IPPR

TAXING TIMES

WHERE MIGHT ADDITIONAL TAX REVENUES BE FOUND?

REPORT

Amna Silim

December 2013

Institute for Public Policy Research

ABOUT THE AUTHOR

Amna Silim is a research fellow at IPPR.

ACKNOWLEDGMENTS

The author would like to thank Tony Dolphin for his help with the research and drafting of this report.

ABOUT IPPR

IPPR, the Institute for Public Policy Research, is the UK's leading progressive thinktank. We are an independent charitable organisation with more than 40 staff members, paid interns and visiting fellows. Our main office is in London, with IPPR North, IPPR's dedicated thinktank for the North of England, operating out of offices in Newcastle and Manchester.

The purpose of our work is to assist all those who want to create a society where every citizen lives a decent and fulfilled life, in reciprocal relationships with the people they care about. We believe that a society of this sort cannot be legislated for or guaranteed by the state. And it certainly won't be achieved by markets alone. It requires people to act together and take responsibility for themselves and each other.

IPPR
4th Floor
14 Buckingham Street
London WC2N 6DF
T: +44 (0)20 7470 6100
E: info@ippr.org
www.ippr.org
Registered charity no. 800065

IDEAS to
CHANGE POLICY

CONTENTS

EXECUTIVE SUMMARY

There are three reasons for thinking about where the next UK government might be able to find additional tax revenues:

1. More measures to cut the fiscal deficit will be required between 2015 and 2020. If the 80:20 ratio of spending cuts to tax increases that has applied in the current parliament is to be extended into the next one, there will have to be some discretionary tax increases.
2. All political parties want to reduce some taxes. For example, both the Conservatives and the Liberal Democrats are likely to pledge to increase the personal tax allowance from £10,000 to £12,500. This will require offsetting tax increases.
3. There are long-term demographic pressures on public spending. If we want to retain current levels of provision of health and social care for older people, revenues will have to increase to pay for them. The alternative is a significant rundown in the quality of public services in the UK in coming decades.

A comparison of tax systems across OECD countries shows that the UK is a fairly average country when it comes to taxation. There are many other economically successful countries – in particular in Scandinavia – that have a significantly higher tax to GDP ratio; but also countries that have a lower ratio. For those looking for potential sources of additional tax revenues, there are no easy solutions to be found in other countries. There are, however, some pointers as to where to start, particularly with the aim of increasing revenues in a progressive way and without causing economic damage.

Broadly, the next government will have three options if it wants to increase tax revenues in some areas:

1. **Less unpopular taxes**: A common means of raising additional revenues historically has been failing to index personal tax allowances (known as 'fiscal drag'). The Coalition's focus on the personal tax allowance has probably removed this option, but other allowances, for example for inheritance tax, have been frozen. Similar measures could be pursued. Additionally, although most taxes are unpopular, there are some that are likely to prove less unpopular, such as a mansion tax – a large proportion of which would be paid by rich foreigners – and a tax on bankers' bonuses. The problem with these taxes, however, is that individually they do not raise vast sums.
2. **Mainstream taxes**: The simplest way to raise additional tax revenues is to increase the tax rates of the main revenue sources: VAT and income tax/NICs. This is seen as politically difficult – particularly for income tax – but it is not impossible. Labour governments increased the NICs rate and the Coalition put up VAT. Reform of council tax, which no government has dared to attempt, could also be a revenue-raiser if, for example, more bands were introduced. If additional revenues are needed in the long-term, and increasing these taxes is judged to be necessary, linking higher taxes to additional resources for the NHS to care for the elderly might be one way of softening the blow.
3. **New taxes**: If less unpopular taxes do not raise sufficient revenues and higher mainstream taxes are ruled out by political considerations, then future governments might have to look to new taxes for additional revenues. These could include a minimum tax, a general wealth tax (wealth is generally taxed relatively lightly), a land value tax or a financial transactions tax.

Higher taxes are not inevitable. The Office for Budget Responsibility might decide that less deficit reduction is required in the next parliament; politicians might decide that they do not want to raise additional revenues from some sources to allow them to reduce the tax take elsewhere or to increase spending; and productivity gains in public services might accelerate sufficiently to offset the mounting demographic pressures on public spending. But none of these outcomes seems particularly likely. At some point, the next government will probably want to find some additional tax revenues. Without making recommendations, this report provides some pointers as to where they might look.

1. INTRODUCTION

In his first budget, George Osborne announced an increase in the main rate of VAT from 17.5 to 20 per cent. Since then, however, the bulk of fiscal consolidation in the UK has been achieved by public spending cuts and the same is true for plans for the next two years. The result is that over the course of the current parliament 80 per cent of deficit reduction will be due to cuts in public spending and 20 per cent due to revenue increases.

Fiscal consolidation is expected to continue well into the next parliament, with the Conservatives pledging to target a budget surplus by 2020. Although other parties might not follow suit, they will be under pressure to make clear before the election by how much they would cut the deficit. Current plans envisage the vast bulk of deficit reduction after 2015 being implemented through cuts in public spending, but this would require swingeing cuts in welfare spending or even larger real-terms annual reductions in departmental spending than in the current parliament. Alternatively, the next government might decide that to ease these pressures it will seek to maintain the 80:20 split between public spending cuts and tax rises that has applied in the current parliament. Moving back to an 80:20 split will require at least £6 billion in tax rises.[1]

In addition, the next government is likely to want to reduce taxes elsewhere. To do so will require raising additional revenues in other areas. Both the Conservatives and the Liberal Democrats have recently sought to take credit for the decision to increase the personal tax allowance to £10,000 in the current parliament and have dropped heavy hints that in the next parliament they would want to increase it further to £12,500. This would have to be financed somehow. Meanwhile, the Labour party leadership has pledged to reintroduce the 10p personal tax rate, funded by the introduction of a mansion tax.

There are also long-term pressures. Tax revenues and social security contributions determine the extent of public sector investment and the generosity of welfare benefits. Fiscal sustainability, according to the Office for Budget Responsibility (OBR), is determined by whether future tax revenues will be sufficient to account for future spending – both historical and future government activities (OBR 2013). As the pressure on public spending intensifies in coming years for a number of reasons, not least the ageing of the population, it will be crucial for the next government to consider the long-term sustainability of its tax base. Demographic and other pressures mean the current level of social provision cannot be maintained without the spending to GDP ratio – and so the tax revenue to GDP ratio – increasing. But the OBR's long-term projections show falling revenues (relative to GDP) from North Sea production and as a result of decarbonisation initiatives, so alternative (or higher) taxes will be needed just to preserve the current level of spending. The alternative would be a substantial deterioration in the quality of public services, not just for older people but across the board.

This report compares the UK's tax system and structure with those of other OECD countries to inform the debate about how the next government might raise additional revenues in the short term – to help with deficit reduction and to allow tax cuts or specific spending increases – and in the long term to match likely trend increases in public spending. It does so while keeping in mind the desirable features of any tax system: that it should be efficient; progressive; support a growing economy by minimising disincentives to work; be relatively resilient to shocks; and help to correct market failures, for example around carbon emissions.

1 http://www.ifs.org.uk/budgets/sr2013/paul_johnson.pdf

Chapter 2 of this report provides a comparative study of tax regimes in a number of countries, particularly across Europe, to identify where UK taxation is relatively heavy and relatively light. Chapter 3 sets out tax trends in the UK to show how the system has developed and looks at key reforms since the second world war. Based on the results of this comparative work and overview of the UK's tax trends, the final chapter sets out how the UK's tax regime could be changed so that some of the burden of deficit reduction in the next parliament can be taken by increased revenues, to allow shifts in sources of revenue and to finance current levels of social provision over the long term.

2. INTERNATIONAL COMPARISONS

In this section we present a comparative analysis of tax ratios and the tax mix across developed economies. We compare the overall level of revenues relative to GDP; the distribution of taxation by type, such as income taxes, wealth taxes, taxes on businesses; and the rates of taxation applied, in particular on personal income. Our aim is to identify where UK taxation falls relatively heavily or lightly.

The level of tax revenues in any particular country is a democratic choice, related to the desired level of investment in public services and the generosity of social security payments. Many European countries, including Scandinavian countries, have opted for an economic model that involves a relatively high level of public spending and tax and social security revenues; whereas countries like the US choose to have smaller public sectors and more private provision of services, such as healthcare. In terms of economic efficiency, there is no evidence to suggest either model is superior. Outperforming and underperforming countries, in terms of long-term growth in GDP per head, can, for example, be found among high-tax and low-tax countries.

Tax as a percentage of GDP

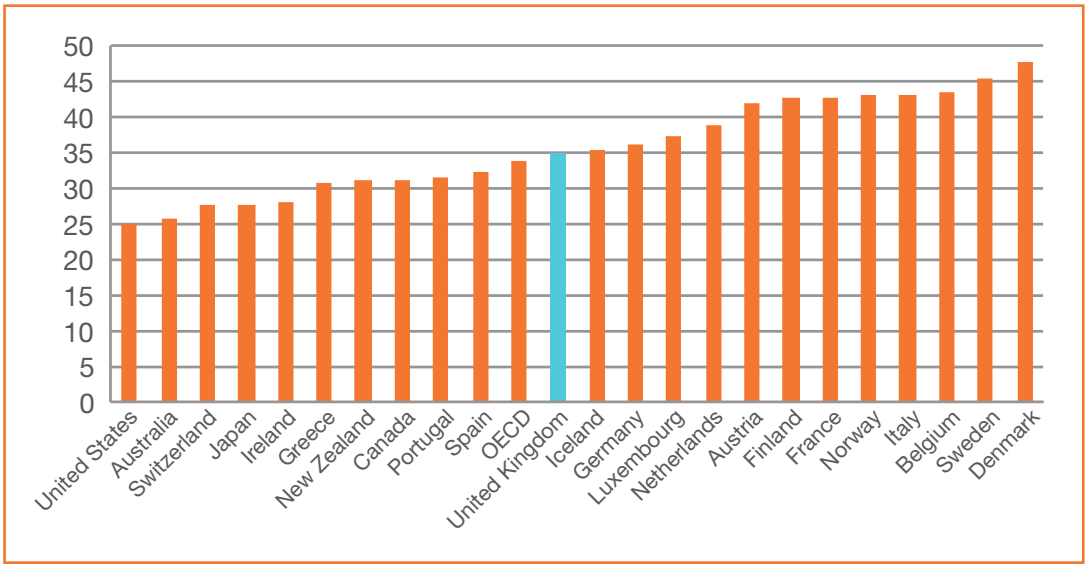
In the short term, tax fluctuates for a number of reasons. The main determinants of tax revenue include the level of economic activity – which affects employment and consumption levels – and fiscal policy – which determines tax rates and the tax base. The impact of these determinants was exemplified during the recent financial crisis and recession when fiscal policy and the drop in output had an impact on revenues. The impact of the 2008–09 recession and the government response was first seen in 2008 revenues and created a large gap in the public finances, pushing up spending and lowering total receipts. Between 2008 and 2011, the ratio of tax revenues to GDP fell from 39.3 per cent to 38.3 per cent of GDP across the EU. However, by 2011 absolute tax revenues were back to pre-crisis levels (EC 2013).

In 2010 the average tax ratio for the OECD (tax relative to GDP) was 34 per cent, roughly equivalent to the UK's rate (see figure 2.1). In comparison, the EU-27 average is higher at 38.8 per cent of GDP. The tax level for the EU-27 is higher than for most advanced countries outside the EU. The UK ranks 13th across the EU, and holds the same position among OECD countries (ibid).

These averages mask great variation in the tax ratio across the OECD and the EU. High-tax countries are mainly the Nordic economies, Austria, France, Italy and Belgium; all have tax to GDP ratios higher than 40 per cent of GDP. Denmark and Sweden have the highest tax to GDP ratios, with ratios greater than 45 per cent (EC 2013). In contrast, five OECD countries had tax ratios below 30 per cent, including the US with the lowest tax ratio among OECD countries at 25 per cent (Brys et al 2011). Differences in tax ratios across countries are largely determined by differing social policies, for example whether the state or the private sector provides certain services such as education, childcare, and healthcare, or whether the state uses tax deductions or government spending to support those on low incomes (EC 2013). Additionally, whether social transfers are subject to taxation is also a factor in determining the size of the tax to GDP ratio. In the UK a number of state benefits, such as working tax credit or housing benefit, are exempt from income tax, while in France replacement income is subject to a reduced social security contribution rate.[2]

2 http://www.cleiss.fr/docs/regimes/regime_france/an_0.html

Figure 2.1
Tax ratio (tax:GDP) 2010



Source: OECD Tax Database

Historical trends

Averaging across the OECD, tax ratios have increased over the past five decades (see figure 2.2), but there has been great variation among OECD countries, with some having experienced a significant rise in their tax ratio, while others have seen little change. For example, Spain's tax ratio has increased substantially; in 1965 it was comparatively low at 15 per cent, but by 2010 it had doubled to roughly 30 per cent.[3] Denmark also experienced a sharp rise in its revenues with the tax to GDP ratio increasing by 18 percentage points, up from 30 per cent of GDP to 48 per cent of GDP – even though Denmark started from a higher tax level than most OECD countries (OECD 2012a). Comparatively, the US has had a relatively stable revenue share of GDP; its tax ratio was at roughly the same level in 2010 as it was in 1965.

Figure 2.2 shows the evolution of the tax ratio across a number of countries. Averaging across the OECD, tax as a percentage of GDP increased between 1965 and 2000 from 25.5 per cent of GDP to 35.2 per cent of GDP. Between the mid-1980s to the mid-1990s many countries introduced rate reductions on personal and corporate incomes – however, despite this rate cutting, the overall tax to GDP ratio continued to increase as tax bases have been broadened.

