifts to charities. 2. To close tax gaps. 3. To encourage charities to make use of donated funds on a timely basis. 4. To support good governance in the charitable sector.
Estimated tax that might be raised as a result of the recommendation made	The behavioural responses to this recommendation cannot be known for certain. What can be guaranteed is that the vast majority of donations to charities will be unaffected by this proposal. What will be affected are:

	• Donations from which the donor seeks to secure publicity e.g. by securing the naming of a facility in their own honour. • Donations where the owner retains control of an assets after the gift has been made e.g. as a result of gifting the ownership of share in a company into a charitable trust where control of the board of directors of that company is retained by the donee after the gift has been made. • Gifts to charities that are reluctant to make use of funds donated for charitable purposes, suggesting that they never had need for tax relief in the first place. The measure is, therefore, an anti-abuse rule to restrict the availability of tax reliefs in all taxes, but which may well have most significance in the case of inheritance tax. No estimate of tax savings that might result from these proposals can realistically be made.
Ease of implementation	The changes proposed will be relatively straightforward to implement. Experience is now available in writing targeted anti-abuse rules (TAARs) to facilitate this process.
Likely difficulties that might result from implementation	There is likely to be some public opposition to this proposal, but few large charities and few donors are likely to oppose it because it is about enhancing the reputation of the charitable sector and ending the risk of abuse.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months.
Consultation period required.	A few months, at most.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/02/the-taxing-wealth-report-2024-restricting-charity-tax-reliefs-to-prevent-their-abuse/

Introduction - charity tax reliefs

There are many tax reliefs available for donations to charities made available within the UK tax system. For example, as HM Revenue & Customs (HMRC) says with regard to income tax[177]:

> ***Gift Aid***
>
> *Donating through Gift Aid means charities and community amateur sports clubs (CASCs) can claim an extra 25p for every £1 you give. It will not cost you any extra.*
>
> *The issues that this gives rise to, including the unfair tax advantage that it provides to higher rate taxpayers, has been discussed in another chapter within the Taxing Wealth Report 2024[178]. It is suggested there that maybe £740 million of tax might be raised by restricting this relief to the basic rate of tax. Nothing in this chapter is meant to change that suggestion.*

This, however, is not the limit to the reliefs available. As HMRC says[179]:

> ***Capital Gains Tax relief***
>
> *You do not have to pay Capital Gains Tax on land, property or shares you give to charity.*
>
> *You may have to pay if you sell them [to a charity] for more than they cost you but less than their market value.*

There appears to be no estimate published by HM Revenue & Customs on the cost of this relief.

177 https://www.gov.uk/donating-to-charity/gift-aid

178 https://www.taxresearch.org.uk/Blog/2023/09/14/capping-the-rate-at-which-tax-relief-is-given-on-charitable-donations-under-gift-aid-is-given-might-raise-740-million-in-tax-a-year/

179 https://www.gov.uk/donating-to-charity/donating-land-property-or-shares

Tax relief on gifts to charities is also available for inheritance tax purposes, about which HMRC says[180]:

> ***Leaving gifts to charity in your will***
>
> *Your will says what will happen to your money, property and possessions after you die.*
>
> *Your donation will either:*
>
> - *be taken off the value of your estate before Inheritance Tax is calculated.*
> - *reduce your Inheritance Tax rate, if 10% or more of your estate is left to charity.*
>
> *You can donate:*
>
> - *a fixed amount*
> - *an item*
> - *what's left after other gifts have been given out*

In summary what this means is that all gifts to charities are exempt for the purposes of inheritance tax and if more than ten per cent by value of an estate is left to charity then the tax rate charged on that estate is then reduced to 36% from the standard 40%.

In 2020/21, which is the last year for which reliable inheritance tax data is available from HMRC, a total of 2,590 estates out of 27,100 estates that were subject to an inheritance tax charge[181] made sufficiently large donations to charity to have their inheritance tax charge rate reduced from the standard 40% to the reduced rate of 36%, which is only available for this reason. As a consequence, they saved approximately £52 million in inheritance tax.

Discussion

In principle, UK society is keen on charities and the tax system has a bias in their favour which reflects that fact. It is, however, known that charitable tax reliefs can be, and are, abused. HM Revenue & Customs published[182] a discussion paper on this issue in 2014. It has not entirely gone away. As a result, another consultation[183] is in progress in 2023.

[180] https://www.gov.uk/donating-to-charity/leaving-gifts-to-charity-in-your-will

[181] https://www.gov.uk/government/statistics/inheritance-tax-statistics-table-122-exemptions-and-reliefs

[182] https://assets.publishing.service.gov.uk/media/5d287a8b40f0b61247b08bd3/avoid-tax-charities.pdf

[183] https://www.gov.uk/government/consultations/charities-tax-compliance/consultation-charities-tax-compliance

This chapter presumes that the UK's existing general anti-avoidance rule[184] can be used to tackle the more extreme forms of such abuse that are purely tax motivated. This does not, however, prevent other potential abuses. The most significant of those are what HM Revenue & Customs describes as 'tainted donations'. There is also a significant issue with donee charities not appearing to make appropriate use of donated funds.

Tainted donations can presently arise in situations described by HM Revenue & Customs as those where the following conditions exist:

1. The donation to the charity and arrangements entered into by the donor are connected.

2. The main purpose of entering into the arrangements is for the donor, or someone connected to the donor, to receive a financial advantage directly or indirectly from the charity.

3. The donation isn't made by a qualifying charity-owned company or relevant housing provider linked with the charity to which the donation is made.

All three conditions have to apply.

It is suggested that this definition is too narrow.

Condition (1) must remain in any new rule.

Condition (2) is defined far too narrowly. It only considers identifiable financial advantages. It should consider situations where indirect advantage, e.g. undue or overt publicity, might arise as a result of the gift. If this does arise then that should make it what is considered to be a 'gift with a reservation of title' as defined for inheritance tax, invalidating the tax deductibility of the gift. Clear guidance would be needed, but the term 'undue' or 'overt' would, for example, apply if a facility was named in honour of the donor by the recipient charity, from which the donor might then secure advantage, social, financial, or otherwise. In contrast, being on a list of donors would not prejudice the gift.

Condition (2) also needs to allow for the potential to secure advantage as well as the fact that one has occurred. So, in particular, if shares in a private company are donated into trust and de facto control of the company remains with the donor because they can, in practice, control

[184] https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules As a matter of full disclosure, the author of this note was involved in the development of the UK general anti-avoidance rule, including sitting on Treasury committees to assist drafting guidance.

the board of the company whose shares were donated then this obvious way of seeking to keep control of wealth (which would be especially relevant if inheritance tax business property relief was reformed as suggested[185] in the Taxing Wealth Report 2024) would be blocked.

Condition (3) is too narrow and rarely relevant.

The problem of donations being made to charities that do not then distribute their funds has also to be addressed. As the Financial Times reported[186] in October 2023:

> *UK charitable foundations with collective assets of more than £12bn are giving away only a small fraction to good causes each year, according to a think-tank analysis. Hundreds of grant-making trusts and foundations (GMTFs) were identified in the research by Pro Bono Economics shared exclusively with the Financial Times.*
>
> *The analysis showed that if GMTFs distributed 3 per cent or more of their assets, this would generate at least an additional £300mn a year for good causes.*
>
> *"A huge amount of money lies unused and the mechanisms do not exist to encourage foundations hoarding cash to deliver it to the causes that need it," said Nicole Sykes, director of policy at PBE.*

It is inappropriate that tax reliefs on funds donated be abused by charities that do not make use of the funds in question. It is suggested that unless a charity uses at least eighty per cent of its funds for charitable purposes in the five years before a donation is made to it or during the three years after it is made than HM Revenue & Customs should have the power to deny tax relief on that donation. A de minimis sum below which investigation would not take place would remove risk for most taxpayers from this provision, which is targeted very largely at private foundations.

The object of these proposals is to:

- Prevent tax abuse.
- Prevent the tax system being used in combination with charitable structures to preserve the current unequal division of wealth within society.
- Encourage good governance on the part of charities.

[185] https://taxingwealth.uk/2023/10/16/taxing-wealth-report-2024-reforming-inheritance-tax-business-property-relief-might-raise-3-2-billion-of-tax-a-year/

[186] https://www.ft.com/content/b3d6926c-fcc5-48d5-ad7d-bd9f6719687e

- Protect the chartable sector as a whole from abuse, meaning that all well managed charities gain from these proposals.

The sum that might be raised as a result of these proposals cannot be known at present. No estimate is made as a result. That is not the purpose of these proposals, which are meant to prevent the abuse of charities and the tax system by those with wealth.

Chapter 11.0

VAT reforms – Introduction

Background

The UK's value added tax (VAT) was introduced in 1965 at the time of the UK;s ad mission into what was then the European Economic Community (the EEC), which became the European Union (EU).

In terms of tax collected, VAT is the UK's third largest tax, raising revenues of £162.1 billion in 2022-23 tax year, which sum represented eighteen per cent of all UK tax collected by HM Revenue & Customs[187].

How the UK's VAT is charged

As far as the UK is concerned, VAT is fundamentally an EU tax which is operated in the UK. There are local choices on matters such as tax rates, and more freedom after Brexit, but in essence little has changed with regard to the management of this tax since Brexit took place.

Value added tax (VAT) can be applied to a supply of goods and services in the UK in one of four different ways. Three involve a charge to VAT being added to the value of the supply made at differing rates[188]:

Rate	Rate of tax charged	Impact
Standard rate	20%	A VAT charge of 20% is added to the charge made for the supply of goods and services e.g., if the value of those goods and services is £100 then a VAT charge of £20 is added and the customer must pay £120 for their supply.

[187] Based on table A5 here: https://obr.uk/download/economic-and-fiscal-outlook-november-2023/?tmstv=1701349270

[188] https://www.gov.uk/vat-rates

Reduced rate	5%	A VAT charge of 5% is added to the charge made for the supply of goods and services e.g., if the value of those goods and services is £100 then a VAT charge of £5 is added and the customer must pay £105 for their supply.
Zero rate	0%	No VAT is added to the value of a supply, but it is deemed that it has been for the purposes of the administration of the tax.

Unsurprisingly the standard rate of VAT is applied to most goods and services.

The reduced rate of VAT is applied to domestic energy supplies and some other supplies deemed essential e.g., sanitary products and children's car seats.

Zero rating applies to food, children's clothing and some other items, mainly related to charitable activities.

A VAT registered business (which is in broad terms one is one making VAT chargeable supplies of more than £85,000 a year) has to add these charges to the sums it bills its customers and pay over the sums collected to HM Revenue & Customs. It has some recompense for doing so: it is permitted to reclaim from HMRC the cost of VAT charged to it (which means that, in effect, zero rated businesses and their customers are in receipt of a tax subsidy).

The fourth category of charge that can apply to the goods and services that a business might supply to its customers is VAT exemption. When a business supplies VAT exempt goods and services than there is no VAT charged added to the charge that they make. Superficially this looks similar to supplying VAT zero rate goods and services. It does, however, differ because a business making VAT exempt supplies cannot reclaim the VAT charged to it in the course of its trade.

VAT exemption applies to a range of goods and services including:

- Land, although this is a complex area. Domestic rents are, for example, VAT exempt whereas commercial rents can be subject to VAT.

- Insurance. Almost all insurance transactions are exempt from VAT, but many are subject to Insurance Premium Tax instead.

- Postal services provided by the Royal Mail are VAT exempt, but other equivalent services are not.

- Education and training when provided by an eligible body like a school, college or university is VAT exempt, but most that is supplied by for profit organisations e.g., professional training courses, is not.

- Finance. Most supplies of financial services are exempt from VAT but those such as bookkeeping and accountancy, debt collection, management consultancy and some investment and almost all finance and taxation advice are usually not. Banking and pension services are the main beneficiaries of this exemption.

- Health and welfare. Healthcare is a complex area for VAT. Exempt supplies include those provided by a qualifying institution like a hospital, hospice or nursing home as well as health services provided by registered doctors, dentists, opticians, pharmacists and other health professionals.

- Investment gold is exempt from VAT.

- Some sports activities are exempt, but like education this exemption largely applies to sport and related education services supplied by certain eligible bodies.

- Gaming, including betting and gaming, bingo, and lotteries are normally exempt from VAT, although the rules are complex.

- Culture. Some admission charges to public and other bodies are exempt subject to specific conditions.

- Qualifying events held by charities are VAT exempt.

- Funerals are VAT exempt, as are a range of other items of less significance.

Problems with the UK's VAT system

There are a number of problems with VAT, of which by far the largest is that VAT is a regressive tax. A regressive tax is one where as a person's income increases the amount of that tax that they pay reduces in proportion to that income even if it increases in absolute amount, i.e. their percentage tax rate falls as their income goes up. The Institute for Fiscal Studies dispute this, because the compare VAT paid with a person's consumption and not income, but they

are technically wrong to do so[189]. By definition, since VAT is a regressive tax it is one that favours the wealthy.

This bias is exacerbated by some of the exemptions available within the VAT system. In particular, exemptions for financial services and private education strongly favour the spending patterns of the wealthiest in UK society.

If the Taxing Wealth Report 2024 was a comprehensive review of the failings of the UK tax system more radical reforms of the UK's indirect tax system[190] might be proposed, including the possibility of creating a progressive indirect tax charge on total financial flows through a person's or entity's bank accounts, but there are so many immediate reforms that might benefit the UK within the existing system that more radical reforms of this sort are not being presented in this report.

As a result, just two reforms to the UK's VAT system to make that tax more progressive are proposed. The first is to remove the VAT exemption on the supply of financial services, which it is estimated might raise £8.7 billion in tax a year, and to remove the VAT exemption from the UK's private schools, which it is suggested might raise £1.6 billion in tax revenues a year.

[189] See https://www.taxresearch.org.uk/Blog/2019/05/27/the-institute-for-fiscal-studies-continues-to-spread-falsehoods-on-vat/ and associated links.

[190] I.e. taxes not directly charged on income.

Chapter 11.1

VAT – Recommendation 21

Abolishing VAT exemption for financial services

Brief summary

This chapter suggests that:

- Reform of the UK taxation system to ensure that those with the highest incomes and wealth pay their fair share of tax does not only require that direct taxes (income tax, national insurance, corporation tax, capital gains tax and even inheritance tax) be considered. It also requires that the role of indirect taxes (such as value added tax) in creating inequality as a consequence of their unreasonably subsidising the consumption of the wealthiest in society should also be taken into account.

- The VAT exemption that the financial services sector enjoys means that this tax is not charged on the supply of financial services to those who consume them in the UK.

- The UK Office for National Statistics estimates[191] that 48.6% of UK wealth is owned by the top 10% of wealth owners and 67.4% is owned by the top 20% per cent of wealth owners. In that case the benefit of this VAT exemption is going almost entirely to those in the higher echelons of wealth owners, and most likely of income earners.

191 https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totawealthingreatbritain/april2018tomarch2020

- In that case the withdrawal of this relief, which has been made possible by Brexit, should now take place.

- The withdrawal of this relief would, according to HM Revenue & Customs, result in an additional £16.3 billion of tax revenue being raised a year. Against this must be offset the tax lost from insurance premium tax if VAT was to be applied to that sector. This would amount to £7.6 billion, leaving a net sum of £8.7 billion of VAT to be recovered. That change with regard to insurance premium tax is likely to be neutral with regard to those on lower incomes.

The proposal	To abolish the VAT exemption on the supply of financial services that currently exists in the UK.
Reason for the proposal	1. To increase the prospect of vertical equity[192] in UK taxation when the current exemption for VAT charges on financial services provides a benefit very largely enjoyed by the wealthiest in society. 2. To raise additional sums in additional tax revenues. 3. To reduce wealth inequality in the UK which this exemption increases.
Estimated tax that might be raised as a result of the recommendation made	There are unlikely to be many behavioural consequences to this recommendation. The business community might well welcome it. Most people will not be impacted. The cost of insurance premiums pre-VAT might well reduce, leaving overall premiums unaffected. Most people in the UK, excepting those with significant income and wealth, incur few costs of the type that this change would impact.

[192] Vertical tax equity requires that as a person's income increases the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.

	The current estimated cost of this tax relief is £16.3 billion per annum, but if the exemption on insurance was removed as a part of this recommendation insurance premium tax would have to be abolished, reducing the cost of the exemption to about £8.7 billion, which is the suggested sum that might be raised. This tax should not impact the international status of the City of London as exports of financial services in the course of business should remain zero rated for VAT purposes.
Ease of implementation	Relatively straightforward. Most financial services business are already VAT registered with regard to some of their activities meaning that this change should not be difficult to implement.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	At least two years notice might be required to make this change
Consultation period required.	A reasonable consultation period will be required.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/07/removing-the-vat-exemption-from-financial-services-could-raise-8-7-billion-in-tax-a-year/

Background

Value added tax (VAT) can be applied to a supply of goods and services in the UK in one of four different ways. Three involve a charge to VAT being added to the value of the supply made at differing rates[193]:

[193] https://www.gov.uk/vat-rates

Rate	Rate of tax charged	Impact
Standard rate	20%	A VAT charge of 20% is added to the charge made for the supply of goods and services e.g., if the value of those goods and services is £100 then a VAT charge of £20 is added and the customer must pay £120 for their supply.
Reduced rate	5%	A VAT charge of 5% is added to the charge made for the supply of goods and services e.g., if the value of those goods and services is £100 then a VAT charge of £5 is added and the customer must pay £105 for their supply.
Zero rate	0%	No VAT is added to the value of a supply, but it is deemed that it has been for the purposes of the administration of the tax.

Unsurprisingly the standard rate of VAT is applied to most goods and services.

The reduced rate of VAT is applied to domestic energy supplies and some other supplies deemed essential e.g., sanitary products and children's car seats.

Zero rating applies to food, children's clothing and some other items, mainly related to charitable activities.

A VAT registered business (which is in broad terms one is one making VAT chargeable supplies of more than £85,000 a year) has to add these charges to the sums it bills its customers and pay over the sums collected to HM Revenue & Customs. It has some recompense for doing so: it is permitted to reclaim from HMRC the cost of VAT charged to it (which means that, in effect, zero rated businesses and their customers are in receipt of a tax subsidy).

The fourth category of charge that can apply to the goods and services that a business might supply to its customers is VAT exemption. When a business supplies VAT exempt goods and services than there is no VAT charged added to the charge that they make. Superficially this looks similar to supplying VAT zero rate goods and services. It does, however, differ because

a business making VAT exempt supplies cannot reclaim the VAT charged to it in the course of its trade.

VAT exemption applies to a range of goods and services including:

- Land, although this is a complex area. Domestic rents are, for example, VAT exempt whereas commercial rents can be subject to VAT.

- Insurance. Almost all insurance transactions are exempt from VAT, but many are subject to Insurance Premium Tax instead.

- Postal services provided by the Royal Mail are VAT exempt, but other equivalent services are not.

- Education and training when provided by an eligible body like a school, college or university is VAT exempt, but most that is supplied by for profit organisations e.g., professional training courses, is not.

- Finance. Most supplies of financial services are exempt from VAT but those such as bookkeeping and accountancy, debt collection, management consultancy and some investment and almost all finance and taxation advice are usually not. Banking and pension services are the main beneficiaries of this exemption.

- Health and welfare. Healthcare is a complex area for VAT. Exempt supplies include those provided by a qualifying institution like a hospital, hospice or nursing home as well as health services provided by registered doctors, dentists, opticians, pharmacists and other health professionals.

- Investment gold is exempt from VAT.

- Some sports activities are exempt, but like education this exemption largely applies to sport and related education services supplied by certain eligible bodies.

- Gaming, including betting and gaming, bingo, and lotteries are normally exempt from VAT, although the rules are complex.

- Culture. Some admission charges to public and other bodies are exempt subject to specific conditions.

- Qualifying events held by charities are VAT exempt.

- Funerals are VAT exempt, as are a range of other items of less significance.

Recommendation

It is recommended that the VAT exemption from the supply of financial services be removed.

This recommendation would not have been possible if the UK was still in the European Union, but it has left and since no major political party is recommending a return at present changes in VAT exemption rules can now be made by the UK.

In 2023 HM Revenue & Customs estimated[194] that the cost of the VAT exemption made available to the financial services industry was £16.3 billion a year. Against this must be offset the tax lost from insurance premium tax if VAT was to be applied to that sector. This would amount to £7.6 billion[195], leaving a net sum of £8.7 billion of VAT to be recovered.

The reason for making this recommendation is that the charges to which this exemption apply relate to the management of wealth and the vast majority of UK wealth is held by a very few people. The UK Office for National Statistics estimates[196] that 48.6% of UK wealth is owned by the top 10% of wealth owners and 67.4% is owned by the top 20% per cent of wealth owners. In that case the benefit of this VAT exemption is going almost entirely to those in the higher echelons of wealth owners, and most likely of income earners. This cannot be justified and as such the exemption should be withdrawn to increase vertical tax equity.

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[194] https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/structural-tax-relief-statistics-january-2023

[195] https://obr.uk/economic-and-fiscal-outlooks/ accessed 26-7-23

[196] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020

Chapter 11.2

VAT – Recommendation 22

Abolishing the VAT exemption for services supplied by private schools

Brief Summary

This chapter proposes that:

- The VAT exemption on the supply of education by private schools be abolished.
- This is necessary to improve the vertical equity of taxation when the current exemption for VAT charges on private school fees provides a benefit very largely enjoyed by the wealthiest in society.
- Removing this exemption might raise £1.6 billion in additional tax revenues per annum.
- This change would be administratively straightforward.
- There are likely that there will be few behavioural consequences arising from this change.

The proposal	To abolish VAT exemption on the supply of education by private schools.
Reason for the proposal	1. To increase the prospect of vertical equity of taxation when the current exemption for VAT charges on private school fees provides a benefit very largely enjoyed by the wealthiest in society. 2. To raise additional sums in additional tax revenues.

	3. To reduce wealth inequality in the UK which this exemption increases.
Estimated tax that might be raised as a result of the recommendation made	There are unlikely to be many behavioural consequences to this recommendation, as the Institute for Fiscal Studies has noted when discussing this issue[197]. The current estimated cost of this tax relief is £1.6 billion per annum. It is assumed that this revenue would be collected if this exemption was removed.
Ease of implementation	Relatively straightforward. Most private schools are already VAT registered for some of their activities.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	At least two years notice might be required to make this change simply to allow appropriate management of the process to take place.
Consultation period required.	A reasonable consultation period will be required.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/15/abolishing-the-vat-exemption-for-services-supplied-by-private-schools-might-raise-1-6-billion-in-tax-a-year/

Background

Value added tax (VAT) can be applied to a supply of goods and services in the UK in one of four different ways. Three involve a charge to VAT being added to the value of the supply made at differing rates[198]:

[197] https://ifs.org.uk/publications/tax-private-school-fees-and-state-school-spending
[198] https://www.gov.uk/vat-rates

Rate	Rate of tax charged	Impact
Standard rate	20%	A VAT charge of 20% is added to the charge made for the supply of goods and services e.g. if the value of those goods and services is £100 then a VAT charge of £20 is added and the customer must pay £120 for their supply.
Reduced rate	5%	A VAT charge of 5% is added to the charge made for the supply of goods and services e.g. if the value of those goods and services is £100 then a VAT charge of £5 is added and the customer must pay £105 for their supply.
Zero rate	0%	No VAT is added to the value of a supply, but it is deemed that a charge has been made for the purposes of the administration of the tax.

Unsurprisingly the standard rate of VAT is applied to most goods and services.

The reduced rate of VAT is applied to domestic energy supplies and some other supplies deemed essential e.g. sanitary products and children's car seats.

Zero rating applies to food, children's clothing and some other items, mainly related to charitable activities.

A VAT registered business (which is in broad terms is one making VAT chargeable supplies of more than £85,000 a year) has to add VAT charges at the appropriate to the sums it bills its customers and pay over the sums collected to HM Revenue & Customs. It has some recompense for doing so: it is permitted to reclaim from HMRC the cost of VAT charged to it in the course of its trade. This means that, in effect, zero rated businesses and their customers are in receipt of a tax subsidy.

The fourth category of charge that can apply to the goods and services that a business might supply to its customers is VAT exemption. When a business supplies VAT exempt goods and services then there is no VAT charged added to the charge that they make. Superficially this looks similar to supplying VAT zero rate goods and services. It does, however, differ because a business making VAT exempt supplies cannot reclaim the VAT charged to it in the course of its trade.

VAT exemption applies to a range of goods and services including education and training when provided by an eligible body like a school, college or university although most education that is supplied for profit e.g. professional training courses, are not.

Recommendation

It is recommended that the VAT exemption for the supply of education services by private schools be removed.

This recommendation might not have been possible if the UK was still in the European Union, but it has left and since no major political party is recommending a return at present changes in VAT exemption rules can now be made by the UK.

In 2023 HM Revenue & Customs estimated[199] that the cost of the VAT exemption for education was £5.2 billion. The Institute for Fiscal Studies[200] has estimated that approximately £1.6 billion of this might relate to the exemption for education provide by private schools. That suggestion is accepted here.

The reason for making this suggestion is that the majority of those children educated at private schools will be the offspring of parents or grandparents with significant income and wealth and as such this subsidy is being provided to those who have no economic reason to enjoy it. The subsidy contravenes the principle of vertical tax equity by subsidising those who are already wealthy.

The Institute for Fiscal Studies has suggested that there will be little behavioural response to this change in taxation. Given that the whole purpose of most parents in sending their children to private schools is to remove them from the influence of state education whilst providing them with the well-recognised economic and social advantages that private education has, to date, supplied this conclusion is accepted here.

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[199] https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/structural-tax-relief-statistics-january-2023

[200] https://ifs.org.uk/publications/tax-private-school-fees-and-state-school-spending

Chapter 12.0

Council tax reforms - Introduction

Background

The Taxing Wealth Report 2024 recognises that the council tax system used in England (of which variations are in use in Wales and Scotland, but not Northern Ireland) was always a hasty compromise when it was introduced in 1993, and that nothing has improved it since then.

For one pragmatic reason, however, it is not suggested that major reform of this tax take place as part of the whole package of reforms suggested in the Taxing Wealth Report 2024. That pragmatic reason is that there are many better ways of transforming the tax system as a whole to tackle the inequalities created by wealth in the UK than by expending a great deal of effort to totally redesign or even replace any of the variants on council tax now in use. If the goal of those seeking to reform the UK tax system is to tackle the issue of wealth inequality in a systemic fashion then complete council tax reform has to come a long way down the list of potential reforms, even though the tax as it currently stands is very far from ideal.

Issues to be addressed regarding Council Tax

That said, there is much that can be done within the parameters of the existing council tax in England (many of which are likely to be of some relevance elsewhere) and this chapter proposes that if the goal is to more appropriately tax high and low value properties, and in the process reduce the regressive nature of this tax, then this will require:

1. Property revaluations.
2. Increasing the number of bands used for property valuation.
3. Changing the ratio of tax charged between top and bottom bands of council tax.
4. Changing the exemptions available to those on benefits.
5. Changing the treatment of second properties.
6. Changing the treatment of vacant properties.

7. Using central government grant giving mechanisms to provide more support for local authorities in poorer areas whose revenues will fall as a result of these proposals.

The result could be a considerably fairer tax than we have at present, although that outcome would still not be an optimal solution, which would have to wait for attention when more of the issues tackled in the Taxing Wealth Report 2024 have been addressed.

Revenue consequences of proposed reforms

It is important to note that it is very unlikely that any of these proposals, which should ideally be seen as a package as a whole, would raise additional tax revenues. There is very little scope to do that within the existing structure of this tax, not least because the number of high value properties that are undertaxed at present is quite small, and any proceeds from taxing them more appropriately should be used to reduce charges elsewhere across the tax bands. The aim should be to create a fairer tax, and that is what this package of reforms is meant to deliver.

Future work

The Taxing Wealth Report 2024 has deliberately looked at reforming existing taxes in the UK. It has not considered those that might need replacement. It could be argued that Council Tax is in need of replacement. That might be the subject of future consideration.

Chapter 12.1

Reforming council tax in England
Recommendation 23

Brief Summary

This chapter recognises that the council tax system used in England (of which variations are in use in Wales and Scotland, but not Northern Ireland) was always a hasty compromise when it was introduced in 1993, and that nothing has improved it since then.

For one pragmatic reason, however, it is not suggested that major reform of this tax take place as part of the whole package of reforms suggested in the Taxing Wealth Report 2024. That pragmatic reason is that there are many better ways of transforming the tax system as a whole to tackle the inequalities created by wealth in the UK than by expending a great deal of effort to totally redesign or even replace council tax. If the goal is to tackle the issue of wealth inequality in a systemic fashion then complete council tax reform has to come a long way down the list of potential reforms, even though the tax as it currently stands is very far from ideal.

That said, there is much that can be done within the parameters of the existing tax and this chapter proposes that if the goal is to more appropriately tax high and low value properties, and in the process reduce the regressive nature of this tax, then this will require:

1. Property revaluations.
2. Increasing the number of bands used for property valuation.
3. Changing the ratio of tax charged between top and bottom bands of council tax.
4. Changing the exemptions available to those on benefits.

5. Changing the treatment of second properties.

6. Changing the treatment of vacant properties.

7. Using central government grant giving mechanisms to provide more support for local authorities in poorer areas whose revenues will fall as a result of these proposals.

The result could be a considerably fairer tax than we have at present, but not an optimal solution, which would have to wait for attention when more of the issues tackled in the Taxing Wealth Report 2024 have been addressed.

It is important to note that it is very unlikely that this proposal would raise additional tax revenues. There is very little scope to do that within the existing structure of this tax, not least because the number of high value properties that are undertaxed at present is quite small, and any proceeds from taxing them more appropriately should be used to reduce charges elsewhere across the tax bands. The aim should be to create a fairer tax.

The proposals	To reform council tax in England to more appropriately tax high and low value properties and to reduce the regressive nature of this tax. This will require: 1. Property revaluations. 2. Increasing the number of bands used for property valuation. 3. Changing the ratio of tax charged between top and bottom bands of council tax. 4. Changing the exemptions available to those on benefits. 5. Changing the treatment of second properties. 6. Changing the treatment of vacant properties. 7. Using central government grant giving mechanisms to provide more support for local authorities in poorer

	areas whose revenues will fall as a result of these proposals.
Reason for the proposal	1. To improve the horizontal equity of council taxation in England, which is currently undermined by the capping of council tax charges on the highest value properties. 2. To increase the prospect of vertical equity of taxation in England, which is seriously undermine at present by the cap on council tax charges in England and other UK constituent nations. 3. To redistribute tax charges made by local authorities. 4. To use government grant giving mechanisms to encourage greater regional redistribution. What this proposal does not do: a. Raise any significant new revenues for local authorities: it merely redistributes existing liabilities. b. Solve the long term problem of how to tax land appropriately.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be small because relatively few properties will be affected by it. It is possible that some property will be made available for use or sale as a result of the proposals, which in view of the shortage of homes in the UK is considered beneficial. There is no intention that the proposed reforms should raise significant revenue, which by themselves they will not. They are meant to be redistributive in nature.
Ease of implementation	Relatively straightforward. The number of properties requiring revaluation as a result of this exercise will be much smaller than a full revaluation would require, and all

	will already be identified as they are now band H properties for council tax purposes. Revaluation will be greatly assisted by the ready availability of property databases and AI techniques.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Two or three years might be required for a revaluation exercise to take place and for resulting issues to be resolved.
Consultation period required.	Relatively short: a few months at most since the principles of the change are straightforward.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/14/taxing-wealth-report-2024-council-tax-reforms/

Background

Council tax is the main tax charged by local authorities in England. Separate rules apply in Scotland, Wales and Northern Ireland and as such comments made here do not apply in those places, although they could be followed in Wales and Scotland. This commentary also only relates to that part of council tax paid by households and does not concern the charge made to businesses.

Council tax was introduced in haste in 1992 in Scotland and 1993 in England and Wales. It replaced the deeply unpopular community charge, or poll tax, which had, in turn, replaced local rates in England and Wales in 1990.

Unlike the rates system of local council taxation, which was supposedly based upon the rental value of a property, council tax is supposedly based upon the property's market value in 1992. A bizarre feature of the tax is that this is the case even if the property had not been built in 1992, when an imputed value is computed for that year.

In England every property is allocated to one of eight tax bands (A to H) based upon the deemed value of the property in 1992. The higher the value of the property, the higher is the

tax band to which it is allocated, although all properties valued above £320,000 are in band H.

As the House of Commons Library noted in 2023[201]:

Council tax calculations are based on a property in Band D. Bills on properties in other bands are proportionate to Band D bills: so for instance, a band G property in a given local authority pays 15/9 of a Band D bill. The highest band, Band H, pays three times that of the lowest, Band A. This means that the spread of council tax bills is far lower than the spread of property values. As a result, lower income households pay a higher proportion of their income as council tax than higher income households.

The taxes due in each valuation band are always calculated according to the following formula[202]:

Band	Value of dwelling (estimated at April 1991)	Proportion of the tax due for a Band D dwelling
A	£40,000 and under	6 / 9
B	£40,001 - £52,000	7 / 9
C	£52,001 - £68,000	8 / 9
D	£68,001 - £88,000	9 / 9
E	£88,001 - £120,000	11 / 9
F	£120,001 - £160,000	13 / 9
G	£160,001 - £320,000	15 / 9
H	Over £320,000	18 / 9

What is almost never noted is how few properties are in that top band where the maximum rate of council tax is paid. According to an Institute for Fiscal Studies study[203] on council tax published in 2020 the proportion of properties in each band is as follows:

[201] https://commonslibrary.parliament.uk/research-briefings/cbp-9712/

[202] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/875124/Council_tax_levels_set_by_local_authorities_in_England_2020-21.pdf

[203] https://ifs.org.uk/publications/revaluation-and-reform-bringing-council-tax-england-21st-century

Band	Tax rate relative to Band D	Property valuation as of 1 April 1991	Percentage of dwellings in each band, September 2019
A	$^{6}/_{9}$	Up to £40,000	24.2%
B	$^{7}/_{9}$	£40,001 to £52,000	19.6%
C	$^{8}/_{9}$	£52,001 to £68,000	21.8%
D	1	£68,001 to £88,000	15.5%
E	$^{11}/_{9}$	£88,001 to £120,000	9.6%
F	$^{13}/_{9}$	£120,001 to £160,000	5.1%
G	$^{15}/_{9}$	£160,001 to £320,000	3.5%
H	2	Above £320,000	0.6%

Source: Table CTSOP1.0 SUPP of VOA (2019).

A quite remarkably small number of properties are taxed at the highest council tax rate, which charge is itself just double the charge levied on a property supposedly worth, on average, about one quarter of its worth. In addition, fewer than nineteen per cent of properties are subject to the higher rates of council tax in England. The regressive nature of this tax, at least in proportion to wealth, is readily apparent as a consequence.

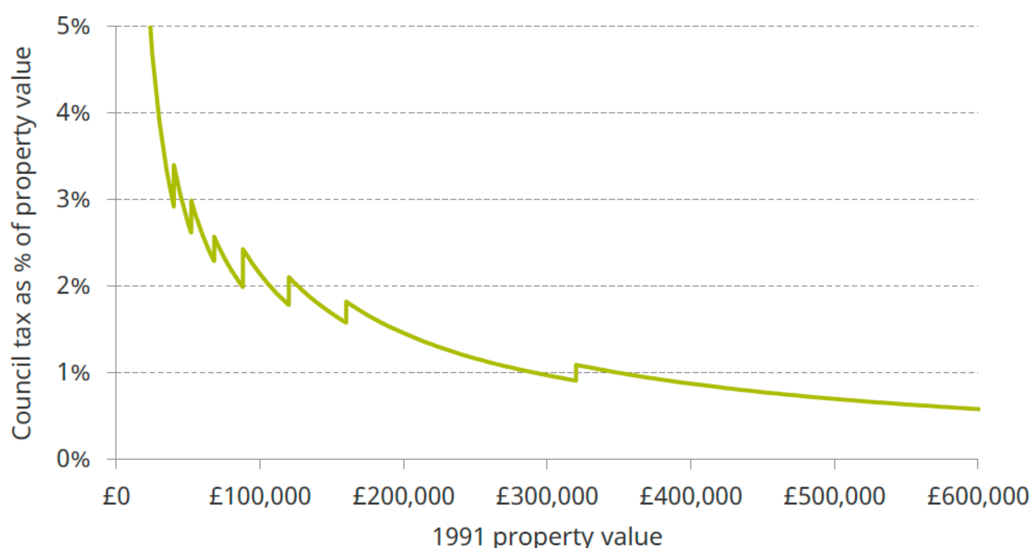
There are numerous problems with this tax. The first is that to run a taxation system based on 1992 property values makes no sense: the likelihood of the wrong tax rate being applied to a property is high. In addition, as a matter of fact, and as the Institute for Fiscal Studies has shown, the disparity in value between high and low value properties has increased considerably. So too has the disparity in value between regions of England. The use of supposed 1992 values perpetuates inequalities within this tax that results in those in the highest value properties in the most highly valued areas paying substantially less as a proportion of their income for this tax than they did when it was first introduced, with the opposite also being true: those in low value properties in the lowest valued areas pay disproportionately too much council tax compared to 1992.

A revaluation is obviously required but the political will to face the resulting issues that might arise has not been found as yet. Memories of the public distaste for the poll tax remain vivid in many politician's minds[204], but that is no excuse for inaction.

The Institute for Fiscal Studies highlighted these injustices in their work:

[204] https://www.jstor.org/stable/41788932

Annual council tax as a percentage of 1991 property value in a local authority charging the 2019–20 English average Band D rate



Source: Institute for Fiscal Studies as noted in text

The 'lumpiness' in the graph reflects the problem with charging a tax in bands.

There is a further problem with this tax, which is that the single person discount available to all occupiers of any property whatever its size makes no economic sense since it encourages an inefficient use of property when there are many in desperate need of suitable housing.

There are, finally, distortions arising with regard to second properties and those that are vacant for any reason.

Second properties are defined as those that are furnished and available for the use of a person who has another property in which they usually reside. There is widespread disparity in the treatment of these properties, from the offering of discounts of up to fifty per cent, to charging the full council tax charge, to the imposition of a premium on that charge. There is now a proposal, not yet enacted, to allow councils to charge up to double the normal council tax charge on second properties, but this has been enacted[205] [206] at the time of preparation of this note.

[205] https://www.gov.uk/council-tax/second-homes-and-empty-properties

[206] https://hoa.org.uk/advice/guides-for-homeowners/for-owners/second-home-council-tax/

Vacant properties are also subject to variation in treatment[207]. Most councils charge council tax on empty properties, although some still offer discounts. A premium can be charged if a property has been empty for 2 years or more which can increase to four times the normal council tax charge if the property is empty for ten years or more. There is little apparent logic to the inconsistencies in these charges.

Potential reform

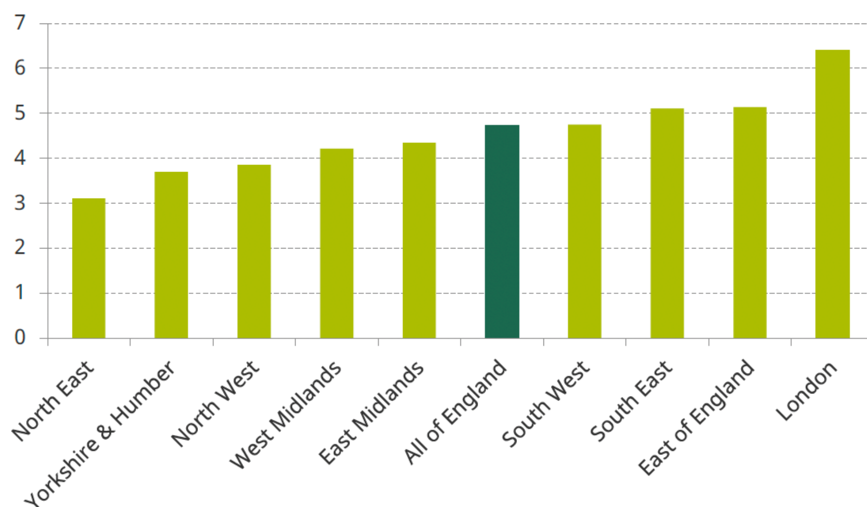
There are some very obvious immediate reforms that are possible with regard to council tax in England.

Revaluation and increasing the number of bands used for Council Tax charging

First within this area of consideration, there could be a revaluation of all properties in England for council tax purposes. Presuming that a banding structure for the tax was retained, and tax was not to be charged as a strict proportion of the deemed value of a property then it is likely that online data would now permit such a revaluation with relative ease and lower cost than might have been the case until recently, subject to appropriate evidence-based appeals procedures being available.

Data from the Institute for Fiscal Studies[208] does, again, indicate the appropriateness of such a revaluation:

Average property price in November 2019 as a multiple of January 1995, by region



[207] https://www.gov.uk/council-tax/second-homes-and-empty-properties

[208] https://ifs.org.uk/publications/revaluation-and-reform-bringing-council-tax-england-21st-century

With such significant disparities having arisen a revaluation is clearly overdue.

Second in this area of reform, the idea of eight property valuation bands needs to be abandoned. There is no reason why significantly more could not be added both within existing ranges and at the top end to reflect the growing diversity in property valuation right across the UK whilst also providing a better basis for the taxation of wealth (with those in retirement being allowed to roll up liabilities until death).

Third, more exemptions and reduced rates are required at the lower level of valuations: it is wrong that households likely to have very low income should pay two-thirds of the sum due on an average house when they are unlikely to have the capacity to pay that sum. In addition, those with low incomes and who are on essential benefits should be exempted from this tax, which is not universally the case at present.

The IFS modelled a number of options for general reform of this tax. First they looked at a model still using eight bands:

Band structures, thresholds and relativities of reform: systems with 8 bands

Band	1991 bands	Q1 2019 bands	Revaluation relativities (option 1)	Proportional relativities (option 2)	Fraction of properties (England as a whole)
A	Up to £40,000	Up to £142,000	6/9	29/100	24.4%
B	£40,001 to £52,000	£142,001 to £204,560	7/9	49/100	19.6%
C	£52,001 to £68,000	£204,561 to £301,810	8/9	71/100	21.8%
D	£68,001 to £88,000	£301,811 to £415,120	9/9	100/100	15.5%
E	£88,001 to £120,000	£415,121 to £571,050	11/9	136/100	9.6%
F	£120,001 to £160,000	£571,051 to £794,420	13/9	187/100	5.1%
G	£160,001 to £320,000	£794,421 to £1,769,840	15/9	284/100	3.5%
H	Above £320,000	Above £1,769,840	18/9	680/100	0.6%

Note: The 'relativities' columns show the tax rates on properties in each band as a proportion of the tax charged on a Band D property. For example, under option 1, a property in Band A would face a tax bill equal to $^6/_9$ of the tax bill for a property in Band D. Figures differ slightly from those reported in Table 2.1 as these figures relate to 2018–19, the year on which our analysis is based, rather than 2019–20.

Source: Authors' calculations using HM Land Registry (2019), MHCLG (2018a and 2019e) and VOA (2018).

Then they suggested increasing the number of bands:

Band structures, thresholds and relativities of reform: systems with 11 bands

Band	Q1 2019 bands	Proportional relativities (option 3)	Less regressive relativities (option 4)	Fraction of properties (England as a whole)
A1	Up to £97,160	22/100	4/9	11.0%
A2	£97,161 to £134,800	33/100	5/9	11.0%
B1	£134,801 to £168,100	43/100	6/9	11.0%
B2	£168,101 to £204,560	53/100	7/9	11.0%
C	£204,561 to £301,810	71/100	8/9	21.8%
D	£301,811 to £415,120	100/100	9/9	15.5%
E	£415,121 to £571,050	136/100	12/9	9.6%
F	£571,051 to £794,420	187/100	15/9	5.1%
G	£794,421 to £1,769,840	284/100	20/9	3.5%
H	£1,769,841 to £2,373,370	570/100	25/9	0.3%
I	Above £2,373,370	909/100	30/9	0.3%

Note: The 'relativities' columns show the tax rates on properties in each band as a proportion of the tax charged on a Band D property. For example, under option 3, a property in Band A1 would face a tax bill equal to $^{22}/_{100}$ of the tax bill for a property in Band D.

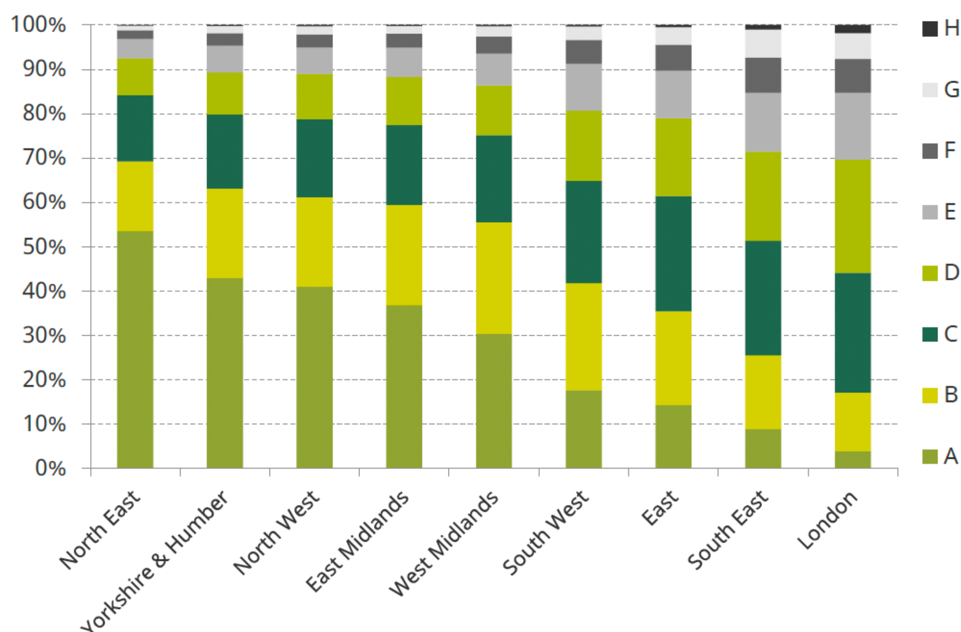
Source: Authors' calculations using HM Land Registry (2019), MHCLG (2018a and 2019e) and VOA (2018).