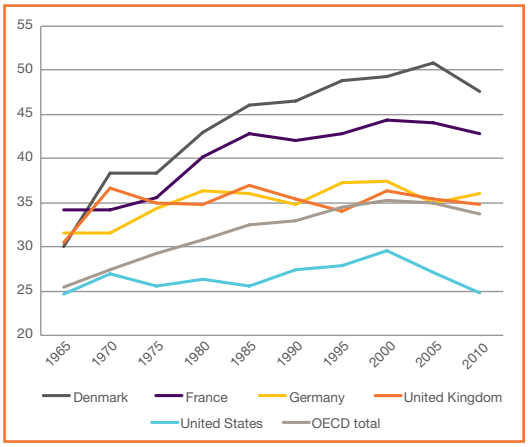
From 2000 to 2007, tax revenues as a proportion of GDP in many countries declined. This was the result of the length of the economic cycle, which led to falls in social security spending on joblessness, and so reduced the need for revenues. Although the severity of the financial crisis and recession led to subsequent increases in spending, governments generally chose not to increase revenues. As a result, in 2010 average receipts in the OECD were still 1.4 percentage points lower than in 2000 (ibid). Many countries experienced much greater falls in revenue; nine OECD countries had drops in revenue of over 3 percentage points between 2000 and 2010, including Sweden (a drop of 5.9 percentage points), Australia (a drop of 4.7 percentage points) and the US (a drop of 4.7 percentage points). In contrast the UK experienced a much smaller fall of 1.5 percentage points although this was much closer to the OECD average (unweighted).

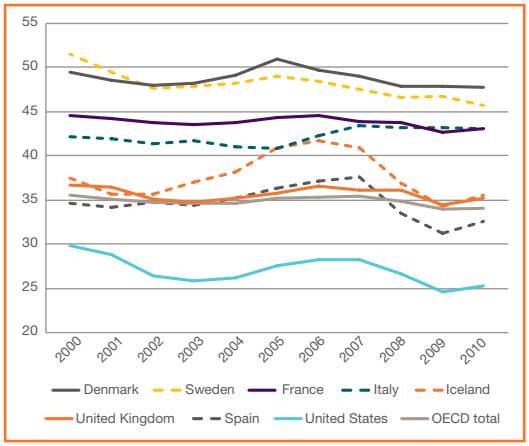
3 See http://www.oecd.org/ctp/tax-policy/tax-database.htm

In contrast to a number of OECD countries, the UK has maintained a relatively stable tax ratio, with smaller fluctuations in response to economic conditions and policy decisions over the past four decades. The UK was a high-tax country compared to other developed countries up to the 1970s (Clark and Dilnot 2002, European Commission 2011). The last half of the 1960s saw the most substantial rise in the tax ratio when it increased by 6.3 percentage points from 30.4 per cent of GDP in 1965. Following this steep rise, the following 15 years to the mid-1980s saw a number of fluctuations, a result of the economic climate and policy. After this period, there was a general decline in the share of receipts up to the mid-1990s. Since 2000, tax receipts have remained relatively constant – just below 40 per cent of GDP.

Figure 2.2
Tax ratio (tax:GDP) since 1965

Figure 2.3
Tax ratio (tax:GDP) 2000–2010





Source: OECD Tax Database

Countries that experienced a sharp fall in their tax ratios between 2008 and 2009 include Spain, New Zealand, Iceland and the US. Although to a lesser degree, the UK also experienced a sharp drop in revenue over the same period – revenues as a share of GDP fell by 1.9 percentage points, compared to the OECD average of 0.9 percentage points (see figure 2.3). In contrast Italy, one of the worst hit countries following the financial crisis, managed to maintain a relatively stable tax to GDP ratio.

The tax mix

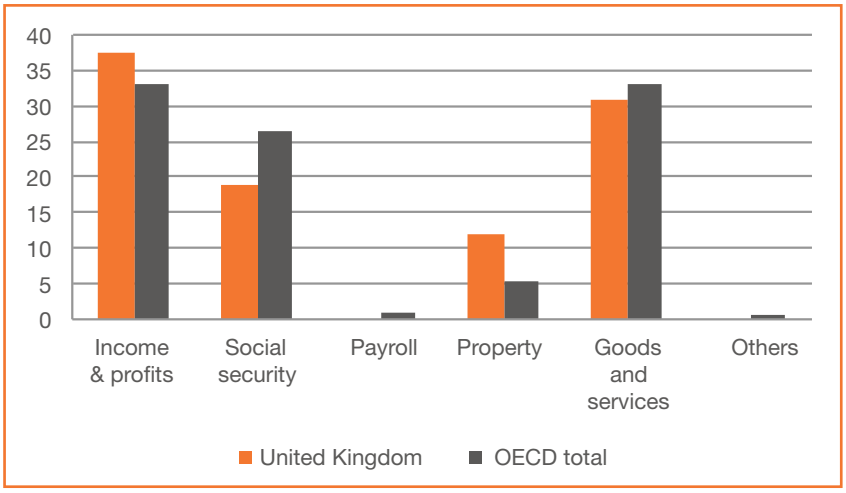
Although tax revenues have risen over the past five decades, the tax structure has remained relatively stable for many countries in the OECD. Taxes are typically categorised as direct taxes, indirect taxes or as social security contributions (EC 2013). Direct taxes are most commonly personal income taxes, corporate income taxes and other income and capital taxes. Indirect taxes include VAT, the main indirect tax in most countries, excise duties and consumption taxes, and other taxes on products and production (EC 2011). These taxes are all affected differently by the business cycle. Direct taxes are most responsive to changes in the business cycle as profits and income are strongly related to the economic cycle, whereas social security contributions are less volatile because they are levied against the aggregate wage bill and often have maximum contribution thresholds which limits volatility (EC 2010).

Among the EU member states there are different tax mixes. The Nordic countries and the UK raise a large proportion of taxes from direct taxes compared to other EU countries. In 2011, the UK had the fifth highest ratio of direct taxes to GDP across the EU at 15.9 per cent of GDP (though, in part, this is a reflection of its relatively low ratio

of employee social security payments to GDP) (EC 2013). These revenues also make up a considerable proportion of tax revenues at 43.9 per cent of total tax revenues – the second highest across the EU. Indirect taxes represent 37.7 per cent of total tax revenue – ranking 16th across the EU, but indirect taxes and direct taxes far outweigh the percentage of social security contributions at 18.5 per cent of total tax revenues (the fifth-lowest share of taxes in the EU).

Disaggregating the tax mix further, figure 2.4 shows the tax structure across the OECD in 2010. On average, income tax and taxes on goods and services both represent the highest proportion of tax revenues, at 33 per cent. Social security contributions are another important source of revenue making up 26 per cent of total tax take. Income tax (corporate and personal) finances a significant portion of public spending in just under half of OECD countries, and represents over 40 per cent of the tax mix in Australia, Canada, Denmark, Switzerland, Iceland, New Zealand, Norway and the US. Although income tax represents the highest proportion of revenues, in 2010 personal income taxes no longer made up the greatest share of revenues, largely because new entrants into the OECD had lower personal income tax rates thereby lowering the average (OECD 2012a).

Figure 2.4
OECD tax structure
(% of total tax revenue)



Source: OECD Tax Database

As in many OECD countries, the UK raises a significant proportion of revenues through income taxes, social security contributions and VAT (Browne and Roantree 2012). At 37 per cent, UK income taxation represents a higher share of tax revenues than the OECD average of 33 per cent. In contrast social security contributions make up a far smaller share of tax revenues than the average (19 per cent compared to an average of 26 per cent), and a lower share of taxes on goods and services (30 per cent compared to an average of 33 per cent).

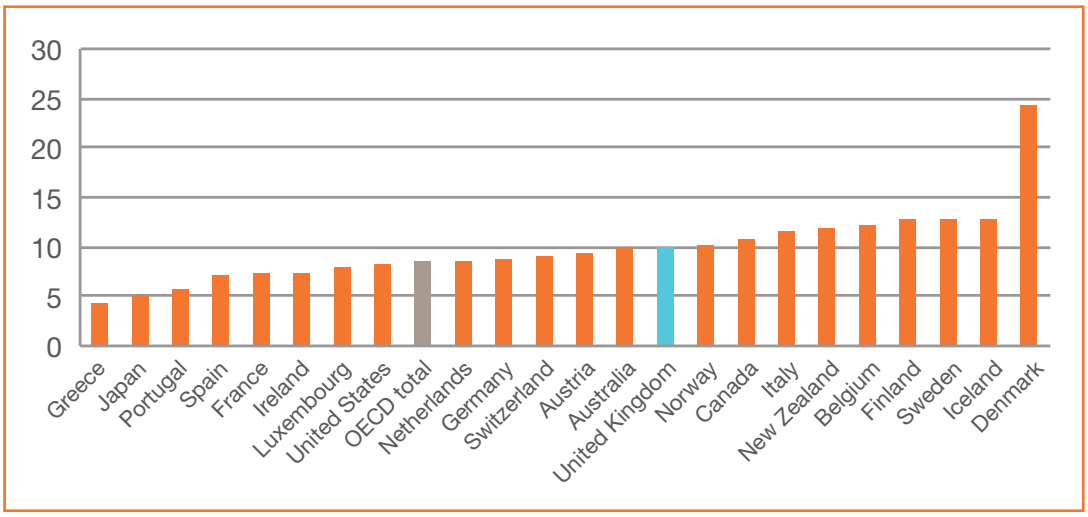
Denmark, and to a lesser extent the UK and Sweden, have substantially lower shares of tax revenues from social security contributions. In Denmark general taxation covers most welfare spending – as a result direct tax levels in Denmark are considerably higher than most other advanced countries, while social security contributions are close to 2 per cent of total taxation.[4] In contrast, France and Germany bring in considerable revenues through social security contributions, and both countries raise relatively low proportions of direct tax revenues (EC 2013).

4 See http://www.oecd.org/ctp/tax-policy/tax-database.htm

Taxes on labour

Taxes on labour consist of a combination of personal income taxes and social security contributions. These two taxes represent a significant share of tax revenues; averaging across the OECD they are equivalent to roughly half of total tax receipts (OECD 2012a).

Figure 2.5
Personal income tax
(% of GDP)



Source: OECD Tax Database

The tax ratio of personal income to GDP for the UK is 10 per cent, above the OECD average of 8.4 per cent of GDP. There are a number of countries with larger personal income tax ratios than the UK. The five countries with the highest personal income tax to GDP ratios are the Nordic countries: Finland (12.7 per cent), ***Iceland (12.9), Sweden (12.8)***, Norway (20.0), and Denmark (24.2). Denmark is a clear outlier with a substantially higher personal income tax to GDP ratio; however, this is explained by their tax structure. Minimal revenues are collected through social security contributions and most welfare spending is covered by direct taxation such as income tax (EC 2011).

The average top marginal personal income tax rate across the EU is 38.3 per cent – although there is great variation within the European Union, with Nordic countries typically having higher top marginal personal income tax rates (EC 2013).

Top statutory income tax rates are the main indicator used for cross country comparison. These are the legislated rates announced and as a result the most familiar income tax rates (in the UK, this is now 45 per cent, having been reduced from 50 per cent in April 2013). In contrast top marginal tax rates are influenced by not only the top statutory rate but a number of other factors. These include tax reliefs such as tax credits, deductions, basic allowances and thresholds. It is a measure of the additional personal income tax that results from a unit increase in gross wage earnings and often requires complex calculation unlike the top statutory income tax rate (OECD 2012c). In 2012, top statutory personal income tax rates for the top five countries were not far from the UK top tax rate of 50 per cent, with the exception of Denmark and Sweden with rates in excess of 56 per cent (see table 2.1). However, since then the UK has reduced its top rate to 45 per cent. Although the UK has similar rates to these countries one clear difference is the earnings threshold where the top personal tax rate first applies is a far higher multiple of the average wage in the UK.

Care must be taken when comparing statutory personal income tax rates, as the same statutory personal income tax rates can have different impacts on the actual amount deducted from personal incomes. This is because tax credits and other reliefs influence how much of one's income is subject to taxation. If the top marginal personal income tax rate is lower than the top statutory personal income tax rate, this means that any additional income above the top tax threshold is still subject to tax reliefs. When both the marginal personal income tax rate and statutory personal income tax rate are the same then all reliefs and deductions have been exhausted above the top income threshold (OECD 2012c).

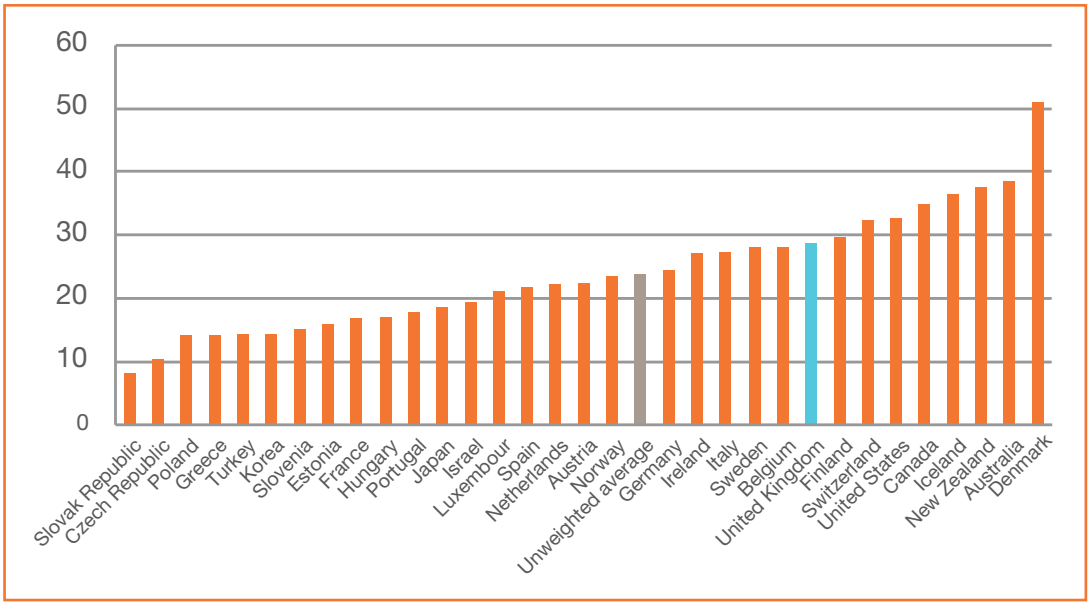
Table 2.1
Top income tax rates

	Top marginal tax rate	Top personal statutory tax rate	Threshold (expressed as a multiple of the average wage)
Australia	47.5%	47.5%	2.4
Austria	43.7%	50.0%	2.0
Belgium	45.3%	53.7%	1.0
Canada	48.0%	48.0%	10.7
Chile	39.4%	40.0%	13.4
Denmark	56.1%	60.2%	1.1
Finland	47.7%	49.0%	1.8
France	50.3%	50.7%	5.1
Germany	47.5%	47.5%	5.8
Greece	40.9%	49.0%	6.0
Hungary	20.3%	16.0%	0.9
Iceland	45.3%	46.2%	1.4
Ireland	48.0%	48.0%	1.0
Italy	47.3%	48.6%	10.4
Japan	47.3%	50.0%	4.7
Korea	38.2%	41.8%	8.9
Luxembourg	41.3%	41.3%	3.2
Netherlands	49.3%	52.0%	1.2
New Zealand	33.0%	33.0%	1.4
Norway	40.0%	40.0%	1.6
Spain	52.0%	52.0%	11.9
Sweden	56.6%	56.6%	1.5
Switzerland	36.1%	41.7%	3.5
UK	50.0%	50.0%	4.2
US	41.7%	41.9%	8.4

Source: OECD Taxation of Wage Income

Figure 2.6 shows the relative importance of personal income taxes within the overall tax framework. There is great variation among OECD countries with respect to the proportion of national total taxes accounted for by personal income tax, ranging between 8 per cent of tax revenue in the Slovak Republic to 51 per cent in Denmark. The UK raises roughly 28 per cent of its revenues through personal income taxes, which is higher than the OECD average of 24 per cent, but lower than eight OECD countries including the US, where a third of revenues come from personal income tax (though the picture changes when employee social security payments are taken into account). Again, Denmark raises a significant proportion of tax revenues from personal income taxes equivalent to just over half of their revenues.

Figure 2.6
Personal income taxes
(% of total tax revenue)



Source: OECD Tax Database

The income tax rate has a number of impacts beyond tax revenue levels; in particular, it may influence work-related decisions. For some people, the average tax rate could influence the decision to participate in the labour market, while the marginal tax rate might affect the decision to increase 'work effort' (OECD 2012c). Therefore, for policymakers, choosing the right level of statutory rates could, in theory, influence labour market decisions. However, in practice, the vast majority of people have little choice over whether to work and for how long, so these effects are likely to be small at the aggregate level.

Over the last two decades almost all OECD countries have significantly redesigned their income tax system (Brys et al 2011). In the late 1980s the US and the UK introduced substantial reforms changing the way income was taxed. These changes largely involved reducing rates and broadening the income tax base by reducing exemptions and deductions. Many advanced economies copied these reforms, reducing marginal income tax rates for a number of workers. Top statutory personal income tax rates were particularly high in the mid-1980s, with a number of countries having rates greater than 65 per cent. By the mid-1990s the significant bulk of cuts to top rates had come to an end, although top marginal tax rates for the OECD average did fall by a further 5 per cent between 2000 and 2010 (Brys et al 2011). Countering a reduction in top personal income tax rates, a number of countries also reduced their income thresholds – the point at which the top statutory personal income tax rate first applies (OECD 2012c). In the decade up to 2010, 20 OECD countries reduced their gross income thresholds, while 11 countries increased their gross income thresholds – and three remained at the same level.

The financial crisis, and the subsequent recession have led to a number of countries reversing cuts to top income tax rates as part of their fiscal consolidation programme, including the UK (EC 2013). As part of the UK's fiscal consolidation programme, the government temporarily increased the top statutory rate from 40 per cent to 50 per cent, a level not seen since the late 1980s. However, this top rate was subsequently dropped to 45 per cent following the 2012 budget announcement.

Often accompanying reductions in top personal income tax rates there has been a drop in the number of tax brackets (OECD 2012c). In the early 1980s, not a single OECD country had one tax bracket and many had over 10 brackets, including Sweden (18), Japan (19), US (16), Canada (13) and Netherlands (10). During the 1980s and 1990s countries drastically reduced their brackets, and by 2010 the average number of brackets across the OECD was five, down from 15 in 1981.

Although much attention is placed on the top personal income tax rate, this rate applies to a minority of workers. Over the last decade another trend, although not as widespread as the cuts to top personal income threshold rates, has been cuts to labour taxes for low-wage earners. This initiative has been introduced to enhance incentives to work for low-wage workers (EC 2011). The statutory rate on average wages has decreased in 23 OECD countries over the same period as the cuts to top personal tax rates. Additionally some countries have also changed the threshold at which individuals begin to pay income tax on their earnings (OECD 2012c).

For every OECD country, there is a level of earnings that are not subject to personal income taxation. Different measures are used across the OECD to implement these exemptions. Governments can exempt an initial level of earnings, as is done in the UK where earnings up to £9,440 are free from taxation (and this will rise to £10,000). Other options include introducing a zero-rate bracket, or a basic personal tax credit. These allowances are justified because every individual spends a portion of their income on basic necessities – and there is a view that the income for this type of expenditure should be exempt from taxation regardless of circumstance. Other arguments supporting allowances is that some income is spent on generating income (for example paying for transportation to work) and should therefore be free from taxation (ibid). A personal tax allowance also adds to the progressivity of income tax.

Social security contributions

Most European countries consider many public services or income protection to be a form of insurance covered by social security contributions. Social security contributions represent a bigger proportion of labour taxes than personal income taxes (EC 2013). Non-wage labour costs, such as social security contributions, are paid by both employers and employees. In theory these contributions should fund social expenditure, such as pensions and unemployment benefits, and countries with large social safety nets often have higher social security ratios to GDP.[5]

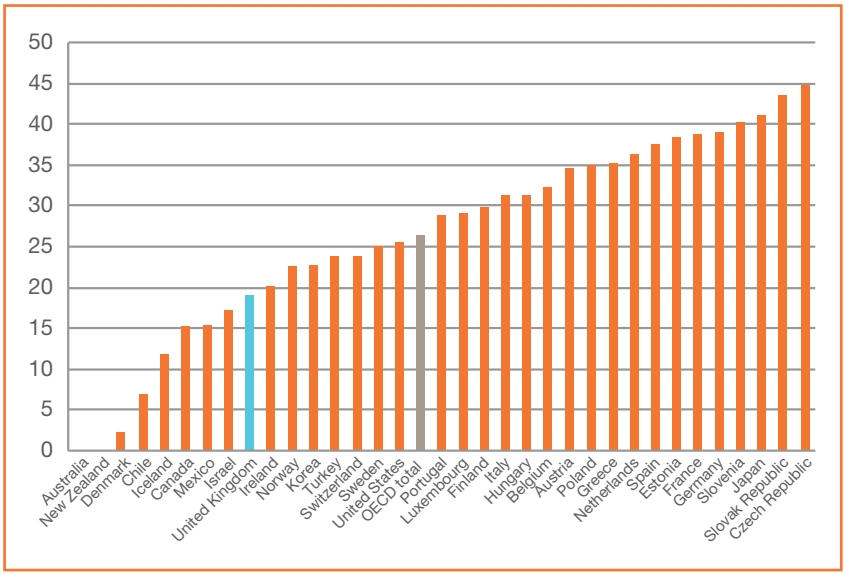
In the UK, however, there is no clear distinction between income taxes and social security contributions. At the margin, additional revenues from either could be used to fund, for example, extra international aid spending or an increase in the state pension. As a result, while the UK has relatively low social security contributions and high personal taxes, the aggregate ratio is not far from the OECD average.

Social security contributions differ markedly across the OECD. For example, in Denmark, the share of social security contributions (SSCs) is low, while Japan has a high share. Denmark funds most of its social expenditure through higher income tax rates; correspondingly it has the highest proportion of taxes accounted for by direct taxes. Other countries with comparatively low proportions of SSC revenues include the UK and Ireland (see figure 2.7). In the UK's case, this might in part be due to the weakening of the link between contributions and benefits.

5 http://www.oecdobserver.org/news/archivestory.php/aid/844/Social_security_tax.html#sthash.k7qE3HYO.dpuf

Countries where social security accounts for a considerable proportion of tax revenues include Japan (40 per cent), France (39 per cent) and Germany (39 per cent). All have a strong contribution-based benefits system and relatively generous level of payments, including compensation for job loss. As a percentage of GDP, France has the highest ratio at 17 per cent, while the UK's SSC as a share of GDP is 6.6 per cent, lower than the OECD average and towards the bottom end of the distribution.

Figure 2.7
Social security contributions (% of total tax revenue)



Source: OECD Tax Database

A number of OECD countries, including the UK, have a rather complex system of social security contributions, with a number of thresholds and different rates. The Netherlands has a significantly higher rate of 31 per cent for earnings up to €33,000. Across OECD member countries, employee SSCs are often charged at regressive rates or at a flat rate. These taxes are also regressive in some countries where earnings above a certain maximum threshold are exempt from employee social security contributions, or charged at much lower rates. Austria, Germany and Spain all have social security contribution ceilings (OECD 2012c). In the UK, weekly gross earnings above £797 are subject to a lower employee contributions rate of 2 per cent, compared to the basic rate of 12 per cent, making SSCs regressive in structure. When SSC was first introduced, the level of contributions was linked to the amount of benefits received, therefore capping payments made sense as it was unnecessary for people to contribute over a certain amount. However, over the last few decades the link between contributions and benefits has weakened, making the cap essentially a regressive feature as SSCs are essentially another form of income taxation. Additionally, unlike the personal income tax rate schedule, most employee social security contributions are paid on the first unit of earnings with the exception of Austria, Belgium, Canada, Ireland, Norway, Sweden and the UK (OECD 2012c). This can mean that some low-income workers' earnings are exempt from personal income tax but subject to substantial social security contributions (Thomas and Picos Sanchez 2012). In the UK, the threshold for paying national insurance contributions is now much lower than the personal tax allowance, so low earners have not been taken out of 'tax' completely. This structure can cause social security contributions to be especially high on low-income employees.

Table 2.2
Personal income tax and employee social security contributions (% of GDP)

	Employee social security contributions	Personal income tax	Total
Belgium	14.1	12.2	26.3
Denmark	1.0	24.3	25.3
Finland	12.7	12.6	25.3
Italy	13.4	11.7	25.1
France	16.6	7.3	23.9
Netherlands	14.1	8.6	22.7
Germany	14.1	8.8	22.9
Spain	12.1	7.0	19.1
Norway	9.7	10.1	19.7
Iceland	4.1	12.9	17.0
UK	6.6	10.0	16.7
Canada	4.7	10.8	15.6
US	6.4	8.1	14.5
Ireland	5.6	7.5	13.0
New Zealand	0	11.9	11.9
Australia	0	9.9	9.9

Source: OECD Tax Database

Although some countries appear to have substantially lower social security contributions, they are often accompanied by higher personal income tax contributions. For example, Denmark raises very little in terms of social security contributions; however, it raises the highest personal income tax revenue as a percentage of GDP across the EU (24 per cent of GDP). Table 2.2 shows that countries with high total revenues (social security contributions and personal income tax revenue) as a share of GDP can have different splits between the two types of taxation. For example, Finland, Italy and Belgium raise roughly equal amounts of personal income tax revenues and social security contributions. France, in contrast, raises a substantial amount from social security contributions (16.6 per cent).

These differences can in some instances be accounted for in the way the different revenues are collected and spent. In principle, social security contributions are directly linked to welfare spending such as pensions, unemployment benefits and health insurance. Revenues raised from general taxation or personal income taxes in theory are not spent on welfare spending, when social security contributions are collected. However, the degree to which this rule is upheld varies across countries. For example, Denmark finances all of its social security benefits through general taxation, while the link between social security contributions and welfare spending in the UK is increasingly tenuous. When revenue from national insurance contributions is unable to cover welfare spending in the UK, the government funds it through general taxation. NICs are effectively another tax on personal earnings (Browne and Roantree 2012). In the previous section, the UK was identified as having one of the highest shares of revenue from direct taxes. However, when considering personal income tax revenues and social security contributions together, this is no longer the case.