This second option is more progressive whether a form of proportionately to value or grading around Band D tax is adopted. The second range of options appears considerably the more useful as a result. It is likely that both for political ease and for the sake of reducing the number of valuation appeals that banding will remain attractive.

However, as the Institute for Fiscal Studies notes, this does require abandonment of the idea that Council Tax is a payment for services: it clearly is not.

It also requires a recognition that there are winners and losers from such reform but overall:

- Less well-off households usually gain significantly, although a few might not. This will have to be managed.
- Better off households are very likely to be asked to pay more.
- The proverbial 'property rich, cash poor' pensioner problem becomes more apparent as a more progressive tax is adopted: this has to be managed by allowing higher liabilities to be rolled up until death when payment is made, secured by a charge on the property.
- There is a more significant problem created by the likely differing numbering of properties in each new band per area, as indicated by existing data, which varies as follows (data, again, from the IFS):



Source: Table CTSOP1.0_SUPP of VOA (2019).

This last issue is addressed in the next recommendation.

It is stressed that whilst this proposal will tackle inequality it is not meant to be revenue generating: the aim is redistribution of existing liabilities to correct failings in what is currently a deeply inappropriately regressive tax.

Regional redistribution

The result of a revaluation and rebanding of properties has a number of consequences, most especially on the total capacity for revenue collection by a council. Those councils that end up with more properties in lower bands (and many will) might see their ability to raise revenue reduced without creating unacceptably high overall Band D tax rates. The converse might be true in areas with disproportionately large numbers of higher value property. An attempt to reduce the regressive nature of a tax should not produce such a perverse outcome.

As a matter of fact, sixty per cent of the funding for local authorities is still provided by central government grants[209]. It follows that the system of grant funding by central government could be used as a mechanism for redistribution between local authorities so that those with limited, and reduced, capacity to charge council tax after rebanding are compensated for losses and

[209] https://www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2021-to-2022-final-outturn/local-authority-revenue-expenditure-and-financing-england-2021-to-2022-final-outturn

those with increased capacity are required to cover a greater proportion of their costs from their own resources.

It is recommended that a process to ensure that this is the case is out in place.

Second properties

It is recommended that all second properties be subject to mandatory double council tax charges.

It is recommended that third and further properties be subject to mandatory quadruple council tax charges.

This is a deliberately progressive taxation charge.

The ordering of properties should be on the basis of days of use, which the taxpayer must prove e.g. by evidence of water usage.

This proposal will raise revenue, but data to estimate the amount is not readily available.

Vacant properties

The current rules with regard to vacant properties are inconsistent and inappropriate as a result. Legislation in 2018 in England extended the maximum additional charges but does not mandate it. As the House of Commons Library noted[210] in 2023:

The law sets a maximum charge that a council can make. For instance, after a property has been "unoccupied and substantially unfurnished" for two years, an authority in England can charge up to 200% of the normal council tax bill.

The amount of the empty homes premium is based on the normal council tax band of the property. The band itself is not affected by the empty homes premium.

It is suggested that this charge be mandatory.

It is also noted that the charges can usually be cancelled by living in the property for six weeks, after which the two-year period of vacancy recommences. This appears to be much too short. A three-month period would seem appropriate until three years from first vacancy, rising by a month each year thereafter.

[210] https://commonslibrary.parliament.uk/why-am-i-paying-an-empty-homes-premium-on-my-council-tax/

After five years vacancy any property is likely to be in a state of serious dilapidation. For the sake of the property and its future use, the place in which it located and recognising the need for housing the charge should then be increased considerably. A rate five times the normal council tax charge would then seem appropriate, with an option to extend this after seven years of vacancy to ten times the normal rate to prevent the nuisance arising.

The right to repossess at fair value if these charges are not paid should be provided for.

It is thought that there are approximately 250,000 vacant properties in the UK at any time, although the definition is based on a time period shorter than two years[211].

This proposal is not being made to raise revenue, as such. Its intention is to bring property into use. This is an effective and alternative form of wealth redistribution.

[211] https://www.leedsbuildingsociety.co.uk/_resources/pdfs/press-pdfs/press-releases/empty-homes-week.pdf

Chapter 13.0

Student taxation – Introduction

The student taxation section of the Taxing Wealth Report 2024 is unusual in focussing both on an issue that is not generally considered to relate to taxation and in suggesting a reform that will reduce government revenue. There are, however, good reasons for that.

The reality is that student loan charges are collected by HM Revenue & Customs vie the Pay as You Earn and self-assessment tax systems. They are also collected as charges on income arising during a period. In addition, given that the charges made have very little relationship to services provided either during past or present periods they behave very much like taxes.

As taxes, student loan charges create considerable horizontal and vertical tax inequities within the UK which would make many of the other recommendations in the Taxing Wealth Report 2024 hard to implement without considerable social injustice arising.

The actual sum raised by student loan charges is around £4 billion per annum at present, a sum that does not even cover the supposed loan interest charges being made on student loan accounts each year, which fact also makes clear that these loan charges have very little relationship to the cost of supplying undergraduate education to those who benefit from it.

As such the Taxing Wealth Report 2024 suggests that student loan arrangements now be cancelled. There is little chance of tax justice whilst they are retained and the greater good of society does, as a result, require this change, the consequences of which are explored in this section of the Taxing Wealth Report 2024.

Chapter 13.1

Student taxation – Recommendation 24

Reforming student taxation

Brief Summary

This chapter suggests that:

- Student loan charges are, in effect, a graduate tax.

- The sums collected by this tax are relatively insignificant, having reached £4 billion in 2022/23 and totalling just £32.7 billion over the nineteen-year period ending then at an average of just £1.7 billion a year.

- This charge creates substantial horizontal and vertical tax inequality within the UK tax system, with it being possible for a graduate on median pay in the UK to have a marginal tax rate more than twice that of a person with similar income derived from investment sources.

- Within the current structure of the so-called student loan charge there is no way in which these inequities can be addressed, and as a consequence it is proposed that student loan charges be cancelled.

- It is recognised as a consequence that more than £200 billion of supposed student debt will have to be written off. However, in practice it is expected that only 27% of students with loans taken out before 2023 will actually repay their liabilities in full, with that forecast supposedly increasing for students starting their courses after 2023 to approximately 64%, but that will be after 40 years. The reality is that much of this debt will never be repaid.

- It is already the case that much of this debt is not on the government balance sheet at present. The UK government Whole of Government Accounts for 2021 (the most recent available at the time of writing[212]) suggests that the debt was worth £87.8 billion in March 2021 when the House of Commons Library suggests that the actual debt nominally owing was slightly more than double that sum at that time[213].

- Importantly, however, it seems likely that student debt is almost wholly excluded from Office for National Statistics national debt calculations and as such the write off of this sum will have no impact on this figure[214]. The reality is that the actual cost of providing students with their education, has already been accounted for in existing debt calculations, and no adjustment to that would be required as a consequence of writing off these sums.

- The sole consequences of this change will be:

    - To reduce foreseeable tax payments by graduates by approximately £4 billion a year, but with significant likelihood that other proposed tax changes noted in this Report will be more acceptable as a result.
    - That some student loan balances that have been sold will have to be repurchased by the government, which will marginally increase the cost of government borrowing, but not in any material fashion.

- The benefits of this proposal are:

    - Disincentives to partake in higher education will be removed.
    - A level playing field will be created within the nation states of the United Kingdom where Scotland, in particular, has pursued a different approach to England on this matter.
    - Horizontal and vertical tax inequalities will be eliminated with overall improvement in tax justice resulting.

[212] https://www.gov.uk/government/collections/whole-of-government-accounts
[213] https://commonslibrary.parliament.uk/research-briefings/sn01079/
[214] The logic for the ONS excluding this debt is explained in this blog post https://www.taxresearch.org.uk/Blog/2023/12/24/the-good-news-this-is-christmas-is-that-trillion-of-the-uks-national-debt-does-not-exist/

- The cost of higher education will be recognised as one that society needs to bear for the benefit that it supplies to everyone, and not just the student partaking in it.
- The likelihood that younger people will be able to afford to buy their own homes and contribute to pensions will increase when at present student loan repayments are a serious impediment to their prospects of taking on these government promoted activities.
- The quality of life for very large numbers of younger people in the UK will be substantially improved with a likely boost to economic confidence and so economic growth.
- it is also possible that reductions in student debt charges will encourage greater entrepreneurial activity in the UK.

The proposal	To cancel student loans charges in the UK.
Reason for the proposal	1. Student loan charges in the UK generated £4 billion of repayments in 2022/23, the highest sum ever. These sums are collected by HM Revenue & Customs as if they are tax. They had averaged £1.7 billion a year over the previous nineteen years. The loan balance outstanding is approximately £200 billion. The interest charges on this debt in 2022/23 were approximately £15 billion. Student loan charges do not represent payment for education undertaken in that case. They do not even cover the interest charges imposed. They are instead a graduate tax at 9 per cent on some graduates in the UK staring on less than median income. 2. Student loan charges are likely to be regressive as the students of wealthy parents tend not to have loans. 3. These charges are also discriminatory within the UK as Scotland has differing arrangements.

	4. Student loan charges undermine the horizontal equity both between graduates of different eras and between those who have and have not partaken of higher education when it is UK government policy to encourage people to do so. Considerable inequality arises as a consequence. 5. Student loan charges also undermine vertical equity of taxation in the UK by creating distortions in the system that are not allowed for in other taxation charges. 6. To reduce the rate of tax avoidance and tax evasion in the UK which the avoidance of these charges might encourage. 7. To consequently improve the rate of tax compliance in the UK. 8. To improve the wellbeing of graduates, many of whom are deeply financially stressed as a result of these charges and face great difficulty in buying properties or in funding pension arrangements as a result of them.
Estimated tax that might be raised as a result of the recommendation made	This recommendation might cost £4 billion in tax revenue foregone per annum, which is considered insignificant in the context of other changes recommended in the Taxing Wealth Report 2024. The behavioural responses to this change, noted in the summary of this proposal, might however stimulate economic activity that might considerably offset this cost as a result of their multiplier effects.
Ease of implementation	Relatively straightforward, although repurchasing student debts already sold might take some time.
Likely difficulties that might result from implementation	Few, excepting the repurchase of student debt already sold and the management of the claimed costs of doing that.

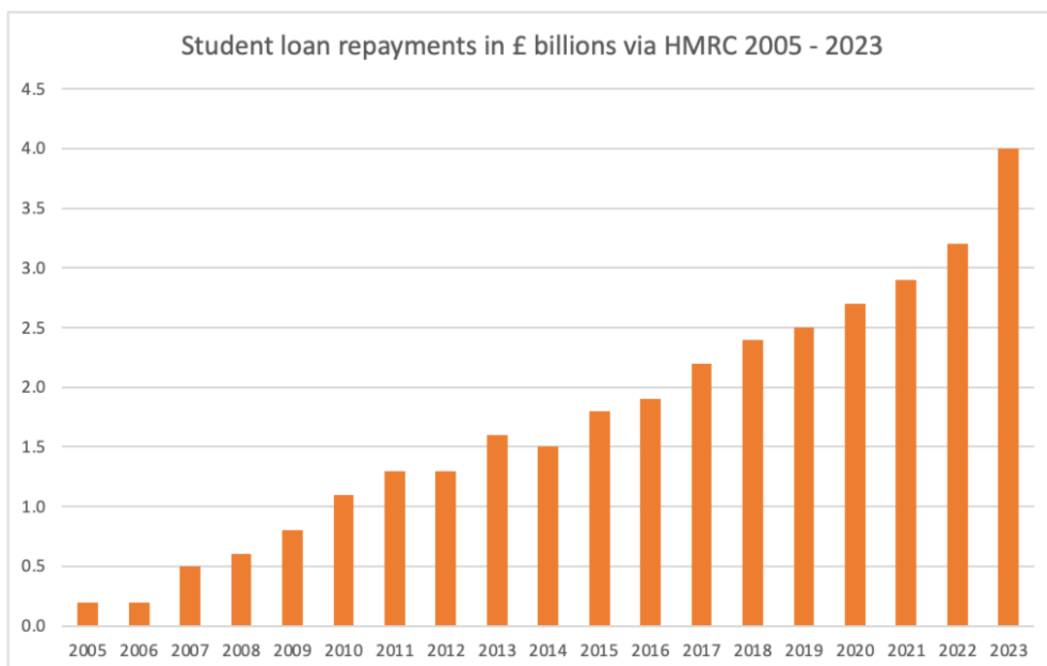
Likely time required to implement the change	Short.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2024/01/23/the-taxing-wealth-report-abolishing-the-uks-student-tax-would-cost-4-billion-a-year/

Background

There is not, officially, a student tax in the UK. However, for all practical purposes there is. As evidence, HM Revenue & Customs has collected these sums from students through its PAYE (pay-as-you-earn) and self-assessment tax assessment systems in the years noted:



Source: HMRC's annual published accounts for the years noted

Total repayments during this nineteen-year period amounted to £32.7 billion, but never exceeded £4 billion in a year.

The Student Loan Company (SLC) that manages this debt was created by a Conservative government in 1989. Its original purpose was to assist students looking for help with funding for their maintenance. The loans were straightforwardly structured and were repayable directly to the SLC.

In 1998 a new Labour government introduced tuition fees for undergraduate students. The loans provided from then on became repayable dependent upon a graduate's level of earnings in the years after they graduated.

From 2006 loans covered both maintenance and tuition fees.

From 2012, when tuition fees in England (but not all other countries in the UK) were increased to £9,000 per annum repayment structures were changed to reflect the considerably increased debt burden that many students then faced on graduation[215].

In 2020/21, which is the last year for which full data is available, English resident students attending UK universities 1,218,000 students took out student loans with a value of £18.4 billion at an average of £15,080 each. Ninety-five per cent of students took out a loan[216]. All of these figures are expected to rise in coming years.

A three-year English resident undergraduate student now faces student debt of around £45,000 when graduating.

Students are charged interest on their loans. The arrangements vary depending upon the loan that they were offered. There are to date five loans schemes:

Plan 1: Income contingent loans made to undergraduates who started before 2012

Plan 2: Income contingent loans made to undergraduates who started between 2012 and 2022 and Advanced Learner Loans to further education students

Postgraduate or Plan 3: Master's and Doctoral loans

Plan 4: Loans to Scottish students who started after 1998

Plan 5: Loan to undergraduates starting from 2023/24

Of these arrangements Plans 1 and 2 are the most significant and Plan 2 now dominates. Interest charges on these loans have usually been set at the increase in the retail price index

[215] Background data based on House of Commons Library reporting at https://commonslibrary.parliament.uk/research-briefings/sn01079/

[216] ibid

(which is rarely used for other purposes, and tends to report inflation at rates higher than the more commonly used consumer prices index) plus three per cent. The impact during the recent period of inflation would have been dramatic. In practice, caps have been introduced to prevent excessive charges. Charges since 2022 have been at around seven per cent per annum instead. This still represents a charge of in excess of £3,000 per annum for many students. This sum is added to loan balances and is not the subject of immediate demand for payment. Like the capital sum owing, payment of interest is only made if the graduate has sufficient income to require it.

At the beginning of 2024 loan repayments were due if income of a graduate who had taken a loan exceeded these thresholds[217]:

Plan type	Yearly threshold	Monthly threshold	Weekly threshold
Plan 1	£22,015	£1,834	£423
Plan 2	£27,295	£2,274	£524
Plan 4	£27,660	£2,305	£532
Plan 5	£25,000	£2,083	£480
Postgraduate Loan	£21,000	£1,750	£403

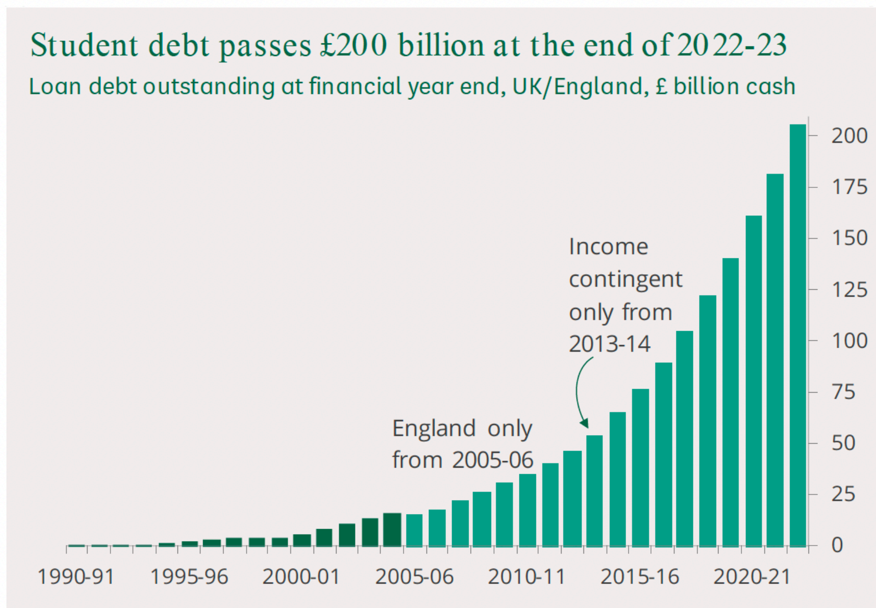
Repayments due are made at the following rates[218]:

- 9% of income over the threshold in the case of Plans 1, 2, 4 or 5
- 6% of income over the threshold in the case of a Postgraduate Loan

What is most important to note if the fact that these rates are not covering the rate at which student debt is accumulating, not least because of the imposition of interest charges. As the House of Commons Library has noted, debt is increasing rapidly:

[217] https://www.gov.uk/repaying-your-student-loan/what-you-pay

[218] ibid



The primary reason for this is the growing number of student staking loans that were repayable over 30 years and will, from 2023/24 cohort onwards, be repayable over 40 years.

However, there are other significant factors, including the fact that of full-time undergraduate higher education students starting in academic year 2022/23,

only 27% are expected to be repay their loan in full. This figure rises to 61% for the 2023/24 cohort because of the ten-year extension in time permitted for repayment from that year onwards[219]. This is now, in effect, a lifetime tax charge.

It is already the case that much of this this debt is not on the government balance sheet at present. The UK government Whole of Government Accounts for 2021 (the most recent available at the time of writing[220]) suggests that the debt was worth £87.8 billion in March 2021 when the House of Commons Library suggests that the actual debt nominally owing was slightly more than double that sum at that time[221].

Importantly, however, it seems likely that student debt is almost wholly excluded from Office for National Statistics national debt calculations and as such the write off of this sum will have no impact on this figure[222]. The reality is that the actual cost of providing students with their

[219] https://explore-education-statistics.service.gov.uk/find-statistics/student-loan-forecasts-for-england

[220] https://www.gov.uk/government/collections/whole-of-government-accounts

[221] https://commonslibrary.parliament.uk/research-briefings/sn01079/

[222] The logic for the ONS excluding this debt is explained in this blog post https://www.taxresearch.org.uk/Blog/2023/12/24/the-good-news-this-is-christmas-is-that-trillion-of-the-uks-national-debt-does-not-exist/

education, has already been accounted for in existing debt calculations, and no adjustment to that would be required as a consequence of writing off these sums.

This is explained by the fact that interest charges currently exceed repayments made on student loans, and this is expected to remain the case until about 2035[223]. In effect the capital on these supposed loans is rarely being repaid. As a mechanism for providing loan finance the student loan arrangement for funding English student attendance at universities very clearly fails.

Discussion

Given the noted facts it is impossible to suggest that the payments made by graduates in respect of their student loans are in respect of the education that they received. There is no obvious correlation between the sums that any one person might pay and the value of the degree that they secured, or the loan that they incurred. The charge made is simply an additional income tax that might cover a penal interest charge on the supposed loan that they incurred with a small capital repayment potentially occurring, but without any certainty. In that case the UK does not have a student loan scheme: it has a graduate tax that penalises those who pursued education that the government encouraged them to partake of. It should be noted that this tax cannot be represented to be a charge on wealth. Whilst it is generally true that graduates do earn more than non-graduates within the UK economy[224], those who have the highest outstanding student balances tend to be students whose parents have more limited means. In other words, the student loan charge is most likely a regressive tax charge, with the wealthiest graduates likely to have no such liability at all as their parents meet the entire cost of their student education. There is, as a consequence, no progressive justification for a student tax charge, and yet we have one in the UK.

There is a serious consequence of the existence of the student tax charge. It effectively adds a nine per cent additional tax charge over and above that otherwise imposed by income tax and insurance on all graduates now earning in excess of a sum in itself less than median UK earnings per annum. This charge destroys horizontal tax equity between graduates and non-graduates. There is also nothing progressive about the charge when the liability owing is as much the consequence of the parental situation of a graduate as it is their own personal circumstance. To pretend that there is a progressive justification for this tax is, therefore, impossible.

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[223] https://commonslibrary.parliament.uk/research-briefings/sn01079/

[224] https://www.statista.com/statistics/1191970/annual-salary-of-graduates-in-england/#:~:text=University%20graduates%20in%20England%20had,average%20salary%20for%20non%2Dgraduates.

In addition, the charge destroys any other attempts at creating justice within the UK tax system by creating particular distortions for some within society, not experienced by others. When the total sum collected by this charge is about £4 billion per annum, this is particularly inappropriate.

It is important to note that there would be contractual issues arising if changes were made to older student debts because some of their debt has now been sold to third parties. However, given the fact that so many of these debts will never be repaid these cannot be insurmountable and compensation could be paid to effectively repurchase this debt.

Recommendation

The UK's student tax is inequitable, creates a disincentive to learning and imposes horizontal tax inequity on graduates for what will in many cases be the whole of person's working life given that forty-year time horizon of the latest loan arrangement. This creates distortions that no fair tax system can tolerate. For example:

- A graduate now earning £28,000 per annum has a marginal tax rate in the spring of 2024 of 39% made up of:
    - 20% income tax
    - 10% national insurance
    - 9% student loan charge / tax
- A non-graduate person earning £30,000 from investment sources may well have a marginal tax rate of less than 20% on their income. This would only be made up of income tax, but that rate may be reduced by:
    - The savings tax allowance
    - The reduced rate of income tax payable on dividend income
    - The offset of expenses against rental income
    - The lower rates of capital gains tax if any part of that income was earned via gains.

This is clearly inequitable. As a result, it is proposed that student loan charges be cancelled in their entirety.

The only significant consequences of this change will be:

- To reduce foreseeable tax payments by graduates by approximately £4 billion a year, but with significant likelihood that other proposed tax changes noted in this Report will be more acceptable as a result.

- That some student loan balances that have been sold will have to be repurchased by the government, which will marginally increase the cost of government borrowing, but not in any material of fashion.

- The benefits of this proposal are:

    - Disincentives to partake in higher education will be removed.
    - A level playing field will be created within the nation states of the United Kingdom where Scotland, in particular, has pursued a different approach to England on this matter.
    - Horizontal and vertical tax inequalities will be eliminated with overall improvement in tax justice resulting.
    - The cost of higher education will be recognised as one that society needs to bear for the benefit that it supplies to everyone, and not just the student partaking in it.
    - The likelihood that younger people will be able to afford to buy their own homes and contribute to pensions will increase when at present student loan repayments are a serious impediment to their prospects of taking on these government promoted activities.
    - The quality of life for very large numbers of younger people in the UK will be substantially improved with a likely boost to economic confidence and so economic growth.
    - It is also possible that reductions in student debt charges will encourage greater entrepreneurial activity in the UK.

Chapter 14.0

Tax incentivised savings reforms - introduction

Background

In the chapter within the Taxing Wealth Report 2024 that explored the cost of providing pension tax reliefs to those making qualifying pension contributions in the UK each year it was suggested that the total cost of those reliefs now amounts to at least £65 billion per annum[225].

In another such chapter, it was suggested that the cost of Individual Savings Account (ISA) tax reliefs now amounts to at least £3.7 billion per annum, with that sum now likely to have increased considerably because of rising interest rates[226].

In total the tax system does, as a consequence, spend approximately £70 billion a year subsidising the savings of those who are already wealthy within the UK[227].

This needs to be placed within the context of UK state spending. The spend in question is equivalent to one third of the sum spent on the NHS, two thirds of the sum spent on education and exceeds spending on defence, public order and safety, transport and housing and communities[228]. The cost of tax relief given to UK savers is, in that case, a major part of UK government spending.

The problem with subsidising savings via the UK tax system

In the two recommendations made in this part of the Taxing Wealth Report 2024 these costs are recognised as the major cost that they are. However, rather than suggest further change to the tax reliefs given on those making these savings contributions, which are issues dealt with in the income tax section of this report, it is instead suggested that the receipt of either pension tax relief on contributions made by a person to a pension fund or the receipt of ISA

[225] https://www.taxresearch.org.uk/Blog/wp-content/uploads/2023/09/Restricting-pension-tax-relief-published-1.pdf

[226] https://www.taxresearch.org.uk/Blog/wp-content/uploads/2023/11/The-use-of-ISAs-published.pdf

[227] By definition, most savings are always owned by those already wealthy. For more information on wealth distribution in the UK see the background notes to this Report.

[228] Spending data from https://ifs.org.uk/taxlab/taxlab-data-item/ifs-spending-composition-sheet

tax relief on sums saved in such accounts should be made conditional upon at least part of the savings in question being made being made available to fund investment for social and economic programmes consistent with the objectives of the government granting such relief. In this way, the exceptional cost of these tax reliefs might give rise to a commensurate return for the sum expended.

One reason for making this suggestion is to ensure that a return is provided for these sums expended to those not personally enjoying the personal benefit of any significant part of these reliefs, who form the majority of the UK's population since most people in the country do not have any significant savings.

There is another reason for suggesting this reform. It is already Labour and Conservative Party policy to encourage greater direct investment by UK pension funds in the UK economy, both having noted how little direct engagement between pension funds and the underlying economy that there is. This is not least because of the marked preference of most pension funds for bond-based investment, little of which can be directly related to investment activity in the real economy, which is an issue that needs to be addressed. The suggestion that these parties make is, however, surprising because there is no evidence that UK business lacks access to capital. The sector of the economy that lacks that access are public services, and neither of those political parties suggests that public services should benefit from the vast sums saved in the UK by those enjoying tax relief on their savings. It is this issue that the recommendations made in this section addresses.

The proposals

The proposals made in this section ae related, but different. Both suggest that in exchange for the tax relief that savers secure by using tax incentivised savings structures that some or all of their funds should be made available to provide the capital required to invest in essential public service within the UK economy.

In the case of pension accounts, it is suggested that at least twenty-five per cent of all new pension contributions should be invested in the following types of project, for which strict criteria would need to be established:

- Capital projects required to deliver the climate transition if net-zero goals are to be achieved.
- New social housing.
- Other new social infrastructure.

- Related training, education and support services.

This could be achieved by investing in:

- UK government green saving bonds of the type now issued through NS&I, which is the government's own savings bank. The use of these funds is noted by the government in occasional reports[229].

- Green gilts issued by the UK government, which are now becoming more common place.

- Bonds issued by a UK government owned national investment bank that had as its purpose investment in the above noted categories of assets, on which returns could be paid by their users.

- Private sector funds meeting the above noted required specification for investment could be used for this purpose. A very clear taxonomy requiring strong evidence of the actual investment of funds raised for green purposes would be required for any company to qualify to raise funds in this way.

It is stressed that no suggestion is made that past pension contributions must be redirected in this way.

It is also the case that no conditions would be attached to the use of the remaining seventy-five per cent of contributions made by taxpayer to their pension fund during a period. They would have complete freedom to suggest the way in which these funds might be invested so long as their choice was compliant with the rules of their chosen pension fund.

In the case of ISA accounts, it is suggested that all existing ISA accounts be withdrawn from offer, although those already in existence should be allowed to continue. In their place, new ISA account would be made available. These would now be the only form available to taxpayers seeking this form of tax incentivised savings account. All the funds saved in these accounts could be subject to a government guarantee of a fixed rate return, which would vary over time, and over the duration of the savings periods for which the saver opted, but all the funds in question would then be invested in the types of savings structures noted

229 https://assets.publishing.service.gov.uk/media/651446cdb1bad4000d4fd916/HMT-UK_Green_Financing_Allocation_Impact_Report_2023_Accessible.pdf

above that might also be used for pension purposes. Private sector funds would not, of course, be subject to a guarantee if they were opted for.

This ISA arrangement would, in effect, provide a form of hypothecated savings account to access particular forms of government bonds that would be available for savers to use to provide periodic fix rate returns, which is what many savers are looking for. The marketing appeal of the product would be that the saver would know that their funds were being used for dedicated social purposes.

In both the pension and ISA cases, the direct relationship between savings and capital investment would have been restored by these products when it is almost entirely absent from the savings market at present.

Although ISAs would appear to be short term savings products, in practice there has been an almost continual increase in funds invested in these accounts over many years and they do, therefore, provide a stable source of new capital for projects of the types noted above in the UK. A present approximately £70 billion a year is saved in ISA accounts in the UK, although some of this is recycled from old accounts. That recycling from old accounts would continue for some time under the new arrangements.

In aggregate it is possible, that £35 billion a year of funding might be available from pensions as a result of the suggestion made, and up to £70 billion a year from ISA accounts, representing in total more than £100 billion of funding available each year to support social transformation in the UK by replacing its outdated and outmoded capital stock with new capital investment suitable for a sustainable economy. This would put the text reliefs available to the wealthy to the best possible use on behalf of society. It would also provide a return to all others in society as a consequence of the grant of those reliefs.

The estimates of tax contribution to be made by these two recommendations are based on different criteria. In the case of ISAs, it is suggested that the value of the tax relief given is better directed, and so it is the value of that tax relief that us suggested to be the direct benefit in that case. In contrast, it is the value of the investment that is indicated to be the worth of the change in pension tax relief rules. The contrast in approach is made deliberately: the way in which this benefit is measured can be viewed from differing perspectives, and this is highlighted by the different measures are used.

Chapter 14.1

ISA savings reforms – Recommendation 25

Brief Summary

This chapter proposes that existing ISA savings arrangements should be scrapped because they provide almost no overall economic return to the country as a whole, very largely subsidise the savings of the already wealthy, and divert funds away from much more constructive use.

Green ISAs are proposed in place of existing ISA savings arrangements. These Green ISAs would have to be invested in either government backed savings accounts or bonds or private sector equivalent accounts, all of which funds would be required to invest the proceeds of sums raised in:

- The transition to net-zero that this country requires.
- Social infrastructure, such as new housing.
- Related activities such as education, training and appropriate support services.

The option of simply leaving cash in moribund bank accounts or of speculating funds on stock markets, which is how the £700 billion or more now saved in ISA accounts is currently used, would disappear over time as existing ISA account arrangements expired and new ones took their place. £70 billion a year goes into ISA accounts at present, the main appeal being their tax-free status.

The creation of a new source of capital for public investment from this source would as a result turn the current £3.7 billion (and rising) annual cost of subsidising such accounts from being lost money into a valuable source of funding for new investments that would in themselves generate new taxation revenues. At the very least the entire cost of the tax subsidy for these accounts would be saved by the tax paid on that new investment (with the actual sum generated likely to be very much higher). As such it is suggested that at least £3.7 billion of tax cost will be saved a year as a result of these changes.

The proposal	To end all existing ISA (Individual Savings Account) savings arrangements and to put in their place new Green ISA

	accounts, the sums saved in which accounts would be required to be invested in the green transition in the UK economy and other social infrastructure projects.
Reason for the proposal	1. To make better use of the near £4 billion tax subsidies being given to ISA account holders in the UK at present when the return to society from the provision of this subsidy is, at present, very hard to establish, and may not exist. 2. To provide a source of capital for new infrastructure investment in the UK that will meet climate and social need. 3. To raise additional tax revenues as a consequence of investments made.
Estimated tax that might be raised as a result of the recommendation made	The tax that would be raised as a result of this change would result from the increase in investment activity that it would give rise to in the UK economy, the economic multiplier effects[230] of which would be large, meaning that the tax raised as a result of new investment might be very much greater than the tax subsidy given to ISA accounts in the future. This is a complete reversal of the current situation where no value for the subsidy given is obtained and permits the suggestion that at least £3.7 billion of tax subsidy might be saved as a result.
Ease of implementation	The changes proposed will take time to implement as they have a significant impact on the profile of savings products on offer in the UK. There will also be technical issues involved in defining the taxonomy of acceptable uses of investment funds that will take time to resolve. However,

[230] A multiplier effect is a measure of the amount by which income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater than 1 then the additional spending produced an increase in income of greater than its own amount, and vice versa. The largest multiplier effects are usually associated with healthcare spending and capital investment, where returns that are several times the size of the sum initially expended can result. In contrast, defence spending has very low multiplier effects. Some multiplier effects e.g. those resulting from spending on education are hard to measure because of the extended time periods involved.

	none of these issues represent significant technical problems to implementation.
Likely difficulties that might result from implementation	There will be resistance from the financial services industry to this change, but if they are given the opportunity to engage with and also market the resulting savings products, even if they are invested in government backed accounts, these problems should be overcome. Once introduced few difficulties should arise from implementation.
Likely time required to implement the change	A reasonable time period for this change will be required. It could not take less than two years and three may be required.
Consultation period required.	As noted, generous consultation periods will be required to get all aspects of this change right.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/20/the-reform-of-the-use-of-isa-funds-could-result-in-the-saving-of-at-least-3-7-billion-of-tax-subsidies-a-year/

Background

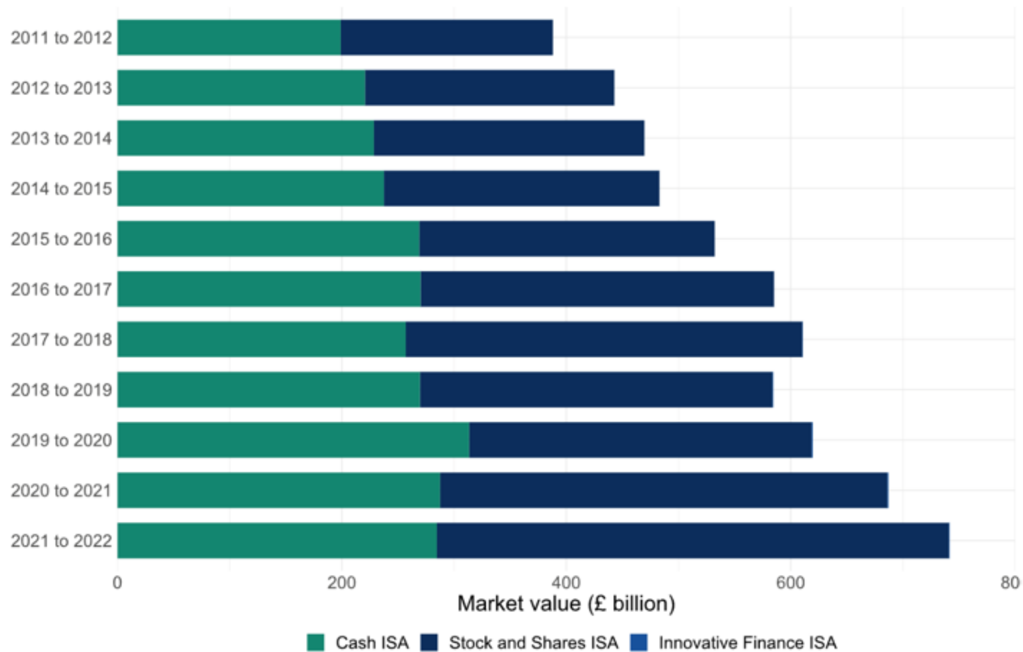
Individual savings accounts (ISAs) and were introduced in 1999 by the then Labour government. They replaced a previous, solely shared based, savings scheme created by its Conservative predecessor.

Over the years since their introduction, ISAs have become more complicated, have allowed significantly greater sums to be saved per annum (with this trend being very marked in more recent years), and have been modified to encourage saving for particular purposes e.g., to assist buying a home. However, the broad principle has remained the same.

That principle is that, subject to annual allowed contribution limits not being exceeded, the income derived from sums that a UK resident individual might save in an ISA are exempt from liability to income tax and capital gains tax. In addition, that income arising need not be

referred to by them on a UK tax return, so simplifying the tax system for some people. The arrangements have been surprisingly attractive to savers. Recent data on the amounts saved, provided in statistics published by HM Revenue & Customs[231], suggest that savings made in this way have enjoyed a broadly upward trajectory, with almost consistent growth in the sums held in such accounts:

Chart 1 – Adult ISA market values 2011 - 2022

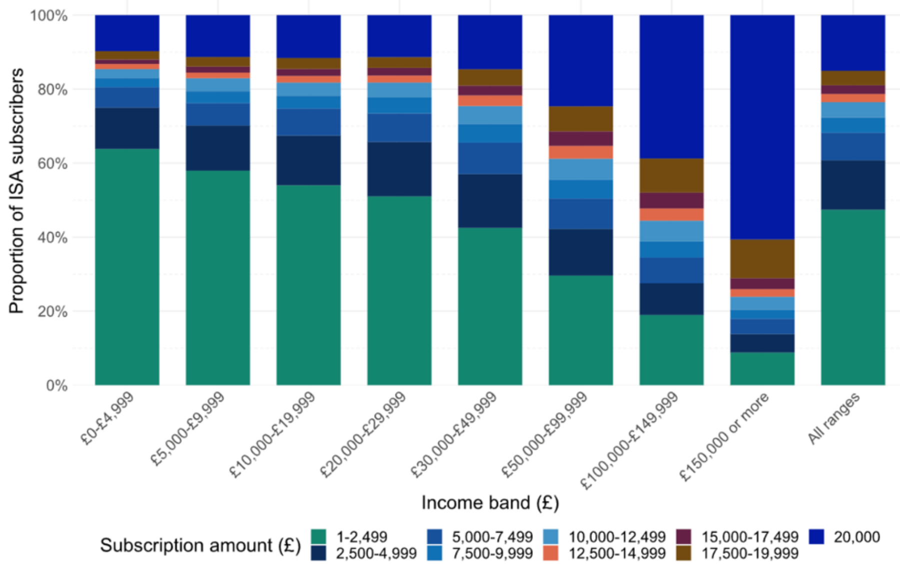


More than £700 billion is now held in ISA accounts.

The same data source shows that the annual contributions made unsurprisingly increase significantly depending upon a person's income:

[231] https://www.gov.uk/government/statistics/annual-savings-statistics-2023/commentary-for-annual-savings-statistics-june-2023#:~:text=Chart%201%20below%20shows%20that,ISAs%20increased%20by%20around%20345%2C000.

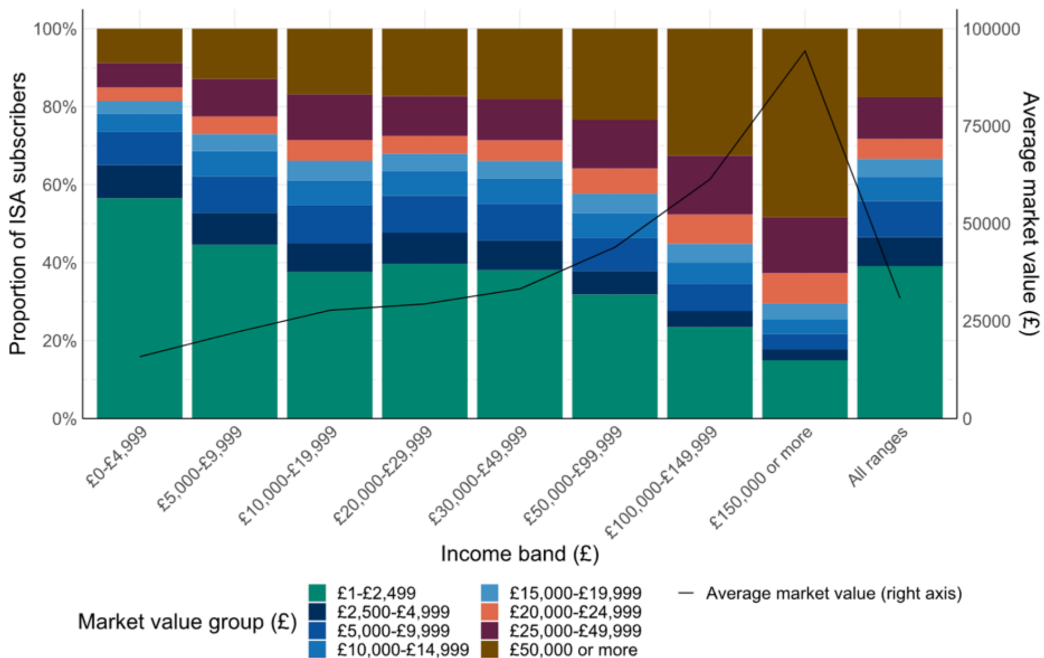
Chart 2 - ISA subscriptions by income band and size of subscription in 2020 to 2021



As is apparent, the group that is by far the most likely to make the maximum permitted £20,000 annual ISA contribution is that made up of people earning £150,000 or more a year. Quite clearly, those with wealth are taking greatest advantage of this scheme.

This is also apparent in the average size of balance ranked by income:

Chart 3 - ISA holdings by income band and ISA market value in 2020 to 2021

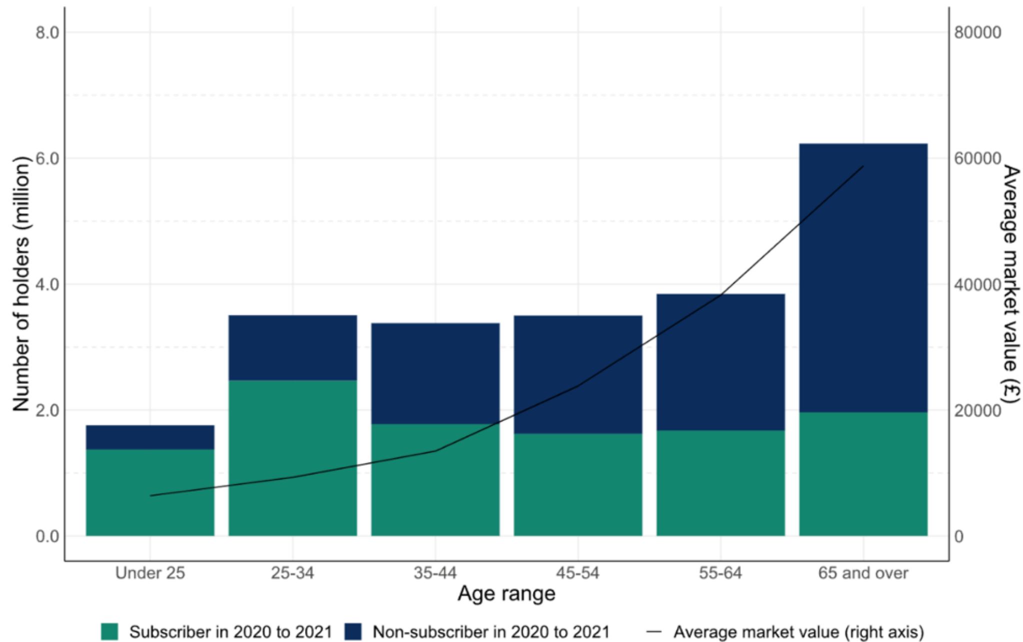


Unsurprisingly, the largest ISA balances are held by those with the largest incomes.

ISA account holders with the largest balances also tend to be amongst the older members of the UK population:

Chart 4 - Age distribution and average market value of

ISA holders in 2020 to 2021



As a result, it is clear that the expenditure on subsidising ISAs is a subsidy to the more elderly and wealthier elements of the UK population. This subsidy increases inequality as a consequence.

The consequence of ISA account growth has been that the cost of ISA tax reliefs has also grown. This data is also from HM revenue and Customs[232]:

Table 1 – Cost of ISA tax reliefs (* = estimated)

Year	**2016 to 2017**	**2017 to 2018**	**2018 to 2019**	**2019 to 2020**	**2020 to 2021**	**2021 to 2022**
Cost (£ million)	2,600	2,850	3,500	3,400	3,050*	3,700*

[232] https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/estimated-cost-of-tax-reliefs-statistics

Despite the significant multi-billion pound cost of ISA savings arrangements, in terms of tax not paid, it appears that there is little question raised, or estimate made, of the value for money that this arrangement provides to the UK Exchequer. Nor has there been any apparent significant testing of whether the arrangement actually induces additional saving or simply increases the net after tax return to those who would save savings anyway.

Discussion

There are good reasons for questioning the economic value of ISA savings arrangements to the UK government, and quite possibly to the UK population as a whole.

Approximately half the sums saved in ISAs are held in cash based accounts, with the proportion changing slightly over time. Cash based saving was rarely rational during much of the period covered by the HMRC data noted above because of the low rates of interest paid on sums deposited, and yet very large sums were saved in that way, largely because of the inherently cautious nature of most savers. There is no criticism implied here with regard to that behaviour: each saver should be able to determine their own risk profile.