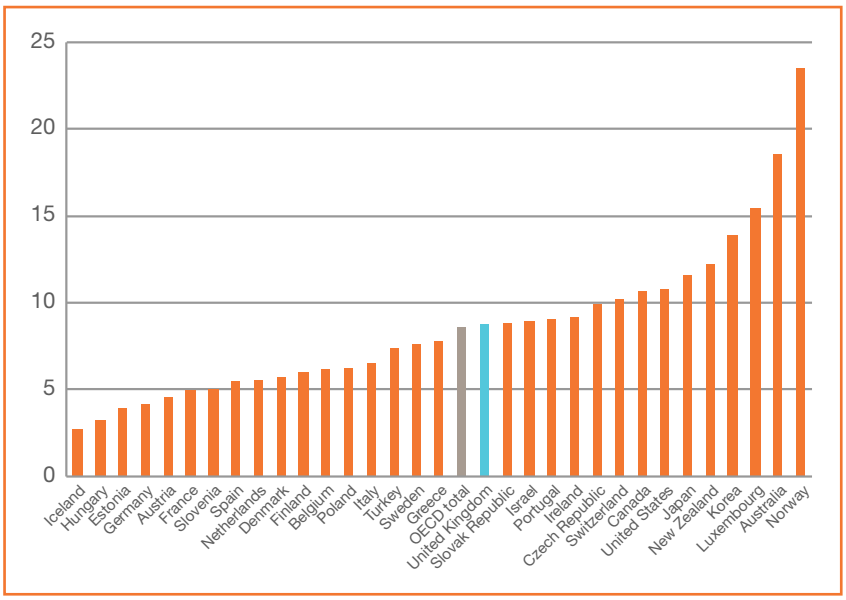
Employees are not the only group who are paying social security contributions, employers are also expected to pay, though the ultimate incidence might fall, in part, on employees in the form of lower wages. Again, rates vary dramatically across the OECD. In Germany, Switzerland, the US, Luxembourg and Japan employers generally pay the majority of

social security contributions, while in Denmark and the Netherlands employees pay more than employers.[6] Averaging across the OECD, employers tend to pay a greater share of social security contributions than employees. Employer social security contributions in 2010 accounted for 15 per cent of total tax revenues, whereas employee social security contributions brought in 9 per cent (OECD 2012a). Employer social security contributions as a share of total tax revenues have increased over the past 45 years, from 10 per cent in 1965 to 15 per cent in 2010. Employer social security contributions bring in over 20 per cent of total tax revenue in Finland (21 per cent), France (26 per cent), Italy (21 per cent) and Spain (26 per cent). These are substantially higher than in the UK, with social security contributions by employer representing 11 per cent of total tax revenue, lower than the OECD average.

Corporate tax rates

Corporate income tax mostly applies to corporate profits and capital. Averaging across the OECD, corporate income tax revenues represent 8.6 per cent of total tax revenues, similar to the UK (8.8 per cent of total tax revenues). There is great variation in the share of total tax revenues that corporate taxes represent across the OECD. In 2010, corporate tax revenue accounted for as low as 3 per cent in Hungary and Iceland but almost a quarter of total tax revenues in Norway (see figure 2.8). Only 10 OECD countries have a share of tax revenues greater than or equal to 10 per cent (OECD 2012a).

Figure 2.8
Corporation tax revenues (% of total tax revenue)



Source: OECD Tax Database

Over time, the relative importance of corporate income tax has declined and it now represents a much smaller ratio of GDP in comparison to the top three earners – personal income tax, SSC and VAT. This is partly because there has been a general downward convergence in corporate income tax rates across the EU, and the OECD (EC 2013); in the past decade, tax rates have been reduced in 31 out of 34 countries (Brys et al 2011). Top statutory corporate income tax rates in the 1980s were seldom lower than 45 per cent; by 2011 the OECD average rate had dropped to less than 26 per cent.

6 http://www.oecdobserver.org/news/archivestory.php/aid/844/Social_security_tax.html#sthash.k7qE3HYO.dpuf

At 37 per cent, Japan has the highest combined corporate tax rate of the OECD member states, while Norway has maintained its tax rate of 28 per cent. Statutory corporate income tax rates across OECD member countries have dropped by an average 7.2 percentage points between 2000 and 2011, from 32.6 per cent to 25.4 per cent (ibid). This was part of a strategy to reduce tax rates while broadening the tax base – removing deductions and reducing depreciation exemptions (Brys et al 2011, European Commission 2010).

This reduction in corporate tax rates has been sold as removing a constraint on growth-inducing activity because corporation taxes discourage businesses from investing in capital, hampering productivity improvements (EC 2010). In practice, however, globalisation has made capital far more sensitive today to changes in corporate tax rates and countries have sought to cut their rates in an effort to increase competitiveness and boost growth by allowing business to reduce production costs, and further invest in capital. For individual countries, this might seem like a sensible approach; in aggregate it risks creating a race to the bottom on corporate tax rates.

Other factors aside from corporation tax rates influence revenues from corporate incomes. These include the extent to which businesses are integrated in a country and the tax rates of oil revenue. Revenues are also not as high as they can be, assuming businesses are often willing and able to pay a lot of money to seek ways to postpone paying taxes or reduce the level of taxes on their profits.

Consumption taxes

Consumption taxes represent a significant share of total tax revenue and together they are the third biggest earner of total tax revenues. Consumption taxes consist of general taxes, such as value added tax (VAT) and retail sales taxes, and specific taxes such as excise duties, customs and other special taxes (OECD 2012a). These taxes are often referred to as indirect taxes – as they tax consumption of goods and services rather than directly taxing income.

The composition of consumption taxes has changed over time, with a shift away from specific to general taxes, resulting in a more broad-based approach to collecting such revenues (OECD 2012a, 2012b). In 1965, VAT and retail taxes made up approximately 12 per cent of total tax revenues, but by 2010 these general consumption taxes were greater than 20 per cent. Over the same period, specific taxes have dropped from 24 per cent of total tax revenues to 11 per cent.

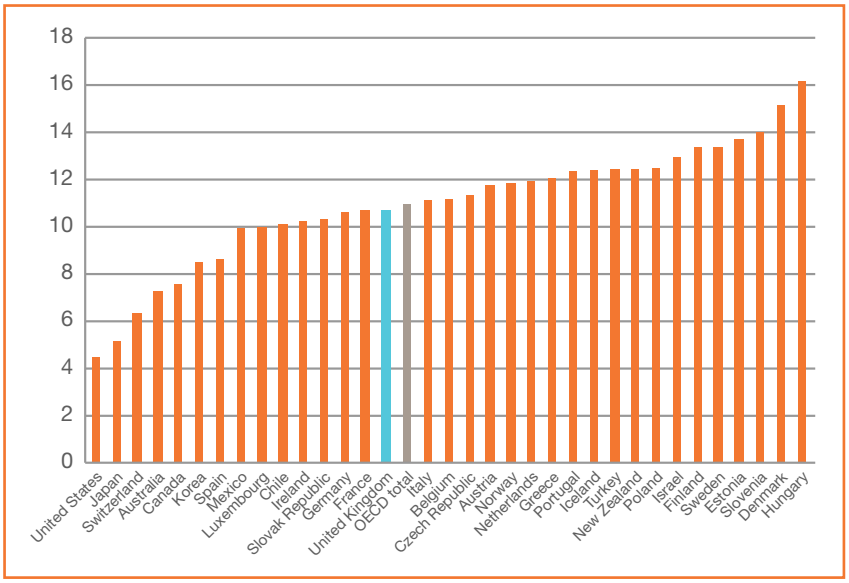
On average across the OECD, total taxes on goods and services represented 33.1 per cent of revenues in 2010, similar to the UK's proportion of 30 per cent (OECD 2012c). As a percentage of GDP, consumption taxes represented 11.0 per cent of GDP, marginally higher than the UK's ratio of 10.7 per cent of GDP. In 1965, consumption taxes averaged across the OECD represented 36 per cent of total tax revenues, since when it has dropped to 31 per cent.[7] Although these revenues as a whole have declined in importance, VAT – a general consumption tax – has become a main earner in the last few decades. It is now one of the most important sources of revenue for many governments.

First introduced in the mid-1950s, VAT has been adopted in 33 out of 34 OECD countries. In 1965, VAT represented 3.3 per cent of GDP, since when it has more than doubled to over 6 per cent (Brys et al 2011). Now accounting for roughly two-thirds of all consumption tax revenues, VAT revenue is a big share of total taxes, bringing in

7 See http://www.oecd.org/ctp/tax-policy/tax-database.htm

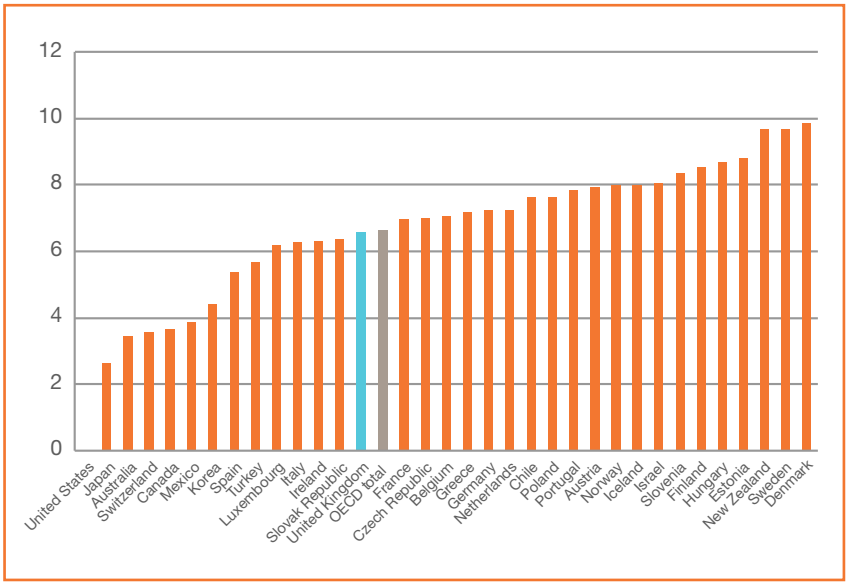
19.7 per cent of total tax revenues – equivalent to 6.6 per cent of GDP. For the UK, VAT revenues are below the OECD average – equivalent to 5.7 per cent of GDP and 16.6 per cent of total tax revenues (OECD 2012b). Countries with VAT revenues to GDP ratios greater than 9 per cent include New Zealand and Sweden with a ratio of 9.7 per cent, and Denmark with 9.8 per cent of GDP.

Figure 2.9
Consumption taxes (% of total tax revenue)



Source: OECD Consumption Taxes 2012

Figure 2.10
VAT to GDP ratios 2010 (% of GDP)



Source: OECD Consumption Taxes 2012

VAT rates vary drastically across the OECD, with higher rates found in Europe. For example, Denmark, Iceland, Norway and Sweden all have rates of 25 per cent. Correspondingly, these countries also have high VAT to GDP ratios at 9.8 per cent, 8.0 per cent, 8.0 per cent, and 9.7 per cent, respectively. Hungary has the highest VAT rate at 27 per cent, and the fifth-highest VAT to GDP ratio. The UK's VAT rate is currently at 20 per cent, and its VAT to GDP ratio is comparatively low. Over half of OECD countries have a standard rate of 15 to 21 per cent (OECD 2012b). The OECD average is 18.7 per cent, whereas the EU average is higher at 21.2 per cent. This is partly because EU member states are bound to certain VAT rules – the standard rate in EU countries must be at least 15 per cent, and countries can have two reduced rates of no less than 5 per cent (ibid), although there are a number of exceptions to the rule on a country by country basis. There are also a number of exemptions to VAT charges, for example financial services are exempt from VAT in a number of EU states.

VAT is said to be a better tax for economic growth than income taxes. This is because VAT has less of an effect on both household and business decisions than taxes on income. Income tax rates can also disincentivise investment and savings, while VAT has no such impact. Additionally, VAT does not harm competitiveness, as it taxes importation and zero-rates exports. VAT is also a popular tax for governments because it is relatively straightforward to collect, and it is comparatively cost-effective in its administration.[8] However, the main argument against VAT is its regressive structure, imposing a greater tax burden on lower-income households than those higher up the income distribution (though the Institute for Fiscal Studies (IFS 2010a) argues VAT is not regressive when judged against consumption).

To overcome some of these distributional concerns, many countries have a zero-rate, reduced rates and exemptions on a number of goods and services, in addition to the standard rate. The rationale behind these different rates is to reduce tax on basic necessities which can represent a large share of household expenditure particularly for low-income households. For example, most countries have zero-rates or reduced rates on food and beverages and the UK has a reduced rate of 5 per cent on fuel and energy consumption for domestic use.

Because of these reduced rates and exemptions many European countries have a narrow base of goods and services taxed at the standard rate. In contrast there are a number of countries, such as Australia, Canada, Korea, New Zealand, Singapore and South Africa, with much broader VAT bases. The UK has the highest number of exemptions and zero-rated goods (IFS 2010a), while New Zealand has one of the broadest tax bases for VAT, taxing most goods and services with very few exceptions or exemptions. As a result New Zealand has one of the highest VAT to GDP ratios among the OECD and advanced economies. Countries that do not have any zero-rated goods include Austria, Italy and France, while Japan and Chile do not have any reduced rates or zero-rated goods (OECD 2012b).

Although VAT is the main source of revenue from indirect taxes, excise duties – specific taxes on goods and services – continue to raise a sizeable share of total tax revenues, particularly excise duties on alcohol, tobacco, and fuel. Governments for some time have recognised the ability of taxes to alter behaviour, and therefore taxes such as excise duties can be an important tool in influencing the level of consumption of a number of goods. Tax rates on particular goods, such as tobacco or alcohol, are expressly implemented

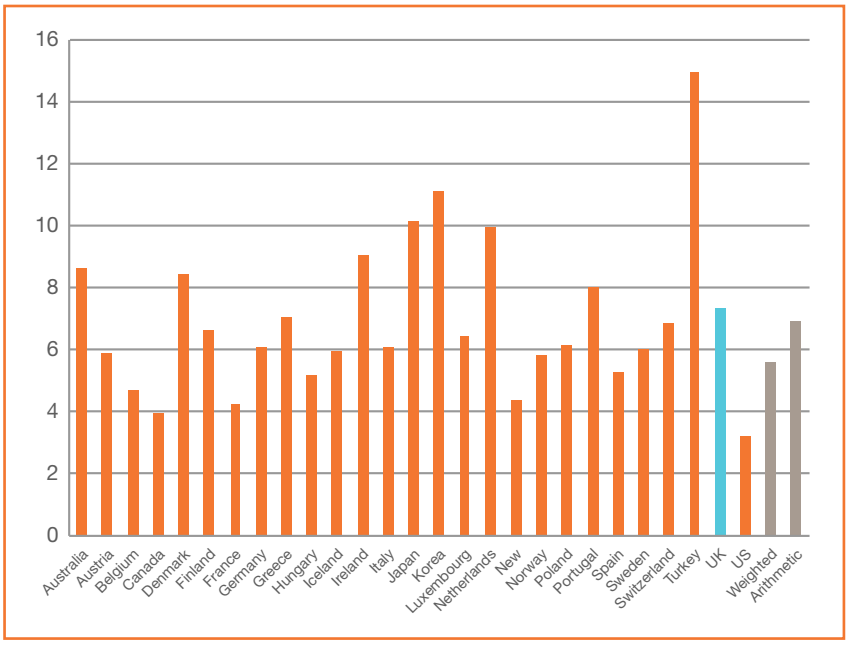
8 http://www.oecdobserver.org/news/fullstory.php/aid/3509#sthash.XjobhFt3.dpuf

to reduce individual consumption, while taxes on fuel are implemented to improve the general well-being of communities in reducing harmful emissions and encouraging firms to innovate to produce low-emission products. There is a case for these taxes to be higher than average VAT rates, in order to substantially correct a market failure. However, as behaviour has changed in the desired direction, the amount of revenue received from excise duties has declined over time.

Environmental taxes

Environmental taxes for the majority of OECD member countries have been 2–3 per cent of GDP (Brys et al 2011, OECD IEA database). In the early 2000s environmental tax revenues as a percentage of GDP fell in many EU member states, reversing an upward trend in previous years (Stamatova and Steurer 2012). This was partly due to a steep rise in oil prices which dampened demand and reduced fuel-related revenues. Other factors were that some countries were not indexing their rates appropriately.

Figure 2.11
Environmental-related taxation (% of GDP)



Source: OECD IEA Tax Database

Environmental taxes are difficult to define and compare across countries; the OECD classifies environmental taxes as 'any taxes levied on environmentally relevant tax-bases, such as emissions to air or water, energy sources, motor vehicles, waste'. The Office for National Statistics (ONS) defines environmental taxes as 'a tax whose base is a physical unit such as a litre of petrol, or a proxy for it, for instance a passenger flight, that has a proven specific negative impact on the environment' (ONS 2006). Some measures, like the 'green levy' added to fuel bills in the UK, slip through this definition. Although historically, taxes on fuel and energy have been designed to increase revenues, newer environmental taxes have been adopted to tackle specific environmental challenges. Environmental taxes are split into four categories: energy taxes, transport taxes, pollution taxes, resource taxes.

As a proportion of tax revenues, countries outside the EU tend to have greater shares of environmentally related revenues. In Turkey, Korea and Japan environmentally related taxes make up over 10 per cent of tax revenues. In the EU, the Netherlands is ranked at the top with the highest share of environmentally related taxes at 10 per cent; the UK is below with 7 per cent, although above the EU-27 average of 6 per cent (Brys et al 2011, EU database). However, interpreting these shares is not as straightforward as it may first appear; a large share of revenues could either be a result of higher tax rates or greater environmental emissions – that is, a larger environmental tax base.

Although there have been a number of new environmental measures introduced over the past 20 years, the composition of environmental tax revenues has remained broadly consistent. The two biggest revenue earners are energy and transport taxes, with pollution and resource taxes bringing in much less substantial revenues (Stamatova and Steurer 2012). The rates of other environmentally related taxes across OECD countries are relatively low, and prices do not reflect environmental damage. In order for environmentally related taxes to change behaviour, it must be accurately priced. Additionally there are significant variations in rates across Europe and the OECD. Taxes on the purchase or use of energy, including taxes on petrol and diesel, have generated most of the revenues, and continue to be the most important source of revenue under this category. Denmark and the Netherlands have the highest average effective tax rates for energy use at 6.26 per GJ (gigajoule) and 5.85 per GJ, while the UK has a relatively high rate at 4.6 per GJ (OECD 2013).

At present, environmental taxes are one of the smaller sources of tax revenues. However, despite the relatively small proportion these taxes represent, greater attention is being paid to them owing to growing concern over climate change, and the increased role these taxes can play in fiscal consolidation (Brys et al 2011). Implementing these taxes does come with its challenges; environmental taxes can impact those at the low end of household income distribution more so than other households. However, this should not be a deterrent: compensatory measures can be introduced to relieve some of the financial pressures facing low- and middle-income households, without reducing the taxes' effectiveness (Stamatova and Steurer 2012).

Property and wealth taxes

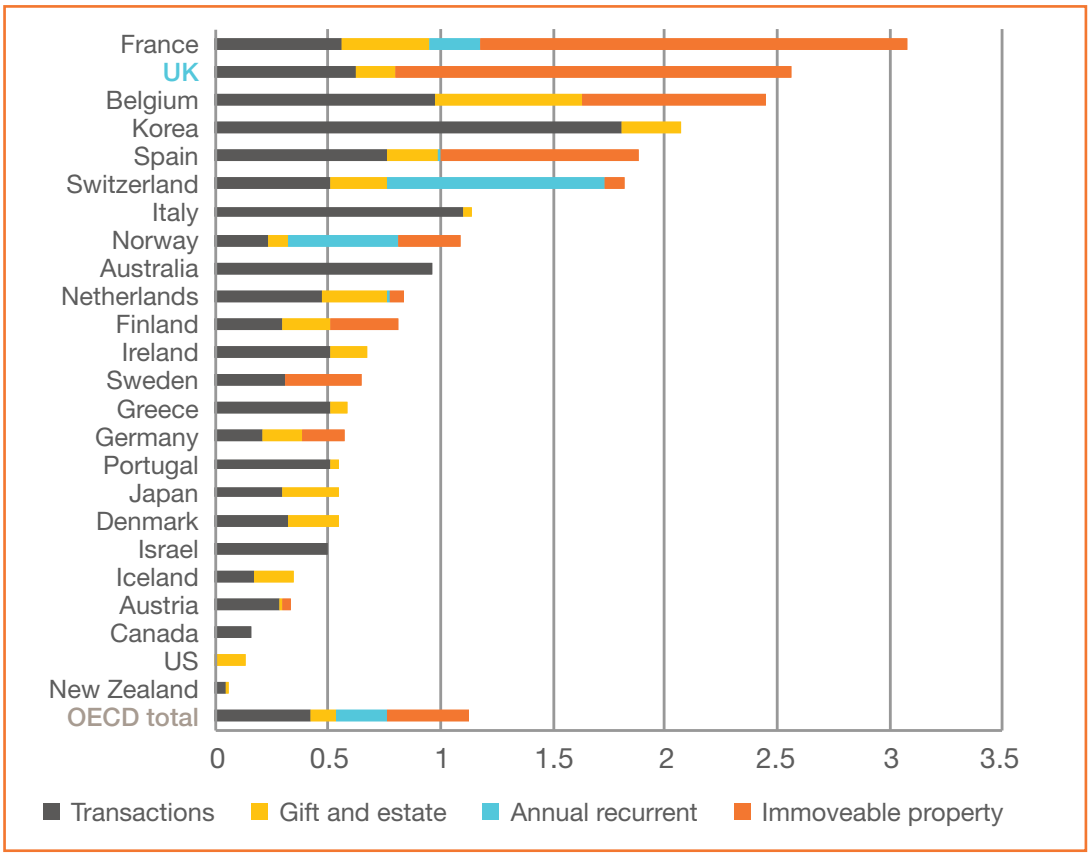
Private households in the UK are estimated to have property and other assets to the value of £10.3 trillion – a staggering amount that is subject to relatively little taxation. In total, property and wealth taxes in the UK are projected to make up just 7 per cent of revenues (Lawton and Reed 2013). Some have suggested it is not a worthwhile revenue stream as even when it is collected it is one of the smaller sources of revenue (Evans 2013).

Taxes on wealth or capital are collected in one of three ways: governments can levy taxes against the holding of capital or wealth, tax the transfer of capital or wealth, or tax the appreciation of capital or wealth (Evans 2013). Across the OECD, property and wealth taxes bring in a relatively small amount of revenue, although they are more significant in the UK than most other countries (Lawton and Reed 2013). Figure 2.12 shows the UK raises the second-highest amount of revenues as a share of GDP from property and wealth. Only France collects more as a share of GDP, however for both France and the UK these revenues only bring in just over 3 per cent of GDP.

Taxes on property brought in an average of 1.8 per cent of GDP in 2010; for most countries these taxes account for between 1 to 3 per cent of GDP. The UK has the highest ratio to GDP, with taxes on property representing 4.2 per cent of GDP in 2010. In the UK, council tax – a charge on property values – is the biggest revenue generator within taxes collected on property and wealth, bringing in around £26 billion or 4.4 per cent of aggregate revenues (Lawton and Reed 2013). This tax is one of the more regressive taxes within the UK system, with those with substantial property wealth not paying more than those with lower-valued properties. This is because the amount of tax property-owners pay does not increase proportionately as the value of their property rises. Those with properties worth more than £320,000 (when properties were valued in 1991) pay only three times as much as those with properties valued at £40,000 and below, despite property values being on average eight times greater (Johnson 2012). Therefore there is scope to change council tax bands and rates to make the system more efficient and progressive.

Across the OECD, just under half of countries have a recurrent tax on the value of residential property, and the revenues collected are often used to fund local services. Across Europe, recurrent property taxes are usually around 1 per cent or less of gross property values, and, unlike the UK, the properties are revalued frequently (Lawton and Reed 2013).

Figure 2.12
Taxes on property and wealth



Source: Lawton and Reed 2013

Taxes on wealth holdings or transfers of wealth are not as prevalent or widespread as other taxes. Taxes on the holding of wealth across the OECD have decreased over the past three decades or so – in 1990 half of OECD countries had such a tax, by 2010 this had dropped to just over a third of countries (Evans 2013). Across the OECD the tax revenue derived by member countries from annual wealth taxes and wealth transfer taxes accounts for less than 1 per cent of total tax revenue (not including CGT). France, Norway and Switzerland all have an annual tax on net wealth. In France the annual tax ranges between 0.55 and 1.8 per cent depending on value of total net household assets greater than €1.3 million (Lawton and Reed 2013). Norway has in place an annual tax of up to 1.1 per cent on net wealth above 750,000 krona. While Switzerland has the smallest tax rate out of the three countries, with a progressive annual tax of between 0.1 and 1 per cent on net wealth above varying thresholds.

Taken together, stamp duty, inheritance tax and capital gains tax – all of which are taxes on transfers of wealth – made up less than 3 per cent of total revenues in 2012–13 in the UK. This is relatively small compared to the three big earners: VAT, income tax and social security contributions.

Inheritance tax is subject to significant avoidance, as people often fail to disclose their wealth, or disclose an incorrect amount. As a result there has been a shift away from taxes on the assets of the deceased towards a tax on the beneficiary (ibid). Inheritance tax in the UK is set at a rate of 40 per cent on estates worth over £325,000. The rate is relatively high in comparison to other EU countries (EC 2013), although it is applied at a higher threshold than in some countries. For example, although Norway has a rate between 6 and 15 per cent, it is levied against assets worth over €62,875. Similarly, in Finland inheritance tax is paid at a rate between 7 and 19 per cent on assets worth more than €20,000, meaning far greater numbers of people are required to pay.

A number of European countries have some type of transaction tax on the sale of properties. Stamp duty, a transaction tax when property is sold, is comparatively high in Belgium, Italy, Luxembourg, Malta and France. Some countries, including the UK and Cyprus, have introduced a progressive tax rate for the sale of properties, while others have a reduced rate for the sale of residential dwellings; for example, Sweden has a rate of 1.5 per cent for residential dwellings, but other transfers are subject to a rate of 7 per cent (EC 2013). The UK has a progressive rate of between 1 and 15 per cent, for the sale of residential properties worth more than £125,000. For residential properties between £125,00 and £250,000 a rate of 1 per cent applies, while properties worth more than £2 million pounds are subject to a stamp duty rate of between 7 and 15 per cent depending on the buyer.

Similar to taxes on the sale of properties, capital gains tax (CGT) is another form of a transfer tax. This type of tax is levied against the profit or gain an individual accrues when selling or 'disposing' of an asset. In the UK this tax brings in roughly 2 per cent of total revenue. Australia raises the most revenue from capital gains tax, bringing in between 2 to 4 per cent of total tax revenue. In the UK residential properties are exempt from capital gains tax, although, some argue this is an unfair practice as it encourages people to use properties as an investment – which can be problematic given the UK's housing shortage. Few countries have a CGT on residential properties.