There was, overall, likely to have been a higher rate of return to those who saved in equity shareholdings over this period, but that said the return in question might have been very volatile, and unstable. Not everyone will necessarily have benefited by saving in this way.

More importantly, from a macroeconomic perspective, neither of these savings mechanisms adds any significant value to the UK economy. Cash held on deposit does at a macroeconomic level represent money withdrawn from circulation within the economy as a whole, and as such has a deflationary effect on overall economic activity. Few would suggest that this was of economic benefit during the course of the period since 2010 when austerity was already prevalent and growth was low.

In addition, and as is little appreciated, cash deposits do not in any way fund the lending made by the banks with which the sums are deposited. This fact was acknowledged by the Bank of England[233] in 2014. As they noted, at that time, loans made by commercial banks are the result of new money creation. Cash deposits made by one person are never loaned to another customer of a bank. As a consequence, cash deposits are, in effect, dead money within the economy, which is one reason why banks are so reluctant to pass on interest payments to depositors. Cash deposits do not add value to banks and so they are unsurprisingly reluctant to pay for them. What this does, however, mean is that these deposit

[233] https://www.bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy

add almost no value to the UK economy, and to subsidise them does, in that case, makes little sense.

There is little reason to suggest that equity share investments made through ISA accounts provide any more economic benefit for the UK as a whole. The vast majority of shares held in ISAs will be held through managed investment funds, most of which will track the performance of large share indices. These funds rarely purchase new shares issued by the companies in which they invest, largely because quoted companies very rarely rely upon this source of finance now. In fact, those companies are usually more intent on repaying their share capital than they ever are on increasing it.

In that case, what this means is that the funds that are held within ISA saving arrangements very rarely, if ever, result in the investment of new funds in new economic activity within the UK economy. They are instead used for speculative, but not investment, purposes. The result is that these savings, just like cash deposits, add almost no value to the UK economy as a whole either by promoting employment or by creating new investment in the productive economy.

Taking these combined observations into account it is apparent that a review of the savings arrangements represented by ISA accounts would now be appropriate. This is most especially the case when it is known that significant new capital is required within the UK economy to fund the climate transition, new social housing and other infrastructure investment.

Recommendation

It is proposed that all existing ISA saving account arrangements should be withdrawn, and that no further deposits into any existing ISA account should be allowed, and that no further new share-based investment from an ISA account should be permitted. It is, instead, proposed that a new form of ISA account arrangement be made available to all UK resident persons. This would be described as a Green ISA.

All sums deposited in Green ISAs would be required to be invested in accounts, bonds, funds and shares that have as their primary purpose the funding of:

- The required climate transition if net-zero goals are to be achieved.
- New social housing.
- Other new social infrastructure.
- Related training, education and support services.

There are a number of ways in which this can be achieved.

Firstly, UK government already issues green saving bonds through NS&I, which is its own savings bank. These could be used for ISA savings purposes. The use of these funds is noted by the government in occasional reports[234].

These funds could also be saved through the collective purchase of green gilts issued by the UK government, which are now becoming more common place.

If the UK was also to create a properly functioning national investment bank that had as its purpose investment in the above noted categories of assets, on which returns could be paid by their users, then bonds issued by that bank could also be used for green ISA purposes.

Fourthly, private sector funds meeting the required specification for investment could be used for this purpose. This category of investment would, however, carry a higher degree of risk than the first three categories, noted above. A very clear taxonomy requiring strong evidence of the actual investment of funds raised for green purposes would be required for any company to qualify to raise funds in this way.

Because of the differing risk profile of these investments, it would be a requirement that at least one half of all savings be made in the first three categories of government-backed savings products noted above. That would, however, leave at least half available for investment in the private sector if that was the saver's choice. This would mean that the current approximate risk profile of average ISA savings could then be replicated through this new ISA arrangement.

Marketing ISA savings

The tax-free status of ISAs coupled with acceptable rates of return virtually guarantees that any ISA accounts is marketable[235]. The proposed Green ISAs should, however, have particular appeal, most especially if the link between a person's saving and the use of the sum saved for investment purposes is highlighted.

[234] https://assets.publishing.service.gov.uk/media/651446cdb1bad4000d4fd916/HMT-UK_Green_Financing_Allocation_Impact_Report_2023_Accessible.pdf

[235] 80% of UK savings are in some form of tax incentivised account https://eprints.whiterose.ac.uk/153627/10/modern_monetary_theory_and_the_changing_role_of_tax_in_society.pdf

One obvious category of such ISAs would be those that might be used for green investment purposes. However, it is entirely plausible that more money than is needed for that purpose could be raised from ISAs and as such funds could also be promoted for investment in:

- Social housing
- School infrastructure
- Infrastructure for the NHS
- Transport infrastructure
- Regions e.g., mayoralties, or areas such as the Southwest, Yorkshire or East Anglia.
- UK member states i.e., Scotland, Wales and Northern Ireland.

It is thought that this would increase the appeal of these accounts.

Fundraising potential

Approximately £70 billion per annum is saved in ISA accounts. Admittedly, part of this represents the recycling of old ISA account balances into new ISA arrangements, but this would continue under the new proposed structure, meaning that it will be entirely reasonable to expect that this level of funding would be secured by these new ISA arrangements each year for some time to come. This would then provide a pool of capital for new investment in the UK economy.

Given the overall aggregate level of savings in recent years, there is no reason to think that significant funds would need to be retained for liquidity purposes. If, however, that was the case, the government would always available to supply liquidity to any saving arrangement of this sort if that was required.

Taxation impact

There are two major taxation impacts to consider from this proposal.

The first is that the current tax cost of this arrangement that provides little or no economic return for the economy as a whole might be saved. If this was the case, then it is reasonable to suggest that £3.7 billion of tax subsidy, at least, might be put to better use as a consequence.

The second, and more important, impact relates to the positive economic use that would now be made of the funds saved in ISA accounts. If these were used as capital to be invested in new green and social infrastructure that will provide benefit to the people of the UK and beyond then a tax return would come in at least four ways.

Firstly, expenditure on these investments would, in itself, generate new tax revenue. Between 35 and 40% of all such expenditure is likely to be returned to the Exchequer by way of tax paid. If £70 billion was invested, this would give a £28 billion return, straight away.

Secondly, those in receipt of this spending because they were working on the investment programmes funded by ISA accounts would then spend their earnings. The additional spending that they might then generate would increase the income of those that they spent their money with. This would then have the consequences that those people would have higher incomes, meaning that they too would pay more tax. Given that £40 billion or so of additional spending might happen in this way, it is entirely plausible that more than £15 billion might be generated in extra tax as a result of this secondary effect.

Third, this cycle then repeats. It is not impossible that most, if not all, of the £70 billion spent could be recovered by way of tax paid as a consequence, in turn providing the means to guarantee repayment of the balances held on ISA accounts. This cycle is referred to as the multiplier effect.

Fourthly, if appropriate investments are chosen, then they too are likely to generate a return. So, for example, the impact of investment in hospitals is very significant in economic terms because this increases the health of the country's workforce, and tends to significantly increase its productivity, meaning that most employees can contribute more when at work, which increases incomes and taxes paid.

Better housing provides an alternative return. It creates stability, enhances well-being, ensures better outcomes for children and their education, and tends to significantly cut the cost of support to families who were previously in either poor quality or insecure accommodation. This then creates a return for the government by reducing spending.

Of all these options the only one included in the taxation revenue estimate for this proposal is the avoidance of money wasted on the existing ISA scheme that delivers little economic return. No claim is made for the upside of the new alternative investments that ISAs could fund. Instead, it is presumed that the £3.7 billion previously invested without return is now invested with a return sufficient to cover any tax relief provided, and this provides the estimate of the tax revenue impact used in this chapter.

Chapter 14.2

Changing the conditions attached to pension tax relief

Recommendation 26

Brief Summary

This chapter proposes that in exchange for the tax relief given on qualifying pension contributions made to a UK pension fund that one quarter of the contributions made should be invested in investments that would fund:

- The required climate transition if net-zero goals are to be achieved.
- New social housing.
- Other new social infrastructure.
- Related training, education and support services.

A further object of this exercise is to provide the opportunity for UK pension funds, which now have a marked preference for bond investment, to do so in a way that permits active choice by the funds and their members in the activities in which they would wish such savings to be used when at present very few bond saving opportunities make any link between funds saved and activity in the real economy.

Given that more than 77 per cent of the UK's financial wealth is saved in pension funds and at least 85 per cent is saved in tax-incentivised assets it is thought unlikely that there will be any significant adverse behavioural response to this proposal.

The proposal does not apply to any past sums invested.

It is thought that this proposal would release at least £35 billion per annum for investment in the activities noted, saving the government from having to do so as a result and providing it with a positive return on its own contribution to pension savings as a consequence. Without any other measure of the impact of this proposal being available, this sum is used for that purpose since it releases an equivalent amount for spending on alternative UK government budgets as a result.

The proposal	To require that in exchange for the tax relief given on qualifying pension contributions made to a UK pension fund that one quarter of the contributions made should be invested in investments that would fund: • The required climate transition if net-zero goals are to be achieved. • New social housing. • Other new social infrastructure. • Related training, education and support services.
Reason for the proposal	1. To make better use of the £65 billion of tax subsidies being given to pension savers each year in the UK at present when the return to society from the provision of this subsidy is, at present, very hard to establish. 2. To provide a source of capital for new infrastructure investment in the UK that will meet climate and social need. 3. To free up government budgets for expenditure on other social priorities as a consequence of investment spending on these issues being met from pension fund savings.

Estimated tax that might be raised as a result of the recommendation made	The tax that would be raised as a result of this change would result from the increase in investment activity that it would give rise to in the UK economy, the economic multiplier effects[236] of which would be large, meaning that the tax raised as a result of new investment might be significant. This is a complete reversal of the current situation where it is hard to estimate that any significant return to the UK economy arises as a result of a great deal of pension saving. Up to £35 billion per annum might be released for active investment in the UK economy each year as a result of this proposal. This is the suggested value of this proposal as it would directly relieve demand for expenditure on these issues by the government, freeing funds for other uses.
Ease of implementation	The changes proposed will take time to implement as they have a significant impact on the profile of pension saving in the UK. There will also be technical issues involved in defining the taxonomy of acceptable uses of investment funds that will take time to resolve. However, none of these issues represent significant technical problems to implementation.
Likely difficulties that might result from implementation	There will be resistance from the financial services industry to this change, but if they are given the opportunity to engage with and also market the resulting savings products, even if they are invested in government backed accounts, these problems should be overcome. Once introduced few difficulties should arise from implementation.

[236] A multiplier effect is a measure of the amount by which income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater than 1 then the additional spending produced an increase in income of greater than its own amount, and vice versa. The largest multiplier effects are usually associated with healthcare spending and capital investment, where returns that are several times the size of the sum initially expended can result. In contrast, defence spending has very low multiplier effects. Some multiplier effects e.g. those resulting from spending on education are hard to measure because of the extended time periods involved.

Likely time required to implement the change	A reasonable time period for this change will be required. It could not take less than two years and three may be required.
Consultation period required.	As noted, generous consultation periods will be required to get all aspects of this change right.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/11/30/reforming-the-conditions-attached-to-pension-tax-relief-could-release-35-billion-a-year-for-investment-in-a-uk-green-new-deal/

Background

In a previous chapter (6.1), it was suggested that the cost of pension tax relief to the UK Exchequer is about £65 billion per annum. Suggestions were made as result to restrict that relief in the case of higher rate taxpayers and to save more than £14 billion of that cost a year as a consequence.

In another chapter (14.1), it was noted that the cost of tax relief given to those who save in ISA accounts did not give rise to a commensurate economic benefit to the government in exchange for the tax relief given. As a consequence, it was suggested that the tax relief given on ISA accounts should be made conditional upon the funds saved in such accounts being used for appropriate social purposes.

In this chapter, those two observations are combined to make suggestion that in addition to pension tax relief being restricted to the basic rate of tax, irrespective of the income tax rate paid by the person making the contribution, the receipt of pension tax relief on contributions made by a person to a pension fund should be conditional upon at least part of the contribution that they make being made available to fund investment for social and economic programmes consistent with the objectives of the government granting such relief. In this way, the exceptional cost of pension tax relief (which is at present almost exactly equivalent

to the current spending on schools in England[237]) could, at least give rise to a commensurate return for the sum expended.

There is another reason for suggesting this reform. It is already Labour and Conservative Party policy to encourage greater direct investment by UK pension funds in the UK economy, both having noted how little direct engagement between pension funds and the underlying economy that there is. This is not least because of the marked preference of most pension funds for bond-based investment, little of which can be directly related to investment activity in the real economy, which is an issue that needs to be addressed.

Proposal

It is suggested that in exchange for pension tax relief being provided on sums saved in tax incentivise pension accounts that at least twenty five per cent of all new pension contributions should be invested in the types of project described in the chapter on reform ISA saving. This would mean that investments in the following would be considered acceptable:

- The required climate transition if net-zero goals are to be achieved.
- New social housing.
- Other new social infrastructure.
- Related training, education and support services.

As suggested in that chapter on ISA savings this could be achieved by investing in:

- UK government green saving bonds of the type now issued through NS&I, which is the government's own savings bank. The use of these funds is noted by the government in occasional reports[238].
- Green gilts issued by the UK government, which are now becoming more common place.

[237] Based on data here: https://www.gov.uk/government/publications/autumn-statement-2023/autumn-statement-2023-html

[238] https://assets.publishing.service.gov.uk/media/651446cdb1bad4000d4fd916/HMT-UK_Green_Financing_Allocation_Impact_Report_2023_Accessible.pdf

- Bonds issued by a UK government owned national investment bank that had as its purpose investment in the above noted categories of assets, on which returns could be paid by their users.

- Private sector funds meeting the above noted required specification for investment could be used for this purpose. A very clear taxonomy requiring strong evidence of the actual investment of funds raised for green purposes would be required for any company to qualify to raise funds in this way.

It is stressed that no suggestion is made that past contributions must be redirected in this way.

It is also the case that no conditions would be attached to the use of the remaining seventy-five per cent of contributions made by taxpayer to their pension fund during a period. They would have complete freedom to suggest the way in which these funds might be invested so long as their choice was compliant with the rules of their chosen pension fund.

Impact

Data published by the pension industry, the Office for National Statistics and dedicated pension publications are universally unclear as to the total of value of pension contributions made in the UK each year. That is because of the wide variety of ways in which such savings can be made by those who are in both employment and self-employment, and the wide variety of funds that are available for people to choose from to save in, whether organised by their employer or of their own choice. However, presuming that the rate of subsidy to pension contributions made each year does not exceed 50% of the sum saved (and this would appear to be a high end estimate) then it is reasonable to assume that not less than £140 billion per annum is saved in tax incentivised pension arrangements each year. In that case this proposal would make available £35 billion per annum for investment in the programmes noted above. As a consequence, the need for the UK government to raise similar sums to invest in those programmes would be removed because they would be funded by pension contributions instead. For that reason, it is suggested that the £35 billion that might be raised in this way can be treated as in indirect contribution to the UK Exchequer.

It is stressed that the majority of UK financial savings are held in pension arrangements. It is likely that in 2020, when the most recent data with regard to this issue was published[239], that seventy-seven per cent of all UK financial assets were represented by pension savings. If ISAs

[239] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/totalwealthwealthingreatbritain

are taken into account, it is likely that at the same date approximately eighty-five per cent of all financial assets were held in some form of tax incentivised savings arrangement[240]. It is therefore very unlikely that there would be a significant behavioural reaction to this proposal with people withdrawing their savings from pension arrangements as a result of it.

That said, there is no obligation on a person to save for their retirement in the tax incentivised accounts, and if they did not wish to do so as a consequence of this proposal there would be no reason why they should not save in another way if that was their preferred choice of action. They would simply lose tax relief as a result.

[240] ibid

Chapter 15.0

Tax administration – Introduction

Introduction

Most of the Taxing Wealth Report 2024 is dedicated to the making of detail proposals for the reform of many of the UK's existing taxes so that inequalities and opportunities for abuse that are created by that system at present, the vast majority of which favour those with wealth, might be eliminated. The aim of the Report is to make clear that the claim that there are no additional funds available to a UK government to undertake reform of public services, if they might wish to take on that task, is not true.

This section of the Taxing Wealth Report 2024, on necessary administrative reforms to the UK tax system, differs from those detail proposals in that it focuses on the ways in which the management of the UK tax system should change if that system is to deliver a just and equitable tax outcome for the people of the UK as a whole, which might then turn that tax system into what is best described as a public good. Public goods are defined as a supply of goods (sometimes) and services (more commonly) that are provided without the intention of profit being made to all members of society, usually by a government.

The fact that these proposals are being made in the Taxing Wealth Report 2024 clearly suggests that the UK tax system is not being managed to best effect present. Each of the chapters within this section details ways in which this is the case at present.

Three of those chapters, concerning better estimation of the UK gap tax gap, the estimation of UK tax spillover effects, and the need for an Office for Tax Responsibility, are related. The fourth, on the reform of HMRC's funding so that it might better meet taxpayer need, stands apart from them.

The tax gap

The UK tax gap estimates the difference between the tax revenues that should be paid in the UK in a period given current taxation legislation and the sum that is actually paid.

HM Revenue & Customs are to be commended on the fact that they have been estimating an annual tax gap for the UK for longer than any other tax authority in the world[241], having begun in 2009. Unfortunately, that being noted, the data that they do report is deficient in very many ways.

In particular, HMRC understate the tax gap because they have adopted an exceptionally narrow definition of tax avoidance, which provides no true indication of the cost of this activity to the UK economy. The result is that commonplace activities, like incorporating companies to avoid national insurance charges on what would otherwise be salary payments, are not included in the tax gap estimate as tax avoidance activity, which makes little sense and understates that estimate.

In addition, with the exception of VAT, HMRC bases its estimates of tax lost almost entirely upon tax returns submitted to it, which is an inherently unreliable basis of estimation when those tax evading will always seek to avoid submitting tax returns to that authority and many hundreds of thousands, if not millions, do not do so each year. It is likely that the UK tax gap is significantly understated by HMRC as a result.

As a consequence, the Taxing Wealth Report 2024 recommends that the whole approach adopted by HM Revenue & Customs towards tax gap estimation should be revised. Only then will this measure be a reliable basis for both performance assessment and decision making on the appropriate allocation of resources and tax reform.

Tax spillovers

One of the major reasons why countries suffer significant gaps is that their tax systems are poorly designed. In particular, it is commonplace for some parts of the tax system to be undermined by other parts of that same system, or by the tax systems of other countries.

So, for example, the low rates of capital gains tax in the UK clearly undermine the effectiveness of the UK's income tax system. That income tax system is also undermined by the low rates of corporation tax in the UK, whilst the way in which dividends are treated within the corporation tax system undermine the UK's national insurance system.

All of these are called tax spillover effects. Whilst it has been known for some time that the UK's systems of tax reliefs and allowances impose significant cost on the UK Exchequer, with the benefits arising from them rarely being estimated, no regular or systematic reviews of these reliefs and allowances is undertaken to make sure they are not detrimental in this broader context to the tax system as a whole. Nor are the threats to the UK tax system from

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[241] https://www.gov.uk/government/statistics/measuring-tax-gaps

outside the UK regularly reviewed even though the risks from tax havens and other locations have long been known. The purpose of tax spillover analysis is to provide this systematic review, which then explains many of the reasons why tax gaps arise. The Taxing Wealth Report 2024 recommends that regular tax spillover assessments be undertaken in the UK alongside annual tax gap estimates.

An Office for Tax Responsibility

That being said, there is a very obvious problem in having HMRC undertake reviews of its own effectiveness in managing the tax system, which is what it does at present when preparing its current tax gap estimates.

As is noted in the Taxing Wealth Report 2024, there is strong evidence to suggest that HMRC's management use gap estimates as a mechanism to support their claim to be effectively managing the UK tax system. When very clear evidence to the contrary does exist, not least within the tax gap data that they themselves produce, there is reason to doubt that claim.

For this reason, the Taxing Wealth Report 2024 recommends that an independent agency, to be called an Office for Tax Responsibility, should be created to undertake both tax gap and tax spillover assessments. This Office for Tax Responsibility should report to parliament, and not to ministers or HMRC, and should be capable of undertaking audits at the specific request of both the Treasury and Public Accounts Committee of the House of Commons in Parliament to ensure the HMRC is properly held to account for its management of the UK's tax system.

The funding of HM Revenue & Customs and meeting taxpayer need

There is one final chapter within this section of the Taxing Wealth Report 2024. This relates to reforming the funding of HM Revenue & Customs to provide a greater focus on customer service on its part.

Ever since HMRC was created in 2005 its senior management have placed too much emphasis on seeking to reduce the cost of tax collected in the UK and insufficient emphasis on collecting all tax owing. There has also been too little focus on assisting those taxpayers who need assistance to make proper payments of tax whoever and wherever they might be in the community.

In no small part it is suggested that this is because HM Revenue & Customs is partly beyond ministerial control (because of the old fiction that it reports to the Crown and not parliament, which is implicit in its name) whilst simultaneously modelling itself on the structure of a public limited company that is seemingly intent on meeting the needs of its most valuable customers (as it anachronistically and annoyingly insists on describing taxpayers as). The result is an

organisation without a focus on delivering a service to all in society. To address this the Taxing Wealth Report 2024 recommends:

- Reforming the governance of HM Revenue & Customs and making it subject to properly funded independent scrutiny by an Office for Tax Responsibility.

- That governance structure should reflect the whole taxpayer community of the UK rather than the wealthy and large business community as it does at present. That means representation should be added from:

    - The small business community.
    - Trade unions.
    - Pensioners.
    - Charities.
    - Consume groups.
    - Civil society.

- Changing the ethos of HM Revenue & Customs so that it:

    - Seeks to maximise tax revenues collected within available law.
    - Assists honest taxpayers to be tax compliant to the greatest of its ability.
    - Seeks to serve people in the community – and not just those online.
    - Is honest about its successes and failures – which its current tax gap reporting is not.
    - Represents all taxpayers and not just the interests of the wealthy and big business.

Because cost cutting, and not these issues, have been the focus of concern of HM Revenue & Customs' management to date the following have happened:

- A significant reduction in staff numbers at HM Revenue & Customs.

- The closure of almost all HMRC offices in the towns and cities of the UK, so that face-to-face advice is now virtually unavailable from HMRC.

- The subsequent closure of many of the helpline facilities that were meant to replace the local office network.

Simultaneously, HMRC has developed a belief that the UK's tax system tax can be digitally managed, largely by imposing considerable administrative and IT demands on UK taxpayers.

HMRC also seems to believe that almost all queries that a person might have when trying to manage their tax affairs can be reasonably answered by online help facilities. This, in the experience of millions of taxpayers, is wrong. The UK's tax practitioner community agrees with taxpayers on this issue. Those taxpayers are, as a result of this approach, bewildered by what is asked of them, unsure of what to do, are without help, and in far too many cases, are terrified of the consequences. What HMRC fails to understand is that taxpayers making enquiry of it are not necessarily seeking facts when making a telephone call. What they are actually seeking is reassurance, and no online help facility will provide that. People need to speak to another human being, either face-to-face or on the end of a telephone, to alleviate the concerns and stresses that they have which a necessarily complex tax system create. Only when HM Revenue & Customs appreciates this fact will they supply the support that people really need from them.

As previously noted, a well-functioning tax system should be a public good within any society. The UK is very far from enjoying such a tax system because of the actions of HMRC in making access to help for those who want to pay the right amount of tax so difficult to secure. As a consequence, in the final chapter in this section, it is recommended that HMRC reopens its network of tax offices in the towns and cities of the UK with this specific goal of providing help to taxpayers who need it.

It is also recommended the HMRC recommence its programme of visiting smaller businesses in their premises to make sure that they are compliant with their tax responsibilities and provide them with the help that they need to be so.

It is suggested that the potential £1 billion cost of undertaking these activities would be recovered many times over if this program would be put in place but that, more importantly, the UK would suffer less stress and a much more friendly environment for the business community if this were to happen.

Chapter 15.1

Tax administration – Recommendation 27

Preparing proper tax gap estimates

Brief Summary

This chapter suggests that:

- The UK should prepare proper estimates of the tax gaps[242] within its tax system.

- Because the UK's HM Revenue & Customs does not prepare comprehensive tax gaps at present a wide variety of tax losses go unreported including:

    - The loss from tax bases, like wealth, that are not taxed;
    - The cost of exemptions, allowances and reliefs within the tax system;
    - The cost of the abuse of those exemptions, allowances and reliefs;
    - The cost of tax avoidance, because HM Revenue & Customs use a very narrow definition for the identification of this abuse.

- It is likely that the UK's tax gap is considerably larger than that reported by HM Revenue & Customs.

- If a broader five-tier gap analysis that included consideration of untaxed tax bases and the cost of tax exemptions, reliefs and allowances was to be undertaken annually:

[242] Tax gaps are the differences between the tax revenues that a jurisdiction should be able to collect and the tax revenues it actually recovers during the course of a period.

- Debate on the UK's tax system would be considerably better informed;
  - HMRC would manage its resources more effectively;
  - Rates of tax abuse might be reduced;
  - Rates of taxpayer compliance might rise;
  - Taxpayer morale would increase over time.

- The cost of undertaking this exercise is small compared to the benefits that might be gained.

- Because there is no direct relationship between better estimation of the tax gap and enhanced tax yield no estimate of that benefit to be gained is made.

- Because many tax gaps are created by measures benefitting the wealthy and those with high incomes this change might have particular impact on them.

- This measure is intended to reduce the chance of illicit accumulation of wealth within the UK.

The proposal	To prepare proper estimates of the UK tax gap since those currently available: • fail to take into consideration most tax avoidance activity; • the cost of both unnecessary and inappropriate tax reliefs, and • the failure to tax all available tax bases.
Reason for the proposal	1. To improve the horizontal equity of taxation by ensuring that all taxes that should be in use to produce that desired outcome are in operation and to check that each of them is being managed appropriately so that all tax due is collected, which is a condition of achieving this goal. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of

	improved horizontal tax equity, which goal is currently undermined by the ineffectiveness of the UK's tax gap estimation that fail at present to indicate the steps required to create both horizontal and vertical tax equity. 3. To reduce the tax spillover[243] effects that are exploited by many of the activities currently not addressed by UK tax gap estimates. 4. To reduce the rate of tax avoidance and tax evasion in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known because there is unlikely to be a direct link between the measurement of tax gaps and changed taxpayer behaviour. The gain comes from: • Better use of HM Revenue & Customs' resources. • Closure of tax gaps. • The creation of improved taxpayer morale as a result of the closure of loopholes resulting in a more level tax playing field, increasing the inclination on the part of taxpayers to be tax compliant[244].
Ease of implementation	Relatively straightforward, although the collection of some data will take time to arrange. The process would be improved if

[243] Tax spillovers are the negative consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.

[244] Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

	undertaken by an Office for Tax Responsibility (see separate recommendation).
Likely difficulties that might result from implementation	Few, although political accountability for failure to address the resulting tax gap estimates might be embarrassing if not undertaken.
Likely time required to implement the change	This could be a rolling process of change meaning that full implementation could be rolled out over a number of years to some advantage as cumulative lessons learned are acted upon.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/19/the-taxing-wealth-report-2024-the-uk-needs-better-estimation-of-its-tax-gap-to-prevent-the-illicit-accumulation-of-wealth-2/

Background

The tax gap has been described as the amount of tax that a jurisdiction does not collect as a consequence of the tax system of that place not being appropriately complied with by those owing tax in that place. As a result, they do not pay tax in accordance with its laws and regulations of that place as they are interpreted by its tax authority[245].

This description does, for example, provide a basis for the estimates of the tax gap prepared on an annual basis by HM Revenue & Customs[246] in the UK. That description does, however, ignore the fact that substantial parts of the potential tax revenues owed in a country are not collected by governments as a result of their decisions not to tax some tax bases (such as wealth), or because of the tax allowances, reliefs and exemptions that they make available

245 For a more detailed explanation of this issue see the authors description of the tax gap at https://academic.oup.com/book/39754/chapter/339816709. An alternative academic explanation of some of the issues addressed here is to be found at https://eprints.whiterose.ac.uk/153627/10/modern_monetary_theory_and_the_changing_role_of_tax_in_society.pdf

246 https://www.gov.uk/government/statistics/measuring-tax-gaps

within their tax laws and regulations, many of which in turn provide opportunities for tax arbitrage , avoidance , abuse and even evasion .

If these issues are taken into account the tax gap can be redefined as the difference between the tax revenues that a jurisdiction might be able to collect and the tax revenues it actually recovers during the course of a period. This represents a significantly different approach to this issue from that taken by HM Revenue & Customs. This alternative, preferred, approach noted here produces a considerably more comprehensive analysis of the tax gap than is possible using the methodology adopted by HM Revenue & Customs. Their approach is suited for use by a tax authority of government that thinks that the sole purpose for tax is to raise revenue. The basis of estimation of the tax gap suggested here is more useful to those governments seeking to use tax as a tool for a wide range of fiscal, social and economic policy purposes, as actually happens in practice in the management of a modern economy.

The five-part approach to the tax gap

There are five tax gaps that can be measured using the second approach noted above:

- Tax base gaps.
- Tax spend gaps.
- Tax evasion.
- Tax avoidance.
- Tax known to be owing but not settled i.e. unpaid tax.

The approach used by HM Revenue & Customs only measures the last three of these gaps. That is why it is of limited use.

Tax base gaps represent the cost of tax bases that a jurisdiction decides for its own reasons not to tax. Wealth is a common tax base that is either not taxed or is severely undertaxed, as is noted throughout the report of which this chapter forms a part, but there are other examples.

Tax spend gaps represent the cost of the exemptions, allowances and reliefs granted within tax bases that are otherwise subject to tax. It is thought that there are more than 1,000 such exemptions, allowances and reliefs in the UK at present. They are likely to have a total value exceeding £400 billion per annum, meaning that their effective management is key to the

proper administration of the UK tax system and yet the cost of many of them is unknown, and their usefulness is rarely, if ever, appraised in most cases.

The tax evasion gap is the tax cost of the illegal non-declaration of income that should be taxed by a taxpayer, or the tax cost of their illegal claim for a tax exemption, allowance or relief to which they are not entitled.

The tax avoidance gap is the tax cost arising from a taxpayer arranging their affairs in such a way that they pay less tax as a result of their manipulation of the tax laws of a jurisdiction in a way that the tax authority of that jurisdiction thinks is contrary to the spirit of the laws in place.

The unpaid tax gap is the tax cost of sums known to be owing to the tax authority that is not paid e.g. due to the insolvency of a taxpayer before payment can be collected.

Why existing tax gap estimates made by HM Revenue & Customs are inadequate

Existing tax gap estimates in the UK are prepared by HM Revenue & Customs. They are inadequate because:

1. HMRC does not estimate the UK tax base gap. As such HMRC do not address this key issue within the UK tax system, which is precisely why the under-taxation of wealth is not known about. That is a major omission on their part.

2. HMRC does not either regularly measure or appraise the effectiveness of all tax exemptions, reliefs, and allowances, or their abuse, within its estimate of the tax gap, and as such fails to appraise this key issue within the UK tax system.

   It also fails to note or provide estimates of the considerable cost arising from the abuse of these tax exemptions, beliefs, and allowances, the arbitraging of which represents a significant focus of most tax avoidance activity within the UK, none of which cost is included in the text gap estimates, meaning that those estimates seriously understate the scale of tax abuse in the UK.

3. With the exception of HM Revenue & Customs' estimate of the VAT gap, tax gap estimates prepared by them are undertaken on what is called a 'bottom-up' methodology. When this approach is used the tax returns that are submitted to HMRC are used as the basis for the analysis of the tax gap. There are significant problems with this approach including:

a. The majority of taxpayers in the UK are not required to submit tax returns, meaning that the sample base for estimation of the tax gap is inherently statistically flawed.
b. Very large numbers of UK limited liability companies (maybe 50%) either are not required to submit a corporation tax return each year, or do not do so as a matter of fact. Given that large amounts of tax abuse of all forms are likely to be undertaken through limited liability companies, this means that the basis for estimation of tax gaps with regard to the activities of these organisations is likely to be significantly and inherently flawed as a consequence.
c. Relatively little of the UK tax base is subject to independent verification of data as a consequence of the provision of information from third parties to HMRC. Obvious exceptions to this observation include wages that are subject to PAYE, interest paid by banks and some recent changes to notifications with regard to land transactions. In the absence of this third-party data, the reliance upon self-declaration of taxpayers is not an adequate basis for estimating the tax gap when it is known[247], for example, that more than 40% of self-employed people understate their earnings on their tax returns, and the same ratio is likely in all areas where self-declaration is the basis for assessment of taxation liabilities.

It follows that if HMRC's tax gap estimates are to be properly appraised as to their reliability then they must be compared to 'top-down' estimates of the tax gap. This was recommended by the IMF[248] in 2013 when they were invited to consider the validity of HMRC's approach.

Top-down estimation of tax gaps uses data based on national income (gross domestic product) statistics to estimate the total value of the tax bases giving rise to taxation liabilities. These estimates are then used to estimate tax owing, which sums are then compared with actual taxes recovered to present an alternative view of tax gaps. Without the adoption of this additional approach, and given the other weaknesses in the data sources already noted, the reliability of current tax gap estimates in the UK has to be considered to be low[249] [250].

[247] Based on HMRC tax gap estimates

[248] https://www.imf.org/external/pubs/ft/scr/2013/cr13314.pdf page 46

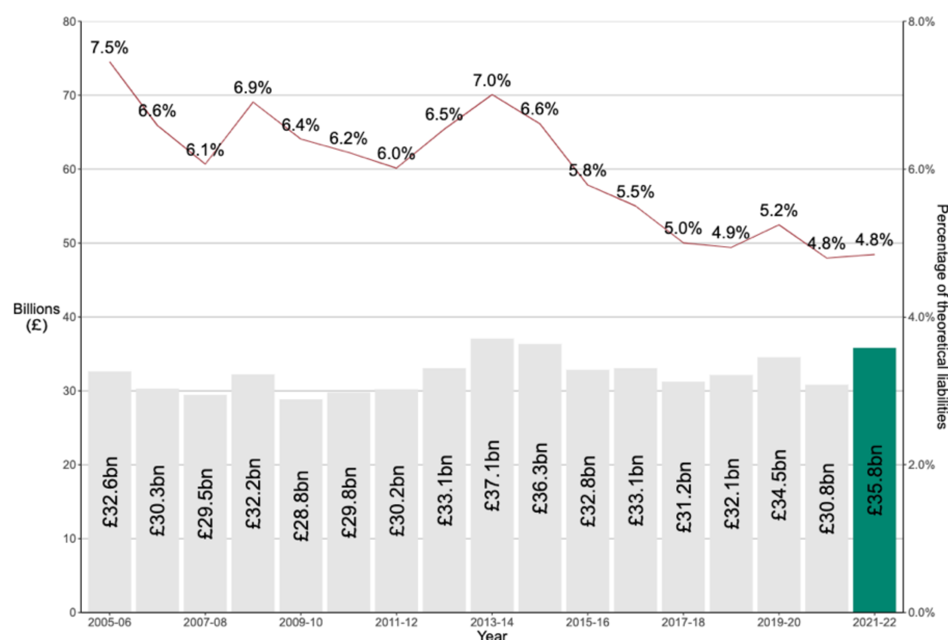
[249] HMRC address this issue but don not adequately justify their approach at https://www.gov.uk/government/statistics/measuring-tax-gaps/methodological-annex

[250] It is notable that HM Revenue & Customs consider that VAT is the only tax gap estimate is the only one they prepare with low uncertainty attached to it, and is also the only significant top down estimate that they prepare. See section B at https://www.gov.uk/government/statistics/measuring-tax-gaps/methodological-annex

4. Some of the definitions used by HM Revenue & Customs in the preparation of tax gaps need to be revised. In particular, the presumption that tax avoidance is only activity that arises as a consequence of a marketed tax schemes[251] requiring notification to HM Revenue & Customs needs to be dropped when measures to prevent use of such schemes have largely been successful. The resulting apparent decline in tax gaps might appeal to the senior management of HMRC, but it does not reflect the full scale of tax avoidance activity being undertaken in the UK economy, and a much broader definition of tax avoidance needs to be used in tax gap estimation in future, taking care to ensure that there is no overlap with tax spend gap analysis.

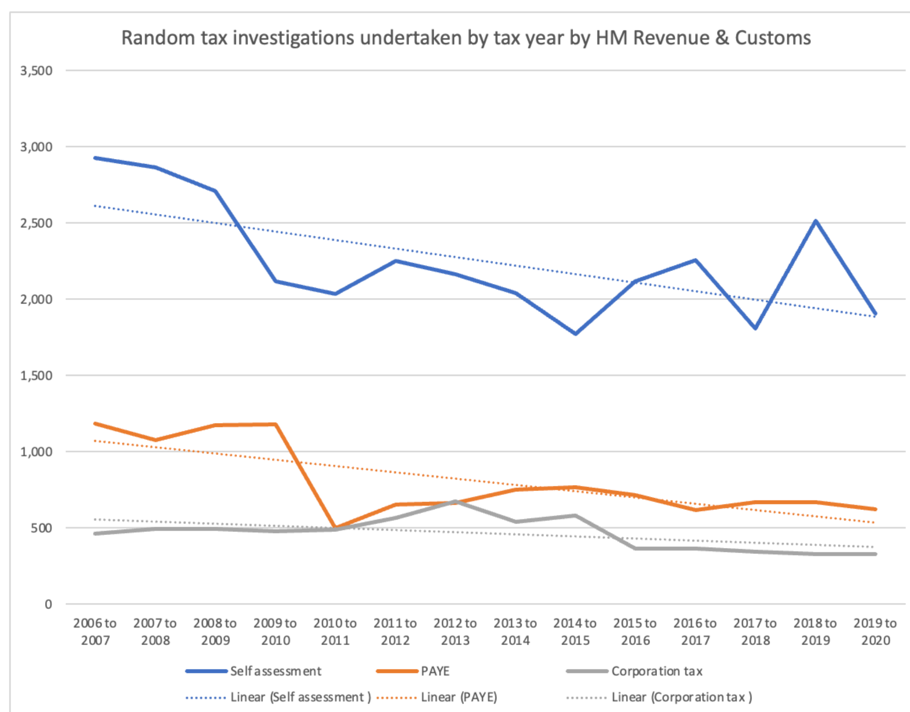
5. All the above being noted, it is also appropriate to suggest that the time has come to take estimation of the UK tax out of the hands of HMRC. It is quite inappropriate that the authority responsible for collecting tax is the same agency as that appraising its efficiency in doing so. The unlikely fact that the tax gap has been recorded as an almost consistent number little different from £35 billion per annum over many years suggests that the time has come for a third-party to undertake this work. As noted above, this might in part be because of the failure to update definitions with regard to tax avoidance, which has assisted the declining percentage tax gap whilst the estimated sum lost remains near constant:

Tax gap by value and as a percentage of theoretical tax liabilities, 2005 to 2006 up to 2021 to 2022



[251] See section K at https://www.gov.uk/government/statistics/measuring-tax-gaps/methodological-annex

6. The other issue to note with regard to this is that the effort invested in the tax investigations that underpin tax gap has declined over the years during which this work has been undertaken, as indicated by the number of random investigations per annum undertaken by HMRC in three major areas of tax, which investigations heavily inform the bottom-up tax gap estimates:



Source: author calculations based on data from HMRC[252].

As is apparent, there is a serious downward trend in the number of tax investigations undertaken when the number of taxpayers has remained almost constant over this period (rising by just 1.2 per cent) although the UK population rose by 10.0 pe cent in the same period, which is in itself a cause for tax gap curiosity. The case for restoring the rate of tax investigations would appear to be compelling in that case.

As is suggested in another chapter that contributes to the Taxing Wealth Report 2024, of which this proposal forms a part, it is considered appropriate that an Office for Tax Responsibility that acts independently of HM Revenue & Customs with the power to audit its activities should now assume responsibility for tax gap calculations to address these concerns.

[252] https://www.gov.uk/government/statistics/measuring-tax-gaps/methodological-annex section H.

Addressing these concerns

The concerns noted should be addressed by addressing the various issues noted above to change the basis of estimation of the annual tax gap in the UK.

In future it is suggested that a five-tier tax gap be undertaken for the UK annually.

It is suggested that this work be undertaken by an Office for Tax Responsibility. A separate chapter on the broader role that this Office for Tax Responsibility might undertake is included in the Taxing Wealth Report 2024.

It is suggested that this Office for Tax Responsibility (ideally, but in its absence, HM Revenue & Customs) should complement the annual tax gap report with a annual tax spillover assessment that appraises tax risk within the UK tax system so that a systematic approach to its elimination can be adopted. This matter is referred to in more detail in another chapter that will form part of the Taxing Wealth Report 2024.

The suggested benefits that would arise are:

1. That there would be a better understanding of the UK tax system as a consequence of the availability of a five-tier tax gap appraisal.

2. That tax decision-making would be improved in quality.

3. The resources of HM Revenue & Customs would be better directed towards those areas in greatest need of attention if tax compliance is to be achieved.

4. As a consequence, tax revenues should improve.

5. It is likely that tax morale amongst tax compliant taxpayers would improve, increasing tax yield.

6. With better informed tax decision making it is likely that both horizontal and vertical tax equity within the tax system will be enhanced. Being realistic, this is a process that would take place over time, but given the relatively small investment required to improve the quality of UK tax gap estimates the rate of return on investment might be very high.

Chapter 15.2

Tax administration – Recommendation 28

Undertaking annual tax spillover assessments

Brief summary

This chapter suggests that:

- The UK should undertake annual tax spillover assessments.
- Tax spillover assessments identify the ways in which one part of a tax system undermines another part of that same tax system, or that of another country, meaning that the expected amount of tax is not paid as a result.
- Tax spillover assessments do, as a result, complement proper tax gap assessments by highlighting why it is likely that anticipated tax revenues are not paid.
- Tax spillover assessments should, by their nature, set out an agenda of legislative reforms to the tax system that will result in it working to best effect.
- If a government sets out to generate a fixed sum in revenue and tax spillover assessments can identify the best way for it to do this at lowest cost then:
    - Cost of tax administration should be minimised
    - Tax avoidance should be reduced
    - Overall tax yields should rise if tax rates are not cut
    - Tax rates could be cut
    - Overall horizontal and vertical tax equity should increase

- Taxpayer morale should rise because honest taxpayers will know that the opportunities for tax abuse will have been reduced.

- Tax spillover assessments would be best undertaken by an independent Office for Tax Responsibility and not HM Revenue & Customs, who cannot be objective on this issue.

- The cost of undertaking tax spillover assessments will be modest.

The proposal	To require the preparation of tax spillover assessments on an annual basis. A tax spillover is the impact that one part of a tax system has on another part of a tax system, whether in the same tax jurisdiction or in another one.
Reason for the proposal	1. To improve the horizontal equity of taxation by ensuring that the tax spillovers that prevent this outcome are identified with a plan of action for their removal being recommended. 2. To improve the vertical equity of taxation by ensuring that the tax spillovers that prevent this outcome are identified with a plan of action for their removal being recommended. 3. To reduce the tax spillover effects that are exploited by many of the activities currently not addressed by UK tax gap estimates. 4. To reduce the rate of tax avoidance and tax evasion in the UK. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.

Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known because there is unlikely to be a direct causal link that can be proved between the measurement of tax spillovers and changed taxpayer behaviour. The gains come from: • Identifying the weaknesses within the UK's tax system. • Identifying mechanisms to address these weaknesses. • Better use of HM Revenue & Customs' resources. • Closure of tax gaps. • The creation of improved taxpayer morale as a result of the closure of loopholes resulting in a more level tax playing field, increasing the inclination on the part of taxpayers to be tax compliant.
Ease of implementation	Relatively straightforward. The process would be improved if undertaken by an Office for Tax Responsibility (see separate recommendation).
Likely difficulties that might result from implementation	Few, although political accountability for failure to address the resulting identified tax spillovers might be politically difficult.
Likely time required to implement the change	Tax spillovers could be introduced as a rolling process of change meaning that full implementation could be spread over a number of years to some advantage as cumulative lessons learned are acted upon.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/29/the-uk-needs-to-undertake-tax-spillover-assessments-if-tax-abuse-is-to-be-beaten/

Background

A tax spillover is the impact that one part of a tax system has on another part of a tax system, whether in the same tax jurisdiction or in another one.

For example, if the corporation tax rate in a country is below its normal income tax rate them there is an artificial incentive to form a company and so save tax.

Alternatively, if a country does not charge taxes on income there is an incentive for income to be shifted to that jurisdiction to avoid taxes that might be due in a country that does have taxes on income.

Importantly, tax spillovers arise as a result of tax policy failures. They might be exploited by taxpayers, but the opportunity to abuse is created by the failure to create an integrated and cohesive tax system. Tax spillover assessments measure those risks and simultaneously suggest how they might be addressed.

Who wins and who loses from a tax spillover?

The usual loser from a tax spillover is the country that does not collect the tax that it might reasonably expect to be paid to it as a result of the laws that it has in operation.

This situation can arise because that country's own laws undermine its own tax system, which is a surprisingly common phenomenon. On occasion this can be accidental. Tax systems are usually large and complex and such conflicts can happen inadvertently. On other occasions this is deliberate, often because of short-sighted policy by a government wanting a particular outcome or incentive to apply at a point of time without really considering the overall consequences of doing so.