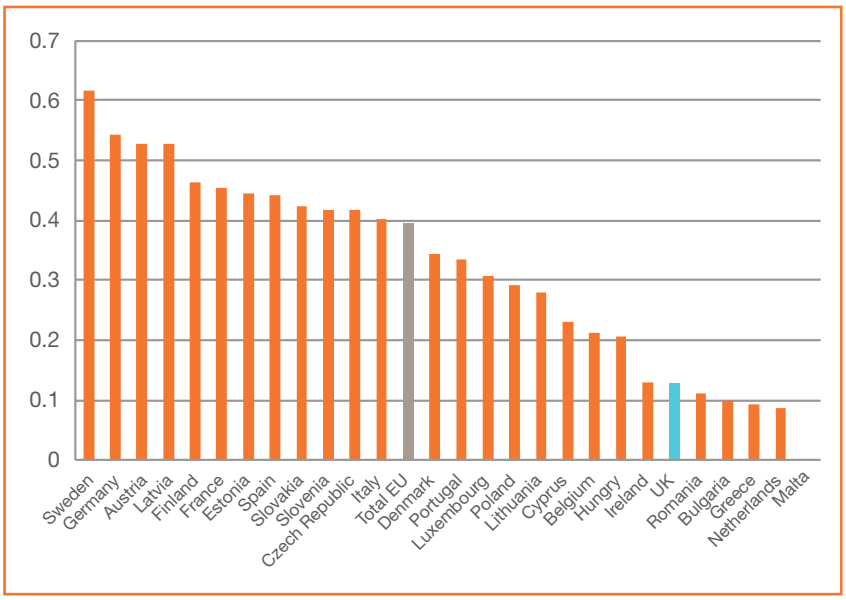
Although in recent decades the general trend has been for governments to reduce wealth taxes, some countries have (re)-introduced a tax on holdings of wealth (such as annual

wealth taxes on individuals) as part of their fiscal consolidation plans. For example, Iceland reintroduced a wealth tax, and Spain introduced a net wealth tax in 2011 – however, these are exceptions to a general downwards trend in wealth taxes.

Where tax is raised

One feature of the UK's tax system is its centralisation. Compared to other countries, a relatively small proportion of tax revenues, and of sub-national revenues in particular, are raised by sub-national taxes. Compared to the EU average of around 40 per cent, only just over 10 per cent of sub-national revenue in the UK is raised through sub-national taxation. In a handful of countries, the percentage exceeds 50 per cent. Any reform of the UK tax system ought to consider increasing this percentage to more closely align revenue-raising and spending powers.

Figure 2.13
Sub-national revenue raised by sub-national tax (%)



Source: CCMR 2012, IPPR North and NEFC 2012

Conclusion

The UK is a fairly average country when it comes to taxation. There are many other economically successful countries – in particular in Scandinavia – that have a significantly higher tax to GDP ratio; but also countries that have a lower ratio. And, although the structure of tax systems varies, there is little about the UK's tax system that makes it stand out. In no broad area of taxation does the UK raise significantly more, or significantly less, than most other OECD countries. There are no areas of taxation that are unique to the UK and no set of taxes being implemented by a number of other countries that are not also applied in the UK. For those looking for potential sources of additional tax revenues, there are no easy solutions to be found in other countries. There are, however, some pointers as to where to start, particularly with the aim of increasing revenues in a progressive way and without causing economic damage.

3. TRENDS IN THE UK TAX SYSTEM

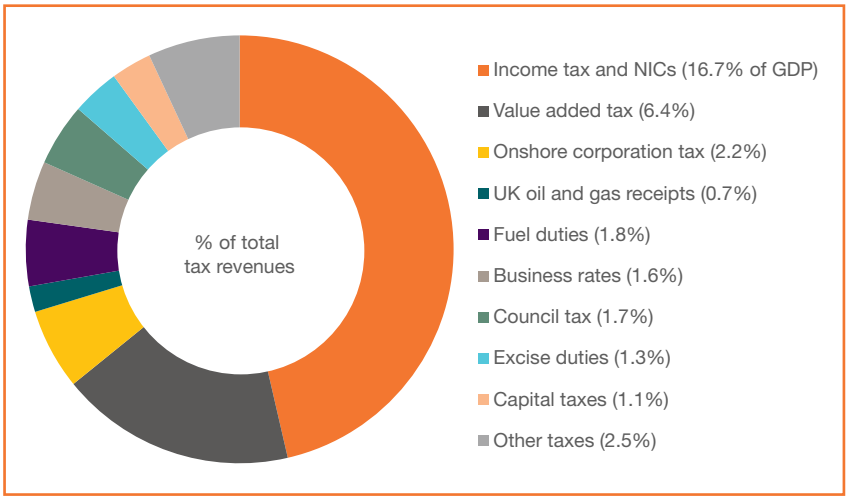
This section summarises the current distribution of tax revenues in the UK, highlights a few of the major trends in recent years, and sets out what might happen in the future.[9]

Current distribution of taxes

The level of tax revenues raised each year is determined by a number of factors including the economic cycle, tax design, demographic and non-demographic factors such as globalisation, and advances in technology. In 2010, the UK tax ratio was 34 per cent of GDP – roughly equivalent to the OECD average. Figure 3.1 sets out the UK tax structure.

As in most advanced economies the three big revenue earners in order of importance are income tax, social security contributions, and VAT. Taken together these three taxes make up roughly two-thirds of all UK tax revenues. Other big earners, although to a much lesser degree, are excise duties bringing in 11 per cent of current receipts, and company taxes which represent 12.5 per cent of current receipts (largely raised from corporation tax and business rates).

Figure 3.1
Composition of tax revenues 2011/12



Source: OBR 2013b

Historical reform

Historically the UK has opted to cover rising public expenditure in some areas by switching spending from other areas in order to keep total spending relatively steady. This has been the favoured approach instead of increasing tax revenues, indicating how difficult it can be politically to increase tax revenues.

Despite relatively stable tax revenues over the past five decades, the UK tax system has undergone some significant changes. The most significant change has been the growth in VAT revenues, largely driven by the more than doubling of the VAT rate. In contrast, other indirect taxes such as excise duties have seen a sharp fall in revenues despite some duties doubling. The income tax structure has also changed dramatically over the past 45 years. During the late 1970s the top income tax rate was 83 per cent, significantly higher than the current 45 per cent rate. Despite significant cuts to tax rates, the share of income tax in revenues has remained broadly stable, not least because successive governments have allowed many more people to pay the higher rate.

9 For an overview of the current UK tax structure, see the annex to this report.

Social security contributions used to be closely linked to benefit entitlement; however this link has weakened in the last few decades. Instead, employee social security contributions more closely resemble a tax on income, as rates and allowances are closer to the income tax rate structure. For businesses, the biggest change has been the reduction in corporation tax rates. In the 1984 budget, the tax rate was slashed dramatically from 52 per cent to 35 per cent – a drop of over a third. Since then corporation tax has been cut numerous times and is planned to be 20 per cent from 2015. The Coalition government argues that this will encourage firms – UK- and foreign-owned – to invest more in the UK, though the evidence to support this view is not strong.

More recently, environmental taxes have been introduced into the tax system. Three new national taxes have been introduced to tackle climate change and environmental concerns. In 1996 a landfill tax – a tax on the disposal of waste – was introduced. Five years later a climate change levy was implemented. This levy had two rates: a main rate levied against the supply of specified energy products such as gas, electricity and coal for use as fuels; and a second rate, classified as the Carbon Price Support (CPS), which is applied to supply of particular energy products, such as coal and gas, for use in electricity generation. A year later an aggregates levy was introduced, taxing the extraction of aggregates. Other environmental taxes introduced include a duty on air travel, and a congestion charge for cars travelling within designated areas in London.

The future

The likelihood that deficit reduction will stretch well into the next parliament and the scale of public spending cuts already implemented mean there is likely to be a need for more tax revenues as part of fiscal consolidation.

Beyond the short term fiscal challenge, a number of trends will further drive a wedge between prospective revenues and spending, intensifying the need to find additional public receipts. For example, behavioural changes are expected to reduce revenues from fuel duty, smoking and other specific taxes. Although each of these revenue sources alone make up a small share of total tax revenues, taken together they are expected to cause total government receipts to follow a mildly negative trajectory (OBR 2013). On top of declining revenues, there are a number of upward pressures on spending from an ageing population, among other drivers of public spending (OBR 2013, Lawton and Silim 2012). Because of these developing trends, the OBR estimates the tax revenue to GDP ratio will decline over the next two to three decades (OBR 2013). The OBR's public finance projections show that future governments will need to raise more tax revenues or reduce public expenditure by roughly 1.9 per cent of GDP – equivalent to £29 billion – from 2018/19 onwards in order to fill the gap between spending and revenues based on current policies.

As a result of these fiscal challenges, both over the long term and short term, the government will likely need to find alternative sources of revenues to cover government spending.[10] However, it is politically difficult to build a coherent forward-looking tax strategy in a climate of political short-termism. In the UK, policy changes are often piecemeal and not based on a long-term strategy for tax revenues. Because of this approach, there is little coherence within the tax system, which leads to a disjointed system of taxes, increasing inefficiency and potential lost revenues (Johnson 2009).

10 A better alternative would be to increase the employment rate in the UK to be in line with the highest in the OECD, at around 80 per cent (see Dolphin and Lawton 2013). This would increase revenues and reduce welfare spending.

4. OPTIONS FOR RAISING REVENUES

Broadly, there are three options for raising tax revenues: increasing 'popular' (or rather 'less unpopular') taxes; increasing mainstream, and therefore visible, taxes; and implementing new taxes. Before considering each in turn, this section describes the principles that should underlie any consideration of tax changes.

Principles behind a good tax system

The UK is not far from the OECD average on most indicators of tax revenues. However, UK taxes are well below those in some countries, in particular the Nordic countries, suggesting there is scope to broaden the tax base from a number of sources, and to do so in a way that spreads risk and creates a more resilient tax system. There is also scope to reform and increase less distortionary taxes, such as consumption, housing and environmental taxes, and perhaps to cut some other taxes.

A tax system should be able to fund public expenditure, and redistribute income effectively, while minimising any economic or administrative inefficiencies that arise out of the tax system. Additionally, the tax system can play a key role in reducing negative externalities and can influence the allocation of resources (IFS 2010a, European Commission 2011)

A good tax system should:

- raise money to pay for the collective goods and services that society wants
- be progressive
- be simple and easy to understand
- avoid arbitrary tax differentiation across people and forms of economic activity
- not be earmarked for any specific purposes
- reduce negative externalities
- support economic growth.

The tax system should also be progressive, satisfying the principle that those with more should pay proportionately more. However, achieving a progressive system does not mean that every tax must be progressive. The aim should be only for this to be true of the overall tax system. This means identifying the taxes that can achieve progressive and distributional objectives most effectively, allowing for the remaining taxes to achieve other objectives such as tackling climate change or supporting growth (IFS 2010a).

In particular, income taxes should be progressive, while other taxes, including indirect taxes, should aim to be economically efficient. Personal income taxes should be reasonably simple, ideally with few brackets and a personal allowance. At present the income tax schedule in the UK is not so straightforward, with a number of different effective rates partly a result of tapering allowances and the interaction of the tax and national insurance systems.

Applying different rates to different sources of income distorts economic activity and in an ideal system most income should be taxed through a single-rate schedule, though there could be some exemptions. The 'normal' rate of return on capital income, savings and investment, for example, might be exempt from tax (though there are problems in measuring this concept). Additionally there could be exceptions for pension savings, so as to encourage people to save more for their later years – alleviating future public spending pressures (IFS 2010a).

A major difference between the UK system and an ideal one is the fact that employee national insurance contributions, which are effectively a tax on income, are subject to a different schedule from income tax. Creating a cohesive income and national insurance tax structure by aligning rules and exemptions between the two forms of revenue would be a very desirable outcome. At the same time, NICs need to be broadened to include self-employment and capital income.

Indirect taxes in the UK are also some way from the theoretical ideal. At present the UK collects roughly 5.7 per cent of GDP in VAT revenues. This is similar to the OECD and the EU averages. The UK VAT rate is currently at 20 per cent; however, there exists a reduced rate, and a number of zero-rated goods and exemptions. Applying reduced rates and exemptions make for complicated administrative processes and can lead to individuals choosing goods for arbitrary reasons. The UK zero-rates far more goods than almost any other country, while in contrast New Zealand applies a broad VAT base successfully.

The current VAT structure means that VAT is a regressive tax. But attempts to use VAT to achieve redistribution should be avoided. Instead, in an ideal system VAT should be an efficient revenue generator, with a few exemptions. To address distributional concerns, extending VAT should be done alongside a package of reforms to the personal tax and benefit systems to account for the distributional and work incentive effects of broadening the VAT base (IFS 2010a).

Other areas where the UK tax system aims to address distributional goals inefficiently is through its taxes on housing. Council tax is based on outdated valuations, and is unnecessarily regressive.

Environmental taxes are a good way of generating greater revenues. However, their current structure in the UK and a number of OECD countries is inefficient. Environmental taxes lack coherence to effectively tackle climate change and congestion. The effective rate on emission charges is dependent on source, leading to a variety of rates – unnecessarily complicating the system.

‘Less unpopular’ taxes

If the next government is interested solely in raising a small amount of additional revenue as a contribution to deficit reduction, it might try to do so through popular, or at least ‘less unpopular’ taxes (those that can be implemented without attracting negative headlines).

One option for raising additional revenues would be to allow fiscal drag to increase tax revenues. Many previous governments have not index linked some tax allowances and limits in line with prices or earnings – raising significant amounts of revenue. This approach could raise roughly £70 billion by 2030 (Fabian Society 2009). However, the Coalition government has made a virtue of doing the opposite with the personal tax allowance, increasing it by more than the increase in prices or earnings. Both the Conservatives and Liberal Democrats are likely to promise to do so again in the next parliament. Consequently, one of the main sources of revenue from fiscal drag has been effectively foregone.