Alternatively, the spillover can arise because of a country's tax system being undermined by the actions of another jurisdiction. Tax havens deliberately undertake this type of activity, seeing to undermine the tax systems of other jurisdictions as a result of the policies that they adopt. This activity is commonly called tax competition.

Tax competition is deliberately designed to create tax spillover effects by incentivising the transfer of income, gains and wealth from the jurisdictions where they arise and should be taxed to tax haven locations where they are undertaxed as a consequence. The tax haven wins from this activity as a result of hosting the activities of the lawyers, bankers and accountants who undertake this tax competition activity and who contribute to the local economy as a result. The clients of those lawyers, bankers and accountants obviously hope to gain an advantage as a consequence.

Overall, the greatest cost of this activity is to society at large. If a government requires a certain level of tax to achieve its goals and some exploit tax spillovers to reduce the sums that they should reasonably owe then others, who are more law abiding, pay more tax as a consequence. This creates injustice in society through the failure to deliver both horizontal and vertical tax equity.

All tax spillovers, however created, undermine fair competition and the level playing field on which it is essential that all business operate if markets are to operate in the best interests of society as a whole. Unfair competitive advantages can be created as a consequence of tax spillovers and this can result in the misallocation of scarce capital within society, with consequent cost to the overall income of all jurisdictions as a result of the inappropriate reallocation of some income to those who have exploited tax spillovers.

For all these reasons tax spillovers need to be identified, risk appraised and eliminated to the greatest degree possible. Tax spillover assessments are the mechanism to achieve this objective.

What does a tax spillover assessment involve?

When the concept of tax spillover was first created by the International Monetary Fund[253] in 2014 the approach used was quantitative, econometric and focussed on the impact of tax competition on the corporation tax receipts of developing countries.

The concept of tax spillover has since been developed by Prof Andrew Baker and Prof Richard Murphy (the author of this chapter), most especially in a 2019 academic paper[254] and in

[253] IMF (2014) Spillovers in international corporate taxation, IMF Policy Paper, available from: https://www.imf.org/external/np/pp/eng/2014/050914.pdf

[254] https://onlinelibrary.wiley.com/doi/full/10.1111/1758-5899.12655#gpol12655-bib-0026

subsequent work for the Global Initiative for Financial Transparency[255], which has had the backing and support of the IMF[256] and World Bank.

As proposed by Baker and Murphy, tax spillover analysis should not be an exclusively quantitative exercise, but should involve a substantial qualitative process, involving reporting and assessing a wide range of tax practices and processes. Such an exercise should be informed by the aim of reducing the harm states do to their own fiscal autonomy and that of other states.

To be comprehensive spillover assessment should consider spillovers between and within tax systems covering the following areas, at a minimum:

- Income tax
- Corporation tax
- Capital gains tax
- Social security or national insurance
- Tax politics
- Tax administration
- Company and trust administration, and
- International tax agreements.

They could in time be extended to:

- Indirect taxes, such as value added tax
- The benefits system
- Wealth taxes

[255] https://fiscaltransparency.net/making-tax-work/ and https://fiscaltransparency.net/tax-transparency-principles/

[256] https://blog-pfm.imf.org/en/pfmblog/2021/08/making-tax-work-pathways-to-enhancing-tax-transparency-and-performance#more

- Land taxes.

Tax politics refers to the attitude of a government towards tax (which varies significantly between states) and its approach to funding a tax authority, tax equity and the integration of tax into broader policy making.

Why tax spillover assessments are needed

A tax authority needs to undertake tax spillover assessments to assist its appraisal of:

- The efficiency of its administration.
- Its focus on closing the tax gap.
- Its effectiveness in promoting tax reform.
- Its ability to promote horizontal and vertical tax equity.
- Its use of data in an equitable fashion.

An appraisal of the interaction of the tax and company and trust administrations within a jurisdiction is also vital: these administrations are a vital sources of data that must be effective if tax spillovers are to be avoided and tax abuse prevented.

Spillover assessment is therefore domestic as well as international and should revolve around three forms of assessment:

- Domestic spillovers
- International risks generated by a jurisdiction, and
- International vulnerabilities of a jurisdiction.

Conducting a tax spillover assessment

Professional assessors conducting spillover analysis should collect impressions about current tax practice through wide ranging stakeholder consultations, including interviews and surveys, in a process similar to the corporate governance ROSCs (Reports on Observance of Standards and Codes) conducted by World Bank Staff.

These field notes should translate into a more qualitative style country reports assessing and reporting on tax practices and the spillover risks in the jurisdiction.

Vitally, they should contain targeted policy recommendations.

The appraisal process recommended by Baker and Murphy is ideal for this purpose and is a focus of their approach. Many of the recommendations made in the broader report of which this chapter forms a part are based on a trial tax spillover assessment for the UK[257].

[257] https://onlinelibrary.wiley.com/action/downloadSupplement?doi=10.1111%2F1758-5899.12655&file=gpol12655-sup-0002-Appendix.docx

Chapter 15.3

Tax administration – Recommendation 29

Creating an Office for Tax Responsibility

Brief Summary

This chapter suggests that:

1. The governance of HM Revenue & Customs needs to be reformed. Since its formation it has used a governance structure similar to that of a public company, which is inappropriate when it is tasked with supplying a public good[258]. The result is that its governance structure needs reform to reflect the wider concerns of UK society.

2. In addition, it is recommended that the UK should create an Office for Tax Responsibility (OTR).

3. This OTR should report to the House of Commons Public Accounts Committee so that it might hold HM Revenue & Customs, HM Treasury and the Chancellor of the Exchequer to account for their management of the UK tax system.

4. The Office for Tax Responsibility should be responsible for preparing annual assessments of the UK tax gap[259] and tax spillovers[260].

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[258] Public goods are defined as a supply of goods (sometimes) and services (more commonly) that are provided without the intention of profit being made to all members of society, usually by a government.

[259] https://academic.oup.com/book/39754/chapter/339816709

[260] https://onlinelibrary.wiley.com/doi/abs/10.1111/1758-5899.12655

5. The OTR should also be responsible for recommending ways to address tax gaps and tax spillovers and for appraising HM Revenue & Customs' progress in doing so each year.

6. The benefits of having an Office for Tax Responsibility are that there would be:

7. Better governance of tax in the UK.

8. Better tax decision making in the UK.

9. An improvement in the quality of the data available to all parties on the management of tax in the UK.

10. Better use of HM Revenue & Customs' resources that should follow as a result.

11. Increased pressure arising to close tax gaps, many of which favour the wealthiest in society at present.

12. The creation of improved taxpayer morale as a result of the closure of loopholes resulting from work on tax spillovers. This should result in a more level tax playing field, increasing the inclination on the part of taxpayers to be tax compliant.
All this being noted, it will be difficult to prove a direct causal link between tax revenues generated and the creation of an Office for Tax Responsibility and no estimate of additional tax revenues to be raised is made as a result.

The proposal	To create an Office for Tax Responsibility that would act independently of HM Revenue & Customs and be tasked with preparing annual tax gap[261] estimates and tax spillover analyses[262]. It might also be given responsibility for proposing tax legislation to address issues arising from these analyses.

[261] https://taxingwealth.uk/2023/09/19/the-taxing-wealth-report-2024-the-uk-needs-better-estimation-of-its-tax-gap-to-prevent-the-illicit-accumulation-of-wealth-2/

[262] https://taxingwealth.uk/2023/09/29/the-uk-needs-to-undertake-tax-spillover-assessments-if-tax-abuse-is-to-be-beaten/

Reason for the proposal	1. To improve the quality of tax governance by reforming the management structure of HM Revenue & Customs so that it is accountable to society in the UK, which cannot be claimed to be the case at present. 2. To enhance that accountability by creating an independent agency responsible for monitoring the effectiveness of the work undertaken by HM Revenue & Customs. 3. To improve the support made available to parliament to investigate the work undertaken by HM Revenue & Customs by making this office jointly responsible to both the Chancellor of the Exchequer and the Treasury and Public Accounts Committees of the House of Commons so that the latter might request that audits be undertaken on their behalf. 4. To improve the horizontal equity of taxation by ensuring that tax gaps estimates and tax spillover assessments are properly undertaken in the UK, with both of these being undertaken to, at least in part, address this issue. 5. To improve the vertical equity of taxation by ensuring that tax gaps estimates and tax spillover assessments are properly undertaken in the UK, with both of these being undertaken to, at least in part, address this issue. 6. To improve the quality of independent advice to the government on the creation of new tax legislation required to address weaknesses identified by tax gap appraisal and tax spillover assessments. 7. To reduce the rate of tax avoidance and tax evasion in the UK.

	8. To consequently improve the rate of tax compliance in the UK. 9. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known because there is unlikely to be a direct link between the creation of an Office for Tax Responsibility and taxpayer behaviour could be established. The gain comes from: • Better governance of tax in the UK. • An improvement in the quality of the data available to all parties on the management of tax in the UK. • The likely better use of HM Revenue & Customs' resources that should follow as a result. • Increased pressure arising to close tax gaps, many of which favour the wealthiest in society at present. • The creation of improved taxpayer morale as a result of the closure of loopholes resulting from work on tax spillovers. This should result in a more level tax playing field, increasing the inclination on the part of taxpayers to be tax compliant. All this being noted, it will be difficult to prove a direct causal link between tax revenues generated and the creation of an Office for Tax Responsibility and no estimate of additional tax revenues to be raised is made as a result.
Ease of implementation	Relatively straightforward, although the recruitment of suitable personnel to staff this Office for Tax Responsibility will be an issue. Considerable care will need to be given to this issue if the OTR is to achieve the required independent status that will be vital to its work.

Likely difficulties that might result from implementation	Few, although political accountability for failure to address the reports of the Office for Tax Responsibility might be embarrassing if not undertaken.
Likely time required to implement the change	Two or three years to create due processes, recruit staff and start work.
Consultation period required.	Short.

A web-based version of this chapter is available here:

https://www.taxresearch.org.uk/Blog/2023/12/19/taxing-wealth-report-2024-the-uk-needs-an-office-for-tax-responsibility/

Background

HM Revenue & Customs is currently responsible for managing the UK's tax system. When doing so it uses a structure similar to that of a public company, with a Board made up of civil servants and people with experience as directors in large corporate entities. It is suggested that this is inappropriate. The range of experience needing to be reflected on the Board of HM Revenue & Customs needs to be broadened to reflect the experience of all UK taxpayers and not just that a few of those who are likely to be wealthy.

In addition, HM Revenue & Customs needs to be better held to account for its performance. This means that measures such as the annual tax gap estimate need to be independently prepared to ensure that they are reliable[263]. A separate chapter in this series of proposals has been prepared that explains the deficiencies in those existing tax gap estimates and makes recommendations for their improvement.

In addition, at present, the UK has never undertaken a formal tax spillover assessment[264] and HM Revenue & Customs has not indicated its willingness to do so. Again, a separate chapter

[263] https://www.gov.uk/government/statistics/measuring-tax-gaps/1-tax-gaps-summary

[264] A tax spillover is the impact that one part of a tax system has on another part of a tax system, whether in the same tax jurisdiction or in another one. Tax spillover assessments are explained here https://taxingwealth.uk/2023/09/29/the-uk-needs-to-undertake-tax-spillover-assessments-if-tax-abuse-is-to-be-beaten/

in this series of proposals has been prepared that explains the reasons why the preparation of tax spillover assessments for the UK would be desirable.

Whether or not tax spillover assessments are prepared, tax gap data is published and It is considered to be poor governance practice for any organisation to audit its own work, but that is what HM Revenue & Customs does at present with regard to this issue, giving rise to doubts as to the validity of some of the reported data[265].

The creation of an Office for Tax Responsibility (OTR) might address these concerns and help create an accountable UK tax authority.

Recommendation

1. HM Revenue & Customs' Board should be restructured to change its ethos so that it:

    - Seeks to maximise tax revenues collected within available law.
    - Assists honest taxpayers to be tax compliant to the greatest of its ability.
    - Seeks to serve people in the community – and not just those online.
    - Is honest about its successes and failures – which its current tax gap reporting is not.
    - Represents all taxpayers and not just the interests of the wealthy and big business. This will require a much broader range of appointments to its Board to reflect the interests of society at large.

2. The OTR should report to the Public Accounts Committees (PAC) of the House of Commons. This would be required to indicate its independence from:

    - The Chancellor of the Exchequer.
    - HM Treasury.
    - HM Revenue & Customs.

    The PAC should be responsible for:

    - Appointing the senior staff of the Office for Tax Responsibility (see below).
    - Ensuring its work holds HMRC to account.
    - That proper recommendations arising from its work are submitted to the Chancellor, Treasury and HMRC.

[265] See, for example, https://lordslibrary.parliament.uk/unpaid-taxes-the-tax-gap/

3. The OTR should be managed by a Director for Tax Responsibility, who should be supported in their work by not less than two and not more than four Commissioners for Tax Responsibility who should, with the Director of Tax Responsibility, constitute the Board of the Office for Tax Responsibility.

   Due care to prevent conflicts of interest in the appointment of these persons should be taken. Within the limits of their number and the requirement for relevant experience due consideration should be given to them being representative of the wider interests of taxpayers within the UK as a whole.

4. The Office for Tax Responsibility should:

   a. Be given a sufficient budget to undertake its duties as laid down in law.

   b. Be given the right to access all information held by government departments, agencies, local authorities and other authorities established under statute that it, in its sole discretion, decides is required to fulfil its duties laid down by law, subject to the sole requirement that all obligations to respect the confidentiality of those with whom those other agents of government engage shall be also be respected by the Office for Tax Responsibility when using that data.

   c. Engage such staff (including the Director and Commissioners) as it needs to fulfil its duties, subject to the condition that those staff shall not be seconded from other government departments, agencies, local authorities or authorities established under such statute and such staff shall not to be seconded to it by any entity registered which, at the time that the secondment shall take place, is registered as a tax agent by H M Revenue & Customs.

   d. Report annually on its best estimate of the UK tax gap. In so doing it shall calculate the tax gap separately for each actual tax and each ignored tax base within the UK but with specific requirement being made that the interaction of the tax gap calculated for any one tax be specifically considered when estimating the tax gap for any other tax before preparing and publishing an estimate of the total annual UK tax gap.

   e. Use a five-tier methodology for calculating the tax gap[266] that estimates:

[266] https://taxingwealth.uk/2023/09/19/the-taxing-wealth-report-2024-the-uk-needs-better-estimation-of-its-tax-gap-to-prevent-the-illicit-accumulation-of-wealth-2/

- Tax base gaps.
- Tax spend gaps.
- Tax evasion.
- Tax avoidance.
- Tax known to be owing but not settled i.e. unpaid tax.

f. Publish its methodology and workings with regard to the calculation of each component of the tax gap subject only to withholding such information as is required to prevent any breach of taxpayer confidentiality.

g. Publish an annual tax spillover assessment for the UK[267], complete with a risk appraisal on the issues arising from that assessment.

h. Report on progress made by H M Revenue & Customs in closing the tax gap.

i. Suggest the methods it would propose H M Revenue & Customs and other agencies, if appropriate, should adopt to better tackle the tax gap, linking those suggestions to tax spillover assessments as appropriate.

j. Suggest those legislative changes required, in its opinion, to close the tax gap.

k. Suggest the budget resources that, in its opinion, H M Revenue & Customs and those other agencies addressing this issue will require to address the tax gap it identifies.

l. Prepare annual forecasts of the taxation and other benefits that might arise from allocating the resources it proposes be used to close the tax gap.

m. Engage with those persons who wish to make representations on matters relating to the tax gap.

The major benefits arising from the creation of an Office for Tax Responsibility

It is anticipated that the benefits resulting from the creation of an Office for Tax Responsibility might include:

[267] https://taxingwealth.uk/2023/09/29/the-uk-needs-to-undertake-tax-spillover-assessments-if-tax-abuse-is-to-be-beaten/

- Better governance of tax in the UK.
- Better tax decision making in the UK.
- An improvement in the quality of the data available to all parties on the management of tax in the UK.
- The likely better use of HM Revenue & Customs' resources that should follow as a result.
- Increased pressure arising to close tax gaps, many of which favour the wealthiest in society at present.
- The creation of improved taxpayer morale as a result of the closure of loopholes resulting from work on tax spillovers. This should result in a more level tax playing field, increasing the inclination on the part of taxpayers to be tax compliant.

Chapter 15.4

Tax administration – Recommendation 30

The reforming of HM Revenue & Customs, its goals and funding

Brief Summary

This chapter suggests that:

- HM Revenue & Customs governance structures are no longer fit for purpose. They are based on the ethos of a public company and are focused almost entirely on meeting the needs of large companies and the wealthy. Both sectors are well represented amongst its non-executive directors; no other group in society is. That is no longer acceptable.

- HM Revenue & Customs has for too long emphasised cost control as its focus of concern rather than serving taxpayers or raising all the revenue owed to it. This has been inappropriate and has prevented the creation of a tax system suited to the needs of society in the UK.

- HM Revenue & Customs' drive to reduce the cost of collection of tax in the UK has largely failed but has as a consequence:

    - Seriously reduced the quality of service that it supplies to taxpayers in the UK, with the quality of everything, from face-to-face services to the answering of telephone calls, to the time taken to reply to letters, all deteriorating significantly leaving many taxpayers without any of the help that they need to pay the right amount of tax that they owe.
    - Seriously reduced the number of staff at HM Revenue & Customs.
    - Reduced the average real pay of staff at HM Revenue & Customs.
    - Considerably reduced the number of tax investigations undertaken each year.

  - Lost control of some major parts of the tax gap, which is the difference between the tax that should be paid and the tax that is actually paid in a year.

- Tax gap measurement has been used by HM Revenue & Customs' management as the indicator of its success, but as has been explored in other parts of the Taxing Wealth Report 2024, the claims made with regard to the tax gap in general are open to question.

- One of the two tax gaps where it is very apparent that matters have got out of control is that for small companies, where around 30 per cent of corporation taxes owing now go unpaid each year, which is way in excess of any reasonable level of loss. The likely annual cost of this loss is now £5.9 billion per annum.

- Another tax gap that is likely to be out of control is that for the 5 million small businesses that pay their taxes via the income tax system. HMRC say this tax gap has fallen from around 32.5 per cent of these taxes owing going unpaid in 2014 to only 18.5 per cent being unpaid now. They have not, however, provided any convincing reason for this improvement in taxpayer compliance which is not matched by improvements in equivalent rates for small companies or in the overall rate of timely tax return submission, half of which returns come from self-employed business owners. The claimed current rate of loss is unlikely to be realistic in that case and an excess loss of maybe £3.4 billion is likely to arise as a result in this area, largely because HMRC has withdrawn from local tax offices that previously supported these taxpayers and from active monitoring of their onsite activities through their now largely abandoned programme of business compliance visits.

- In combination the losses from just these two tax gaps amount to maybe £9.3 billion and can be attributed to HM Revenue & Customs mismanagement of its activities in the community, whether that be through maintaining local offices where face-to-face help is available or by visiting businesses at their own premises.

- It also seems that HM Revenue & Customs' claims for the benefits of its Making Tax Digital programme seem to be seriously overstated, which is a fact repeatedly noted by the House of Commons Public Accounts Committee. The costs of creating this programme appear to be out of control. The costs it imposes on business taxpayers are excessive. Worst of all, it is likely to alienate millions of people from the tax system and most likely increase the tax gap as a result, rather than reduce it. It also makes the UK a significantly worse place in which to run a business, which is likely to impose serious costs on society at large.

- As a result, this report recommends that:
  - That HMRC reforms its governance structures and objectives.
  - HMRC restore its local office help centre presence in towns and cities across the UK, and widely advertise the availability of this support service.
  - HMRC's should restore its programme of site visits of businesses to monitor their tax compliance to cover checking both PAYE and VAT records.
  - HMRC should stop the rollout of its Making Tax Digital programme so that no business that is not VAT registered will never be enrolled in this programme.
- The cost of restoring these services will be very much less than the sums that might be raised by reducing the two gaps that have been noted to reasonable levels (i.e. those that were maintained during periods when HMRC was better resourced in the past) but since some of those sums capable of recovery have already been noted elsewhere in the Taxing Wealth Report 2024 no additional account of such recovery is made here. That said, because other tax gaps would also undoubtedly improve if HM Revenue & Customs were to re-establish its presence in UK towns and cities the likely cost of this programme – which might be £1 billion a year, or twenty per cent of the current cost of running HMRC - is not taken into account either. Nor is the likely significant gain from reducing taxpayer strain taken into consideration, or the gain from making the UK a more tax-friendly environment, to which considerable harm has been done since 2010.

The proposal	To reform the governance structure of HMRC and to restore the proper funding of HMRC so that it might: • Restore its tax office presence in the community with the specific goal of assisting those requiring help with their tax affairs. • Restoring its programme of on-site inspections of smaller business with the aim of improving tax compliance. • Abandoning its Making Tax Digital programme for all non-VAT registered businesses to reduce the

	considerable cost and strain that this will impose on those taxpayers which will likely increase the tax gap.
Reason for the proposal	This proposal is intended to: 1. Improve relationships between HM Revenue & Customs and taxpayers, which are very strained. 2. Reduce the tax gap. 3. Make the UK a more tax friendly environment in which smaller business can operate. 4. Improve taxpayer morale.
Estimated tax that might be raised as a result of the recommendation made	This recommendation might raise more than £9 billion in tax revenue from just two groups of taxpayers but to avoid risk of double counting gains no account of this is taken in overall Taxing Wealth Report 2024 totals. The cost of the recreation of an HMRC presence in the community might be £1 billion per annum. This is, again, not accounted for in Taxing Wealth Report 2024 totals because it should be more than covered by the additional sums noted in the previous paragraph.
Ease of implementation	It would take a major change of strategy on the part of HM Revenue & Customs to make this change. That might also require a change its senior personnel. Combined with the necessary recruitment and training programmes for the many additional staff that this programme will require and the need to find suitable premises, the likelihood is that this programme would take longer than the life of a single parliament to implement.
Likely difficulties that might result from implementation	The impediments to this programme will be internal within HMRC and amongst ministers who still cannot see our tax authority as a service agency that should create the public good that a well-functioning tax system represents.
Likely time required to implement the change	At least five years, and maybe longer.

Consultation period required.	Short. This is a matter for ministers and HMRC to decide upon and wide consultation would not be required.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2024/02/29/reforming-the-organisation-goals-and-funding-of-hm-revenue-customs/

Background

HM Revenue & Customs is a relatively new government organisation. It was created in 2005 as a result of the merger of the Inland Revenue, which previously dealt with most direct taxes, such as income tax, corporation tax, and national insurance, with HM Customs and Excise, which previously dealt with most indirect taxes, such as VAT and excise duties.

HMRC was created with the aim of breaking down the divisions between tax collection authorities and so improve the coordination in their methods of working. It was also created with the intention of delivering operational efficiencies. It is suggested that this has been an inappropriate focus for its concern. There has also been too little focus on collecting all tax owing and on assisting those taxpayers who need assistance to make proper payments of tax whoever and wherever they might be in the community. These issues can only be addressed by changing the governance structures of HM Revenue & Customs.

Reforming the governance structures of HM Revenue & Customs

HMRC's governance structures are failing because it is, at least in part, beyond ministerial control (because of the old fiction that it reports to the Crown and not parliament, which is implicit in its name) whilst simultaneously modelling itself on the structure of a public limited company that is seemingly intent on meeting the needs of its most valuable customers (as it anachronistically and annoyingly insists on describing taxpayers as). The result is an organisation without a focus on delivering a service to all in society. To address this the Taxing Wealth Report 2024 recommends:

- Reforming the governance of HM Revenue & Customs and making it subject to properly funded independent scrutiny by an Office for Tax Responsibility.

- That governance structure should reflect the whole taxpayer community of the UK rather than the wealthy and large business community as it does at present. That means representation should be added from:
  - The small business community.
  - Trade unions.
  - Pensioners.
  - Charities.
  - Consume groups.
  - Civil society.
- Changing the ethos of HM Revenue & Customs so that it:
  - Seeks to maximise tax revenues collected within available law.
  - Assists honest taxpayers to be tax compliant to the greatest of its ability.
  - Seeks to serve people in the community – and not just those online.
  - Is honest about its successes and failures – which its current tax gap reporting is not.
  - Represents all taxpayers and not just the interests of the wealthy and big business.

Because cost cutting, and not these issues, have been the focus of concern of HM Revenue & Customs' management to date the following have happened:

- A significant reduction in staff numbers at HM Revenue & Customs.
- The closure of almost all HMRC offices in the towns and cities of the UK, so that face-to-face advice is now virtually unavailable from HMRC.
- The subsequent closure of many of the helpline facilities that were meant to replace the local office network.

Simultaneously, HMRC has developed a belief that the UK's tax system tax can be digitally managed, largely by imposing considerable administrative and IT demands on UK taxpayers.

HMRC also seems to believe that almost all queries that a person might have when trying to manage their tax affairs can be reasonably answered by online help facilities. This, in the experience of millions of taxpayers, is wrong. The UK's tax practitioner community agrees with taxpayers on this issue.

Those taxpayers are, as a result of this approach, bewildered by what is asked of them, unsure of what to do, are without help, and in far too many cases, are terrified of the consequences.

What HMRC fails to understand is that taxpayers making enquiry of it are not necessarily seeking facts when making a telephone call. What they are seeking is reassurance, and no online help facility will provide that. People need to speak to another human being, either face-to-face or on the end of a telephone, to alleviate the concerns and stresses that they have which a necessarily complex tax system create. Only when HM Revenue & Customs appreciates this fact will they supply the support that people really need from them.

Without a change to its governance structures to reflect the wider interests of all communities in the UK it is thought unlikely that the necessary changes to HM Revenue & Customs' culture to make good these changes will happen. The recommendations made in. the rest of this note are likely to be conditional on this change happening.

The failings of HM Revenue & Customs

It has been widely acknowledged, by the House of Commons Public Accounts Committee[268] and many others, such as professional accounting and tax institutes, that the quality of service supplied by HM Revenue & Customs to UK taxpayer has fallen significantly since about 2010. This has been the consequence of a deliberate policy of seeking to cut costs in that organisation. As a result, the following have happened, although this list should be considered representative of the issues that have arisen rather than being comprehensive:

- Almost all local tax offices in the UK have been closed, denying taxpayers access to face-to-face support with their tax affairs[269].

- On-site VAT inspections of the books and records of almost UK registered traders has ceased.

- On-site inspection of PAYE records of UK registered traders has very largely ceased.

- The telephone helplines that were meant to replace local tax office support have largely closed[270], and were almost unavailable during the autumn of 2023 and January

[268] https://publications.parliament.uk/pa/cm5804/cmselect/cmpubacc/76/summary.html
[269] http://data.parliament.uk/DepositedPapers/Files/DEP2020-0609/HMRC_Office_closures_and_regional_centre_opening_dates.pdf
[270] https://taxaid.org.uk/hmrc-announces-temporary-closure-of-its-self-assessment-helpline

2024, during which period demand was at its peak amongst those seeking help with their tax returns[271].

- Delays in answering the telephone at HMRC have increased dramatically and the number of people getting through at all has fallen[272].

- Delays in correspondence with HMRC have increased considerably, particularly with regard to any issue involving complexity[273].

- The number of tax investigations has fallen[274].

- HMRC has considerably increased the burden of tax compliance on taxpayers through the introduction of their Making Tax Digital programme, which requires many more interactions between a self-employed person, landlord, or company and HMRC a year than was the case prior to its introduction. The introduction of this programme is continuing despite it being admitted that HMRC's costings of taxpayer benefits from this programme were always wrong[275] and the programme itself costing much more to deliver than was ever forecast.

- HMRC operating costs have risen despite the above noted facts[276].

The above facts are referenced where appropriate, but attention is also drawn to the ongoing scrutiny of HMRC's performance by the House of Commons Public Accounts Committee, who have regularly documented over a period of more than a decade the failings of HMRC to meet any reasonable customer service standards. Their work in this area is comprehensive and as such it has not been felt necessary to repeat it here.

Focus of this work

The focus of this chapter is, instead, different from that undertaken by the Public Accounts Committee and has been to highlight that:

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[271] https://www.gov.uk/government/news/self-assessment-helplineto-focus-on-priority-queries
[272] https://publications.parliament.uk/pa/cm5803/cmselect/cmpubacc/686/report.html
[273] Ibid
[274] https://www.thebureauinvestigates.com/stories/2024-02-18/hmrc-fraud-teams-civil-inquiries-fall-by-half-over-five-years/
[275] https://publications.parliament.uk/pa/cm5803/cmselect/cmpubacc/1333/summary.html
[276] HMRC accounts, noted below.

- HMRC costs have not been controlled, despite declining public service, and despite the considerable difficulties that HMRC have created for the long-term analysis of its performance because of the opacity of the accounting information that it publishes on an annual basis.

- HMRC's claim that it has improved its efficiency in managing the UK tax system as evidenced by a falling tax gap[277] is open to serious doubt when evidence from within their own tax gap reports suggests that the data that they publish is potentially unreliable whilst also being deeply contradictory. That data also suggests implausible changes in the behaviour of some groups of taxpayers that are unlikely to be true. This is most especially the case when other sources of data suggest the changes in behaviour that HM Revenue & Customs suggest have taken place have not occurred.

- HMRC has lost control of the small business corporation tax gap and is most likely to have done the same with regard to the self-employed business income tax gap, although their data suggests otherwise in the latter case. This loss of control can be specifically stated to have begun in the case of the small business corporation tax scam in 2012, when the process of closing HMRC local tax offices in communities across the UK, and of winding down HMRC VAT and PAYE[278] compliance visits to smaller UK trading entities, meaning that an essential level of scrutiny of their trading records disappeared, most especially when the independent audit requirement of smaller companies had been withdrawn from the 1990s onwards.

In this chapter evidence is drawn from the accounts of HMRC from 2006 onwards[279], with those that represented the combined organisations for 2005 also being included for the sake of comparison. The data secured from these accounts is then compared with data from:

- HM Revenue & Customs' own published tax gap data;

- Reports by the House of Commons Public Accounts Committee;

- Other sources with concern about the performance of HM Revenue & Customs.

The intention is to determine whether the supposed benefits of cost saving at HM Revenue & Customs have really delivered benefits for society or whether greater investment in the organisation might yield dividends in terms of more tax recovered and greater well-being in

[277] See notes below on what the tax gap is.

[278] PAYE is the Pay as You Earn system of tax deduction from the wages of employees in the UK.

[279] Thanks are due to Christopher Lunt for assistance with data collection for this note.

society, and most especially in those parts of it that have, perforce, to engage with HM Revenue & Customs on a regular basis. The overall intention is to review the suggestion that the UK has seriously under invested in tax collection.

Summary of findings

On the basis of the review undertaken it is suggested that if appropriate investment had been made from 2011 onwards in HMRC's continued presence in the community and in undertaking onsite inspections of taxpayer records it is likely that significantly more tax would have been collected from those with wealth in the UK over this period.

The focus of the research in this chapter has been on the small company tax gap and self-employed business tax gap as declared for income tax purposes. That has been the case to keep the work within reasonable scope. Even so, it is suggested that HM Revenue & Customs has lost control of the small company tax gap at an annual cost of at least £5.9 billion per annum.

It is also suggested that it has almost certainly lost control of the small business tax gap as declared for income tax purposes, where the cost of doing so is likely to be £3.4 billion per annum.

In combination the annual cost is £9.3 billion per annum. This can be compared with a total cost of running HMRC of £5 billion per annum, based on its most recent accounts.

If it cost £1 billion per annum to restore HM Revenue & Customs' presence in the UK's towns and cities and to revive its programme of onsite inspection io taxpayer books and records, the yield would still exceed £9 for every additional £1 spent.

If this programme was also associated with abandonment of much of the Making Tax Digital programme, which is widely thought to be failing whilst incurring significant cost over-runs, morale amongst UK taxpayers could be significantly increased. Tax compliance might also rise as that onerous programme encourages evasion. The UK might also become a significantly more tax-friendly place in which to do business, boosting the economy as a result.

The additional resources that might have been collected from these sectors with particularly high tax gaps that could have been collected if greater resources were available to HM Revenue & Customs would also have assisted:

- Control of the rate of increase in income and wealth disparities in the UK, which disparities are increased at present by the failure to collect taxes owing by those who evade their obligations.

- The retention of HM Revenue & Customs offices in the communities of the UK so that those needing face-to-face help with other aspects of their tax affairs might have been able to secure it.

- The provision of sufficient well-trained staff so that back logs in correspondence with HM Revenue & Customs need not have arisen, which would have considerably reduced the stress of many people in the UK and greatly assisted the smooth operation of the UK's tax system whilst reducing cost for all who have to engage with HM Revenue & Customs.

- The provision of sufficient well-trained staff so that telephone help lines could both operate and do so without undue delays for callers being suffered.

Methodological approach and data sources

1. HMRC accounts

The approach adopted here is not intended to be a comprehensive review of the operating costs of HMRC, largely because changes in its accounting methodologies over the years reviewed makes preparing such data a little too subjective to be useful. Instead, tax collection data as published by HMRC (which does not necessarily always agree with that published by other UK authorities) is compared in the first instance with the staff cost of collection of that tax noted in HMRC's accounts. This is considered an initially appropriate proxy for total costs when staff are the primary resource used by HMRC to manage the collection of tax owing. These staff are also the critical personnel who interact between the taxpayer and the tax authority to assist the correct payment of tax at the right time. HMRC data on their staff numbers and the cost of employing them is consistently available within their accounts unlike comparable total cost data[280].

In many cases this data can be expressed in percentage terms because costs in a year are being compared with revenues in that year. However, where appropriate other approaches are adopted. Where this is the case, this is clearly indicated in the notes that follow.

On occasion data is also necessarily restated into current prices. When doing so the consumer prices index has been used because most restatements relate to employee costs and

[280] The assistance of Christopher Lunt in undertaking reviews of HMRC's accounting data is gratefully acknowledged. We both came to the conclusion that much of it is opaque and seriously lacking in comparability over time.

employee costs are microeconomic information rather than macroeconomic data, and so the use of a GDP deflator for restatement purposes would be inappropriate.

Data is also, on occasion, restated on the basis of cost per head of population. Where that is the case annual population figures supplied by the Office for National Statistics have been used. These have not been adjusted to reflect the fact that not everyone is a taxpayer because whilst not everyone is a taxpayer, everyone in society benefits from the payment tax.

HM Revenue & Customs' annual published accounts are all available on government websites for the period reviewed although some persistence is required to find them all. Individual references are not noted excepting for 2022/23[281].

2. Tax gap data

Tax gap data has been based on that published in 2023 by HM Revenue & Customs. However, note has been taken of revisions to data from earlier years, many of which are material. The data is mainly extracted from the spreadsheet files that HM Revenue & Customs have made available[282].

3. Other sources

Other sources are noted to when referred to and have been used to highlight the decline in HM Revenue & Customs' service delivery over the years reviewed.

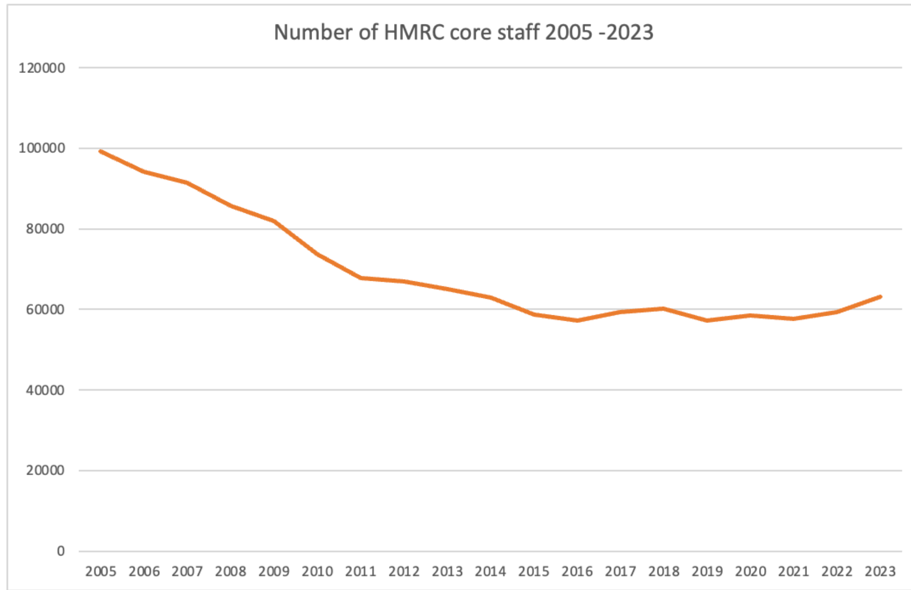
Data findings

1. HMRC costs and employee related data

The number of staff engaged by HMRC between 2005 and 2023, excluding those employed in non-core operations such as the valuations office was as follows:

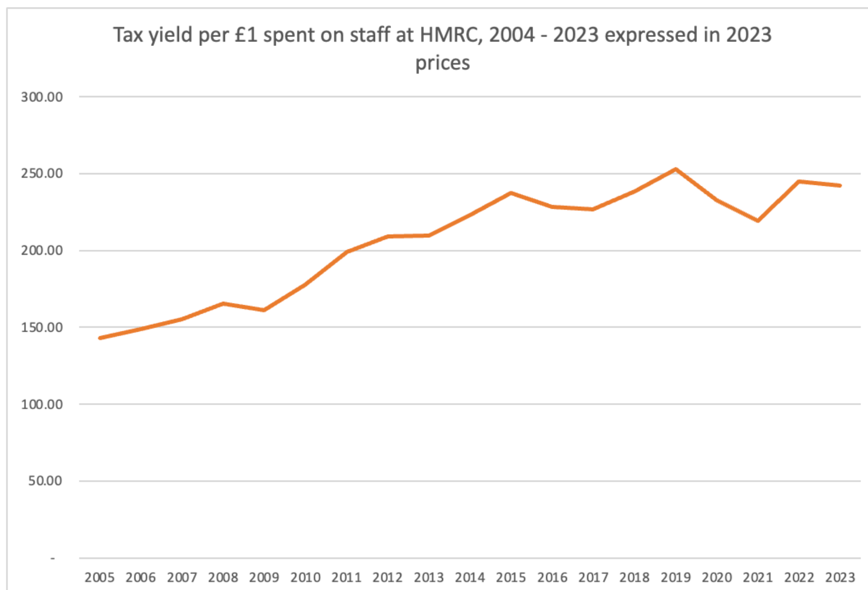
[281] https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2022-to-2023

[282] https://assets.publishing.service.gov.uk/media/6491bef6103ca6000c03a248/Measuring_tax_gap_online_tables_2023.xlsx



As is apparent, the core HMRC management objective of cutting the number of employees engaged in tax collection during this period was achieved, with staff numbers being cut heavily between 2005 and 2014. Since then they have stabilised at around 60,000 with a slight upturn post-Covid.

As a result of cutting the number of staff that it employed, HMRC also succeed in cutting the cost of tax collected when expressed as a ratio to total staff costs. The following data compares tax collected per pound spent on staff costs by HMRC from 2005 to 2023:



The impression gained is of considerable increases in productivity.

This impression is quite misleading. HM Revenue & Customs' accounts are deeply opaque, subject to frequent restatement and reclassification of data, and are clearly designed to discourage any form of long term analysis, but the following data has been extracted from two tables that they have themselves published that appear to share broadly common descriptions of HMRC's costs. They come from the accounts for 2020/21[283] and 2022/23[284]. The data from the earlier accounts is highlighted in blue and that from later accounts in yellow. The years 2018/19, 2019/20 and 2020/21 were common to both tables. Data from the later period was used for the overlap as the data published in the two sets of accounts is not consistent. Presuming the earlier table excludes depreciation costs the differences were £9 million in 2018/19, with the later statement of cost exceeding the earlier one, with the differences being £215 million and £161 million in the next two years. However, the direction of difference changed: in 2019/20 costs were later restated downward but for 2020/21 they went up. Subject to these inconsistencies in HM Revenue & Customs' own data, this is the relevant information:

HMRC operating costs 2015/16 to 2022/23 in original prices

	2015/16 £'m	2016/17 £'m	2017/18 £'m	2018/19 £'m	2019/20 £'m	2020/21 £'m	2021/22 £'m	2022/23 £'m
Base cost	3,541	3,277	3,122	3,032	2,705	3,141	2,977	3,214
Additional funding	36	104	345	263	106	135	373	342
Transformation		360	265	235	177	155	367	373
Avoidance and evasion		94	177	247	285	339	369	450
Brexit funding			36	193	423	715	761	648
Other	3	5	5	(1)		(1)		1
Total costs pre-dep'n	3,580	3,840	3,950	3,969	3,696	4,484	4,847	5,028
Cost of living payments								724
Covid funding						95	843	107
Depreciation				401	379	382	334	541
Total costs incl dep'n				4,370	4,075	4,961	6,024	6,400

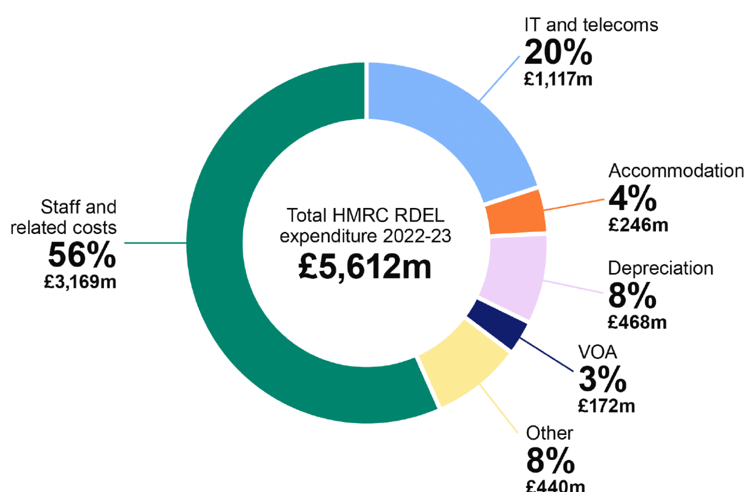
It will be noted that HMRC categorise their spending between base costs and additional funding that appeared to be a feature of its activities within its accounting from 2015/16 onwards. Depreciation has been excluded in all cases as it is a non-cash cost. Exceptional costs relating to Covid and Cost of Living pay-outs managed by HM Revenue & Customs are excluded from total costs used for analysis in this table although they are included in the table in the 2022/23 accounts, quite misleadingly as HMRC was only a paying agent in these cases.

Even more misleadingly, in 2022/23 HMRC said in its accounts that its operating costs were as follows:[285]:

[283] Page 32

[284] Page 75

[285] Page 79



The figures, as is normal for HM Revenue & Customs, even within the same set of accounts, do not reconcile. They did add this table after the above noted one:

Table 3: 5-year trend on our spending[1]

	2018-19 £m	2019-20 £m	2020-21 £m	2021-22 £m	2022-23 £m
RDEL	3,956	4,287	4,796	5,717	6,329
CDEL	362	337	538	665	556
Total DEL	**4,318**	**4,624**	**5,334**	**6,382**	**6,885**[2]

1 Numbers may appear not to sum due to rounding.
2 2022-23 RDEL includes Cost of Living spend of £718m, this is not part of our running costs in figure 34 above.

Note the additional note 2 in this second table: for reasons that make no sense £714 million of costs relating to Cost-of-Living Payments made are excluded from the chart but those relating to Covid payments are not. Even so, the figures still do not reconcile with the data in the table noted above extracted from page 75 of the same accounts. If data this poor was sent to HM Revenue & Customs to support a tax liability it is likely that serious penalties might be payable by the taxpayer.

Using the above noted data for 2015/16 to 2022/23 (with caveats on data quality being noted) the following data on wages cost and tax recovered for expenditure incurred can be created:

HMRC staff cost data 2015/16 to 2022/23

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Total staff costs original prices £'m	2,348	2,532	2,540	2,482	2,735	2,778	2,982	3,356
Total staff costs 2023 prices	3,021	3,184	3,117	2,989	3,245	3,272	3,282	3,356
% of base cost relating to staff	66.3%	77.3%	81.3%	81.9%	101.1%	88.5%	100.2%	104.4%
% of total cost excl depreciation relating to staff	65.6%	65.9%	64.3%	62.5%	74.0%	62.0%	61.5%	66.8%
Number of staff	60,914	63,074	64,228	61,456	62,651	61,867	63,852	67,621
Average pay current prices £ 2023 prices	37,591	37,403	36,246	36,486	37,144	39,313	37,958	36,222
% real rate of pay change		-0.5%	-3.1%	0.7%	1.8%	5.8%	-3.4%	-4.6%

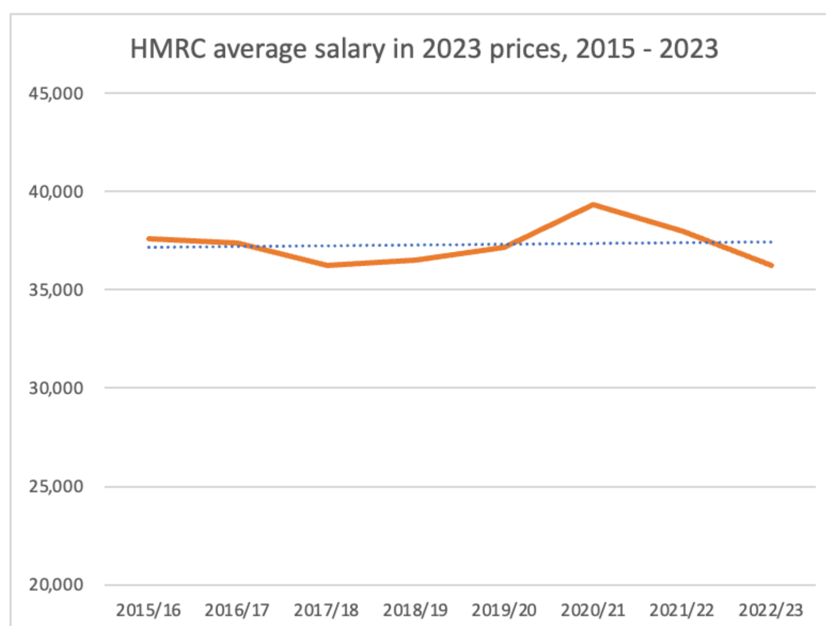
The number of staff at HMRC has been surprisingly stable over this period, the last year or so apart. Real costs of staff were also remarkably stable, reflecting the absence of real pay rises pay rises over this period, and an actual fall by 2022/23. An aberration in total costs in 2018/19 appear to relate to pension costs. What is clear as a result is that as a proportion of what HMRC calls its base cost, staff costs have risen.