The Coalition has, however, frozen inheritance tax allowances. In 2012 inheritance tax raised roughly 0.5 per cent of total receipts (Lawton and Reed 2013). There is scope for inheritance tax to be a greater source of revenue. Currently it is levied against the estate of the deceased and not the beneficiary, so a potential reform for the UK could be a tax on the beneficiary instead of the donor, as is the case in most OECD countries. Depending on how it is implemented this could raise roughly £1 billion more for the Treasury (Dolphin 2010). A

more significant reform would be to tackle evasion by taxing all gifts and inheritance over a lifetime as is done in Ireland (Lawton and Reed 2013), although the likely revenue gain from such a move is yet to be quantified for the UK. To garner support for such a move, it could be presented as a tax on unearned income. Framing this reform to the public as a means of achieving reduced inequality of wealth and opportunity might make it politically palatable. Such a change would improve the progressivity of the UK tax system.

A tax on bankers' bonuses is one of the few that might be described as 'popular' among the public. The Labour government raised £3.5 billion from the bonus tax that it implemented after the financial crisis, and the Labour leadership already has plans to reintroduce such a tax should it win a majority at the next election.

The Labour government also introduced the additional higher income tax rate of 50p for those with extremely high incomes, which subsequently has been reduced to 45p by the current government. There is some dispute over how much additional revenue this move generated, a calculation complicated by companies' efforts to help their employees pay less tax by bringing forward bonus payments before the tax was introduced and delaying them until after it was cut. A move back to 50p would only be wise if it was sure to raise extra revenues.

The Mirrlees review sets out the case for all forms of income to be subject to the same tax rate schedule. For the UK, this would require aligning capital gains tax (CGT) and income tax. At present the CGT rate is lower at both the basic and higher rate (18 per cent, and 28 per cent). Raising the lower capital gains rate by 2 per cent up to 20 per cent would raise only £10 million in 2014/15. The higher capital gains rate is much lower than the higher statutory income tax rate of 40 per cent, and top statutory income tax rate of 45 per cent. Raising the higher capital gains rate by 12 percentage points to 40 per cent so that it aligns with the higher income tax rate would raise £960 million. Despite this shift leading to relatively small gains, such an alignment would make the overall tax structure more efficient and it would allow for less tax evasion and avoidance. Taxing nominal capital gains at lower rates makes tax avoidance more attractive, leading to earned income being accounted for as lightly taxed capital gains (IFS 2010b).

Council tax is a regressive tax greatly in need of reform. The amount levied against properties is based on valuations that are over 20 years old and it also has a number of exemptions and discounts that cause distortions and further complicate the system. For example, a discount applies to single occupancy which can lead to inefficient use of the housing stock (Lawton and Reed 2013). The simplest way to raise more revenues from council tax, and to reduce its regressive nature, would be to introduce additional bands, paying a higher rate of tax, above the existing top band.

One possible source of additional revenues that has been proposed in recent years is the so-called 'mansion tax', which was backed by the Liberal Democrats in 2010 and more recently by the Labour party. This tax was initially conceived as a property tax of 0.5 per cent on high-value properties of £1 million and above, raising roughly £1 billion in additional revenues. In 2010, this proposal was amended so that a 1 per cent levy would be applied to properties valued above £2 million, increasing total revenues by £0.7 billion to £1.7 billion. This would be a progressive tax as it would be very unlikely to affect those on low to middle incomes, and would be targeted at high-earners, or those with high-value assets. There is a perception that it would be paid by overseas buyers of expensive London properties, which might make it easier to sell.

Mainstream taxes

The problem with less unpopular taxes is that they are not large potential revenue raisers. If a future government wants to increase revenues significantly, it might be forced to consider politically unpopular increases in mainstream taxes such as income tax, NICs and VAT.

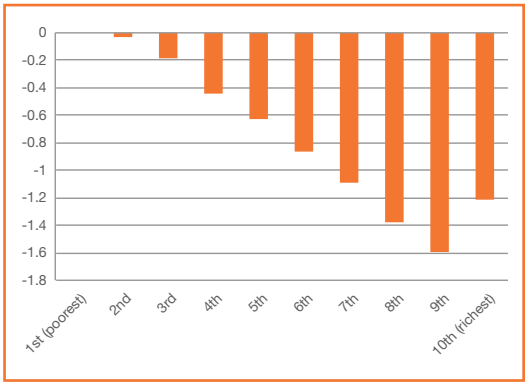
Increasing the basic income tax rate by 2p would yield £8.3 billion in 2014/15, while increasing the top income tax rate by a similar amount would raise £2 billion. If the corporation tax rate was increased by 2p this would result in an additional £1.7 billion of revenues. Although administratively straightforward to implement, such moves appear politically impossible. There is widespread resistance towards increasing income tax rates – and no government has been willing to risk such a move for over three decades. This is despite the fact that a personal income tax rate of 22 per cent or a top rate of 47 per cent would still be below comparable rates in a number of OECD countries. Apart from the political difficulties, a hike in income taxes would increase the tax on labour making it one of the more inefficient ways of raising revenues. This is because an increase in personal income taxation may further distort economic activity, weakening incentives to work and potentially constraining growth. Furthermore, income is very closely linked to the business cycle making income tax not the most resilient of tax bases.

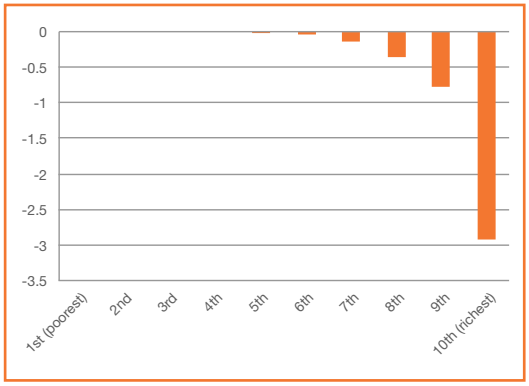
Using IPPR's tax benefit model, figure 4.1 shows the distributional impact of an increase in the basic rate of income tax. A 2p increase would have the greatest impact on households at the top of the income distribution. Households in the ninth decile would be hardest hit, with weekly incomes dropping by 1.6 per cent.

Another option to raise revenues through income taxes would be to increase the 40p rate of income tax by 2 per cent. Figure 4.2 shows this change would reduce earnings for the top 10 per cent of households the most. The tax change would also only impact the top 40 per cent of households.

Figure 4.1 (left) Distributional impact of a 2p rise in basic rate of income tax (% change in weekly income)

Figure 4.2 (right) Distributional impact of a 2p rise in 40p rate of income tax (% change in weekly income)





Source: Author's own calculations

At present, revenues from national insurance contributions by employers and employees are relatively low compared to other OECD member countries. Another approach might be to increase employee contributions. If the UK increased its employee national insurance contributions rate by 2 percentage points, this would increase revenues by £7.2 billion, and a further £4.4 billion in 2014/15 if the employer rate was increased by the same amount.[11]

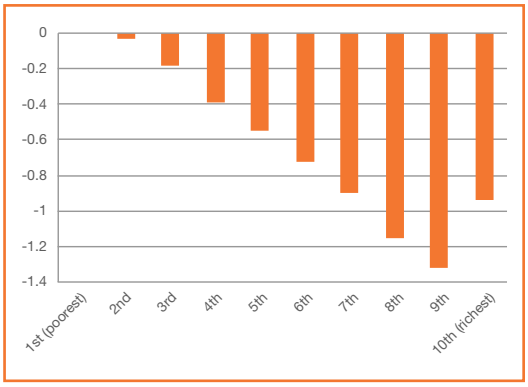
11 Class 1 NICs.

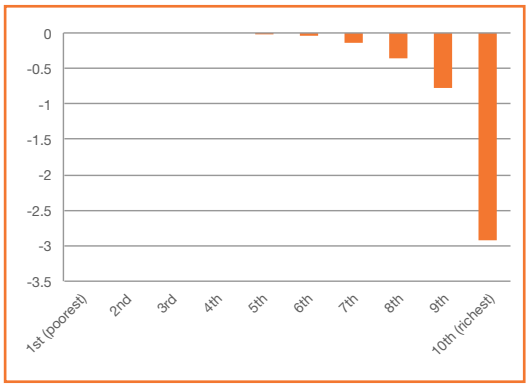
This would impact those at the top of the income distribution more than those at the bottom (see figure 4.3). Although NIC rates are less visible politically, employee national insurance contributions are effectively a tax on income, so the same arguments about work incentives apply to increasing NICs.

One area for potential reform is addressing the regressive nature of employee national insurance contributions. At present in the UK, employees are subject to a tax of 12 per cent on earnings below £797 per week, after which a tax of 2 per cent is levied on higher earnings. This is clearly regressive, with lower taxes applied to higher earnings. Additional revenues would be raised if the UK were to align tax rates for employees across all earnings. Based on 2009 estimates, abolishing the upper earnings limit would generate a net £9.3 billion for the Treasury. This change would also make the overall structure of taxing labour income more progressive, and less complex in structure. The tax benefit model was used to estimate the distributional impact of aligning the basic and higher rate of employee NICs. Figure 4.4 shows the increase would have a greater impact on households at the top of the income distribution, while those in the bottom 40 per cent would experience no change in their weekly incomes. The top 10 per cent would be hardest hit, with incomes dropping by close to 3 per cent.

Figure 4.3 (left)
Distributional impact of a 2p rise in employee NICs (% change in weekly income)

Figure 4.4 (right)
Distributional impact of removing 2p rate of NICs (% change in weekly income)





Source: Author's own calculations

Since the financial crisis, the VAT rate has been increased in a number of countries. The UK saw an increase from 17.5 per cent to 20 per cent in 2011, while in 2012 the Netherlands increased its standard rate of VAT to 21 per cent, up from 19 per cent. Finland has also increased its standard VAT rate by 1 per cent to 24 per cent. Other countries have chosen to increase the reduced rate or broaden their VAT tax base. Iceland, for example, removed the reduced VAT rate for hotels and accommodation, and now these services are subject to a 25.5 per cent tax instead of 7 per cent (Ernst & Young 2013). New Zealand and other countries that have introduced VAT in recent years have much better designed systems often with a single rate and a much broader tax base – generating greater revenues from VAT.

Although the UK has increased VAT, there is still scope for additional reforms. The UK has the highest number of exemptions and zero-rated goods among developed economies. Exemptions in general are estimated to cost roughly £12 billion, a large portion of that being an exemption on financial services (roughly one third). Therefore the UK could also introduce a VAT on financial services if it wants to increase tax revenues (IFS 2010b).

One potential reform would be to further broaden the base such that VAT would be applied to all final consumption expenditure by households – although expenditure on business inputs would remain untaxed. Using VAT to achieve distributional aims by zero-rating items such as clothing and food has widely been acknowledged as ineffective. Instead the UK could aim towards a broader tax base, with limited differential tax rates across goods and services. The politics of putting VAT on food and children's clothing might appear difficult, but many other countries apply VAT to these items and the effect on low- and middle-income families can be mitigated by other measures. Simulations by the IFS, done when the main VAT rate was 17.5 per cent, have shown that removing all current zero and reduced rates (except for housing and exports) while increasing all means-tested benefit and tax credit rates by 15 per cent would improve the lives of the bottom 30 per cent (in terms of household income distribution) of the population and increase net tax revenues by £11 billion (ibid).

Another possible source of revenue would be to remove the reduced VAT rate on energy consumption for domestic use. At present, the UK charges a reduced rate of 5 per cent for electricity or gas supply for domestic or charitable non-business purposes. This would raise a substantial amount if increased to the standard rate of 20 per cent. However, this move would be regressive. At a time when households in the UK face higher soaring energy bills and they are at the centre of political debate, the chances of such a move are remote indeed.

But, if the UK is to pay for the public services it wants in coming decades, extra revenues will be required to fill a projected gap between spending and revenues. The ageing of the population will put upward pressure on spending as a share of GDP at the same time that revenues are likely to fall as a result of reduced production of North Sea oil and lower spending on petrol and diesel. It is a cliché to say that the UK wants Scandinavian-style public services while paying US-style taxes, but one containing a lot of truth. In the past, governments have managed at times to give the impression of delivering both, in no small part thanks to cuts in spending in areas like debt interest and defence. This is not an option for the future. Even maintaining services at current levels will require some increases in taxes.

One way for the government to make the public face up to this truth would be to link future increases in tax to spending in the area most likely to be affected by the ageing of the population: the national health service. For example, it could ask the OBR to project, based on known demographic trends and likely productivity developments, the level of spending required over the next, say, 20 years to deal with the increased demand on the NHS that will result from increased numbers of old people, while also maintaining the level of service to the rest of the population. The government could then commit to raising the revenues required from taxation, whether from increases in VAT rates, national insurance contributions, taxes on business, or even income tax. The public would then see more clearly that the alternative to tax increases is a potentially substantial decline in the degree of healthcare that could be offered to older people and the government would find it easier to get the democratic support it needed to fund the NHS.

New taxes

If less unpopular taxes raise insufficient revenues and increases in income tax, national insurance contributions and VAT are politically unpalatable, then extra revenues might be needed from new sources.

Wealth taxes might be one option. Some argue that assets belong not to an individual but to family units and should therefore be free from taxation at any time. Those in favour of wealth taxes highlight the additional revenue they would generate, contributing to reducing the fiscal deficit, while helping to reduce the severe inequality in economic resources across the UK (Lawton and Reed 2013). Compared to other taxes they are more efficient because they have a lower distortionary effect on economic activity than, for example, taxing income.

A significant reform would be to introduce a recurrent tax on net wealth. A net wealth tax, levied at the household level, would be a tax applied to all worldwide assets. Across the OECD, only three countries have a recurrent tax on net wealth. France has a progressive annual tax on net wealth of more than €1.3 million of between 0.55 and 1.8 per cent. Norway has an annual tax of up to 1.1 per cent on net wealth greater than 750,000 krona; this tax applies to roughly 17 per cent of adults. Instead of a flat wealth rate, Switzerland has an annual rate of between 0.1 and 1 per cent on net wealth above varying thresholds. This a progressive approach to a wealth tax and thresholds also vary according to family status and residency.