That said, so too, however, have overall costs stated in current prices, with tax collected also being stated in those terms in this table:

HMRC revenues compared to costs in 2023 prices, 2015 - 2023

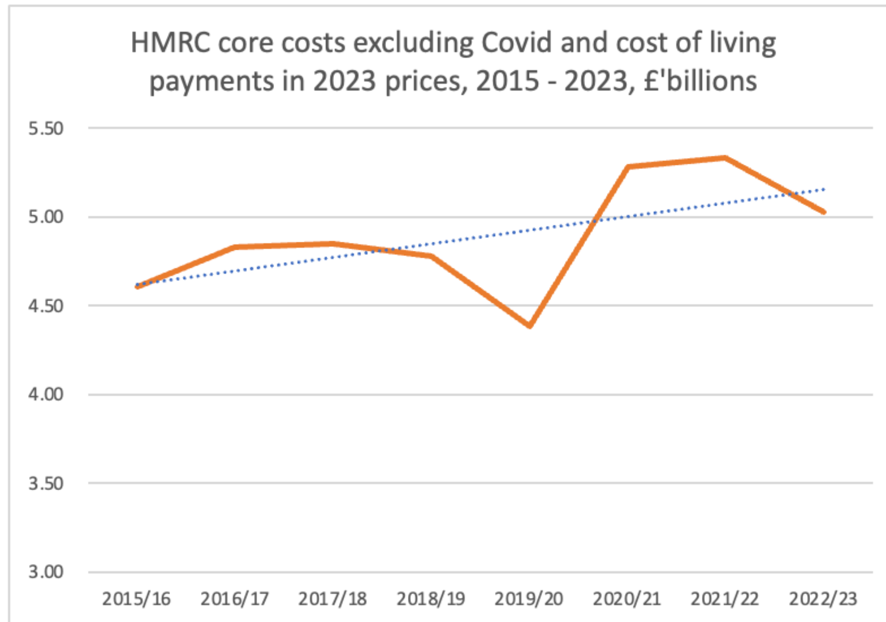
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Total tax collected, current prices (billions)	690.66	722.93	743.51	756.21	755.30	717.08	804.63	814.00
Total HMRC spend in current prices (billions)	4.61	4.83	4.85	4.78	4.38	5.28	5.33	5.03
Tax collected per pound spent - pounds	149.94	149.71	153.37	158.20	172.27	135.77	150.84	161.89

This data makes clear that in real terms HMRC salaries are now falling, presumably pursuant to its management's policy of cutting staff costs:

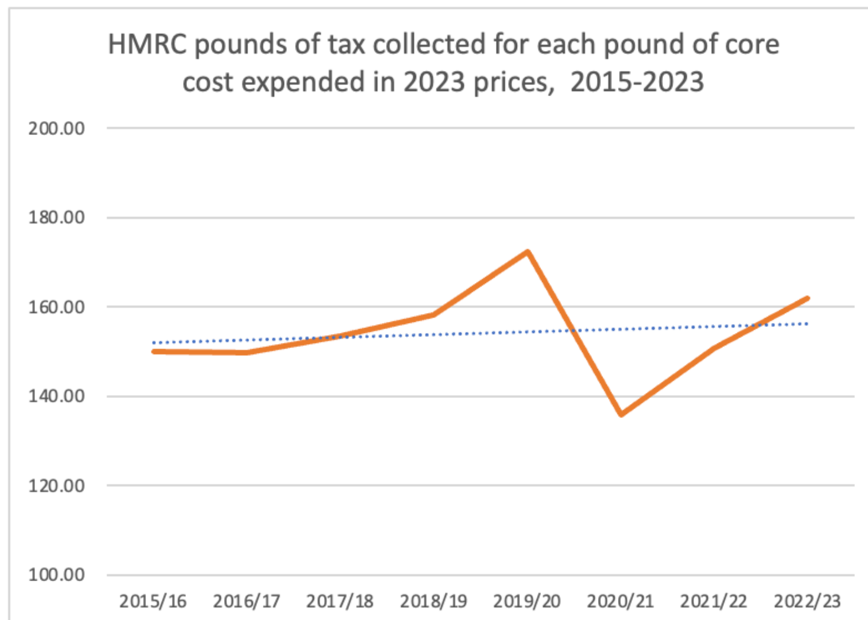


A dashed trend line has been added to this and the following charts to aid interpretation. In this case the trend line if almost flat, but current salaries are now falling markedly in real terms.

However, core costs are clearly rising when exceptional items are excluded from HMRC's own data:



In combination, the result is that costs of tax collected have risen in real terms since 2015:



The consequence is that HMRC's goal of delivering greater efficiency has, over much of the last decade, hardly been achieved. What is also clear is that HM Revenue & Customs' staff are now bearing the cost of its management trying to meet this goal.

2. Tax gaps

HMRC bases a great deal of its claim to be successfully managed on the tax gap data that it published annually[286]. Tax gaps represent the difference between the tax revenues that a jurisdiction might be able to collect and the tax revenues it actually recovers during the course of a period[287].

HMRC has published tax gap data since 2009, covering years since 2005. The latest version suggests that the tax gap expressed in currency of the period was:

[286] https://www.gov.uk/government/collections/measuring-tax-gaps

[287] The tax gap is the difference between the tax revenues that a jurisdiction might be able to collect and the tax revenues it actually recovers during the course of a period.

There are five tax gaps that can be measured:

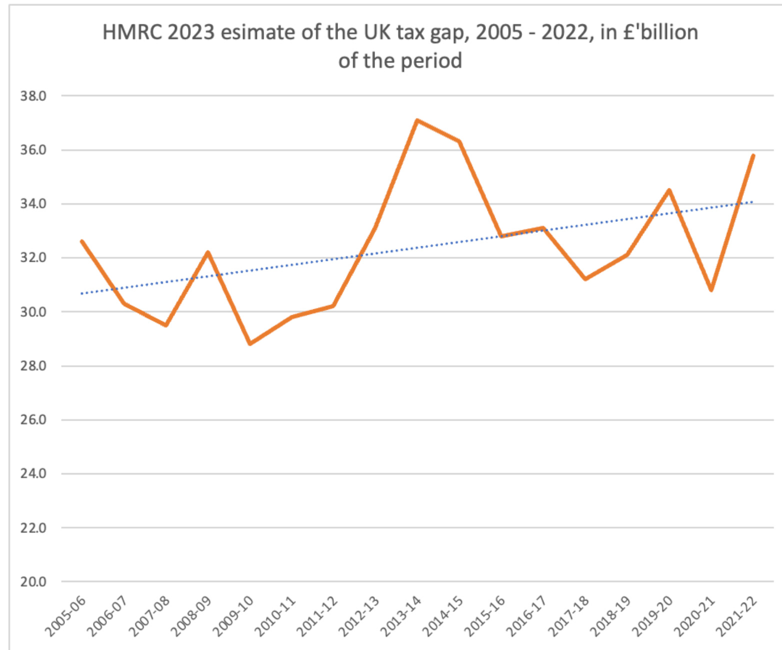
- Tax base gaps;
- Tax spend gaps;
- Tax evasion;
- Tax avoidance;
- Tax known to be owing but not settled i.e. unpaid tax.

Tax base gaps represent the cost of tax bases that a jurisdiction decides for its own reasons not to tax. Wealth is a common tax base that is not taxed, but there are many other examples.

Tax spend gaps represent the cost of the exemptions, allowances and reliefs granted within tax bases that are otherwise subject to tax.

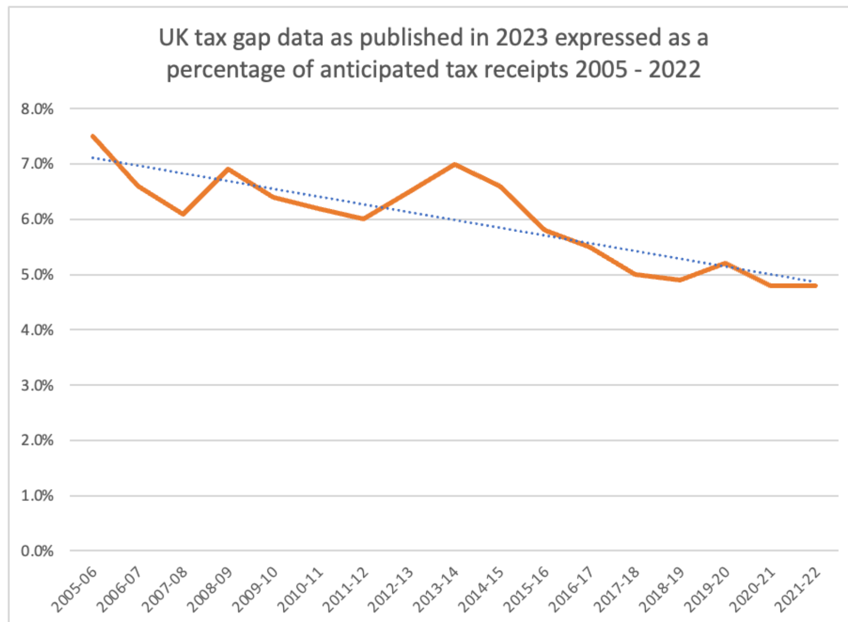
The tax evasion gap is the tax cost of the illegal non-declaration of income, that should be taxed, by a taxpayer or the tax cost of their illegal claim for a tax exemption, allowance or relief to which they are not entitled.
The tax avoidance gap is the tax cost arising from a taxpayer arranging their affairs in such a way that they pay less tax as a result of their manipulation of the tax laws of a jurisdiction in a way that the tax authority of that jurisdiction thinks is contrary to the spirit of the laws in place.

The unpaid tax gap is the tax cost of sums known to be owing to the tax authority that is not paid e.g. due to the insolvency of a taxpayer before payment can be collected.



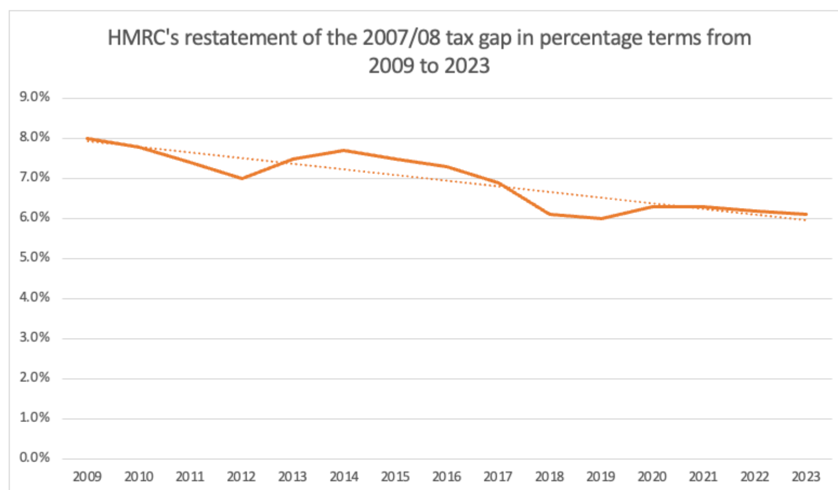
It will be noted that the tax gap can be almost any figure that you like so long as it is remarkably close to £32 billion.

In terms of the percentage of total revenues not recovered, which HM Revenue & Customs suggest to be the true performance indicator to consider, this data was reported in the 2023 version of the tax gap report to be as follows:

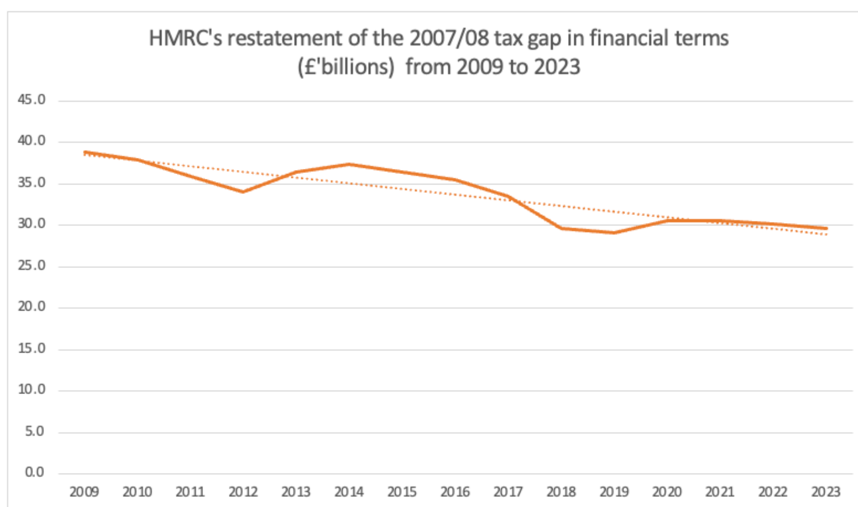


HMRC are suggesting that the tax gap has fallen significantly and that its management's policy is a success as a result. It should, however, be noted that these figures published in 2023 include many restatements of earlier years data that are very often of significant amount,

meaning that they are material, as an accountant might describe them. For example, HMRC has re-stated the tax gap figure for the year 2007/08, every year since it was first published, with the percentage of total tax revenues lost since then being stated as follows[288]:



In cash terms the restatement was as follows:



1.9 per cent of the tax gap for 2007/08 has disappeared since 2009. That is 23.8 per cent of the total for that year. In cash terms the restated sum in question is £9.2 billion lower in 2023 than it was in 2009.

That would be good news if it was true. Actually, most of it is down to changes in calculation methodology since then. What is stated to be the case now is not what was thought in 2009 when this data was first published. The consequence is that the 2023 data is deeply misleading: it claims to be a time series but in any real sense it is not because it does not

[288] HMRC 2023 tax gap data table 1.6.

show what has actually happened over time, but is instead a retrospective reworking of that view.

In itself this gives rise to doubts about the quality of the data in the tax gap reports. If a commercial organisation revised its reporting accounting information for a year fourteen times over the fourteen years subsequent to is first publication serious questions about the underlying quality of the accounting information of that reporting entity would arise and its auditors would become subject to intense scrutiny, but this is what HMRC has done. This is what HM Revenue & Customs has done, justifying this by saying[289]:

> *The methodologies used to estimate tax gaps are subject to regular review and can change from year to year due to improvements in methodologies and data updates. These can result in revisions to any of the published estimates. Estimates are made on a like-for-like basis each year to enable users to interpret trends.*

This is misleading: interpreting trends requires that what was known at the time be compared with what is known now. Each year's tax gap data is now inherently uncertain precisely because it does not let us appraise performance in past periods against knowledge as it was then understood, but instead appraises it against knowledge as it is now understood, which is almost meaningless as a consequence.

If this was the only obvious statistical problem inherent within the tax gap, reports issued by HM Revenue & Customs it could be adjusted for. In fairness, HMRC does provide data on some original and revised estimates, even if no one pays them much attention, and they never highlight them in their publications. However, there are very many other very good reasons for concern about the quality of the information that HMRC supply that are not referred to in the methodology notes, or in the analysis of the data that they publish, year by year.

The very clear evidence from the data that they produce in percentage terms is that, in their opinion, there is a strong downward underlying trend in the tax gap. Their suggestion is that the overall tax gap (measured using updated source data) has fallen from 7.5 per cent in 2005 to 4.9 per cent in 2022, or a decline of 36 per cent. However, within the underlying data that HMRC publish there are very strong indicators to suggest that in those areas where HMRC engagement with taxpayers has a significant impact on compliance rates (for example, with business, in particular) a reverse trend is highly likely to be true.

In addition, the overall suggestion implicit within the noted tax gap data that the UK is becoming significantly more compliant, and that HMRC's approach to management of the

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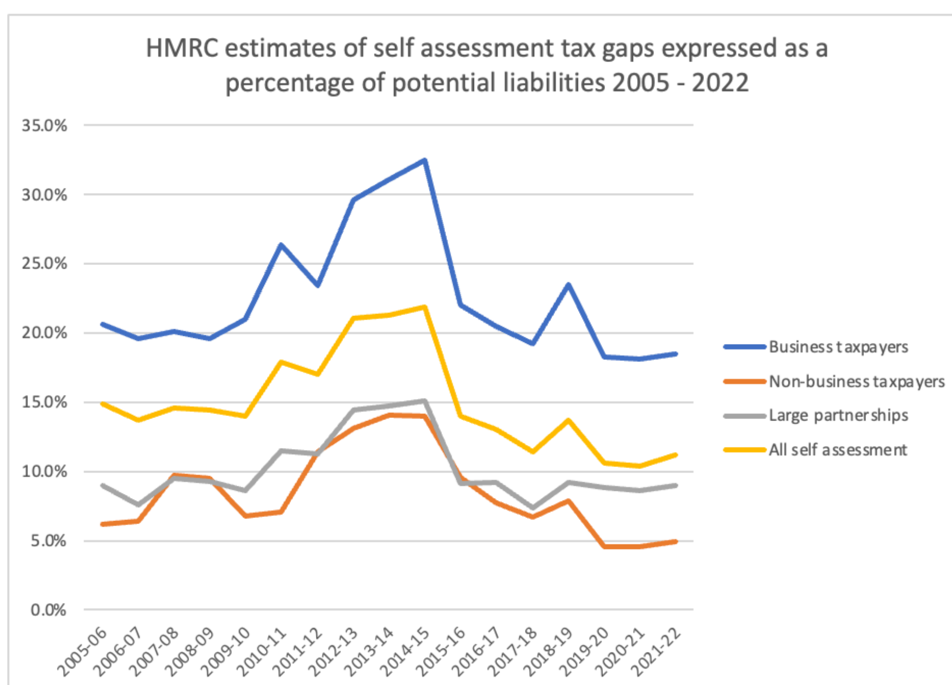
[289] https://www.gov.uk/government/statistics/measuring-tax-gaps/methodological-annex

tax system is, as a consequence working, is strongly contradicted by evidence on rates of compliance with the requirement to submit tax returns on time, where no such trend is seen. Given that the tax return data in question is not based upon a very small sample sized estimate, which most tax gap data is, but is instead based upon populations of 10 million or more, it is highly likely that tax return submission data provides a much stronger indication of behavioural trends than any HMRC tax gap data does. These issues are considered in the sections that follow.

3. The trends in business tax compliance

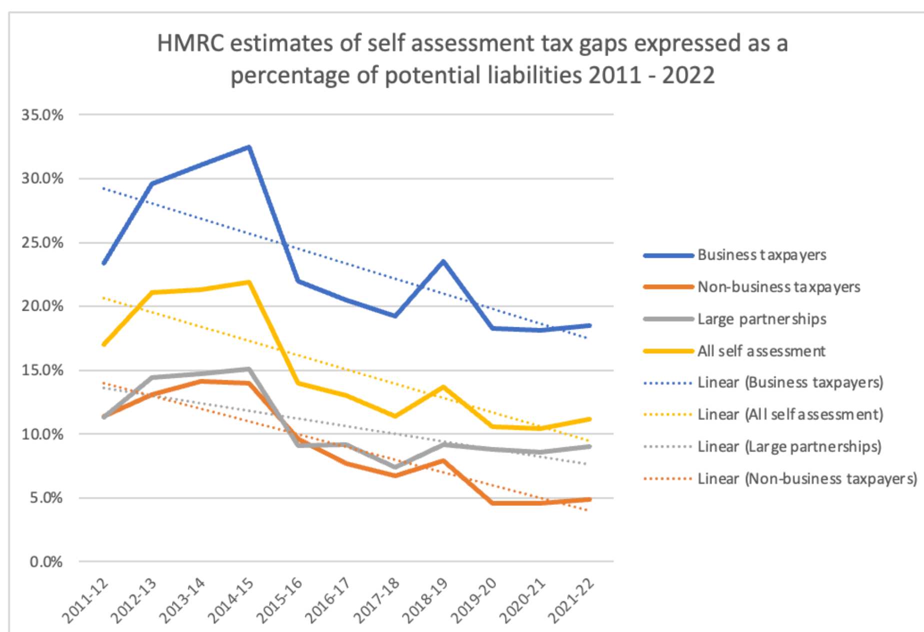
Changing trends in business tax compliance can be seen in three areas. These are corporation tax compliance, income tax self-assessment compliance, particularly as it relates to business taxation, and VAT compliance. The last is not considered here in the interests of brevity.

HMRC suggest that income tax self-assessment tax gaps, split between business, non-business and large partnership tax gaps, together with the overall rate of tax gap in this area between 2005 and 2022, are as shown in this chart[290]:



Restating, this chart for periods from 2011 onwards, for which period tax return submission data is available as noted below, and over which period HMRC appear to imply that their methodologies were maturing, results in the following chart:

[290] HMTC 2023 tax gap data table 4.2

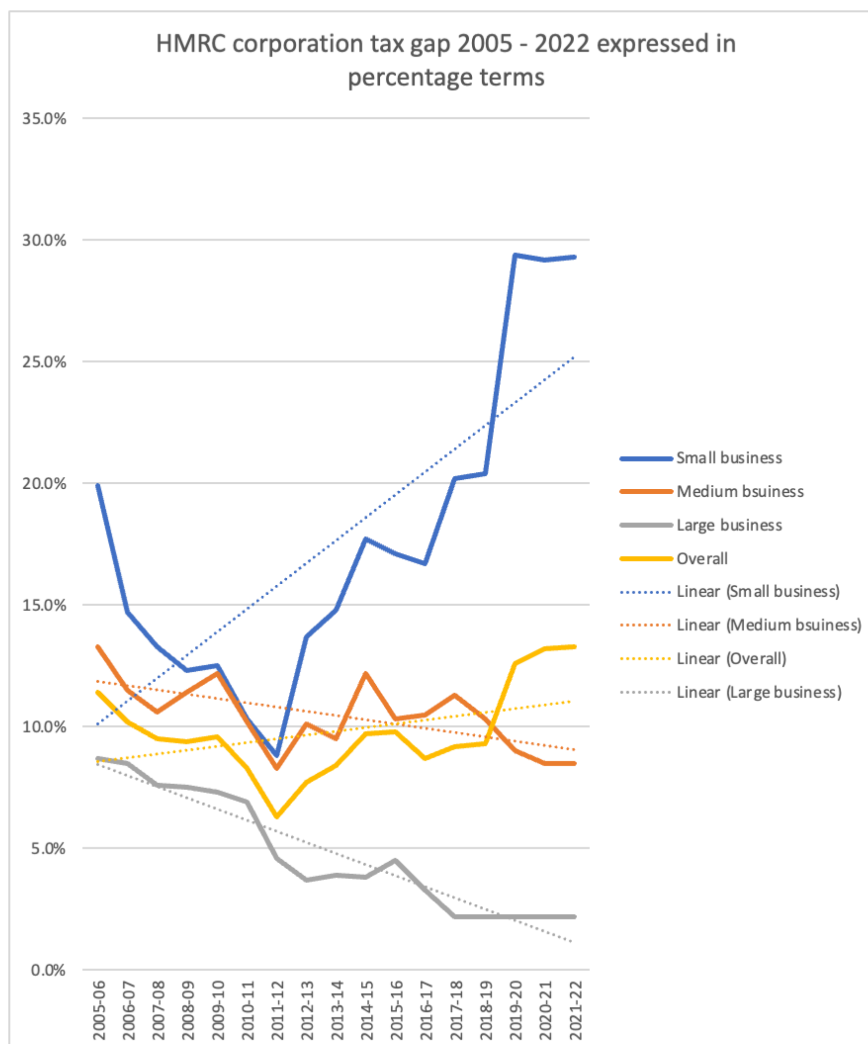


Trend lines have been added to show how marked is HM Revenue & Customs' suggestion of a behavioural change by all income tax self-assessment payers over this period.

Doubts about that claim might be implicit in the erratic nature of the changes in data. The reversal from marked increases in non-compliance to 2015/16 to rapid falls thereafter is most notable in this regard.

These patterns of behaviour amongst small business taxpayers look to be particularly improbable. One reason for suggesting this to be the case is that, unusually, there are in effect two sets of data produced by HMRC with regards to small business tax compliance rates. One is this data within income tax self-assessment, and the other is the data that HMRC produces on rates of compliance, and so tax gaps, amongst smaller companies subject to corporation tax charges.

Percentage rates of non-compliance amongst corporation taxpayers over the period from 2011 to 2022 has been as follows, expressed in value terms:



These patterns require broader analysis that will not be undertaken here, but within the context of the matter being discussed in this report, the important point to note is that the population of people submitting self-assessment business returns is remarkably similar to the population of those who are also responsible for submitting the corporation tax returns of small companies. There is no obvious reason why these populations should behave differently when it comes to tax compliance, not least because they will very often be competing with each other in similar business areas. Many will also swap between these populations, or might even be in both, as the author of this report is. This being noted, the two charts present remarkably different impressions of the tax behaviour of these two groups.

According to HM Revenue & Customs, the small business self-assessment income tax gap has fallen from 32.5 per cent in 2014/15 to 22 per cent just a year later and 18.5 per cent now. This tax gap has fallen by 14 per cent from its peak.

In contrast, the small company corporation tax gap has grown from 8.8 per cent in 2011/12 to 29.3 per cent now. This tax gap has grown by 20.5 per cent.

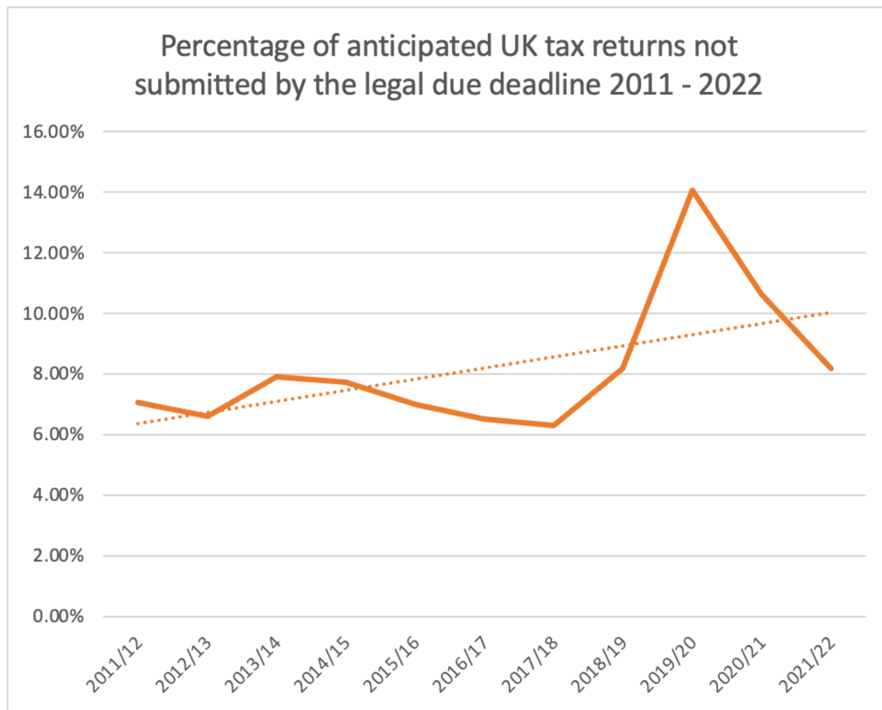
These tax gaps have moved in totally different directions. It would appear to be very unlikely that this is really the case. As already noted, there is no obvious reason, why these groups should behave differently, let alone so differently.

Presuming that the small company corporation tax gap is right (and the fact that it varies so considerably from the other corporation tax gaps suggests that it has some credibility, albeit that it might still be understated for reasons already noted elsewhere in the Taxing Wealth Report 2024[291]) then it is very unlikely that the extraordinary behavioural trends supposedly noted by HM Revenue & Customs with regard to small businesses paying their tax via income tax self-assessment systems can be correct.

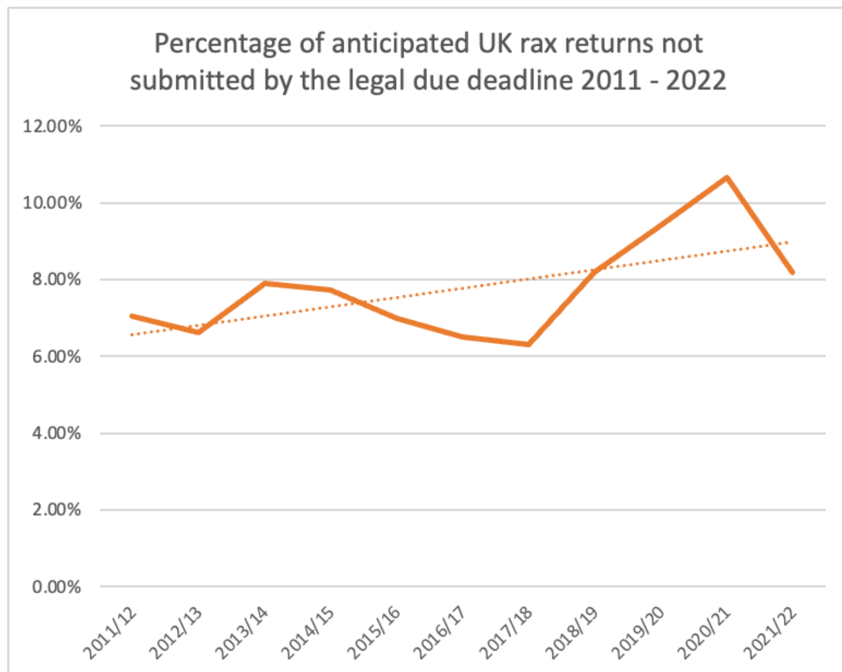
4. Tax return compliance data

To test this hypothesis another source of data has been used. Data on the submission of self-assessment tax returns has been collected for the years from 2011/12 onwards using a wide variety of sources, including HMRC press releases, HMRC annual accounts, and news media report when original HMRC data could not be located on its website. Data suggests that the trend in compliance with regard to the submission of self-assessment tax returns on time (i.e., by 31 January following the end of a tax year) has, since 2011, been as follows, with the number indicated being the percentage of anticipated returns not submitted on time:

[291] See sections on HMRC management of corporation tax and the management of Companies House as well as the need to improve measurement of the tax gap and to measure tax spillovers within the Taxing Wealth Report 2024.

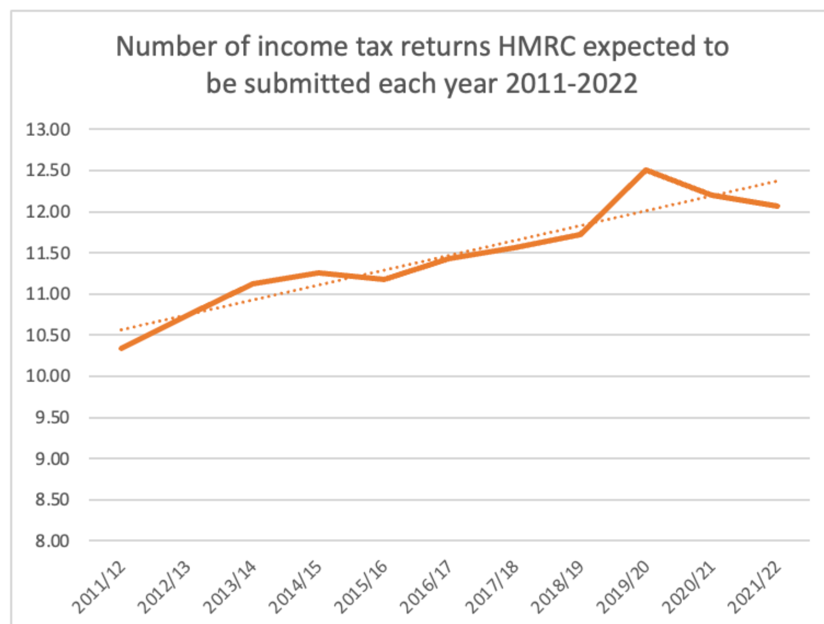


The data for 2019/20 is aberrational. This deadline was not changed in law, but in practice the deadline was extended by a month because of Covid and people took advantage of this fact to submit their tax returns late. HMRC do not appear to have published data for submissions to the extended deadline, only doing so for the legal one. If it is assumed that the figure for that year was the average of that for the year before and after it, then the chart might be restated as follows:



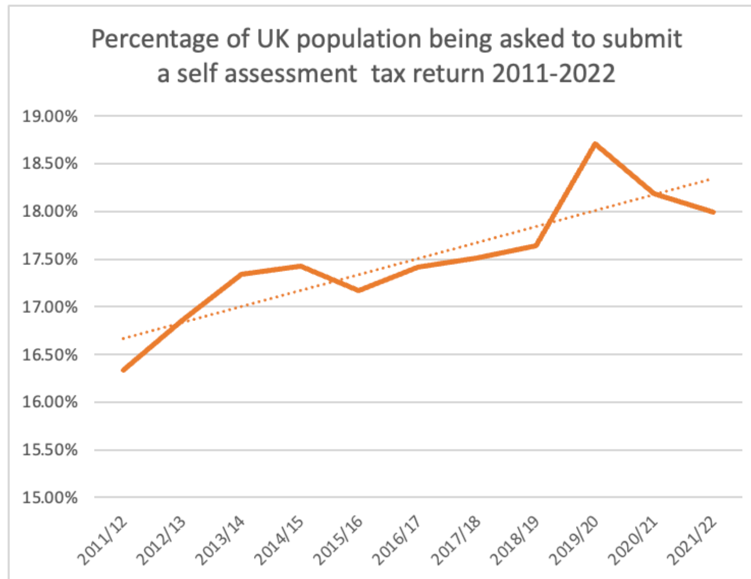
Making this reasonable assumption, it is still clear that there was an upward trend in non-compliance over this period. That was also true, although less obviously so, from 2011/12 until 2018/19, during which period data was unaffected by Covid. When this information, which is based on the collection of data from more than ten million people in each year and suggests that compliance rates did not improve over this period, and overall got worse, it seems very unlikely that that the compliance behaviour of the near five million[292] small business people paying their taxes through the income tax self-assessment tax system improved radically, which is what HMRC claim in their data on that issue.

There is another reason for thinking this. The number of tax returns requested from people in the UK is rising. Over this period the number requested has been as follows:



As is apparent this number is increasing. This is not particularly because population is growing (although it is). It is instead that the proportion of the population being asked to submit tax returns has grown over this period:

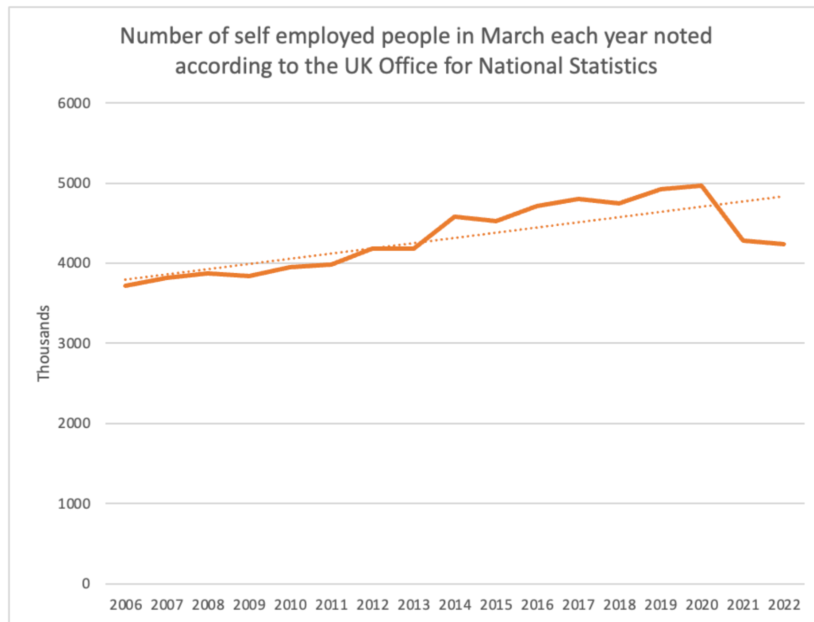
[292] See Office for National Statistics data noted below



It will be apparent that the pattern of change in the two graphs is similar. The significant point is that when the number of people being asked to submit tax returns is growing the likelihood that compliance rates are growing is small, simply because of new submitters' inexperience of the tax system.

That inexperience is also likely to be a factor that might increase rather than decrease non-compliance is also apparent from the trend in the number of self-employed people in the UK, based on Office for National Statistics data[293]. Over the period from 2005/06 to 2021/22 that trend has been as follows:

293 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/understandingchangesinselfemploymentintheuk/january2019tomarch2022



A trend line has been added.

As is apparent, until the Covid crisis emerged the number of self-employed people in the UK rose steadily, reaching a peak of almost 5 million just before that crisis erupted in 2020. Particularly noticeable though was that this growth was above average during the period from 2014 to 2018, which was the precise period during which HMRC has suggested that compliance rates by self-employed people increased significantly. This is very unlikely. With many new self-employed people needing to report their incomes compliance rates are likely to fall, not rise.

What is most especially surprising is that HM Revenue & Customs has claimed an increase in compliance rates when their own research on the shadow economy suggests that is very likely. In a report on research that they had undertaken on involvement in the shadow economy that they published in 2022 they said[294]:

> *An estimated 8.8% of the UK adult population were identified as participating in the Hidden Economy. When compared with the figure from [2016] (4.9%), there appears to have been an increase in the prevalence of those involved in the Hidden Economy.*

The suggestion made in this chapter that the tax gap for small businesses paying income has remained at the levels seen in 2014/15 does appear to be generous in that case.

[294] https://www.gov.uk/government/publications/the-hidden-economy-in-the-united-kingdom-wave-2-2022/executive-summary

Conclusions from this review.

A number of conclusions can be drawn from this extensive review of HMRC's accounts, the tax gap and related data.

Firstly, HM Revenue & Customs' accounts do not suggest that the economy measures it has imposed on the UK's tax collection system have reduced the cost of tax collection in any significant way, whilst the evidence of failing performance on a wide range of issues suggests that taxpayers are getting a very much worse service from the organisation. Runaway IT costs have played a major role in keeping costs high, although it has to be recognised that the costs of Brexit have also not helped.

The second is that HMRC did lose control of the small company corporation tax system from 2011/12 onwards, with almost 30% of tax liabilities now owing by this taxpayer group now going unpaid according to their own data, with the Taxing Wealth Report 2024 suggesting that this figure is likely to be understated[295].

The evidence presented also suggests that HMRC's claims on the tax gap amongst self-employed people making declaration of their earnings via the income tax system is very unlikely to be correct. Their rates of non-compliance are likely to be at least as high as those found amongst small companies. In reaching this conclusion it is important to note that their rate of non-compliance grew from 2011/12 until 2014/15, as was also the case for small companies. It was only thereafter that HMRC's claims on these rates diverged, for reasons that are inexplicable. It is suggested that it is in fact much more likely that the tax gap amongst small business making self-assessment income tax returns remained at rates broadly consistent with those seen in 2014/15, thereafter, just as the small company corporation tax has remained at a broadly consistent rate over the last three years for which data is available.

It is suggested that HM Revenue & Customs has lost control of both these tax gaps for similar reasons. These are that they have withdrawn their support within the community to millions of small business and company taxpayers. HMRC has now even denied them telephone support. Simultaneously HMRC has actively withdrawn from active monitoring of the activities of these concerns within the community and, as a consequence, non-compliance rates have increased considerably.

If the small company corporation tax gap had remained at the same percentage rate achieved in 2011/12 thereafter, which might have been possible if investment has been continued by

[295] See sections on HMRC management of corporation tax and the management of Companies House as well as the need to improve measurement of the tax gap and to measure tax spillovers within the Taxing Wealth Report 2024.

HMRC in tax compliance in the sector, then an additional £24.7 billion of tax would have been raised over the period since then. In the tax year 2021/22, which is the most recent for which data is available, that increase in tax collected would have been £5.9 billion, which by coincidence is almost exactly the sum suggested that might be raised by HMRC if it was to appropriately focus its resources on collection of tax from small companies in another chapter included within the Taxing Wealth Report 2024[296].

If the small business income tax gap had also been maintained at the average rate recorded over the period from 2005/06 to 2009/10, which was 20.2 per cent (with remarkably little variation), and presuming that the actual tax gap suffered from 2015/16 onwards was at the rate actually suffered on average during the period from 2012/13 to 2014/15, which was 31.1 per cent, then the tax lost due to HM Revenue & Customs as a result of losing control of this tax gap since 2015 will have exceeded £15 billion, with the cost being £3.4 billion in the year 2021/22, which is the most recent for which data is available.

What follows from these observations is the suggestion that, taking into consideration only these two tax gaps, and having allowed for a continuing base level of tax gap of the level suffered during the periods when HMRC invested in a presence in the community, then a similar investment now might have raised an additional £9.3 billion of tax revenue in 2021/22.

It is also stressed, particularly in the case of corporation tax gap, that it is highly likely that the VAT and PAYE tax gaps would also have fallen significantly if this policy of maintaining an active HMRC presence in the community had continued. No estimate of this additional revenue that might have been raised as a result of an increased HMRC presence in the community has been made.

Comparing these potential additional revenues with the cost of running HM Revenue & Customs which, as noted above, only just exceeds £5 billion per annum, makes it clear that the additional sums that might be raised as a consequence of investing in an HMRC presence in the community with the aim of reducing the tax gap, both by helping taxpayers to be compliant and by actively checking that they are, might raise sums considerably in excess of the total annual cost of running HMRC. The marginal cost of supplying this additional support within the community by reopening local tax offices and by undertaking programmes of compliance checks might be significant but would most likely be offset by reduced costs of employing staff in call centres. Those additional costs would also be offset by increased rates of tax compliance in other areas. Presuming that the programme of restoring HMRC's presence in the local and business communities might have an annual cost of £1 billion per

[296] https://taxingwealth.uk/2023/09/22/reforming-the-administration-of-corporation-tax-in-the-uk-might-raise-at-least-6-billion-of-tax-a-year/

annum the above noted data suggests that the rate of return on this investment might be at least £9 recovered for every £1 spent, with this likely to be a cautious estimate.

It is also appropriate to note the potential external benefits within the economy of this suggested programme, particularly if it was matched by a cancelling of much of HMRC's Making Tax Digital programme, which has proved to be exceptionally expensive in terms of IT costs, delays, and stress imposed upon taxpayers way above the levels that HMRC predicted. HMRC's policy of externalising its cost by imposing them on taxpayers has failed, making the UK a considerably less attractive place for a person to undertake business . If HMRC instead pursued a policy of making life easier, rather than harder, for taxpayers by providing proactive local, face-to-face, support, and by eliminating cheating within the tax system that undermines the endeavours of honest taxpayers, then the prospects for growth within the UK economy would be considerably enhanced. In that case, the potential savings from such a programme would be considerably in excess of those noted above.

In addition, it is suggested that this programme would also provide the funding so that HMRC might spend sufficient to ensure that:

- All telephone calls to it are answered promptly.
- Those answering those calls are properly trained.
- Letters to HMRC are replied to promptly.
- Sufficient numbers of tax enquiries are undertaken.
- The tax gap is properly estimated.
- The Making Tax Digital programme that risks alienating taxpayers from the UK tax authority can be abandoned and instead focus might be placed upon providing support to those who need to, no more than once a year, declare details of their affairs to HMRC on a timely and accurate basis so that their taxation liabilities might be settled.

This would require a whole change in the management strategy of HMRC, but given that the current strategy has been both inappropriate and failing for some time the need for that change in approach is a necessary conclusion of this work.

Finally, to place this work within the context of the Taxing Wealth Report 2024, it should be noted that closing tax gaps is a significant goal if greater equality is to be achieved within the UK. Tax gaps undermine horizontal tax equity because some people pay tax on their income,

and others do not. That is clearly inequitable. In addition, those who accumulate wealth on an untaxed basis disrupt the vertical tax equity of society. It is, therefore, necessary for the programmes noted to be undertaken if progress is to be made towards both horizontal and vertical tax equity within the UK, both of which are increasing at present because HMRC has lost control of key elements of the UK tax system at cost to UK society at large.

Chapter 16.0

Background Notes – Introduction

Background

The whole of the Taxing Wealth Report 2024 is based upon data, economics and analysis. Whilst making recommendations for tax reform does require consideration of politics, ethics, and pragmatic economics, all such decision-making has to also be informed by data on what is actually happening in the economy at present, and what might happen if changes to the tax system were made. That in turn requires that some understanding of the macroeconomic environment in which tax decision takes place does exist. As a consequence, whilst every section of this report is referenced to the sources used that inform those data-informed decisions that are reflected in this work it was also felt appropriate to add some background notes within this report to assist the understanding of the environment in which the Taxing Wealth Report 2024 decisions have been made.

The first of these background notes or chapters is on the methodology adopted for use in this report. Those seeking to rely upon the work undertaken should take note of this.

The second note in this chapter refers to the taxes that were actually paid in the UK in the year 2022/23, which is the most recent for which we have reliable data at the time that the Taxing Wealth Report 2024 has been written. That information comes from budget reports written in November 2023 by HM Treasury and the Office for Budget Responsibility. Whilst this information tends to be updated and revised over time, because all accounting data can be subject to finessing, it is exceptionally unlikely that the relative significance of the taxes noted in this section will change in any material way.

That section makes clear that the largest taxes in the UK are:

UK taxes paid by type 2022-23

	Outturn 2022-23	% of total tax revenues
	£'bn	%
Income tax	250.2	27.8%
National insurance contributions	176.9	19.7%
Value added tax	162.1	18.0%
Corporation tax	78.6	8.8%
Council tax	42.0	4.7%
Business rates	28.3	3.2%

Several things are worth noting based on this data:

- The assumption that all tax debate should be about income tax is wrong: it represents only just over a quarter of all tax revenues.

- National insurance is a more important tax than most people appreciate, in no small part because more than £100 billion of the total contribution its makes is paid by employers, and not employees. Hidden taxes are still taxes.

- The same is also true of VAT, with few people appreciating just how much of this tax that they pay.

- For all the attention given to tax abuse by major multinational corporations over the last two decades, corporation tax is not a very significant UK tax.

- Wealth taxation comes nowhere near this list, which is why the Taxing Wealth Report 2024 is so important given the significance of wealth increases in the UK and the consequent untaxed increases in inequality that they have given rise to.

If there is one thing that is clear from this section it is that data, and how it is organised, matters. That is why the Taxing Wealth Report 2024 has taken it seriously.

The third note in this section explains the political economy of money and tax, which are intimately related issues. It is quite hard to understand the recommendations within the Taxing Wealth Report 2024 without understanding what is said in this chapter. As is said therein:

It would be very easy to issue a report on the reform of tax in the UK and to ignore in the process of doing so the role of tax in creating the power of the state, the management of the macroeconomy and within our society. This is, after all, what almost every politician, journalist and so-called tax specialist in the UK does whenever they comment upon the subject. The latter are particularly good at doing so, frequently talking about reforms that they would like to see in the tax system without ever showing the slightest awareness that tax has a very broad political, social and economic purpose within UK society.

This chapter adds that essential understanding.

So too does the next one, which explains what the UK's national debt is, and how it should be understood when at present this is about is misunderstood as tax and the true nature of money are. This chapter does then build on the foundations of the previous one to set these issues in their proper context.

Finally, there is a chapter on government money and tax flows within the economy which seeks to explain the economic impact of the recommendations made in the Taxing Wealth Report 2024, showing how they are designed to have impact on the economy by increasing the multiplier effect of the transactions that they impact upon[297].

Together these chapters add vital context to the recommendations made in this report. That is why they need to be read alongside it.

[297] Multiplier effects measure of the amount by which national income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater than one then the additional spending produces an increase in income of greater than its own amount, and vice versa.

Chapter 16.1

Background Notes

Methodology and decision criteria

Brief summary

This chapter suggests that the Taxing Wealth Report 2024 is based on four related conceptual ideas that raise issues that need to be addressed if additional tax revenues are to be raised in the UK in a way that is fair to all taxpayers. These are:

1. The creation of horizontal tax equity, which requires that all incomes of similar amount be taxed the same sum irrespective of where that income comes from.
2. The creation of vertical tax equity, which requires that as a person's income increases the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.
3. The identification and elimination of tax gaps, which are the differences between the tax revenues that a jurisdiction should be able to collect and the tax revenues it actually recovers during the course of a period.
4. The identification and elimination of tax spillovers, which are the negative consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.

Tax spillover assessments identify the causes of tax gaps and so, in turn, the reasons why horizontal and vertical tax equity do not exist within a tax system.

Whilst addressing these issues the chapter makes clear that the Taxing Wealth Report 2024 uses microeconomic theory to justify:

a. The recognition of all sources of increase in the financial well-being of a person as being of equal value to that person and that all such sources should, as a result, be subject to equal rates of taxation. This recognition does, as a result, remove the distinction that is commonplace in tax between earned and unearned income and income, capital gains and capital receipts, all of which are considered as equal for these purposes.

b. The idea that progressive taxation is equitable because of the reducing marginal utility of each additional sum received by a person as a contribution to their financial well-being during the course of a period.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2023/09/07/the-taxing-wealth-report-2024-methodology/

Background

The changes proposed in the Taxing Wealth Report 2024 are justified against a number of criteria, as follows:

- Horizontal tax equity, which requires that all incomes of similar amount be taxed the same sum irrespective of where that income comes from.
- Vertical tax equity, which requires that as a person's income increases the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.
- Reducing tax spillover effects[298] to close the tax gap[299] and reduce tax avoidance and evasion, meaning by implication at the rate of tax compliance[300] in the UK is increased.
- Raising additional tax revenue.

[298] Tax spillovers are the consequences of the interactions between different tax systems or different parts of the same tax system that can often (sometimes unintentionally) reduce tax revenues and the size of a tax base.
[299] The tax gap is the difference between the tax revenues that a jurisdiction might be able to collect and the tax revenues it actually recovers during the course of a period.
[300] Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

In this chapter the reasons for adopting these criteria are explained.

Horizontal tax equity

The principle of horizontal tax equity requires that all increases in the financial well-being accruing to people in equivalent circumstances within a population be taxed in equal amount whatever the origin of that increase in financial well-being might be.

To put this in context, it should not matter whether this increase in financial well-being arises from employment, self-employment, a rent, a return on savings in whatever form paid, a capital gain or, maybe, a gift. Each of these activities increases the financial well-being of the recipient and in that case if a tax system is to be equitable there should be no discrimination in the amount of tax paid by persons in equivalent circumstances if they are to enjoy an increase in their financial well-being for any of these reasons.

Note, however, that this principle does not say that all income should be taxed in equal amount. Horizontal tax equity does not justify a flat tax, which is a tax of equal amount on any increase in financial well-being that a person might enjoy irrespective of each such person's differing financial circumstances. Instead, horizontal tax equity quite specifically allows that the different circumstances of taxpayers can be taken into consideration when determining tax due, so long as the same consideration of circumstances is made for each person in an equivalent situation.

Importantly, horizontal tax equity applies to all sources of increase in a person's financial well-being, and not just to their income. In other words, it is indifferent to whether that increase in financial well-being arises as a consequence of income earned (whatever its source) or increases in wealth (again, irrespective of the origin of that increase) or gifts.

This logic is based upon standard microeconomic theory. Based upon that theory, which in this case appears to accord closely to observed reality, there is no reason to think that a person should, or does, value their increase in financial well-being differently as a consequence of it source. What matters to them is the fact that their well-being has been enhanced. As a consequence, tax differentials that discriminate between the origins of increase in financial well-being are contrary to the principles of horizontal tax equity.

This concept of indifference as to source is also implicit in modern accounting theory and in the accounting standards used to record the income of companies both in the UK and internationally. The primary method of computing the income of any entity using these standards is to compare the net worth of a company at the end of a period (£A) with the net worth of that same company at the beginning of the period (£B) having allowed for sums

withdrawn from the entity during the period by its owners, whether by way of dividend, share buyback or other means (£C), and the issue of new shares or other equity (£D).

In other words, profit or income (£Y) is calculated as:

£Y = £A - £B + £C - £D

This may come as a surprise to those who presume that the income of an entity during a period is the figure included as net profit after tax in the profit and loss account or income statement of the entity in question (£E). This is not the case. The movement in the value of the balance sheet at the end of a period (£A) is, instead, reconciled with the value at the beginning of the period (£B) by publication of three separate statements:

- The income statement (or profit and loss account, as some might know it), which estimates the net sum earned from trading, having allowed for tax during the course of the period (£E).
- The statement of comprehensive income for the period, which recognises the change in the market value of the assets and liabilities of the enterprise during the course of the period when stated at fair market value at both the opening and closing dates, some of which movements may be taxable. (£F)
- A statement of the change in equity arising during the course of the year, which explains the sums withdrawn from the entity during the period by its owners, whether by way of dividend, share buyback or other means (£C), and the issue of new shares or other equity (£D).

As a result, and given that the changes in equity have already been included in the calculation noted above, earnings (£Y) can also be stated as:

£Y = £E + £F

To translate this to the context of this chapter, the earnings a person has during a period broadly equate to the earnings a trading entity records in its income statement (£E). It is this figure that most think represents their total income in the year. This idea is also implicit in most tax systems, largely because almost all of our taxes were created before modern theories of income and accounting were created.

This idea of income is, however, wrong. Within the context of taxation, the only relevant criteria of capital that can be used for measurement purposes is a financial one since tax can only be paid using money and can only be charged on tax bases that can be measured in monetary terms. In that case a person’s total income in a period must be their increase in net worth having allowed for what they have consumed and should therefore also include the change in the fair value of the assets that they own and sums that they owe during the course

of period, as is reflected in modern accounting (£F). In that case horizontal tax equity needs to be based upon this concept.

Vertical tax equity

Vertical tax equity assumes that horizontal tax equity exists. In other words, it assumes that all people of similar circumstance make the same tax payment on each additional sum that increases their financial well-being irrespective of its source.

What vertical tax equity then suggests to be appropriate is that any additional sum payable in tax resulting from an increase in financial well-being should increase in proportion to the total increase in the financial well-being of the recipient of that additional payment in a period irrespective of the source of that increase in financial well-being.

This suggestion has its origin in microeconomic theory. That theory suggests that as a person's financial well-being increases each additional incremental increase in that well-being will have a reduced overall impact on the enhancement of their overall well-being. In other words, the marginal value of increasing financial well-being declines as financial well-being does itself increase.
That this logic is likely to be true is apparent. For a person on very low income any additional sum made available to them will usually have a significant impact upon their perception of their financial well-being. The same sum when received by a person with considerable financial well-being is likely to be of much lower significance, to the point where that person might not even notice it at all. That said, any suggestion that this change in the marginal well-being of a person arising from additional financial well-being can be measured precisely across the range of increased well-being that a person might enjoy is inappropriate, as such measurements are always subjective and so will vary between people. However, in aggregate the observation that such differences in reaction do exist clearly holds true and is observable in human behaviour. As such, it is entirely reasonable to base policy upon it.

Tax, fiscal policy and vertical tax equity

When establishing its overall fiscal policy a government needs to determine what part of its expenditure will be paid for with newly created money, which part will require taxation to be raised to control inflation and what part will be funded using borrowing facilities. This chapter only concerns itself with the taxation element of this decision, which is usually by far the largest component in this equation, but it is important to note that decisions that a government makes on tax do not exist in isolation and represent only a part of a government's overall fiscal strategy.

This being noted, when a government decided on what taxes might be levied to fulfil its overall goal of revenue generation, it is normal for it to take into consideration its broader, social, economic and industrial objectives, including those with regard to:

- Redistribution of income and wealth.
- Re-pricing market failure with regard to products like carbon, tobacco and alcohol.
- Reorganising the economy through the use of fiscal incentives, and charges to encourage preferred activity (such as those related to a green transition) and discourage those which a government considers to be legal but nonetheless undesirable (such as gambling, speculation and carbon intensive activity).

Most governments claim to have a policy with regard to redistribution of both income and wealth, although as findings elsewhere in this report demonstrate, that goal is only weakly represented in overall UK taxation policy. If it were to be enhanced through a policy of vertical tax equity the government would have to firstly create as much horizontal tax equity as it can plausibly achieve. It would then use that achievement as a platform for the creation of progressive taxation across all aspects of taxation, taking into consideration the impact of all taxes on financial well-being.

Doing so would reflect the fact that, based on the already noted logic of the diminishing marginal utility of each incremental increase in financial well-being, there is also a diminishing marginal cost in terms of utility foregone to a person to settle their taxation liabilities as their financial well-being increases. A policy of vertical tax equity seeks to impose taxation charges that will, on average, impose equal perceived marginal costs to taxpayers when settling their taxation liabilities, whatever their sources of financial wellbeing. This necessarily requires that those with the highest level of financial well-being during a period make the greatest tax contribution during the course of that same period. That should not be seen as an accident of tax policy, but its required design outcome of seeking to achieve vertical tax equity.

Closing tax gaps

The tax gap has been defined in slightly varying ways by differing tax authorities and academics[301]. For example, the US Internal Revenue Service (IRS) defines the tax gap as 'the difference between the tax that taxpayers should pay and what they actually pay on a timely basis.' The definition in question is useful because it includes a dimension that most omit, which is that of time. However, the definition remains incomplete for a reason that the IMF notes, which is that the appraisal is usually undertaken within 'the current policy framework' of the jurisdiction being appraised. In that case the tax gap appraised by most tax authorities

[301] This section is based on work by the author published at https://academic.oup.com/book/39754/chapter/339816709

might be defined as 'the difference as measured within the current policy framework between the tax that taxpayers should pay and what they actually pay on a timely basis.'

It is important to note that this report does not accept this definition of the tax gap. That is because it does not accept that the current tax policy framework should be excluded from consideration when appraising tax gaps. That is in turn because a great many of the advantages that those with wealth enjoy within the UK (and other) tax systems arise because of the failure of current tax systems to either tax that wealth or because those systems provide opportunity for reducing taxes paid in entirely legal ways but which, nonetheless, undermine horizontal and vertical tax equity. To exclude these issues from review within tax gap analyses does in that case make no sense.

The standard definition of tax gaps noted above leads to tax gap analyses that usually refer to three identifiable tax gaps. However, for the purposes of this report five are considered. These are:

1. The tax base gap, which refers to the cost of tax bases not taxed by choice e.g. wealth.

2. The tax rate (or policy) gap, which refers to the costs (both positive and negative) of granting higher and lower rates of tax that vary from the norm or standard rate, as well as the cost of all allowances and reliefs granted to taxpayers, for whatever the reason.

3. The cost of tax evasion.

4. The cost of tax avoidance.

5. The cost of bad debt i.e. declared sums owing but not actually paid.

The last three tax gaps are those measured by most current tax gap appraisals. The first two are the additional tax gaps that this report suggests should be appraised if a tax gap appraisal is to suggest how horizontal and vertical tax equity can be created.

Recognition of this broader range of gaps than is usually calculated is important for a number of reasons and would, it is suggested, add to the quality of tax debate, whether at the macro- or micro-economic levels.

For example, a calculation of the first two noted tax gaps would encourage discussion on issues such as inequality, management of the environment, and investment incentives. The important point is that this makes clear that tax is not just about raising revenue: it is also about redistribution, repricing market failure and the delivery of fiscal policy.

Importantly, a comprehensive tax gap analysis would also change the focus of discussion on the third, fourth and fifth tax gaps that relate to tax evasion, avoidance and tax paid late or not at all. Estimates of each of these gaps are useful, but there are practical problems in distinguishing each of these gaps. For example, the boundary between tax evasion and avoidance is notoriously fluid. As importantly, informed discussion on these gaps would not just focus on their quantum, important as it is, but the cause for their having arisen. This would require that tax spillovers be taken into account in any such discussion. This is why tax spillover analysis (noted below) is now so important.

Tax spillovers

A tax spillover is a loss arising within and between tax systems, whether domestic or international, as a result of one part of a tax system undermining the effectiveness of another part of the same tax system, or that of another state. The tax avoidance industry exploits the opportunities that tax spillovers create. Unless tax spillovers are properly understood that industry cannot, as a consequence, be appropriately challenged, with its activities being brought to a close.

As importantly, nor can, the changes required to deliver horizontal and vertical tax equity be properly identified. This is an issue of particular significance when considering the first and second tiers of the tax gap. These relate to tax bases not subject to tax and the availability of allowances and reliefs as a matter of taxation policy that do, however, undermine both the integrity of the tax system as a whole and the horizontal and vertical equity of it.

Whilst the impact of not taxing an available base, such as wealth, is relatively easy to identify issues relating to the tax policy or tax rate gap, as the second tier of loss is called, are much harder to appraise, not least, because of the confusion that they cause. For example, a person or company making use of an opportunity that is explicitly provided to them in law that results in their payment of less tax than might otherwise be expected is often said to be tax avoiding. However, that is not true. If they are quite explicitly working within the letter and spirit of the law to claim an allowance or relief, or to take advantage of a tax rate that has been made available in law, then they cannot be avoiding an obligation, and as such are not tax avoiding. The blame for the loss that has arisen as a result of the taxpayer's activity falls fairly and squarely upon the government that made the opportunity of which they have taken advantage available. The taxpayer cannot be blamed for taking advantage of an opportunity that the government should not have made available to them. Tier two of the tax gap measures this government created cost, which might explain why it is so rarely estimated.

Another importance of tax spillover methodology is that it makes clear that tax gaps are related to each other: in other words, a tax loss arising in one tax might also indicate a loss in another tax. This will most particularly have an impact on the estimation of losses arising

from tax evasion because what this suggests is that they cannot be calculated by tax in isolation, as is commonplace at present. For example, to use accounting logic, if the reporting of turnover is suppressed to evade declaration of a value added tax liability then it follows that, firstly, the suppressed income cannot be reintroduced into other tax declarations (such as those for corporation tax, personal income tax and social security charges) without the VAT under-declaration being apparent and secondly, that under-declarations of those other taxes must follow. This understanding is key to correct estimation of tier three of the tax gap.

Tax avoidance, as properly defined, is the focus of tier four of the tax gap. Tax avoidance involves an activity deliberately undertaken by a taxpayer in a way that they know might not be tax compliant. In this context, tax compliance means seeking to pay the right amount of tax (but no more) in the right place at the right time, where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

A taxpayer who is undertaking tax avoidance activity, meaning that they are necessarily taking the risk of not being tax compliant, is taking a calculated risk that the way in which they declare a tax liability might be wrong but that the balance of probabilities suggests to them that this is a risk worth taking because the prospect of penalty in the form of additional liability is limited, even if the error might become apparent. Tax spillover analysis can suggest the likelihood of this activity taking place. For example, if there is a lax tax or company and trust administration in a jurisdiction the chance that any tax avoidance will be identified and challenged is low if such entities are made use of in the tax avoidance arrangement, as is very often the case. This can then give rise to a probabilistic estimation of this tax gap.

The fifth tier of the tax gap is usually, and superficially, about unpaid tax but it should become much more broadly based if it is to be really useful. That is because whilst some non-payment of tax is due to genuine insolvency for reasons that have arisen beyond the taxpayer's control, some might also result from the design of the tax system itself, and from the level of administrative resources provided to it. In other words, unpaid tax can be seen as a metaphor for a broader issue of concern, which is the risk of spillover within both national and international tax systems arising from poor systemic tax design, whether that be because of the creation of undetected or unaddressed arbitrage risk within tax legislation and between tax legislation and that regulating accounting, company or contract law; or because of risk resulting from the arbitrage of the tax system when tax rate differentials within and between states encourage that abuse. The suggestion is that this risk is measurable and expands the base for this tier of the tax gap beyond a simple consideration of unpaid tax.

This five-tier approach is different from that adopted by most countries addressing tax gap issues at present. The difference is essentially one of scope and ambition. HMRC typifies current thinking on this issue when it says that 'thinking about the tax gap helps the

department to understand how non-compliance occurs and how the causes can be addressed'. What appraisal of the tax gap, assisted by tax spillover analysis can do is something substantially more significant, which is to set out an agenda for reform of a tax system so that it can address issues arising from:

- Horizontal tax inequality.
- Vertical tax inequality.
- Faults in the design of a tax system.
- The failure to supply resources to a tax system in adequate amount to permit the collection of tax owing.
- Tax avoidance and tax evasion.

This should put tax gap analysis at the core of the whole process of macro-prudential regulation used by a state to assess the systemic tax risks that it faces both within and beyond its jurisdiction.

Preventing tax spillovers

The subject of tax spillovers has already been noted since it is an issue intimately related to interpretation of tax gaps, but a further explanation of this issue is still appropriate.

The concept of a tax spillover was first noted in academic literature by the International Monetary Fund (IMF) in 2014, when it published a report looking at the potential economic impact of corporation tax policy in some developed countries on the corporation tax collected by developing countries. This issue was the major focus of much tax justice debate at the time, where losses due to international tax competition were of primary concern. Unfortunately, the IMF methodology was deeply econometric, and whilst there is nothing wrong with this in principle, in this particular case the data was what is described as 'noisy', meaning that far too many possible explanations for the observed variations in tax paid were available, the consequence being that very few useful conclusions could be drawn.

This does not, however, undermine the usefulness of the concept of tax spillovers. This concept has been developed since 2014, mainly within the NGO community and also in academia by Professors Andrew Baker and Richard Murphy of Sheffield University (the latter also being an author of this chapter). Baker and Murphy define tax spillovers as the impact that one part of a tax system has on the effective operation of another part of that same tax system or a part of the tax system of another jurisdiction.

The idea is relatively easy to understand. As is readily observable in a tax system like that of the UK, which has been the subject of piecemeal development over time, many parts of that system as a whole undermine other parts of it. This can either be because of the offer of an

incentive in one part that undermines the objective of another element or, it can be because tax rates on offer in one tax can directly undermine the demand for tax owed under the regulations relating to another tax, with the taxpayer having some degree of choice about which they might pay.

In addition, the concept of tax spillovers has been extended by Baker and Murphy to appraise the difficulties created by the administration of tax; the availability of data to the tax authority from other parts of the economy; the attitude of governments towards tax and the degree of international tax cooperation the government of a jurisdiction is willing to participate in.

It could be expected that the resulting appraisal of tax risk would, given the multifaceted nature of this examination, be something hard to appraise. Baker and Murphy have addressed this issue, suggesting that in practice the appraisal system can be reduced to the preparation of a grid looking not unlike a chessboard, if eight variables happen to be included in the appraisal, as they suggested in their work. This would then permit each element of the tax system being appraised to be compared with each other element of the tax system subject to appraisal:

Country X	**Issue impacting upon**										
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax competition	Tax Politics	Company and trust administration	International agreements	Total	Sub totals
Issue being considered	Income tax										
	Corporation tax										
	Capital gain tax										
	Social security										
	Tax Politics										
	Tax administration										
	Company and trust administration										
	International agreements										
	Total										

The basis of appraisal can include objective elements, such as tax rate differentials, but quite importantly it also includes the possibility of the subjective judgement of those who are familiar with a tax system and the way in which it is used as well as abused in practice,

Ideally, a number of people or organisations with relevant tax expertise would undertake such an appraisal with the scores of being aggregated. The resulting marks are intentionally, straightforward, and so indicative. They are only available from within a range from 1 to 5, with no consideration been given to the use of decimal points at present.

A score of one means that the element of the text system being appraised reinforces the element of the tax system with which it is being compared. In contrast, a score of five indicates that the elements of the tax system being appraised does seriously undermine the other elements of the tax system with which it has been compared. A score of three is neutral whilst

those of two and four suggests that some element of reinforcing or undermining (respectively) of other parts of the tax system is taking place, but not to such an extent that a score of one or five is required.

The advantages of this system of tax system appraisal are:

1. It allows for both objective and normative opinion to be taken into account.

2. It is relatively quick and cost effective to undertake.

3. It can produce a ranking by adding the scores, as the grid noted above shows.

4. By colour coding the marks (green for 1 through to red for 5) a visual risk indicator can be prepared.

5. Vitally, the system automatically indicates the areas where most attention might be needed.

An example of such an appraisal for the UK tax system with fill supporting notes has been produced[302] as has a full explanation of the methodology[303 and 304].

[302] https://onlinelibrary.wiley.com/action/downloadSupplement?doi=10.1111%2F1758-5899.12655&file=gpol12655-sup-0002-Appendix.docx
[303] https://onlinelibrary.wiley.com/action/downloadSupplement?doi=10.1111%2F1758-5899.12655&file=gpol12655-sup-0001-Appendix.docx
[304] https://onlinelibrary.wiley.com/doi/full/10.1111/1758-5899.12655

Chapter 16.2

Background notes

UK taxes in 2022-23

Background

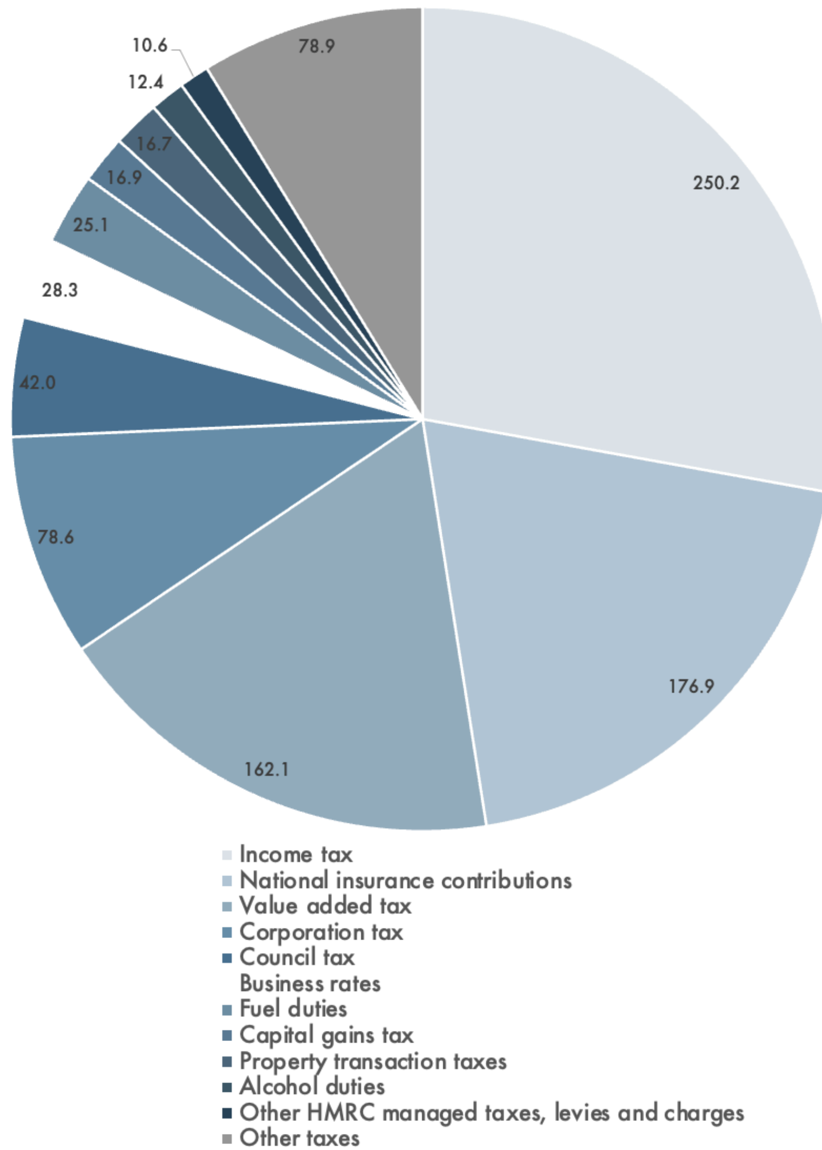
If you ask most people in the UK about taxes the one tax they will, almost invariably, think of is income tax. So do most politicians and commentators. That is why it is incredibly common to hear the claim that the wealthiest people one percent of people in the UK pay more than 25% of all tax[305]. This is based upon the proportion of income tax that they supposedly pay, when it is unlikely that they pay nothing like the same amount of any other tax. There are, in fact, very many taxes in the UK, even if none is as big in terms of revenue raised as income tax.

The data

he following chart summarises, the total sum paid for all the major UK taxes in the year to March 2023[306]:

[305] The figure is itself uncertain. It depends on the basis of calculation. What is undoubtedly true is that the top 3% or so of income earners pay 25% of all income tax, but it is most likely that they pay much less of overall tax than that.

[306] Based on table A5 here: https://obr.uk/download/economic-and-fiscal-outlook-november-2023/?tmstv=1701349270



The taxes paid are listed below the chart in order of size, working clockwise round the chart.

A more detailed list is as follows:

UK taxes paid by type 2022-23

	Outturn 2022-23 £'bn	% of total tax revenues %
Income tax	250.2	27.8%
National insurance contributions	176.9	19.7%
Value added tax	162.1	18.0%
Corporation tax	78.6	8.8%
Council tax	42.0	4.7%
Business rates	28.3	3.2%
Fuel duties	25.1	2.8%
Capital gains tax	16.9	1.9%
Property transaction taxes	16.7	1.9%
Alcohol duties	12.4	1.4%
Other HMRC managed taxes, levies and charges	10.6	1.2%
Other taxes	10.0	1.1%
Tobacco duties	9.4	1.0%
Insurance premium tax	7.5	0.8%
Vehicle excise duties	7.3	0.8%
Inheritance tax	7.1	0.8%
Environmental levies	6.6	0.7%
Emissions Trading Scheme	5.8	0.6%
Energy profits levy	4.2	0.5%
Stamp taxes on shares	3.8	0.4%
Licence fee receipts	3.7	0.4%
Apprenticeship levy	3.6	0.4%
Air passenger duty	3.3	0.4%
Bank surcharge	2.6	0.3%
Climate change levy	2.1	0.2%
Bank levy	1.3	0.1%
Digital services tax	0.6	0.1%
Electricity generator levy	0.4	0.0%
Petroleum revenue tax	-0.2	0.0%
National Accounts taxes	**898.7**	**100.0%**

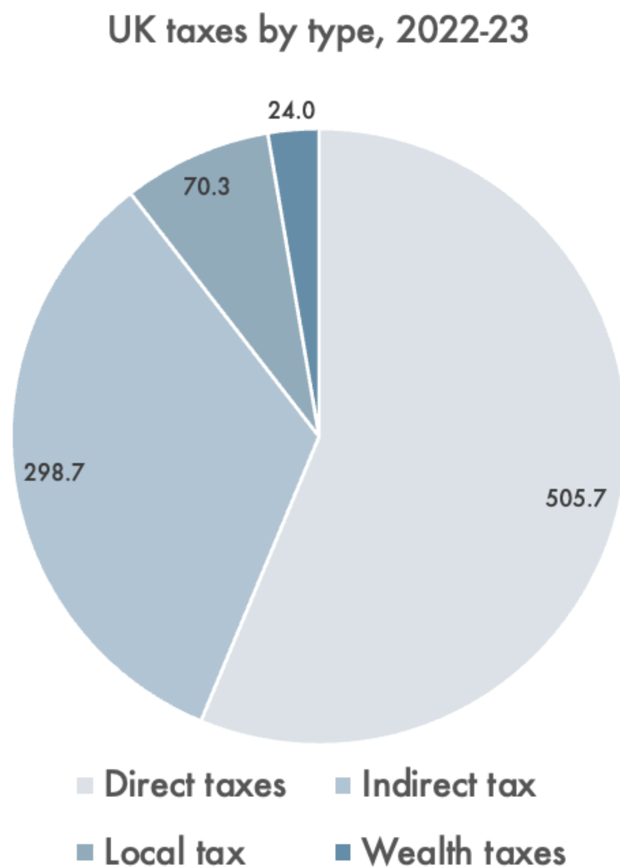
Categorisation by type of tax

Of these taxes, some are described as direct taxes. This means that they are taxed on income, whether of individuals or of companies. Income tax, national insurance and corporation tax are the most significant direct taxes.

Some taxes are local. Council tax and local business rates are by far the most significant of these.

Others are described as indirect taxes. They are, broadly speaking, charged on the value of sales made. Some are, in effect, charges. The largest of these are VAT and duties, but stamp duties can also be put in this category. Most of the smaller taxes listed are indirect taxes. Few of our taxes are charged on wealth. Both inheritance tax and capital gains tanks could be described as direct taxes, however, they might be better to described as taxes on either wealth, or income derived from wealth.

Using these categorisations, total UK tax paid looks like this:



The Taxing Wealth Report 2024 is unsurprisingly, given its title, concerned with the taxes paid by the wealthiest people in the UK. However, because there are no taxes not paid by wealthy people, that means that every tax is potentially within its scope. That said, because of the difficulties that direct taxation of wealth creates, it has limited its focus to increasing the amounts of tax that might be paid by those with wealth in the UK that can be achieved by modifying existing taxes, or by reducing tax reliefs given by law at present that reduce the amount of tax paid.

Given that the aim is on revenue raising this does, inevitably mean it has also focussed on the largest taxes in the UK as noted above.

Chapter 16.3

Background notes

The political economy of tax and money

Background

A state is defined by its ability to:

- Define and defend its borders.
- Legislate within its domain.
- Create a currency.
- Tax.

All other aspects of political economy flow from these issues. In that case, and presuming that the definition and defence of borders is not an issue of concern, the power of the state to create a currency and to tax is fundamental to its ability to create and enforce policy that meets the needs of its population. A proper understanding of the relationship between money and tax is, in that case, fundamental to the creation of successful economic policies.

Definitions

Some terms need to be defined to make sense of the discussion that follows:

- A currency is the unit of account used to describe the money in use in a jurisdiction.
- Money is a measure of debts owing denominated in the currency of a jurisdiction. Money may also be used as a measure of the value of debt-based exchanges that have taken place within an economy.

- A fiat-currency is the currency declared to be the legal tender of a jurisdiction by its government. This is a legal concept: a currency is legal tender merely because the government of a place declares it to be so using its power to legislate.

- An asset-backed currency is a fiat currency that enjoys the right of convertibility into another asset. If an asset backed currency fails it is claimed that demand might then be made by the person holding that currency to the central bank that issued it for the substitution of another asset, such as gold, in lieu of that money. In practice, if this was ever possible at any time in history it is implausible in a modern economy.

- Tax is a legal obligation contractually due to a state because economic events of a prescribed form have occurred.

- Government borrowing, if denominated in the currency of the jurisdiction in which the borrowing takes place, is a facility offered by the government of that place for the safe deposit of funds by those who wish to place them with a government owned and backed institution always guaranteed to be able to repay its debts. This is akin to a banking arrangement. It should, however be noted that like all savings arrangements, this borrowing has the consequence of removing money from circulation within an economy in much the same way as taxation does (see below). A reduction in saving has the opposite effect of increasing the money in circulation in an economy. The use of interest rates can, in that case, impact the volume of savings and as such borrowing by a government in its own currency can provide a mechanism for influencing interest rates throughout an economy in addition to providing a secure savings facility to those wishing to save funds denominated in the fiat currency that it has created.

- Government borrowing denominated in the fiat currency of a jurisdiction other than that which is undertaking this borrowing represents a promise to pay requiring that the government that has borrowed secure access to sufficient of the currency in which the borrowing has taken place by the time that repayment of the loan is due. This is a debtor relationship.

Some technical issues also need to be addressed:

- Base money is money put into circulation by the central bank of a jurisdiction. Base money is denominated in the fiat currency of the issuing jurisdiction. That money is issued into circulation as a record of the promise to pay made by the government of the jurisdiction in question that it offers in exchange for the supply of goods and services procured by it.

Examples of base money include notes and coins. It also includes the balances held by commercial banks with the central bank of a jurisdiction that represents sums spent into the economy of its jurisdiction by a government and not recovered by it from within that economy either by way of borrowing or taxation.

Base money is destroyed by the payment of tax and the issue of government debt issued in the fiat currency of the jurisdiction.

There is no theoretical limit to the amount of base currency that a jurisdiction may issue. However, to issue such currency in an attempt to procure resources in a jurisdiction already at full employment will always result in inflation unless additional tax charges are simultaneously imposed. As such there are practical constraints on the issue of base money.

- Commercial bank created money is money created by the commercial banks of a jurisdiction when advancing loans to a customer who promises to make repayment of that debt in return. Commercial bank money is destroyed by the repayment of the bank loan that created it. The practical limits to the capacity to create money in this form are:

  - The availability of borrower with the ability to make repayment.
  - The availability of capital within banks to sustain bad debts arising on debts that default.
  - Regulation intended to direct credit or to limit its availability.

- The payment of tax has to always follow the expenditure of money by the government. Given that governments with stable currencies always demand payment of tax in their own currency (so creating a demand for that currency within their economies that then requires its use in most everyday transactions in most jurisdictions) this has to be true: if the spend did not come first then there would be no money available to pay the tax due.

Consequences

If these definitions are accepted:

1. All money is debt: as matter of fact the nature of double entry book-keeping, which is the only verifiable method available to record monetary transactions, does not permit it to be otherwise.

2. Debt free money cannot exist as a result. Money on deposit is always owed to the depositor. Money owed to a bank or other person is always a debt. There is no money that exists that is not a liability of one person and the asset of another.

3. Money can only acquire value because of its capacity to settle a debt.

4. Base money acquires its value because it is used to settle tax liabilities owing, which are legally created debts intended to impart value to a currency.

5. Tax does not as a result fund government spending: it cancels the money created by government spending, whose legal creation is permitted by a properly authorised government budget.

6. All money is as a consequence intangible in its nature.

7. Tax, if not used to fund government spending acquires a range of other social purposes:

    a. To ratify the value of the currency: this means that by demanding payment of tax in the currency it has to be used for transactions in a jurisdiction;
    b. To reclaim the money the government has spent into the economy in fulfilment of its democratic mandate;
    c. To redistribute income and wealth;
    d. To reprice goods and services;
    e. To raise democratic representation - people who pay tax vote;
    f. To reorganise the economy i.e. fiscal policy.

8. Governments do not spend taxpayers' money. They do, instead, create new base money to fund their expenditure. That base money is then cancelled, largely through the imposition of taxation charges, but also through government borrowing in its own currency that has the effect of taking that base money out of circulation.

9. Banks do not lend depositors' funds to customers when advancing loans. Instead, they create new money when doing so based upon the mutual promises to pay that the bank and the customer exchange when arranging that loan. That new money created by the loan made immediately becomes a deposit with a bank that mirrors the loan made. Banks' books do always balance as a result. Money created in this way is cancelled by repayment of the loan.

10. Governments do not borrow money in their own currency to fund government expenditure. Governments do, instead, provide a safe deposit facility for their own currency whether created by their own spending or by commercial bank lending. This is a banking arrangement. The funds in question might be better thought of as part of the national capital of jurisdiction. If hypothecated for investment purposes, this might explicitly be the case.

11. Commercial banks do not require deposits to make loans to customers. Deposited funds are never loaned in this way. Depositors' funds are, instead, part of the assets of the bank, and are available to meet its obligations to its creditors in the event of the bank being unable to meet its obligations. Few depositors appear to be directly aware of this, although the unease that depositors have is reflected in the guarantee that governments like that in the UK supply to depositors holding up to £85,000 with UK banks.

Economic policy

Based upon this understanding a government should in pursuit of a sustainable economic policy:

1. Must determine the sustainable capacity of its economy, taking into consideration labour, natural, financial and manufactured capital resources.

2. Determine the potential value in use of those resources.

3. Decide on what part of those resources it might wish to procure to supply public services, and what value those services might have.

4. Determine the quantum of its resulting expenditure, also taking into consideration any desire it might have to maintain, replenish or deplete capital stocks, and taking into consideration the multiplier effects of its own spending, if material.

5. Decide the extent to which the remaining net injection of funds into the economy that it might make needs to be withdrawn from circulation by way of taxation or borrowing as a necessary means of controlling inflation if that is perceived to be a risk.

6. Determine the extent, if any, to which commercial credit creation needs to be controlled to facilitate the government's economic objectives and to consider the resulting necessary regulatory and taxation changes required to achieve this outcome.

7. Determine the extent to which it might wish to change the sums it has borrowed, considering interest rate policy as a part of this process.

8. Determine which taxes at what rates might fulfil its social, economic and environmental goals.

9. Determine which policies might minimise the impact of interest charges and other rent seeking activity within the economy as a whole in pursuit of its social policies.

10. Make clear its intentions and the reason for them.

11. Communicate these issues, including to banks and others directly impacted as a result.

12. Adequately resource those agencies such as HM Revenue & Customs that are critical to delivery of these goals.

Conclusions

What this analysis suggests is that most currently commonplace thinking, such as that which suggests that tax funds government expenditure, and that deposited funds are loaned by banks to their customers, is wrong.

The latter has been explicitly recognised to be wrong by the Bank of England and other central banks.

The former is implicitly recognised within the operation of central bank reserve accounts, which have become commonplace and material within most developed economies since the 2008 global financial crisis. See appendix 4 to this note for an explanation.

Ben Bernanke, the Chair of the US Federal Reserve, summarised this process of government created money being what government uses to deliver its policy very effectively when discussing how the money to pay for the 2008 Global Financial Crisis was found. He said[307]:

"It's not tax[payers'] money. The banks have accounts with the Fed, much the same way that you have an account in a commercial bank. So, to lend to a bank, we simply use the computer to mark up the size of the account that they have at the Fed."

[307] Quoted at https://www.ft.com/content/5e5b2afb-c689-4faf-9b47-92c74fc07e66

And that is how the government pays for everything. It is also how most money is created. And it is why tax is essential to cancel the impact and so prevent inflation, when that is necessary. Everything else in economics is a footnote to this understanding, which is not to diminish the importance of the matters discussed in the appendices to this chapter. What is, however stressed, is that tax has to be properly understood within its true economic role if tax policy is to be correctly directed. That is the aim of the Taxing Wealth Report 2024.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2024/01/27/the-political-economy-of-money-and-tax/

Appendix 1 to Chapter 16.3 - Fiscal policy

Fiscal policy is a term used to describe one of the two most common approaches adopted by a government towards macroeconomic management of the economy for which they are responsible, the other being monetary policy.

Fiscal policy uses the management of government expenditure and taxation income to, in combination, either stimulate or suppress economic activity within a jurisdiction.

Based upon the ideas of the 20th-century British economist, Lord John Maynard Keynes, fiscal policy suggests that if a government wishes to stimulate economic activity because, for example, there is significant unemployment or under-employment in a jurisdiction, then it will spend more money into the economy than it raises in taxation revenue, with the reverse being true if it wishes to suppress activity because, for example, it thinks markets are overheated and there is a risk of inflation.

The inherent logic implicit in fiscal policy is that government expenditure in excess of government taxation revenue stimulates economic activity whilst this situation persists, with the reverse having a dampening effect on economic activity.

Fiscal policy is finessed by deciding upon the mix between government revenue expenditure, i.e. that which is incurred for immediate purposes, and government capital expenditure, i.e. that which represents investment for long-term benefit. These two types of expenditure tend to have different fiscal multiplier effects, with government capital expenditure usually generating greater long-term taxation benefits for a government than current revenue expenditure does.

Fiscal policy can also be finessed by altering which taxes are increased or lowered within the economy. Reducing taxes on those with the lowest pay tends to have a higher fiscal multiplier effect with, as a result, more and more immediate fiscal policy impact than reducing taxes for those with the highest levels of income and gains does. That is because those with lower incomes tend to spend the benefit of any tax cuts that they receive almost immediately, whilst those with higher incomes and gains tend not to spend the benefit of tax cuts that they enjoy but save them instead, producing, as a result, smaller fiscal multiplier effects. In both cases, the reverse is also true.

As the previous paragraph makes clear, because government expenditure and government taxation revenue are not independent variables because government spending does invariably give rise to activity that is subject to taxation, fiscal policy management can never be a precise science. The resulting imprecision in fiscal policy management is exacerbated by the delay that exists within any economy between the announcement of policy, the undertaking of expenditure, and the consequent changes in taxation revenue. These delays create inherent uncertainty in fiscal policy management.

Keynes created the concept of fiscal policy because he correctly noted that markets do not by themselves, and without government invention, necessarily deliver conditions of full employment in any economy. Keynes thought full employment to be the goal of macroeconomic management, particularly given the experience of economies in the inter-world-war era.

Every modern government of any size does now necessarily consider its fiscal policy when managing its affairs and those of the economy for which it is responsible. Many will, however, also seek to manage the continuing fiscal cycles of relative boom and depression that occur despite their doing so through the use of monetary policy. This seeks to control the scale of short-term economic activity by the use of artificial movements in interest rates set by the government. They do so despite the evidence of the success of monetary policy being limited. In contrast, there can be no doubt that the post-1945 growth in economies around the world has arisen because of the use of fiscal policies and the implicit desire for full employment inherent within it.

Appendix 2 to Chapter 16. 3 - Money creation by banks

Many central banks (i.e. the banks owned by governments that issue the fiat currency in use within their jurisdictions) have issued explanations of how banks, including central banks

themselves, create money by making loans[308].

This explanation, by Norway's central bank, the Norges Bank, is one of the more straightforward to follow[309]:

> *When you borrow from a bank, the bank credits your bank account. The deposit – the money – is created by the bank the moment it issues the loan. The bank does not transfer the money from someone else's bank account or from a vault full of money. The money lent to you by the bank has been created by the bank itself – out of nothing: fiat [literally means] 'let it become'.*

The money created by the bank does not disappear when it leaves your account. If you use it to make a payment, it is just transferred to the recipient's account. The money is only removed from circulation when someone uses their deposits to repay a bank, as when we make a loan repayment. The money supply is therefore only reduced when banks' claims on the rest of the economy decrease.

The Bank of England addressed this issue quite comprehensively in 2014 in its first Quarterly Review of that year, in which it noted[310]:

In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood: the principal way is through commercial banks making loans. Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money.

Central bank or base money is created in exactly the same way except that the central bank makes the loan and the government it serves borrows the funds that the central bank creates. The money in question is cancelled by the collection of taxation revenues or by what is called government borrowing, but which is actually deposit taking by the government in the currency it has created, with the government effectively providing a banking (or deposit taking) service to the rest of its economy as a result.

Appendix 3 to Chapter 16.3 - Multiplier effects

A multiplier effect is a measure of the amount by which national income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater

[308] See https://www.taxresearch.org.uk/Blog/2024/01/06/central-bankers-on-the-ability-of-banks-to-create-money-out-of-thin-air/

[309] https://www.norges-bank.no/en/news-events/news-publications/Speeches/2017/2017-04-25-dnva/

[310] https://www.bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy

than one then the additional spending produces an increase in income of greater than its own amount, and vice versa.

The largest multiplier effects are usually associated with healthcare spending and capital investment, where returns that are several times the size of the sum initially expended can result. In contrast, defence spending has very low multiplier effects.

Some multiplier effects e.g. those resulting from spending on education are hard to measure because of the extended time periods involved.

In the context of the Taxing Wealth Report 2024:

- Tax charges on the wealthy have low multiplier effects, because the wealthy do, by definition, save part or all of their marginal income as their income grows. As a consequence, whilst the savings of the wealthy might fall as a result of increased tax charges arising upon them proposed in the Taxing Wealth Report 2024, because savings are by definition funds taken out of circulation within the economy the impact on overall economic activity as a result of these tax increases will be limited because the wealthy will still have sufficient to spend to meet all their ongoing needs.

- Tax cuts for those on low income, and the payment of additional state benefits to people also on low levels of income, do in contrast have high multiplier effects. That is because it is very likely that the beneficiaries of these cuts or benefit payments will spend almost all that they gain almost immediately within the economy, providing an immediate boost to economic activity resulting in additional activity that is quite likely to exceed the cost of the cuts or benefits paid.

- It follows that the policy implicit within the Taxing Wealth Report 2024 of reallocating the tax burden from those with low incomes to those with high incomes will have a beneficial impact on the overall level of economic prosperity within an economy. It is, in fact, very likely that many of the economic problems that the UK currently faces arise because tax charges as currently imposed have been so heavily orientated towards those on low income, and against those with wealth, creating adverse multiplier effects.

- The focus within the Taxing Wealth Report 2024 on redirecting tax incentivised savings away from their current, largely speculative use or cash based dormancy, and into active use in providing capital for investment within the economy is again intended to change the multiplier effects on this very significant item of overall government spending when £70 billion a year is spent subsidising savings. The existing multiplier effects of this expenditure are likely to be very low indeed, because there is almost no

relationship between current tax incentivised savings and proactive investment in new capacity within the UK economy. By creating this relationship, the measures noted within the Taxing Wealth Report 2024 have the deliberate intention of significantly increasing the multiplier effect on this government expenditure, with likely considerable benefit to the overall growth and well-being within the UK.

Appendix 4 - Central bank reserve accounts and the quantitative easing process

Central bank reserve accounts (CBRAs) are held by the UK's commercial banks with the UK's central bank – the Bank of England.

As a central bank, the Bank of England is owned by the UK government. It is responsible for the day-to-day management of the money supply in the UK, for the regulation of commercial banks in the UK, and for managing the settlement of inter-bank debts in sterling, for the issue of which currency it is responsible.

The central bank reserve accounts serve two purposes. Firstly, they provide the mechanism by which payments from commercial banks and their customers are made to and from the government. Secondly, they are the mechanism used by commercial banks to make settlement of the liabilities that they owe each other when fulfilling the obligations that their customers' request be settled with customers of another bank.

These accounts restricted for the use of commercial banks and some other regulated entities in the financial services industry. It is, as a result, believed that there are only a few hundred of them.

Before 2007 there were almost no balances on the central bank reserve accounts, at least in total. The current situation where all CBRAs are, in effect, bank deposit accounts held by the UK's commercial banks as a mechanism to guarantee their ability to make settlement to each other is almost entirely a creation of the post-2008 global financial crisis.

This change was in no small part motivated by those banks refusal to trust each other to make settlement after 2007, in which year it became clear that major commercial banks could fail when none in the UK had effectively done so since the 1860s. Once banks had demonstrated their own inability to manage their balance sheets at the time of the global financial crisis it became apparent that these banks would need to hold funds with the Bank of England to prove their ability to fulfil their own promises to pay.

As a result the central bank reserve accounts of UK banks were deliberately boosted in value by the Bank of England to facilitate this inter-bank payment process. This was the way in which banks were bailed out post-2008 to prevent them failing again.

In that case the way in which these reserve accounts have been increased in value needs to be noted. Doing so requires a number of things to be understood:

1. Overall, the sum held on these accounts is not within the control of the commercial banks. The sum that each bank might hold will vary from day to day. However, that is the consequence of payments between banks varying. However, the quantum of funds held in the CBRAs as a whole is determined by the Bank of England on behalf of the government because it is the sole creator of what is called 'base money'.

2. 'Base money' is sometimes called 'central bank money'. It comprises the currency issued by central banks in the form of notes and coins plus the balances on the CBRAs.

3. Base money is created as a result of the CBRAs being used to transfer funds from the Bank of England into commercial banks on behalf of the government, to whom it acts as primary banker through what is called the Consolidated Fund, which is in effect the government's consolidated bank account, and to also receive payments from those banks that are due to the government.

4. In summary, payments from the Bank of England Consolidated Fund account to the commercial banks increases the sums held in the central bank reserve accounts and so create what is called base money. These payments are made in the ordinary course of government business to make settlement to whomsoever the government chooses to make payment to, from an old age pensioner to the sums used to redeem gilts when they reached their repayment date. Payments to the government from the private sector economy via UK commercial banks via the CBRAs include taxes due, the proceeds of new gilt issues and the receipt of the many trading sums owed to government agencies.

5. The balances on the central bank reserve accounts are a proxy for the impact of fiscal policy as a consequence.

In that case the only way in which the balances on the central bank reserve accounts can increase is by the government spending more into the economy than it receives back from it. There is no other way in which this can happen. In turn that is only possible because the government can decide to fund its expenditure with new money created on its behalf by the Bank of England. That new money that the Bank of England creates for the government is base money.

The corollary is also true. The only way in which the balances on the CBRAs can be reduced is by the government collecting more money from the commercial banking system than it

spends into the economy e.g., as a consequence of taxes paid being in excess of government expenditure, or by raising new borrowing in excess of current requirements e.g. because of quantitative tightening.

In this context, the role of quantitative easing can appear to be confusing, although it is actually quite straightforward. The pattern of the transactions involved in QE is as follows:

1. At any time it wishes the government can decide to issue new financial instruments. These can be very short term, in which case they are described as Treasury Bills, which are often redeemed in a matter of days. Alternatively, the government can issue bonds or gilts, which can have duration from a year or so to fifty years, or more. It has been government practice to only issue such bonds when there is a deficit on the government's Consolidated Fund account with the Bank of England, the aim being to restore a neutral balance on that account. This, however, is not a necessity and before 2008 it was commonplace for this account to also be cleared through the so-called Ways and Means Account that the government maintained with the Bank of England, which was an overdraft in all but name.

2. The issue of new financial instruments, of whatever their nature, results in new financial flows from the commercial banks to the government either because the banks themselves buy these instruments or, more commonly, because their customers do. The resulting funds to acquire these financial instruments flow through the CBRAs in either case since this is the financial conduit to and from the government available to the banking sector to use for this purpose. Whether the payment the commercial bank makes is as principal or agent for their customer makes no difference: the flow is from them to the government via the central bank reserve accounts. The result of the issue of new bonds is to reduce the balance in the CBRAs, meaning that the balances on those accounts created by government spending being in excess of routine income are cancelled in whole or part. Bond issuance of this sort, it is stressed, is not a part of the quantitative easing process.

3. If the Bank of England decides to undertake quantitative easing all that it does is lend funds to its legal subsidiary, the Bank of England Asset Purchase Facility Fund Limited (the 'APF')[311]. This company is fully indemnified with regard to its activities by HM Treasury and as such an agent of Treasury and is not under the effective control of the Bank. That company then uses the loan funds provided to it by the Bank of England to buy bonds issued by HM Treasury on the open financial markets. There is no reason why the bonds acquired need to be owned by the commercial banks, and it is likely

[311] https://www.taxresearch.org.uk/Blog/glossary/A/#asset-purchase-facility

that most of them will not be. This is inconsequential to the resulting movement through the central bank reserve accounts, which is represented by a flow of funds from the account of the APF to the commercial banks, which as a result increases the central bank reserve accounts balances.

4. As a result of the above noted transactions, it is apparent that bond issues cancel the CBRAs created by government spending being in excess of government income, but QE then in turn cancels that cancellation process as if the bond issue never took place, effectively restoring the CBRA balances created by expenditure exceeding income. Given that the bond that was issued is, after being repurchased using QE under the effective ownership and control of HM Treasury it is easy to argue that the bond in question has effectively been cancelled. This is the accounting position reflected in the UK government's Whole of Government Accounts, which are the only true and fair accounting representation of this transaction[312].

5. QE is then a simple way of swapping bonds that need never have been issued for base money, and quantitative tightening (QT) then reverses that swap by cancelling QE.

As a result, the reality is that QE and QT are simply window dressing and it is the excess of government spending over income and routine bond issuance since 2008 that has created the current CBRA balances.

[312] https://www.gov.uk/government/collections/whole-of-government-accounts

Chapter 16.4

Background notes

The UK's national debt and how to understand and interpret it

Brief Summary

This chapter is part of the background materials that seek to explain the basis for the recommendations made in the Taxing Wealth Report 2024.

In this chapter the nature of the UK's national debt is explained. It is suggested that:

- What is described as the national debt is, in the case of a country like the UK where the government is possessed of a central bank and a currency that it has declared to be legal tender, which currency is widely accepted for use in transactions of all sorts in that jurisdiction, and which only borrows in the currency it has itself created, the cumulative difference between the expenditure made by a government into the economy it has responsible for over time and the sums it has withdrawn from that economy by way of taxation over that same period of time.

- That national debt can be split into two parts:

    - That part which is funded by central government borrowing from its own central bank, which part represents new money creation by that government with those funds being made available for use in its economy. This part is best described as national capital since only a government has power to create and use money in this way. These sums are only repayable at the choice of the government that created them and any interest paid on them is voluntarily settled, meaning that they behave like equity and not debt in accounting terminology.

  - National savings, which are that part which is funded by the provision of safe deposit facilities for use by those wishing to save sums denominated in the currency that the government has created.

- A government that only has liabilities owed to those who have deposited funds with it denominated in the currency that it has created cannot have a national debt but can only be the provider of deposit savings facilities to those who wish to make use of them.

- There can never be a risk that those deposit saving facilities will not be repaid precisely because the means of making that repayment are solely within the control of the government that created them, which is a characteristic shared by no other savings institution taking deposits in that currency.

- The interest payable on these deposits will, assuming that the physical limitations on the scale of government expenditure noted below are respected, always remain within the control of the government making them available, and those costs should never create a constraint upon its capacity to meet any other obligation as a result.

- Attempts to repay the national debt can result in:

  - Austerity.
  - Cuts to public services.
  - Potential credit crises.
  - Reduced security for private wealth.
  - Financial instability.
  - Threats to international trade.
  - Increased risk for pension funds.
  - The value of the currency being undermined.

  Those demanding repayment need to justify their actions in this context as a result.

A web-based version of this chapter is available here:

https://www.taxresearch.org.uk/Blog/wp-content/uploads/2024/02/National-debt-an-explanation-published.pdf

Introduction

National debt is one of the most difficult concepts to understand within economics, not least because there is a very good argument that it does not exist, at least as it is commonly understood in countries like the UK.

Definition

A country's national debt as conventionally described in a country like the UK, where the whole of the sum described as such is denominated in the fiat currency that is the legal tender of that jurisdiction, is the cumulative difference between the money expended by a government using the funds created for its use by its own central bank over a period of time (usually considered to have started in 1694 in the case if the UK[313]) and the net taxation revenues that it has generated over that same period.

This definition of the UK's national debt represents an accounting identity given the facts noted, i.e. it has to be true. The money created by the UK's central bank (the Bank of England) for the government that it serves is either in existence or it does not. There is no other possible state that the money in question might have.

Money created by a central bank for the government it serves always ceases to exist when tax is paid. The cancellation of money created as a result of government expenditure is, as a consequence, the primary purpose of taxation. It follows that taxation does not fund government expenditure. It does instead cancel the money created as a consequence of that expenditure taking place as a means of controlling inflation.

Reasons for the national debt

[313] See this article for an explanation as to the use of this date, which is when the UK's national debt is considered to have first been created. https://www.bankofengland.co.uk/freedom-of-information/2020/details-of-the-bank-of-england-loan-to-the-government-in-1694

It is neither necessary, let alone always possible, for a government to collect tax revenues equivalent to the sum that it spends into its economy during a period. There are several reasons for this:

- The government in question might wish to leave some part of the money that it creates in circulation within the economy because doing so provides that economy with the base liquidity, or money supply, required to ensure that transactions in the fiat currency that it has declared to be the legal tender of the jurisdiction can take place.
- The government might wish to stimulate the economy for which it is responsible as a consequence of the fiscal policy that it has adopted, which means that it must leave part of the sums it has expended into the economy uncollected by way of tax charged.
- Leaving a part of that expenditure uncollected in the economy means that the balance in question can be re-deposited with it in savings mechanisms of various forms. The government's ability to vary the rate of interest paid on those savings mechanisms that it makes available provides it with the means to influence interest rates in the economy as a whole as part of its overall economic strategy that combines both fiscal and monetary policy.
- The forecasting of taxation revenues is a decidedly imprecise art and is most definitely not a science. The level of tax paid in an economy can, for example, vary considerably as a result of exogenous shocks, such as the global financial crisis in 2008 and the covid crisis of 2020, both of which massively reduced taxation yields in the years in question.
- Levels of government expenditure can also vary in unplanned ways after taxation rates have been set, with 2008 and 2020 providing further evidence in this regard.

Deficit financing

There are two possible responses that a government might make to the injection of money that it has had newly created on its behalf by its central bank that it does not plan to recover by way of tax charges. Those choices are that it might either:

- Leave the balance that it owes to its central bank for new money created to fund expenditure as outstanding on what would, in effect, be an overdraft facility with that

central bank. This was quite commonplace in the UK until 2000, the account in question being called The Ways and Means account[314].

- Induce those persons still in possession of those funds in the private sector economy to deposit them with it on savings accounts of various forms. This has been the universal practice since 2008.

National savings

The most common types of savings accounts offered by the UK (and most similar) government for this purpose are:

- Bond or gilt accounts, where a sum is saved for a fixed period at a fixed rate of interest with redemption taking place on a predetermined date at either a fixed amount or at an amount that is increased depending upon the rate of inflation within the jurisdiction from the time of issue of the bond to the time of its redemption.

- Very short-term savings accounts that are usually described as treasury bills that are only of any real interest to professional participants in the financial markets of a jurisdiction.

- Savings accounts of a type more commonly provided by commercial banks, including instant access or term deposit facilities. In the UK, these are described as National Savings and Investments (NS&I) accounts.

- Unconventional savings products, which in the UK are best represented by premium bonds.

Some of these products are more commonly considered to be government borrowing in popular narratives, e.g. bonds and treasury bills tend to be referred to as government borrowing, whilst more conventional government-provided savings facilities such as NS&I accounts and unconventional savings products, such as premium bonds, tend to be thought of as savings accounts.

In reality, all these arrangements have a number of things in common:

[314] https://assets.publishing.service.gov.uk/media/623a22078fa8f540ecc60532/DMR_2022-23.pdf provides evidence that the mechanism still exists. It was temporarily expanded to £20 billion in April 2020. Its use was commonplace until cash flow management was moved from the Treasury to the government Debt Management Office in 2000 and was faded out after 2008. See https://www.dmo.gov.uk/media/10808/sa240108.pdf. The pretence that the current way of managing debt is normal is, as a result, wrong: it is a recent innovation.

- They are all intended to induce the deposit of what is, in effect, government-created money with government-backed savings agencies so that the government in question might then clear its apparent overdraft with its central bank that was created to facilitate government expenditure before taxation revenues were received, as always happens.

- All these balances are credits on the government's balance sheet. Such balances can either be considered to be liabilities, of which borrowing is a particular form, or they can be considered to be equity, i.e. sums without any fixed repayment date or obligation to pay a return.

- Because all of the savings accounts noted have an identifiable third party to whom a sum might eventually be payable, they can, correctly, be considered liabilities. This contrasts with any balance owed by the government to its own central bank, e.g., on its Ways and Means Account. Because that central bank is effectively a part of the government, there is no third party to whom liabilities are owed as a result, and as a consequence, any sum of money owed to that central bank by the government that controls it cannot be a liability but is, instead, a balance equivalent to equity capital. It should be added that since government-created money is spent into the economy via central bank reserve accounts, which are explained here, these balances are also equivalent to equity capital as they have no fixed repayment date, and there is no legal obligation to pay a return upon them, and none was until 2006.

- It follows that when a government chooses to induce people holding funds within its economy to save with it, with those sums saved effectively representing money created by it but not yet withdrawn from circulation as a consequence of taxation paid, it does, as a result, choose to substitute a liability on its balance sheet for capital on that same balance sheet. At the same time, it can be argued that it also chooses to accept a fixed obligation to a third party to make payment in compensation for their choice to hold funds with the government as opposed to having an arrangement where no such obligation exists.

The question that then arises is whether or not the decision by a government to voluntarily accept liability to third parties for sums that impose cost to their budgets can ever be an issue of economic concern within its overall macroeconomic policy?

The obvious answer to this question is that this is not the case for three reasons. They are:

- Firstly, that those who have chosen to deposit funds with the government have done so voluntarily, knowing the terms on which they do so, also being aware that in the vast majority of cases repayment will not be due to them for a considerable period of

time. The risk profile within this liability is, as a consequence, inherently low because the vast majority of it will not be due for payment at any point in time.

- Secondly, the vast majority of those choosing to deposit funds with the government will do so precisely because they are aware that, unlike commercial banks and deposit takers, a government possessed of its own central bank and its own currency that is acceptable for exchange within its own economy can never run out of money to make repayment to a person to whom a liability is owing by it, precisely because it can always create the necessary money to make that repayment by simply issuing a demand to its central bank to make the payment in question.

- Thirdly, within very broad parameters, the rate of interest payable by a government on its borrowing is normally its to choose because its own central bank determines the base interest rate in use in that economy at any point of time, and that base rate has significant influence upon other interest rates in use in that economy, including those payable on sums deposited with its government.

Why, then, is there an obsession, mainly on the part of politicians, with the size of the national debt that a country might have, usually expressed as a proportion of its national income or gross domestic product?

There is no rational answer to this question unless the debt in question is denominated in a currency other than that of the jurisdiction itself. This is, of course, commonplace in the case of low-income countries and those states that are, for example, dependent upon funding from international financial organisations such as the World Bank, most of whose loans are denominated in US dollars.

In those situations, it is the case that the liability owed by a government can create real financial stress for its jurisdiction because it is duty-bound to then generate revenues in the currency in which its liabilities are due. That requires that it maintain a steady flow of exports from its jurisdiction that are not matched by imports of equivalent value, and that necessarily means that a drain is imposed upon consumption within that jurisdiction to service the debt in question, the interest on which will necessarily represent a transfer of well-being from the borrowing state to that institution or state that made the loan to it. It is entirely possible in this circumstance for a country to become over-leveraged, meaning that it has borrowings in excess of its capacity to service repayments and it can, as a result, default on its obligations. However, this situation cannot be extrapolated to a jurisdiction that has borrowings solely or almost entirely denominated in its own currency, which is the circumstance of the UK, as outlined above.

For reasons that appear to be entirely political, confusion between the situations of states in these very different positions has been created. The result has been that pressure has been brought to bear on countries whose only borrowing is denominated in their own currencies to reduce or at least moderate that borrowing, even though by doing so they might:

- Restrict the necessary new money supply, and so liquidity, that their economy requires.
- Fail to undertake necessary expenditures to fulfil the demand for government services within their jurisdiction.
- Unnecessarily reduce economic growth within their jurisdiction, especially when the multiplier effects of government expenditure are taken into consideration.

These consequences do, however, explain the motivation for the imposition of the supposedly necessary limits on government borrowing in its own currency. The intention of those promoting such limits is to reduce the scale of government activity within a jurisdiction.

This is not to say, of course, that a government can, as a consequence, create money without limit. In practice, there are practical limits on a government's capacity to create money to fund expenditures, which are:

- The need to control inflation.
- Its ability to recover taxes due to it from the economy for which it is responsible. This ability is always constrained because no government has ever discovered a way to recover all sums owing in tax to it. The extent of that constraint is, however, to some degree under its own control, depending upon its willingness to invest in the tax authority that it gives the task of recovering sums owing to it.
- The ability of the government to induce people holding the currency that it has created within its own economy to save with it, which is necessarily constrained by the levels of interest that it thinks are appropriate to be used within that economy in combination with the economic, social and fiscal policy goals that it wishes to fulfil.
- The actual capacity of the economy for which a government is responsible to meet the demand that government creates for the supply of goods and services to it, which is a physical rather than a financial limitation.
- The exchange rate that a government wishes to maintain with other jurisdictions which can be impacted if it seeks to overinflate the scale of economic activity within its jurisdiction so that imports must be relied upon to meet the demand that a government creates.

Repaying the national debt

All the above having been noted, a number of refrains are commonly heard from politicians, including:

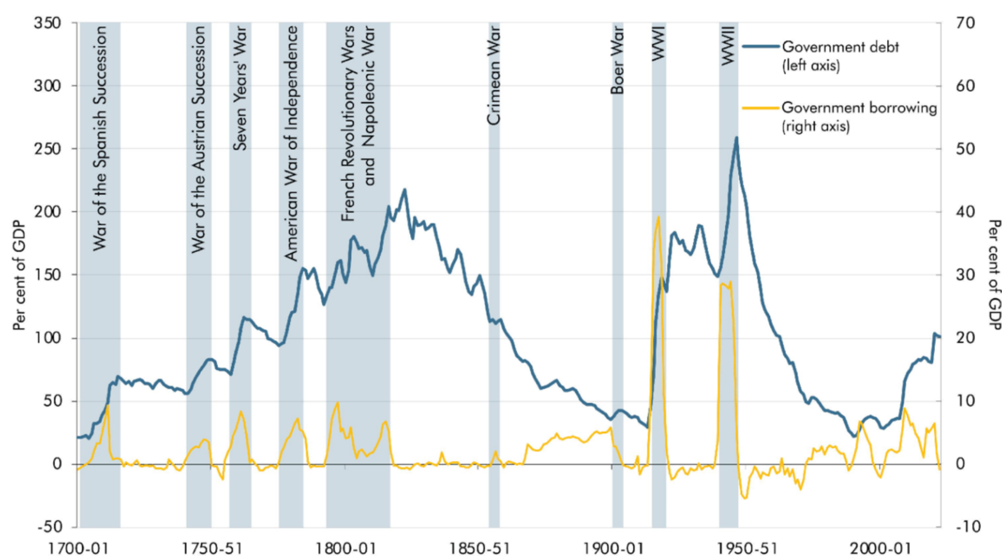
- The national debt is too high.
- National debt is squeezing out private investment, which is too low as a result.
- We are leaving a burden of debt to our grandchildren.
- The national debt is unaffordable.
- Unless we get the cost of the national debt under control we cannot afford public services.

The implication of all of these is that we would all be better off if the national debt was repaid.

None of the claims that these politicians make are true. For example:

- For very long periods of time, the ratio of UK national debt to National income was much higher than it is at present and calamity did not follow. In fact, NHS, much of our social housing, and the rebuilding after the Second World War all happened when National debt was at vastly higher levels than it is now:

Government borrowing and debt since 1700



Source: Bank of England, ONS, OBR

Source: https://articles.obr.uk/300-years-of-uk-public-finance-data/index.html

- There is no evidence that our national debt is in any way reducing the amount of investment in private business. Private business may not be investing enough in the UK, but that is because it cannot think of things to do with investment funds despite the fact that they were exceptionally cheap for more than a decade and has nothing to do with the size of the national debt.

- The national debt has never been repaid, as is apparent from the above chart. Our grandchildren will not repay it, any more than we have repaid the national debt created by our own grandparents. In fact, lucky grandchildren will inherit part of the national debt because it is made up of private savings accounts that form a part of private wealth. Inheriting a part of your grandparent's savings is what many grandchildren might hope for.

- The national debt is always affordable. The government can always choose to make it so in a country like the UK. If the interest rate is too high at any point in time, then that is a measure of the fact that the Bank of England is setting inappropriate interest rates, and not that the national debt is too expensive.

- There is nothing about our national debt that prevents the government supplying services to people who need them in the UK. That is partly because doing so will always pay for itself if there are resources available to supply those services because they are then put to use, creating income, and so taxes paid on that income and the spending (and so further income) that it then generates. That is also because there is no known cap on the level of national debt that we should limit ourselves to. Many European countries have debt to national income levels considerably higher than that in the UK, and Japan has a national debt to income level well over double that of the UK, and all those economies are functioning perfectly well. So can we even if we increase the national debt.

Perhaps more importantly, repaying the national debt would be disastrous. It would mean that:

- The government would have to withdraw more than £1.6 trillion of money from use in the economy, which would most likely create an unprecedented financial crisis, deliver a recession, and leave businesses and households without the basic cash resources that they need to make payment to each other, not least because the banking payment system would be crippled without there being a national debt that delivers it with the money that it needs to function.

- Almost all public services would collapse because their funding would have to be withdrawn for extended periods.

- Most private pensions would collapse, because they use the savings facilities that the national debt provides as the foundation for the payments that they make the most pensioners.

- The government would lose control of interest rates within the economy.

- Because of the shortage of pounds available to make payments within the economy that repayment of the national debt would create it is likely that we would have to use foreign currencies to trade in the UK, creating massive uncertainty for the whole economy. This would also make it almost impossible to run an effective tax system.

- Foreign governments and companies would have great difficulty holding sterling balances, and this would enormously harm trade in UK goods and services.

Those demanding repayment of the national debt really ought to be very careful about what they wish for. Even partial repayment or limitations on the growth in that debt could produce some of the above outcomes.

The truth is that the national debt is fundamental to the success of our economy because it provides us with our national money supply, and we cannot survive without that. Those suggesting we can either limit this so-called debt, do without it, or repay it, must be treated with suspicion. What they propose not only threatens the entire public sector of the UK, but also the economic viability of the country as a whole. It is for them to justify why they would wish to do that.

Conclusions

These points, being noted, none of them alter the fact that:

- A government that only has liabilities owed to those who have deposited funds with it denominated in the currency that it has created cannot have a national debt but can only be the provider of deposit savings facilities to those who wish to make use of them.

- There can never be a risk that those deposit saving facilities will not be repaid precisely because the means of making that repayment are solely within the control of the government that created them, which is a characteristic shared by no other savings institution taking deposits in that currency.

- The interest payable on these deposits will, assuming that the physical limitations on the scale of government expenditure noted above are respected, always remain within the control of the government making them available, and those costs should never create a constraint upon its capacity to meet any other obligation as a result.

Seen in this way, a country like the UK does not, in fact, have a national debt. It does, instead, have a national savings bank or facility, which is a matter of considerable benefit to the people of the country.

It also has national equity capital, which, in the case of the UK is at present broadly represented by those government bonds now owned by the government itself as a consequence of the operation of quantitative easing policies since 2008, and although this situation has been complicated by the decision of the UK government to make payment of interest on central bank reserve account balances that is another issue, not necessarily related to the supposed national debt as such.

Chapter 16.5

Background Notes

Tax and money flows within the economy

Brief Summary

This chapter is part of the background materials that seek to explain the basis for the recommendations made in the Taxing Wealth Report 2024.

In this chapter the money flows created by government expenditure, and the resulting demand by a government for funds, are explained through a series of six diagrams.

The intention is to show how the Taxing Wealth Report 2024 seeks to:

- Maximise the fiscal multiplier effects[315] resulting from government spending of new funds into the economy.

- Maximise the fiscal multiplier effects arising from the best choice of tax rates, meaning that those on low incomes should have low overall effective tax rates and that those on high incomes should have higher overall tax rates, which delivers this outcome.

- Provide reason why the government should encourage more direct saving in the savings products that it makes available for this purpose that together are often described as the national debt but which might be much better thought of as national savings.

[315] Multiplier effects measure the amount by which national income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater than one then the additional spending produces an increase in income of greater than its own amount, and vice versa.

- Explain the cost of tax abuse to the government in terms of excess borrowing that it has to take on as a result, which has amounted to not less than £435 billon since 2010.

- Demonstrate the cost to the government of pension saving subsidies that might have cost £800 billion since 2010, or fifty-five per cent of the so-called national debt incurred in that period.

- Maximise the fiscal multiplier effects from saving so that new investment can be generated from this activity which has not been the case for many decades in the UK, with a resultant boost to our economy, employment, and growth as well as to the creation of the capital infrastructure needed to address climate change and other social issues in the UK.

In the process the chapter also hopes to expand understanding of the nature of the cash flows resulting from government expenditure and to slay some of the myths commonly told about that issue.

This chapter suggests that the proposals in the Taxing Wealth Report 2024 will have larger positive multiplier effects than the existing tax system does.

A web-based version of this chapter is available here:

https://taxingwealth.uk/2024/02/12/tax-and-money-flows-within-the-economy/

Background

As the section of the Taxing Wealth Report 2024 on economics, money, tax and their intimate relationship demonstrates, much of what is true with regard to these matters is counter-intuitive to what is still commonplace understanding, particularly amongst politicians, economic commentators, journalists more generally, and tax specialists.

As that section makes clear:

- Government expenditure must precede the raising of taxation revenues or there would be no money available to pay taxation liabilities.

- The money spent by the government into the economy is newly created for it by the Bank of England every time that expenditure takes place. Most importantly, tax funds received are never involved in that process, meaning that they can never be a constraint on spending.

- The money created as a result of government spending financed by the Bank of England is withdrawn from circulation in the economy to prevent inflation taking place by way of taxes being charged and by what is commonly called government borrowing, but which would be much more accurately described as government deposit-taking from savers seeking a safe place for their funds.

- Government created money is called base money. It is not, however, the only money in circulation within the economy. Commercial banks can also create money, which they do by making loans to customers. Importantly, just as the government does not use tax revenues to fund its expenditure, nor do commercial banks use funds deposited with them to make loans to their customers. Instead, every loan that they make creates new money which is in turn cancelled when that loan is repaid, just as government created money is cancelled when taxes are paid.

To fully understand the role of tax in the economy, and the way in which the Taxing Wealth Report 2024 seeks to exploit that understanding to improve the well-being of people within the UK by both changing who pays tax and the way in which tax incentivised savings arrangements work within the UK economy, the money flows that government spending and tax (which really are the flip side of each other) create within that economy need to be understood. A series of diagrammatic representations of those money flows will be used for these purposes.

The following should be noted with regard to these diagrams:

- These diagrams might be entirely incomprehensible to some readers, and if that is the case, simply skip this chapter. Most of the Taxing Wealth Report 2024 can be understood without them, but it is hoped that these diagrams will assist understanding for some people.

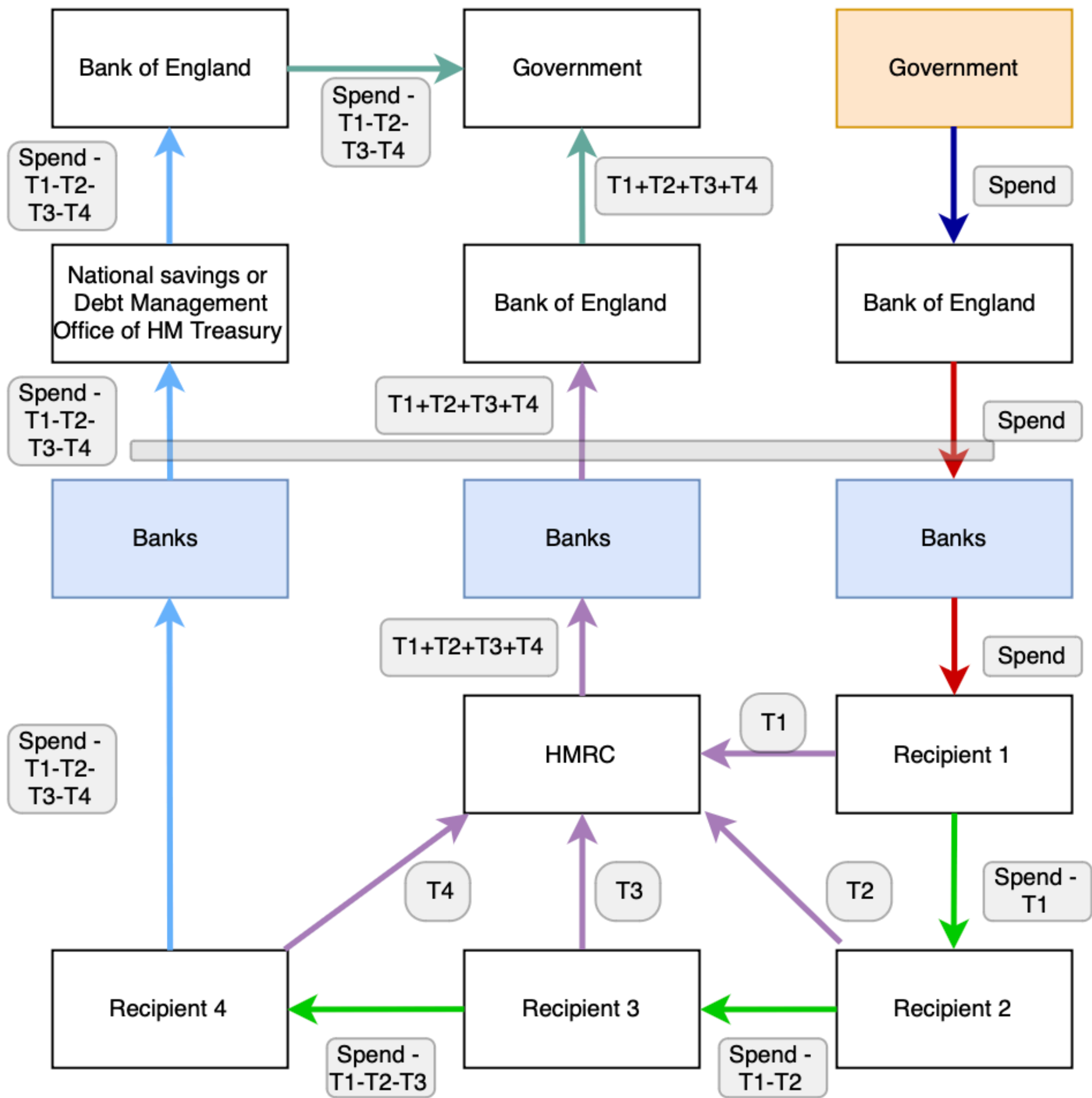
- Diagrams, like maps, are representations of reality but are not real in themselves. They, inevitably, simplify matters to avoid excessive complication. It is important to appreciate that this has been done in the diagrams that follow.
- Crucially, the diagrams that follow are only intended to represent the flows arising from government expenditure and the government's consequent demands for

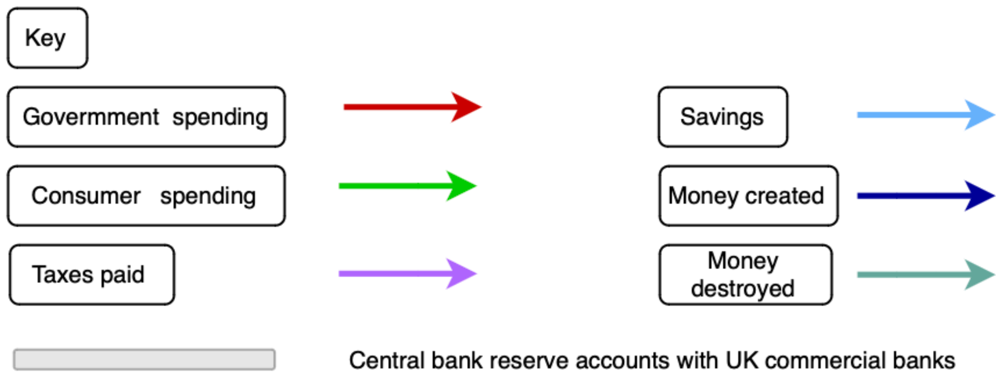
taxation revenue and savings flows to the government. Flows primarily or solely associated with commercial bank money are not shown in the diagrams. It is accepted that this could be a basis for criticism of them, but there are two reasons for accepting this compromise:

- Firstly, the diagrams would almost certainly be incomprehensible if they also reflected commercial money flows.
- Commercial money flows are, in reality, impossible to differentiate from those created as a consequence of the use of base money within our economy, at least when we come to make payments through our own bank accounts. To abstract base money flows in the way done in these diagrams is not, then, a hindrance, but actually serves to highlight something that is otherwise not apparent.

First diagram – the essential tax, spending and savings flows resulting from government spending.

The first of the diagrams that explains these money flows sets the pattern for all the diagrams that follow, in which it is always embedded as they grow in complexity:


Bank of England
Spend - T1-T2-T3-T4
Government
Government
Spend - T1-T2-T3-T4
T1+T2+T3+T4
Spend
National savings or Debt Management Office of HM Treasury
Bank of England
Bank of England
Spend - T1-T2-T3-T4
T1+T2+T3+T4
Spend
Banks
Banks
Banks
T1+T2+T3+T4
Spend
Spend - T1-T2-T3-T4
T1
HMRC
Recipient 1
T4
T3
T2
Spend - T1
Recipient 4
Recipient 3
Recipient 2
Spend - T1-T2-T3
Spend - T1-T2


Key
Government spending
Consumer spending
Taxes paid
Savings
Money created
Money destroyed
Central bank reserve accounts with UK commercial banks

The process which the diagram portrays starts in the top right corner, with the government (indicated in this case by a box highlighted in pale orange) deciding to spend, as a consequence of which it instructs the Bank of England to make a payment. The Bank of England creates the money for the government to do so.

The Bank of England then routes this payment via the central bank reserve accounts[316] (indicated throughout the following diagrams by the grey line crossing the flows shown) to a commercial bank, highlighted in blue.

That commercial bank does, then, in accordance with the instruction that it has received from the Bank of England make payment to the first recipient of the funds from the government, effectively creating commercial money with the backing of the base money payment from the Bank of England in the process[317].

The identity of the first recipient of funds from the government does not particularly matter. It could be a commercial organisation receiving payment in respect of services supplied to the government, or it might be a teacher, civil servant, or NHS employee in respect of wages due, or it could be the beneficiary of a state pension or other state benefit. The important point to note is that they decide to undertake two transactions upon receipt of the funds.

One is to pay the tax due on the funds received, which it is assumed represents income in their hands, with that payment going to HMRC, and being described as T1 on the diagram.

The second payment that they make is to Recipient 2, from whom the first recipient buys goods or services to the value of the payment made to them, net of tax owing, to them by the government.

Recipients 2 and 3 then repeat the transactions undertaken by Recipient 1, except that the value that they will receive is reduced in each case by the amount of tax paid by previous recipients, so that, for example, Recipient 3 pays tax on the sum that they have received which is equivalent to the gross value received by Recipient 1 less the tax paid by Recipients 1 (T1) and 2 (T2). Recipient 3 then also pays tax (T3).

Recipient 4 breaks the pattern of spending following the receipt of funds. They make settlement of their tax liability (T4) but then saves the whole net balance of funds that they have received and does so by placing this net sum on deposit with a government agency. That agency might be National Savings and Investments (NS&I), or it could be the Debt

[316] See https://www.taxresearch.org.uk/Blog/glossary/C/#central-bank-reserve-accounts for an explanation of these the role of these accounts.

[317317] See https://www.taxresearch.org.uk/Blog/glossary/B/#base-money for an explanation of base money

Management Office of HM Treasury as a result of them buying government gilts. For the purposes of this exercise, it does not matter which. The essential point is that the funds that they have saved flow back through their bank and onward through the central bank reserve accounts to the consolidated fund of the Bank of England, and in turn, therefore, to the government's accounts. Money is cancelled as a result.

As will also be noticed, HM Revenue & Customs also collect the various tax payments made to it in a commercial bank (it usually uses Barclays for this purpose) which in turn then remits those funds through the central bank reserve accounts back to the Bank of England, and so once more to the government, where the money in question is cancelled.

The representation is, of course simplified. It is very unlikely that each recipient will spend all the money that they have received with a single further recipient. Recipients 2, 3 and 4 can in this case be seen as typifying all the potential beneficiaries of the funds received by Recipient 1. Each of these might still, however, have taxation liabilities that will be settled.

It also need not be the case that no saving takes place until funds reach Recipient 4. There could be saving by each previous recipient, but this would only complicate the diagram.

Finally, it is, of course, the case that some funds might be saved with commercial banks or other entities, but this would then require that commercial bank created money be reflected in the diagram because it would then be commercial bank created money that would be redirected into savings with the government if, as the government always now does, it seeks to meet any deficits between its spending and taxation receipts by issuing bonds, Treasury Bills, or by attracting savings to NS&I.

These points having been made, the simplified diagram does represent the substance of the flows that are created by a single payment by the government to a recipient, for whatever reason it might arise.

The following points might then be made:

- As will be apparent, the tax generated by the government as a consequence of the payment that it makes is not restricted to the tax payment owing by the initial recipient. It is, instead, dependent upon the number of recipients of the net proceeds of the payment that there are until such time as those net proceeds are saved, and therefore taken out of circulation within the economy. Maximising the number of times that the net proceeds are spent increases the tax yield. The aim of the Taxing Wealth Report 2024 is, therefore, to keep those funds in use for as long as possible to increase the net tax recovery from the payment made in ways noted below.

- Increasing the tax rates on those who are most likely to save the net proceeds of the initial payment when they receive it, both at the time of that receipt and when they receive the income that they derive from doing so, provides some compensation for the failure of those persons to maintain the multiplier effect that might otherwise exist, and in the process provides compensatory tax yield because of their failure to pass those proceeds on within the active economy. This explains the desire in the Taxing Wealth Report 2024 to increase tax rates on savings.

- Reflecting these contrasting tax positions is one of the key underpinning economic logics of the Taxing Wealth Report 2024. By redistributing tax payments due from those on low pay to those on high pay the value of net proceeds circulated in the economy by those with high marginal propensities to spend (the lower paid, in other words) increases the likelihood that overall taxes payable as a result of government expenditure into the economy will eventually rise, whilst increasing taxes on those with high pay on both that income and their savings income is a recurring theme of the Taxing Wealth Report 2024 because doing so compensates for the low multiplier effect resulting from more of their income being saved.

- This chart might be relatively simple but it allows these essential points to be made.

- What the chart also makes clear is how a single payment can have impact much greater than is initially apparent. For example, assuming that each of the recipients noted on the diagram pays tax at an overall rate of 30% and the payments flow as indicated, and then assuming that the initial payment was of £100, the resulting flow of funds would be as follows:

Recipient	Government spend	Net receipt	Tax @ 30%	Net spend	Saved
	£	£	£	£	£
1	100.00		30.00	70.00	
2		70.00	21.00	49.00	
3		49.00	14.70	34.30	
4		34.30	10.29		24.01
Total	100.00	153.30	75.99	153.30	24.01
Aggregate totals		253.30	75.99	153.30	24.01
Tax + net spend + saved		253.30			

The total income recorded within the economy as a consequence of the initial expenditure of £100 by the government would be £253.30. Total tax paid will be £75.99 and the balance of the initial spend would be represented by £24.01 that would flowback into government sponsored savings products of one sort or another.

If it was then assumed that recipient 4 had a tax rate of 60% because they enjoyed a higher overall level of income that permitted them to save the entire proceeds of their labour, then the above noted table would change in the following way:

Recipient	Government spend	Net receipt	Tax @ 30% or 60% (recipient 4)	Net spend	Saved
	£	£	£	£	£
1	100.00		30.00	70.00	
2		70.00	21.00	49.00	
3		49.00	14.70	34.30	
4		34.30	20.58		13.72
Total	100.00	153.30	86.28	153.30	13.72
Aggregate totals		253.30	86.28	153.30	13.72
Tax + net spend + saved		253.30			

The tax paid by Recipient 4 would in this situation have doubled from £10.29 to £20.58, with a consequent reduction in their level of saving. Total tax paid would now have increased to £86.28 with the net balance of the initial £100 expenditure by government now being compensated for by reduced savings of £13.72. The scale of government borrowing is reduced as a consequence of the use of appropriate rate tax rates that reflect the relative incomes of the participants in this process.

Second diagram

The second diagram in this series is a simple variant on the first. The only change is in the use of Recipient 4's savings. Instead of these now going from Recipient 4's bank straight to National Savings and Investments or into a gilt holding which Recipient 4 then holds in their own name those funds are instead diverted into financial markets, where they are saved.

Bank of England
Spend - T1-T2-T3-T4
Government
Government
Spend - T1-T2-T3-T4
T1+T2+T3+T4
Spend
National savings or Debt Management Office of HM Treasury
Bank of England
Bank of England
Spend - T1-T2-T3-T4
T1+T2+T3+T4
Spend
Financia markets
Banks
Banks
Banks
T1+T2+T3+T4
Spend
Spend - T1-T2-T3-T4
HMRC
T1
Recipient 1
T4
T3
T2
Spend - T1
Recipient 4
Recipient 3
Recipient 2
Spend - T1-T2-T3
Spend - T1-T2

Key
Govermment spending
Consumer spending
Taxes paid
Savings
Money created
Money destroyed
Central bank reserve accounts with UK commercial banks

This then creates a situation where the government is short of cash flow, as it will not borrow on its Ways and Means Account with the Bank of England. As a consequence, an apparent dependency on financial markets on the part of the Debt Management Office of HM Treasury seems to be created as it appears from the flows credited by Recipient 4 that the Debt Management Office now needs to borrow from financial markets. It does not of course: it is only convention that demands that this borrowing take place. The diagram does, however, show that this borrowing does occur.

This diagram shows that:

- This borrowing from financial markets would not be necessary if the government, via the Debt Management Office, was willing to borrow direct from the public. As it is less than 0.2 per cent of UK government bonds are owned by the public, which makes almost no sense at all[318].
- The cost of government borrowing could be reduced if more use was made of direct borrowing from the public. NS&I pays less than Bank of England base rate on the accounts it provides, and less than the cost of gilt offerings in most cases. It could raise rates and still pay less than the cost of gilt offerings whilst being competitive in savings markets. To encourage the use of these accounts would, therefore, make complete sense.
- If the public held more gilts in their own names they would make a greater return than doing so via financial intermediaries who charge for arranging such holdings. It would be easy for the government to make this facility available, but it chooses not to do so.
- The myth of dependency in financial markets has, then, been created by governments: it is not true that it actually exists. Borrowing from financial markets is not necessary at all, and if borrowing is required there are other ways to secure funds.

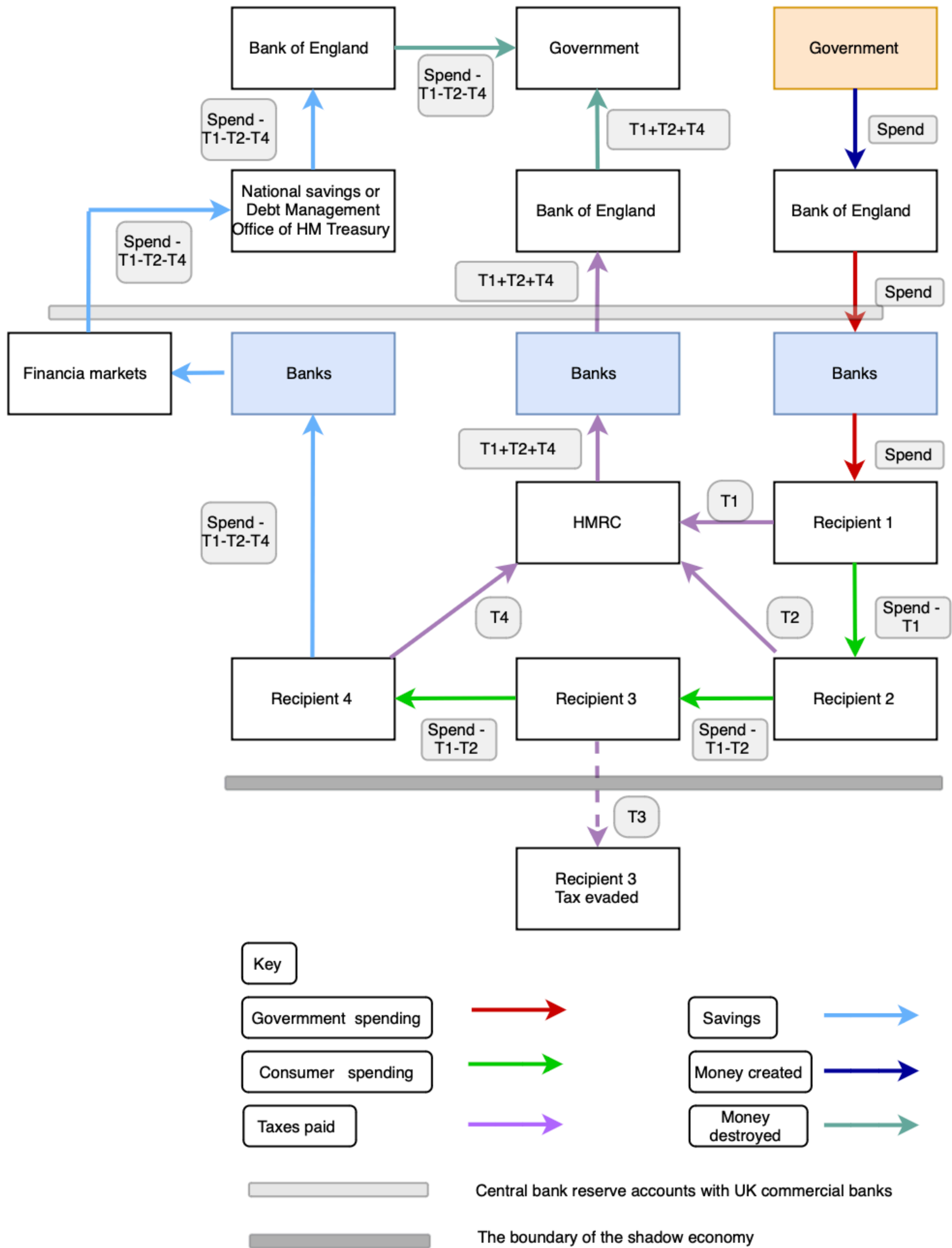
The obvious conclusion is that the government is not minimising the cost of its borrowing by structuring its borrowing as it does. As importantly, it is not borrowing in a way intended to suit the needs of those who wish to save securely within its own population. In the process it has created an economic myth about its dependency on financial markets. It is hard to avoid the feeling that this is deliberate.

Third diagram

The third diagram is a variant on the second, for convenience.

The change shown in this diagram is that the third recipient of funds, Recipient 3, does not pay their tax and instead diverts their income and the tax that should have been paid on it into the shadow economy, as it made clear at the bottom of the diagram:

[318] https://www.dmo.gov.uk/media/xl5bo4as/jul-sep-2023.pdf



This does not mean that the money T3 receives cannot be spent: much of it might well flow through a bank account in the seemingly legitimate economy e.g. T3 might be a company that appears to be appropriately trading but never declares that fact to HM Revenue &

Customs. They simply increase their own effective purchasing power by not paying the taxes that they owe. After all, why else would someone tax evade?

Their doing so means that Recipient 4 might receive more than they might have done as a result of T3 not paying their tax. It could be argued that the tax liability that Recipient 3 should have paid is simply passed on to be paid by Recipient 4 as a result, but that is not the case. If Recipient 3 received £49 (as noted in the example in the discussion on Diagram One) and should have paid £14.70 of tax on that, but did not, then Recipient 4 might receive £49 and pay tax of £14.70 but the tax that they would otherwise have paid of £10.29 on the net receipt that they should have enjoyed if T3 had settled their tax liability is lost, permanently.

The consequence of Recipient 3's tax evasion is that total tax paid is reduced and the sum saved by Recipient 4 is increased by the same amount, quite legitimately on their part.

Overall, however, the tax evasion leaves the government more exposed to borrowing if it wishes to balance its budgets.

Since 2010 HM Revenue & Customs suggest that the UK tax gap has totalled approximately £435 billion, assuming that the two most recent years for which estimates are not yet published continue to have tax gaps at the rate of the last published year[319]. The Office for Budget Responsibility has suggested that national debt over that same period has increased by about £1,450 billion[320]. In other words, almost exactly thirty per cent of all UK government borrowing over the period from 2010 to 2024 arose because of the failure to close the UK tax gap. Because of the weaknesses in the UK's tax gap estimates[321] the actual tax gap would be at least twice the amount that HM Revenue & Customs estimate. The evidence that large parts of the UK's national debt have arisen because of the failure to collect tax owing due to the underfunding of HM Revenue & Customs is very strong.

Fourth diagram

The fourth diagram in this series is based on the first diagram with the flows being expanded as follows:

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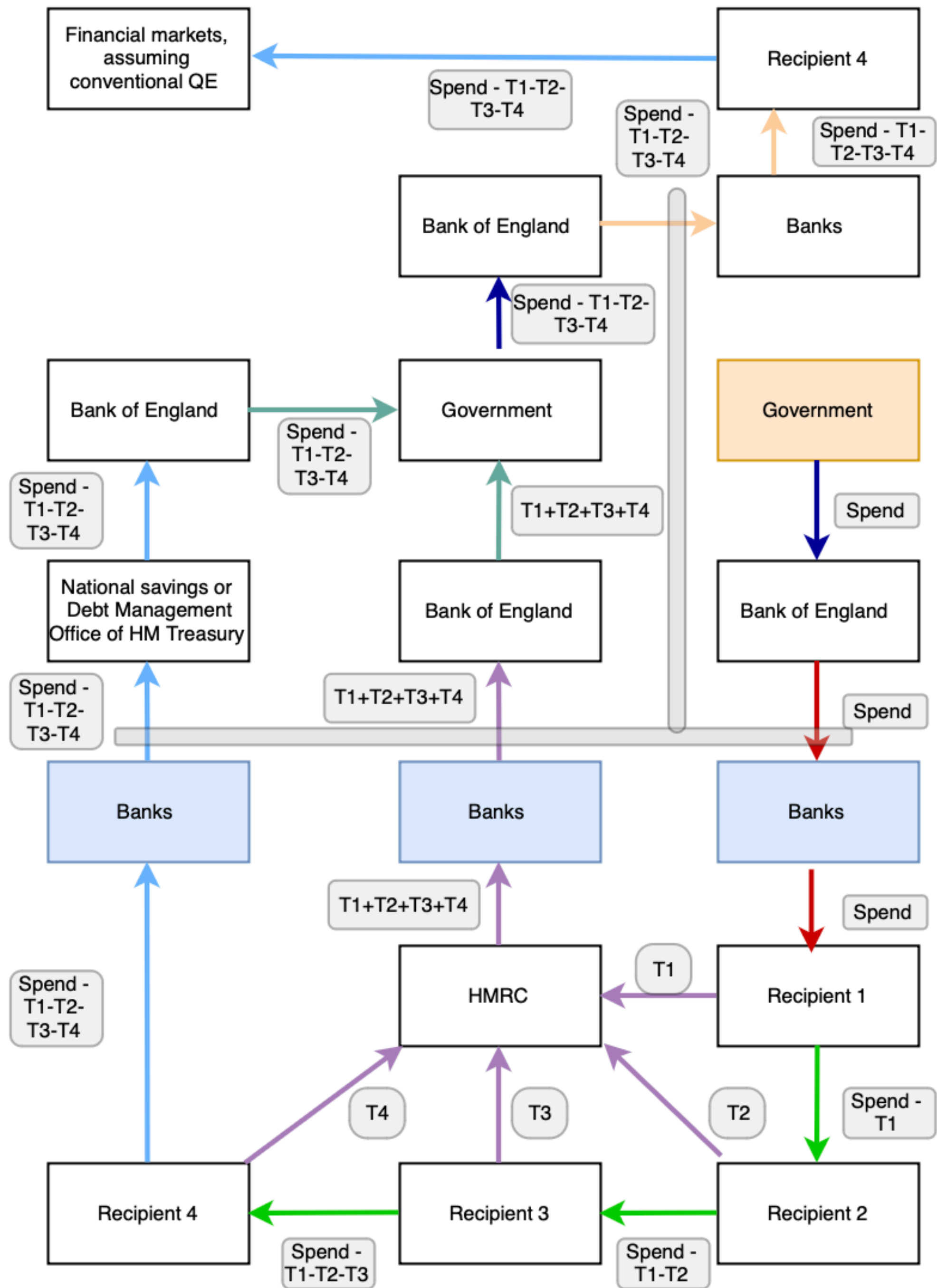
[319] https://www.gov.uk/government/statistics/measuring-tax-gaps/1-tax-gaps-summary

[320] https://obr.uk/download/public-finances-databank-november-2023/?tmstv=1707402181

[321] See https://taxingwealth.uk/2023/09/19/the-taxing-wealth-report-2024-the-uk-needs-better-estimation-of-its-tax-gap-to-prevent-the-illicit-accumulation-of-wealth/



Key

Govermment spending

Consumer spending

Taxes paid

Savings

QE

Money created

Money destroyed

Central bank reserve accounts with UK commercial banks

As should be apparent, except for four additional boxes at the top of the diagram, everything is much the same as in Diagram One. However, in this diagram it is assumed that quantitative easing (QE) is taking place. As a result, the government-backed products savings purchased by Recipient 4 in the previous diagram are now repurchased from them with new money created for that purpose. The Bank of England is effectively funded to do so by the Treasury, which has to give explicit consent for this action to take place[322]. The Bank of England then makes a payment to the commercial bank that Recipient 4 uses to settle this liability (as a result expanding the value of its central bank reserve account, with the grey line representing the boundary between base and commercial money that the central bank reserve accounts represent being extended to represent this transaction). Recipient 4, now being denied the opportunity to save with the government, which has effectively reduced the value of its product offering as a result of QE, has to instead save in the private sector financial markets, whose liquidity and value increases as a result, as was always the stated intention of QE.

The flows clearly suggest that QE:

- Reduces the value of government debt because that part previously owned by Recipient 4 is no longer available for sale, and is now owned by, and is effectively cancelled, by the government.
- QE has increased the liquidity of the financial sector, effectively by creating new reserves, which is what inflated central bank reserve accounts represent.

The sums saved in financial markets are treated as being outside the active economy shown at the bottom of the diagram because that is what the savings process does: it removes money from use in the active economy. As a result quantitative easing was largely used to fund speculation and not to fund useful economic activity in the UK economy, to its overall cost.

Fifth diagram

The fourth diagram can now be developed again in this fifth diagram of flows:

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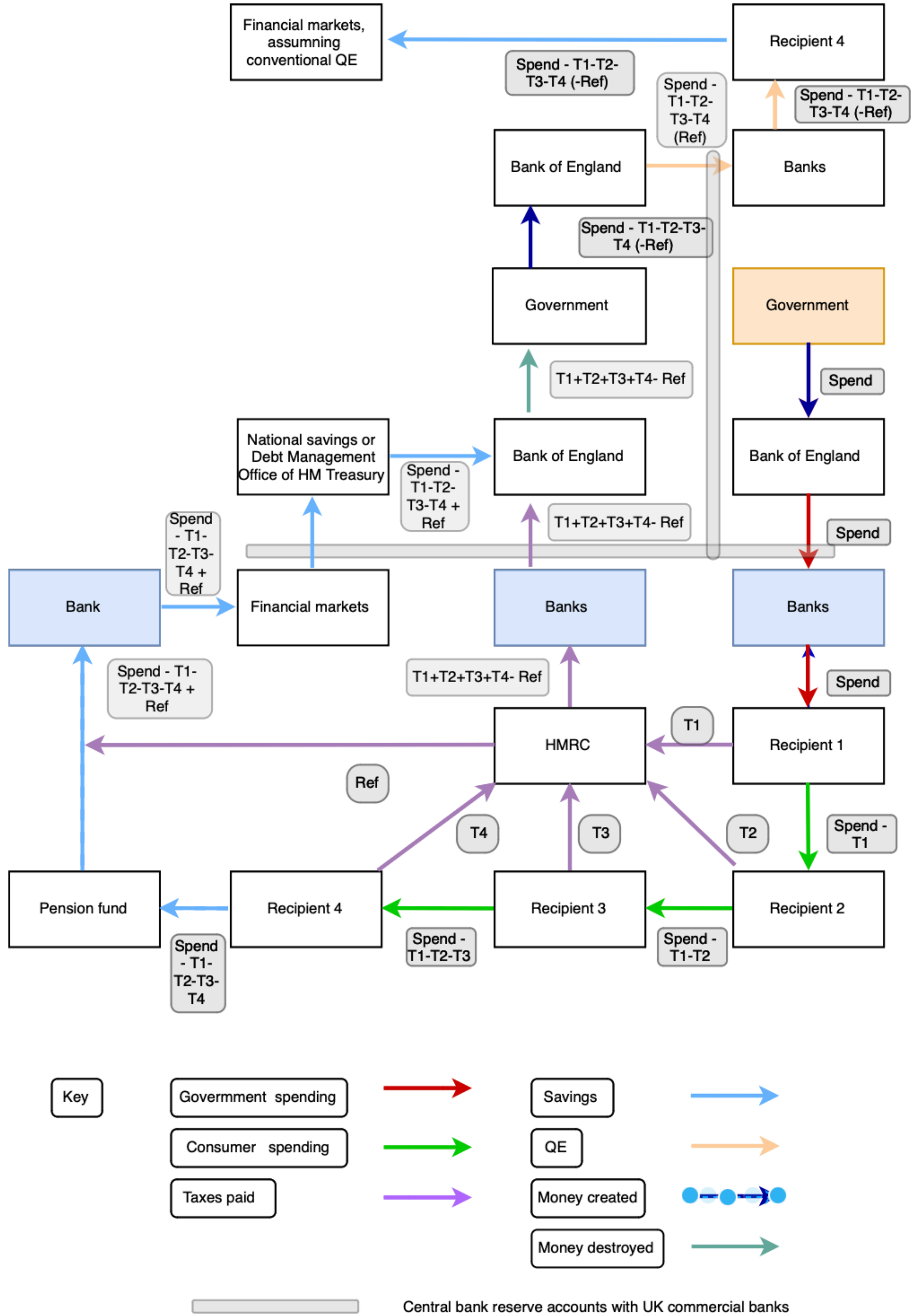
[322] See the letter establishing the Bank of England Asset Purchase Facility (APF) in which it was made clear that a) the Bank of England would act under direction from the Chancellor of the Exchequer and b) the Bank of England would be indemnified for any gains and losses that it made as a result of undertaking activity on behalf of HM Treasury and c) note the fact that as a consequence the accounts of the APF are not consolidated into those of the Bank of England because it is not a subsidiary under its control. https://www.bankofengland.co.uk/-/media/boe/files/letter/2009/chancellor-letter-290109



Financial markets, assumning conventional QE
Recipient 4
Spend - T1-T2-T3-T4 (-Ref)
Spend - T1-T2-T3-T4 (Ref)
Spend - T1-T2-T3-T4 (-Ref)
Bank of England
Banks
Spend - T1-T2-T3-T4 (-Ref)
Government
Government
T1+T2+T3+T4- Ref
Spend
National savings or Debt Management Office of HM Treasury
Bank of England
Bank of England
Spend - T1-T2-T3-T4 + Ref
T1+T2+T3+T4- Ref
Spend
Spend - T1-T2-T3-T4 + Ref
Bank
Financial markets
Banks
Banks
Spend - T1-T2-T3-T4 + Ref
T1+T2+T3+T4- Ref
Spend
HMRC
T1
Recipient 1
Ref
T4
T3
T2
Spend - T1
Pension fund
Recipient 4
Recipient 3
Recipient 2
Spend - T1-T2-T3-T4
Spend - T1-T2-T3
Spend - T1-T2
Key
Govermment spending
Savings
Consumer spending
QE
Taxes paid
Money created
Money destroyed
Central bank reserve accounts with UK commercial banks

What has been added to the diagram here are pension contributions. It is assumed that Recipient 4 now decides that instead of saving in government-based savings accounts (gilts, or NS&I products) that they will instead be motivated by the tax incentive that the government provides to them to save the net proceeds of the receipt that they enjoy into a tax approved pension arrangement.

The whole of the net proceeds that Recipient 4 enjoys are now shown as going to a pension fund rather than to a national savings product. However, because of the tax incentives provided for pension saving, HM Revenue & Customs now provides a refund of tax paid by Recipient 4 to the pension fund which flows with the contribution that Recipient 4 has made through a bank account and into financial markets, where it is saved. What is now apparent is that there are a number of costs to the government from this pension savings arrangement. One is, very clearly, that the cost of the tax refund made on the pension contribution reduces the tax flows from HM Revenue and Customs to the government via the Bank of England.

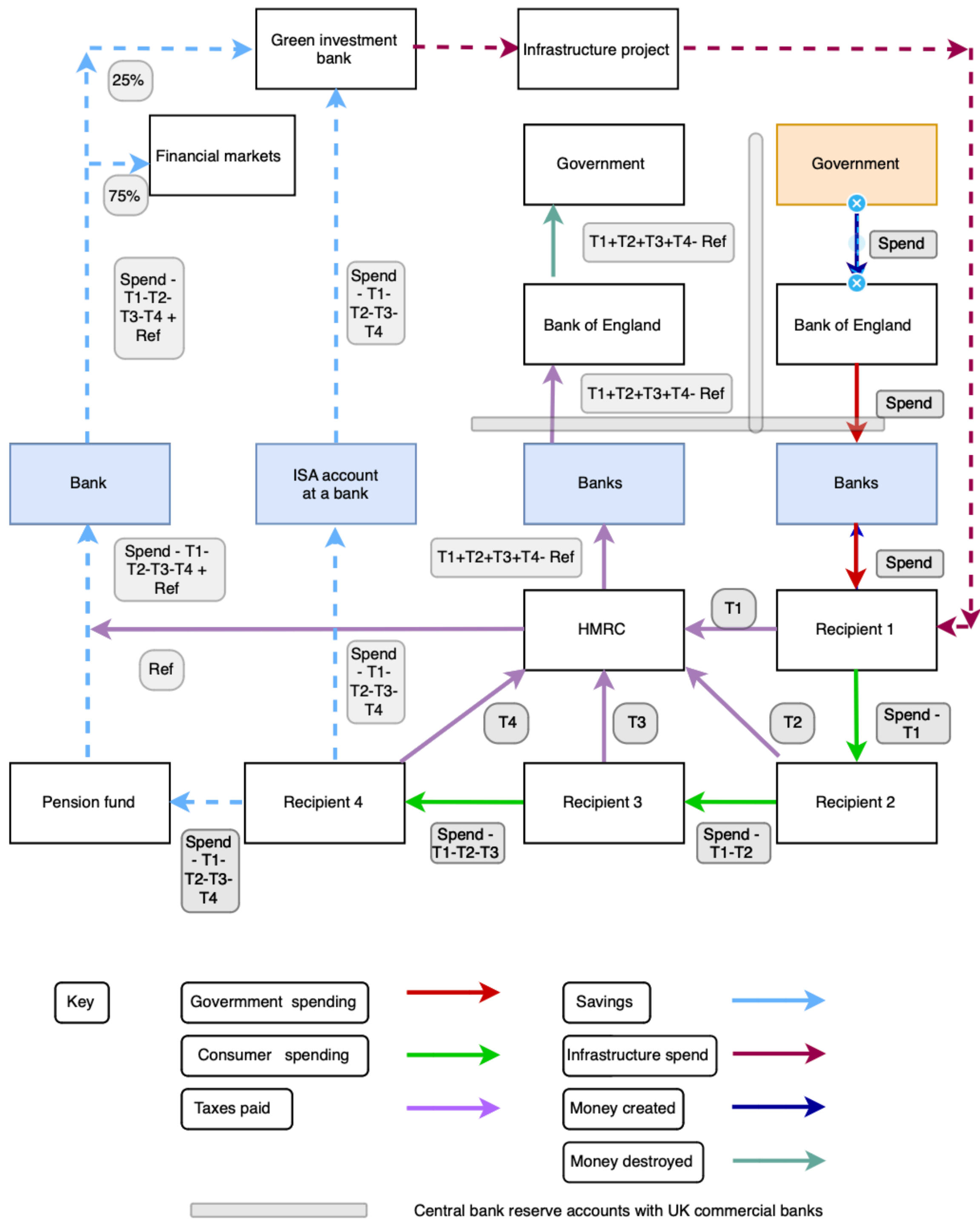
Another consequence is that savings previously held with the government are now held in financial markets. For convenience, it is assumed that these saved funds are then returned from financial markets to the Debt Management Office to be invested in gilts, so balancing the government's cash account, but what is clear is that these tax incentives are likely to reduce direct saving with the government in the way that they are offered at present. QE arrangements are still, however, shown as taking place. That is because these are not necessarily dependent upon repurchasing bonds issued to savers in the current period, but can be used to purchase bonds put into circulation in earlier periods.

The fundamental point made is, however, that this tax incentive provided to pensions is a subsidy to financial markets that can potentially impact the government's own financial position by reducing revenue and by reducing sums saved directly with it. The government is then forced to borrow the cost of the subsidy it has provided to financial markets back from those markets if it wishes to balance its cash flows, paying for the privilege of doing so. If the government thinks itself financially constrained this demonstrates the very real social cost of the £70 billion cost of this pension subsidy.

The cost of subsidies that have been provided to those savings in pension funds since 2010 have amounted to approximately £800 billion. The increase in the so-called national debt over that same period has been approximately £1,450 billion. Approximately fifty-five per cent of all government borrowing since 2010 has been necessitated by the cost of pension subsidies provided to those using such facilities, most of whom were already wealthy enough to save.

Sixth diagram

A final iteration of this diagram can be offered to explain some of the changes to the tax incentives for savings made in the Taxing Wealth Report 2024.



In this final diagram in this series, a number of new assumptions are made.

The first is that conventional quantitative easing has been cancelled, removing those parts of the diagram that referred to this.

Secondly, it is assumed that Recipient 4 now saves in one of two ways (or splits their saving in two ways: this need not be specific for the purposes of the diagram and explanation of it). Part is saved in a pension fund where, as is suggested in the Taxing Wealth Report 2024, twenty-five per cent is invested in a way that creates new infrastructure investment in the UK economy. For these purposes, it is assumed that these funds do not go to financial markets but do instead go to a green investment bank. Financial markets receive the remaining seventy-five per cent of the funds saved by Recipient 4, including their tax refund.

Thirdly, another part of Recipient 4's savings are placed in an ISA account at a bank, with those funds then being used by a green investment bank for the purposes of infrastructure investment in the UK economy, as again suggested as a requirement for ISA saving in the Taxing Wealth Report 2024.

As is apparent from the diagram, the changes to the required investment of funds saved if tax relief is to be enjoyed have a significant impact on the economy. Conventional saving, whether in cash or in traded financial products, has the effect of withdrawing funds from active use in the economy.

This is by definition the case when saving takes place in cash deposits, because they are never used to fund loans.

That is almost invariably the case with funds saved in financial markets because those markets very rarely provide new capital to businesses for investment purposes, but do instead trade assets already in existence, such as quoted shares already in circulation or buildings that have already been constructed. Funds saved in this way are, therefore, shown in this diagram as being removed from circulation in the active economy.

In contrast, funds saved in tax incentivised savings arrangements in the ways proposed in the Taxing Wealth Report 2024 are instead routed into new infrastructure projects, as the diagram makes clear.

In practice, although sums saved in ISA accounts do not enjoy the same tax benefits as pensions, meaning the total sum saved in an ISA by Recipient 4 is smaller than it would be in a pension because no immediate tax relief is received, because only part of pension savings are directed towards green and infrastructure investment and all of ISA savings are directed for use in that way in the recommendations made by the Taxing Wealth Report 2024, the

actual benefit to the economy from ISA savings might be greater than from pension savings if the recommendations in this report were followed.

The consequence of saved funds being used as capital for infrastructure investment is that additional spending has to take place into the economy to secure the service of those who will work on these projects. The precise sum involved cannot be known given the options available in the diagrammatic representation shown, and therefore dashed lines are used for these purposes. However, what is clear is that these funds when saved in this way return from the savings economy into the active economy as shown by the line on the right-hand side of the chart.

Recipient 1, which could just as easily be a company as an individual in this diagrammatic representation, sees their income rise as a result of the spending on new capital projects. As a result, the whole process of fiscal multipliers described when discussing Diagram One, above, begins all over again as a consequence of this new input into the economy, which has indirectly arisen as a consequence of the change to the rules on tax reliefs associated with savings products. As such, instead of those tax relief now being used as an effective subsidy to both wealth and the financial services industry, they are now instead being used to promote economic activity in the country that then generates wealth and income. Fiscal multiplier effects result that amplify that gain. These multiplier effects are not, however, shown separately in this diagram because it would become too complicated.

Conclusion

Subject to the obvious limitations required when simplifying a complex system into diagrammatic form, these diagrams do demonstrate a number of the key economic ideas that underpin the proposals made in the Taxing Wealth Report 2024, all of which have been designed with the intention of creating more and more socially beneficial economic activity within the economy.

For example, in Diagram One the particularly important point is the existence of multiplier effects. The normal representation, commonly made by politicians, is that government expenditure is the equivalent of money being poured into a black hole. Multiplier effects make clear that this not the case. That is because government expenditure is, as must always be the case within any macroeconomy, someone else's income. That income is then taxable, almost invariably creating an immediate return to government, which fact is also almost never referred to when discussion on the way in which government is to fund its spending takes place.

As that diagram also makes clear, in addition to expenditure by a government creating new income for its first recipient, on which taxes are paid, that recipient can then create additional

income for other people as they, in turn, spend the net proceeds that they have received after making settlement of the tax that they owe. This process then continues until saving takes place, which process of saving stops the multiplier effect working any further, assuming that the funds saved are then deposited in savings mechanisms that do not give rise to new investment activity.

That said, if that saving is in a government sponsored account then that return of funds to the government, which is what saving in this way does, achieves the apparent holy grail of government funding, which is of it balancing its cash flow, with tax receipts and borrowing equating to tax spending. The apparent benefit of saving in government sponsored accounts, which is sometimes called funding the national debt, is demonstrated as a result. If those accounts are in use, and properly promoted, no government should ever be able to claim that its books do not balance.

The second and subsequent diagrams expand this basic idea to consider various commonplace aspects of current government financing.

Diagram Two demonstrates that there is a cost to both the government and savers as a result of the government not encouraging people to save directly with it. Savers pay fees to financial market participants when they could avoid these by saving directly. The government, by not appropriately promoting National Savings and Investments (NS&I) might well pay too much for its borrowing. At the same time a myth of market dependency is created. None of this makes sense.

Diagram Three makes clear that there is a very real cost to then government from tax abuse. Since 2010 this might have amounted to £435 billion, or thirty per cent of total government borrowing over that period. Given that the tax gap is likely to be considerably underestimated by HM Revenue & Customs, this cost might be much higher than that. Failing to invest in HM Revenue & Customs directly fuels the growth of government borrowing. Again, this makes no sense.

Diagram Four considers the consequences of quantitative easing. What it shows are three things.

The first is that when quantitative easing is in use it does, in effect, deny consumers the choice of saving in government sponsored savings facilities, with them being forced instead to use alternative commercially available accounts. This is sub-optimal when it is known that cash-based deposits with banks do not fund loans, and therefore do not create new investment in the economy, whilst financial market based saving is almost entirely related to speculative activity, and not new capital creation. As such, this diversion of funds denies funding to the active economy.

Simultaneously, and secondly, because governments-based savings accounts are withdrawn from the economy, pressure from the supposed incurrence of government cash-flow deficits arises as a result. New money must necessarily be injected into the economy as a consequence, which is represented by an inflation in the central bank reserve accounts. These sums are then, in turn, reflected in an increase in savings in financial services sector savings accounts, with all the consequences noted above. Given that interest is paid on the central bank reserve account balances this does not make sense.

Thirdly, although it is not explicit within the diagram, the obvious conclusion can be drawn that if it is desirable to increase the quantity of government created money in the economy, and there have clearly been occasions when that is the case, doing so by increasing direct spending into the economy without seeking to recover those sums, at least for a period of time, through taxation would be a much more direct and effective method of doing so as this boosts the active economy in a way that boosting financial services sector saving does not. The government should run an overdraft with its central bank as part of fiscal policy, in other words, and avoid quantitative easing as a result.

Diagram Five incorporates pension saving into the flows. This is appropriate because the cost of subsidising these savings in tax terms might be around £70 billion a year according to the analysis presented in the Taxing Wealth Report 2024. Given this exceptional cost it is important to understand the consequences of this, which Diagram Five demonstrates.

The consequence of this subsidy is that pension savings and the additional tax refunds provided to boost them by the government flow out of the active economy and into the financial services sector where these funds are lost from use in that active economy for the reasons noted above. As a consequence, the government does either have to seek savings from the financial services sector to balance its cash flows, which makes no sense when it would be much better for those savings to be placed with it individually by those whom that sector serves, or it has to run increased cash flow deficits, which it will not do. The result is that this tax subsidised diversion of savings from the government to the financial services sector, coupled with the government's own illogical refusal to run an overdraft in its Ways and Means Account with the Bank of England, creates the appearance of the dependence by the government on funding from the City of London when no such dependence exists.

Since 2010 it is likely that the total cost of tax subsidies to pensions, and so to the financial services sector of the economy, has amounted to approximately £800 billion whilst so-called government debt has grown by £1,450 billion. The relationship between the two is not coincidental.

Finally, Diagram Six looks at what might happen if the government was to reform the tax reliefs associated with both ISA and pension savings as recommended in the Taxing Wealth

Report 2024. It demonstrates that if the tax relief made available to subsidise savings had conditions attached to them so that some (in the case of pension savings) and all (in the case of ISA savings) were required to be used to provide capital for investment in new infrastructure projects supporting a climate transition then significant sums, which the TWR suggests could be more than £100 billion a year, could be made available for this purpose, with those funds then being returned from savings into the active economy where they would begin the process of creating fiscal multipliers all over again.

In other words, this simple change to the tax incentives attached to savings could fundamentally alter the funding available to tackle climate change in the UK whilst simultaneously providing a strong positive fiscal multiplier effect from doing so, which the current tax relief does not. In fact, current tax reliefs have a negative multiplier effect in this regard, because they result in the withdrawal of funds from use in the active economy by diverting them into financial speculation or cash deposits, neither of which result in new capital formation. It is for these reasons that these changes to the tax rules associated with savings products are promoted in the Taxing Wealth Report 2024.

Putting these various points together, what the Taxing Wealth Report 2024 seeks to do is:

- Maximise the fiscal multiplier effects resulting from government spending of new funds into the economy.

- Maximise the fiscal multiplier effects arising from the best choice of tax rates, meaning that those on low incomes should have low overall effective tax rates and that those on high incomes should have higher overall tax rates, which delivers this outcome.

- Provide reason why the government should encourage more direct saving in the savings products that it makes available for this purpose that are usually collectively called the national debt, but which might be better described as national savings.

- Explain the cost of tax abuse to the government in terms of excess borrowing that it has to take on as a result, which has amounted to not less than £435 billon since 2010.

- Demonstrate the cost to the government of pension saving subsidies that might have cost £800 billion since 2010, or fifty-five per cent of the so-called national debt incurred in that period.

- Maximise the fiscal multiplier effects from saving so that new investment can be generated from this activity which has not been the case for many decades in the UK, with a resultant boost to our economy, employment, and growth as well as to the

creation of the capital infrastructure needed to address climate change and other social issues in the UK.

Chapter 17

Next Steps

What the Taxing Wealth Report 2024 has not done, and what might happen next

Introduction

The Taxing Wealth Report 2024 set out with a very specific objective to fulfil. It sought to demonstrate that any government that wished to transform the delivery of public services in the UK and, if it wished, fund necessary investment in the net–zero transition that the UK must undergo over coming decades could find the necessary funds to do so if it was willing to transform the taxation of those with wealth in the UK. It has achieved both those goals and has done so based upon the self-imposed constraint of not considering the creation of new taxes, like land value taxation or wealth taxes. Instead, for reasons of political pragmatism, it was decided to only propose reforms of existing UK taxes, tax reliefs, and allowances.

Given the limitations of this self-imposed remit, the suggested levels of potential funds that might be raised or substantial. It is suggested that maybe £90 billion worth of additional taxes could be raised. The incidence of these additional taxes would fall almost entirely on those in the top decile, or less, of income owners in the UK.

In addition, by proposing reforms to the use of funds saved in tax incentivised arrangements such as ISAs and pension funds, it is suggested that more than £100 billion of additional saved funds could be made of available to provide the capital for investment in the UK's net–zero transition. In combination, these sums exceed the £170 billion per annum by which the Taxing Wealth Report 2024 suggests that wealth is undertaxed each year in the UK at present[323].

All this being aid, there are things that the Taxing Wealth Report 2024 has not done. In particular, there are existing taxes in the UK that looking increasingly unfit for purpose. If further work to expand the Taxing Wealth Report 2024 was undertaken in the future, then considering the replacement of these outdated taxes would be high on the list of priorities.

[323] https://taxingwealth.uk/2023/09/06/wealth-is-undertaxed-by-170-billion-a-year-in-the-uk/

The following possibilities have not been considered in the Taxing Wealth Report 2024 but are noted as areas for future tax reform. They suggest that this work is not finished as yet.

National insurance

National insurance is now an outdated tax. It was created more than a century ago by a pre-First World War government that wished to create an improved social contract between the people of the UK and its government that had an implicit insurance element within it. The promise made was that those who reached the state retirement age would thereafter receive a pension sufficient for them to live upon when they could no longer work. The arrangement was intended to be self-funding.

National insurance was substantially expanded after World War II as a result of the state's social contract being expanded to offer enhanced unemployment and other benefits so that the destitution of the 1930s would not be revisited, with an additional offer of free healthcare from cradle to grave also being supposedly provided in exchange for national insurance contributions.

In practice, national insurance long ago ceased to provide all the funding required to honour these commitments, and it is now no more than another tax. As the Taxing Wealth Report 2024 has made clear, the remaining implicit social contract between the government and those in work inherent in that contract is now deeply problematic. That is not least because the basis of charging means that those who earn their income from investments, rents and other such sources do not contribute to the well-being of society in the way that those who work for a living do but they can still secure at least some of the benefits might arise despite that fact. The consequence is some particularly unjust features of the UK tax system. Perhaps even worse, this tax undermines the incentive for anyone to provide employment and so to deliver the fundamental goal of full employment that almost every government since 1945 has sought to achieve.

Many people have suggested that this problem can be overcome by merging the income tax and national insurance systems in the UK. There are, however, many problems that might arise from doing so, including some very high income tax rates compared to other countries. There would also be difficulties in finding an appropriate basis for taxation for those in retirement who do not pay national insurance contributions at present. Unsurprisingly, the many attempts to find a way to merge these two taxes have failed as a result.

Something much more radical is needed as a consequence if the substantial revenues raised by national insurance contributions (£176.9 billion in the 2022/23 tax year) are to be replaced in a way that is just and equitable and, as a result, progressive. There is a need for a progressive indirect tax as a consequence.

The most likely option available is a tax that is only now technically feasible, which would be a financial transaction tax on all flows through UK sterling bank accounts whether owned by individuals or companies, and maybe even charities and other such organisations.

To make this tax fair, the charge should start at a very low rate and remain at that level until at least UK median earnings were likely to be enjoyed, whereafter the rate should increase progressively. Arrangements to make sure that charges on transfers between accounts under common control e.g. a person's current, deposit, mortgage, loan and credit card accounts, and maybe between a person and other members of their family, would be necessary to prevent unfair charges. The same might also be true within groups of companies.

The rate of this tax, which would be on all flows including those relating to savings and investments except as noted above, would be set to ensure that those with limited financial resources would pay no more, and quite possibly less, than they do at present in national insurance. When it comes to companies, this charge might represent a turnover tax, intentionally reflecting the cost that their activities impose upon society, to which they should make an appropriate contribution. These sums would replace the employer's national insurance charge. It is likely that this would most likely favour those who employ large numbers of people since part of the overall employer's national insurance liability might then pass to those who generate their incomes without providing the social benefit of employment. This also addresses some of the problems arising from AI and the increasing use of robots in the economy.

Further details of this proposed radical tax reform that would need considerable work to develop were as a result outside the scope of the Taxing Wealth Report 2024.

Council tax

As the section of the Taxing Wealth Report 2024 on council taxation makes clear, the current council tax in the UK provides little opportunity for radical reform, or for the raising of additional tax revenues because there are far too few high valued properties for any such reform to have any significant impact on the future funding of local authorities in this country.

That said, any system of local taxation within the UK is inherently difficult because of the considerable variation in population density throughout the country as well as the enormous variations in both income and wealth between the UK's regions and countries. These variations necessarily require that those parts of the UK that are affluent must raise taxation revenues in excess of local need for redistribution to those parts with below average incomes

and wealth, and this necessarily undermines the scale of local autonomy that might be attainable by any local, devolved or regional government in the UK.

It is exceptionally unlikely that land values taxation could overcome these problems. That tax, which makes a charge on the deemed rental value of land, whether it is in use or not, has considerable problems inherent within it, including the fact that rental value does almost invariably reflect local levels of income since rents must be paid out of them. The problems noted above are, therefore, replicated in this form of taxation and mechanisms to address these deficiencies would, therefore, still be required.

Any mechanism for creating greater local governments fiscal autonomy must, therefore, be more broadly based than the apparent fiscal constraints of local taxation might imply. This necessarily means that instead of the debate on local government financing concentrating on local taxation alone, it must also consider:

- Which parts of government services should be devolved to local authority control whilst giving those local authorities some degree of flexibility in deciding on the relative priority of these matters in their local area.

- Ways in which the central government macroeconomic requirement to tax government-created money out of circulation can be reconciled with a desire that local governments have autonomy with regard to the provision of services in the area for which they are responsible. This might require that a fixed proportion of total government spending be passed to local control without a locally based capacity to raise revenue being required.

- That capital expenditure budgets, and mechanisms to borrow to fund such expenditure, be devolved to local governments. This would also require that the necessary apportionment of responsibility for servicing debt be agreed upon. However, to provide long term stability to local government investment programmes constraints that might otherwise be created on local authorities as a consequence of central government macroeconomic monetary policy will need to be resolved. This might necessarily require the supply of long-term credit to local governments from central government at fixed rates, with central government then assuming the responsibility for varying interest rate risk.

- Enhanced mechanisms for the accountability of local government both within authorities themselves, and to those who elect them, as well as to central government. All of these mechanisms must be capable of comprehension by lay persons given that they are the people most likely to be elected as local politicians.

- Arrangements for the delivery of minimum service guarantees by local authorities might be necessary.

As is apparent, these are complex issues and that is why this topic could not be addressed within the scope of the Taxing Wealth Report 2024.

Inheritance and wealth taxes

As the Taxing Wealth Report 2024 has made clear, wealth taxes always look to be attractive in theory. However, as any experienced tax practitioner might confirm, the reality is that agreeing asset valuations for taxation purposes in the absence of actual market data is complicated, time-consuming, expensive and the subject of extensive negotiation with HM Revenue & Customs before agreement is reached. Any wealth tax would necessarily require vast numbers of these negotiations be entered into on a recurring basis, many of them being required only to prove that a person did not have a wealth tax liability. This would, as a consequence, be a hopelessly inefficient, and potentially unjust, basis for imposing a tax charge. That is why the Taxing Wealth Report 2024 has placed so much focus on securing better taxation of the income and gains arising from wealth instead of on taxing wealth itself. These complications would continue if a wealth tax was to become a regular and recurring tax and as such the likelihood of a successful wealth tax being introduced is extremely low, however politically attractive such a tax might look to be to some.

As is noted in the Taxing Wealth Report 2024, the only approximation to a wealth tax that the UK currently has, which is its inheritance tax, is supposedly the most unpopular tax in the UK. This is hard to understand when only 4% of all estates of people dying in the UK are likely to be subject to it at present, but the media persists with this view.

As the Taxing Wealth Report 2024 makes clear, this tax could not only be made significantly more progressive than it is at present by re-organising the rates at which is charged, but some of the major reliefs and exemptions available within it, particularly with regard to business and agricultural property and some other forms of preferred gifts, could be significantly reformed, closing in the process many of the loopholes currently largely exploited by those with significant wealth.

That being noted, thereafter and in the necessary absence of a wealth tax, inheritance tax needs to be subject to further reforms that have not been the subject of consideration within the Taxing Wealth Report 2024 because of the likely time that it would take for such reforms to be implemented.

The first of these reforms would be to extend the time period prior to death during which an inheritance tax charge might apply. There would be an increase in tax justice if this were to be done.

A second reform would be to look through the trust arrangements that are now used by the wealthiest people in the UK to avoid inheritance tax charges. Many of these arrangements will have been in place for a considerable period of time. That only adds to the offence taken by many at the use of these arrangements since they have contributed to the massive inequalities in wealth in the UK that still exist. To achieve this goal a system of attributing the ownership of property within trusts to real people resident in the UK will be essential so that they might be taxed on the disposal of these assets. This will take time to both develop and be implemented.

Finally, a system of inheritance tax discounts might be appropriate if estates were more widely distributed rather than being concentrated in the hands of one or only a few beneficiaries at the time of a person's death. This would have the advantage of making inheritance tax behave in a fashion akin to a gifts receipt tax when the latter is very unlikely to work in practice (even if it is, once again, an excellent idea in theory) by diversifying the ownership of wealth in the UK.

More work is required on these issues and as a result they have not been addressed in the

Value added tax

The Taxing Wealth Report 2024 has considered problems inherent in some of the tax reliefs, exemptions and allowances permitted within this tax, but has not addressed all the remaining biases and distortions that it can create within the UK economy, particularly when some of those allowances and exemptions are exceptionally poorly focused. Addressing these issues requires much more work than was possible within the scope of the Taxing Wealth Report 2024, particularly when it comes to integration of any proposed changes with reform of the benefits system which might well prove to be necessary if the Scandinavian approach to this issue is considered. Consideration of these issues was, as a consequence, necessarily deferred.

Integration with the benefits system

One of the highest goals for any taxation system would be the creation of a seamless transition between taxation and benefits, meaning that these two systems could be fully integrated so that a person might move without economic stress arising between being a taxpayer and the recipient of benefits dependent upon their level of income and personal circumstances.

In reality, no practical method for achieving this goal has yet been identified, nor have any of the mechanisms intended to overcome these integration problems, such as the payment of a universal basic income, offered methods of integration that do not in themselves create significant impediments to the effective operation of the overall tax system. In that particular case, the requirement that considerably higher rates of income tax than are currently commonplace in the UK or any comparable country if a genuine basic income were to be paid would be a major impediment to progress.

Because of the complexity of this process of integration, no attempt to address it has been made within the Taxing Wealth Report 2024. If this work was to be extended it would, however, be necessary to consider these issues.