IPPR has estimated that the effect of introducing a net wealth tax at the household level of 1 per cent on all non-pension assets greater than a threshold of £500,000. Only assets held in Britain and owned by private individuals would be subject to this tax. Modelling estimates suggest it would raise roughly £6.9 billion a year (ibid). Despite its progressive nature, and its potential as a revenue generator, a wealth tax would be difficult to administer. Problems associated with such a tax include how to accurately identify the tax base, and how to cap avoidance – a major problem facing wealth taxes.

A better option might be a land value tax (LVT), which is much harder to avoid and so is a good way for the state to raise revenue. It is efficient, and is similar to taxing economic rent. It has been advocated by many economists, including Adam Smith and David Ricardo. Location largely determines land values. Therefore land values are not determined by what the owner does with the land, but by the services provided by the state and the community around the land. Proximity to key public services, access to transport, and adequate infrastructure influence the value of land (Dolphin 2013). The Mirrlees review says the case for an LVT is 'almost undeniable'. It encourages productivity-enhancing activity, as the tax paid does not tax any improvements made to the land or property on the land. This type of tax, therefore, could stimulate efficient development of land. The difficult part would be accurately valuing the land; but once this has been determined, this type of tax is easy to collect – and hard to avoid. Countries that have a land value tax include: Austria (1 per cent), Denmark (1.6 to 3.4 per cent) (Lawton and Reed 2013).

Financial transaction taxes (FTTs) are a topic of fierce debate among policymakers and politicians across the EU. They have the potential to raise significant amounts of revenue and 11 countries across the EU are seeking to introduce a financial transaction tax in the coming year – although it has faced fierce resistance and legal hurdles.[12] The EU proposal would involve a tax of 0.1 per cent on the exchange of shares and bonds, and a tax of 0.01 per cent on derivative contracts. This would apply to transactions including at least one financial institution that is based in a member state of the EU.

12 http://www.ft.com/cms/s/0/b0a6c7a8-19fd-11e3-93e8-00144feab7de.html#axzz2lIL0wdM6 (£)

The rationale behind such a tax is that it would work to stabilise the finance industry by reducing the rewards of high-risk activities, such as high-frequency trading, hedge funds and proprietary trading. Proponents of FTTs also argue they would discourage speculation and allow for more efficient allocation of capital (Dolphin 2013); and this type of tax would probably prove popular among the general public. Many feel that the finance industry has not contributed enough towards the recovery and tax revenues, particularly as it is judged responsible for the financial crisis. A recent YouGov poll found 61 per cent of people support introducing such a tax, in comparison to the 19 per cent that would oppose it. If the 11 EU countries go ahead with their financial transactions tax and it proves not to have significant detrimental effects, the case for the UK following suit would be a strong one.

Environmental taxes have some potential as an additional source of tax revenues, particularly as climate change pressures intensify**.** Although a number of environmental taxes are now in place there is further scope to increase 'green' tax revenues to internalise the costs of environmental damage – the 'polluter pays' principle – and to raise additional revenues. At present, the largest source of income from environmental taxes comes from fuel duty, though it is an indirect charge on vehicle emissions. The Mirrlees review argues it is a poorly targeted tax, and in its place could be a better-targeted tax such as road pricing. Estimates suggest moving to a congestion charge, a form of road pricing, could raise revenues equivalent to 1 per cent of GDP.

Finally, the UK could look to introduce a version of the alternative minimum tax (AMT), brought in in the US in 1982. This would be designed to stop individuals, companies and other taxable entities, such as trusts, using exemptions and avoidance schemes to excessively reduce their tax bills. The tax liability for AMT would be assessed by applying a single rate to all income above a certain threshold (one that is higher than the income tax allowance to allow for the valid use of other tax allowances). If the liability under AMT came out larger than the individual or company's liability under the normal income or corporation tax system, they would have to make up the difference. If not, the calculation would be disregarded. Such a tax would reduce the scope for higher earners to limit their tax liability to the point that they pay a lower average tax rate than those on low and middle incomes.

Conclusion

Some of the main options for increasing tax and social security revenues in the UK are set out in the following table.

Table 4.1
Options for raising tax revenues

Tax change	Revenue raised in 2013/14 (£m)
Increase basic rate of tax by 1p	3,700
Increase higher rate by 1p	635
Increase employee main rate of national insurance contributions by 1p	3,550
Increase employer main rate of national insurance contributions by 1p	4,200
Increase lower capital gains rate by 1p	5*
Increase upper capital gains rate to 40 per cent	960*
Increase main rate of corporation tax by 1p	460
Increase rate of inheritance tax by 1p	30
Increase standard rate of VAT by 1p	4,750
Introduce mansion tax	1.700
Introducing annual net wealth tax of 1%	6,900

Sources: http://www.hmrc.gov.uk/statistics/expenditures/table1-6.pdf, Lawton and Reed 2013
Note: * Estimates for 2014/15

REFERENCES

Browne J and Roantree B (2012) *A Survey of the UK tax system*, London: Institute for Fiscal Studies

Brys B, Matthews S and Owens J (2011) *Tax Reform Trends in OECD countries*, Paris: OECD

Clark T and Dilnot A (2002) *Long-Term Trends in British Taxation and Spending*, London: Institute for Fiscal Studies

Council of European Municipalities and Regions [CCMR] (2012) *EU Sub-National Governments 2010 Key Figures*, Paris/Brussels

Dolphin T (2010) *Death and Taxes: Why Inheritance Tax should be replaced with a Capital Receipts Tax*, London: IPPR. http://www.ippr.org/publication/55/1818/death-and-taxes-why-inheritance-tax-should-be-replaced-with-a-capital-receipts-tax

Dolphin T (2013) *Don't bank on it: The financialisation of the UK economy*, London: IPPR. http://www.ippr.org/publication/55/10058/dont-bank-on-it-the-financialisation-of-the-uk-economy

Dolphin T and Lawton K (2013) *A job for everyone: what should full employment mean in 21st century Britain*, London: IPPR. http://www.ippr.org/publication/55/11002/a-job-for-everyone-what-should-full-employment-mean-in-21st-century-britain?

Ernst & Young (2013*) Indirect Tax in 2013: A review of global indirect tax developments and issues*, UK: EYGM

European Commission [EC] (2010) *Monitoring tax revenues and tax reforms in EU member states*, Brussels

European Commission [EC] (2011) *Tax reforms in EU Member States 2011: Tax policy challenges for economic growth and fiscal sustainability*, Brussels

European Commission [EC] (2013) *Taxation Trends in the European Union*, Brussels

Evans C (2013) *Wealth taxes: problems and practice around the world*, Birmingham: Centre for Household Assets and Savings Management

Fabian Society (2013) *Spending Wisely: Principles for a good spending review*, London

Institute for Fiscal Studies [IFS] (2010a) *Tax by Design: The Mirrlees Review*, London

Institute for Fiscal Studies [IFS] (2010b) *Dimension of Tax Design: The Mirrlees Review*, London

IPPR North and Northern Economic Futures Commission [NEFC] (2012) *Northern prosperity is national prosperity: A strategy for revitalising the UK economy*, London: IPPR. http://www.ippr.org/publication/55/9949/northern-prosperity-is-national-prosperity-a-strategy-for-revitalising-the-uk-economy

Johnson P (2009) 'Opportunities for new taxes' in Oppenheim C and Dolphin T (ed) *Opportunities in an Age of Austerity: Smart ways of dealing with the UK's fiscal deficit*, London: IPPR. http://www.ippr.org/publication/55/1745/opportunities-in-an-age-of-austeritysmart-ways-of-dealing-with-the-uks-fiscal-deficit

Johnson P (2012) *Fairer by design: efficient tax reform for those on low to middle incomes*, London: The Resolution Foundation

Johnson P (2013) *Better Budgets: making tax policy work*, London: Institute for Fiscal Studies

Lawton K and Reed H (2013) *Property and Wealth Taxes: The context for reform*, London: IPPR. http://www.ippr.org/publication/55/10503/property-and-wealth-taxes-in-the-uk-the-context-for-reform

Lawton K and Silim A (2012) *Pressures and priorities: The long-term outlook for Britain's public finances*, London: IPPR. http://www.ippr.org/publication/55/9633/pressures-and-priorities-the-long-term-outlook-for-britains-public-finances

Office for Budget Responsibility [OBR] (2013) *Fiscal Sustainability*, London

OECD (2011) *Environmental taxation*: A guide for policy makers, Paris

OECD (2012a) *Revenue Statistics 1965-2011, 2012 Edition*, Paris

OECD (2012b) *Consumption Trends*, Paris

OECD (2012c) *Taxing Wages 2011: Special Feature: Trends in personal income tax and employee social security contribution schedules*, Paris

OECD (2013) *Taxing energy use*, Paris

Office for National Statistics [ONS] (2006) *UK environmental taxes: classification and recent trends*, Newport

Stamatova S and Steurer A (2012) *Environment and energy*, Brussels: European Commission

Thomas A and Picos-Sanchez F (2012) *Shifting from Social Security Contributions to Consumption Taxes: The impact on Low-Income Earner Worker Incentives*, Paris: OECD

ANNEX
OVERVIEW OF UK TAXES

This annex sets out the broad structure of the major taxes in the UK.

Personal income tax

As with most personal income tax systems across the OECD, the UK income tax system has a set of allowances and different rates for different bands of income. The UK has three personal income tax rates of 20 per cent for taxable earnings up to £34,370, 40 per cent for taxable earnings between £34,370 and £150,000 and a top statutory income tax rate of 45 per cent, applicable for earnings above £150,000. All workers are entitled to a certain level of earnings before tax – the personal allowance. In 2013–14, taxpayers below the male state pension age of 65 years old have a personal allowance of £9,440, while older people are entitled to higher personal allowances – £10,500 for workers between 65 and 74 years old, and £10,660 for workers older than 74 years of age.[13] Although older people are entitled to higher thresholds, the personal allowance amounts are tapered for those earning above £26,100. Additionally, new claimants are no longer entitled to this age-related allowance. The allowance is also tapered for those earning more than £100,000. Although most income is subject to income tax, there are some exemptions and different rates. Means tested benefits and child benefits are exempt from taxation, certain types of savings are also classified as non-taxable income or are subject to different income tax rates (Browne and Roantree 2012).

National Insurance contributions

Social security contributions are paid by employees and employers. For employees, contributions are paid at a rate of 12 per cent above the primary threshold of £149 a week in 2013–14 up to the upper earnings limit of £797. Above the upper earnings limit, earnings are subject to a rate of 2 per cent. Employers pay according to a different schedule of taxation. For every employee that earns above £148 per week, they must pay 13.8 per cent of all earnings above this level. Although in principle national insurance contributions entitle workers to particular social security benefits, the link between the payments and benefits has weakened over time (ibid).

VAT

Since early 2011, the VAT rate has been set at 20 per cent, up from 17.5 per cent. There are a number of goods eligible for the reduced rate of 5 per cent including domestic fuel and power, sanitary products, children's car seats, contraceptives, certain residential conversions and renovations, certain energy-saving materials and smoking cessation products. In addition to reduced-rate goods, there are a number of other goods that are either zero-rated or exempt from VAT including food and drink, water supplied to households, books, children's clothes and footwear, and financial services. This means the UK has a comparatively narrow VAT tax base.

Excise duties

Excise duties are applied to specific goods including alcoholic drinks, tobacco and road fuels. A flat rate is applied per unit; in addition all tobacco rates have an additional rate of 16.5 per cent applied to the total retail price (ibid). These are commonly known as sin taxes – and are implemented at high rates in order to drive down consumption – though they also generate additional revenue for the Treasury.

13 http://www.hmrc.gov.uk/incometax/personal-allow.htm

Corporation taxes

The standard corporation tax rate is 23 per cent, due to fall to 21 per cent in 2014 and 20 per cent in 2015. A reduced rate of 20 per cent already applies to companies with profits below £300,000.[14] For companies with profits higher than £300,000 but below £1,500,000 a set of reliefs apply leading to an effective marginal rate of 25 per cent on profits greater than £300,000 in 2012–13 (ibid). This system of reliefs increases the average tax rate up to 24 per cent for the same year.

Corporate tax rates are levied on global profits of UK resident companies, public corporations and unincorporated associations. For firms that are not classified as resident, these firms pay tax only on profits generated within the UK (ibid).

Property and wealth taxes

There are a number of taxes on property and wealth in the UK. Of these, council tax is the most important source of revenue. Council tax is levied against the value of a property in 1991. Each property is categorised into a council tax band with a corresponding council tax charge. There are a number of discounts available for single occupancy, or second homes. Stamp duty land tax is a transaction tax on property sales, levied on the buyer. Rates range from 1 per cent on properties purchased for more than £125,000 to 7 per cent on properties bought for over £2 million. Inheritance tax and capital gains tax are two other taxes on wealth. Inheritance tax is charged on the estates of the deceased, or on gifts given seven years before death. A rate of 40 per cent is charged on estates over the value of £325,000. If the value of the estate is transferred to a spouse, no tax is levied and the relief is preserved (meaning the surviving spouse can leave an estate of £650,000 without being liable to inheritance tax). Capital gains tax is levied on 'gains arising from the disposal of assets by individuals and trustees'. It is set at a rate of 18 per cent for basic rate taxpayers and 28 per cent for higher and additional-rate taxpayers, although like many other taxes it is subject to certain exemptions and reliefs.

Environmental taxes

The Treasury and the ONS have different taxes which they consider environmental taxes. For the Treasury, the Climate Change Levy, Aggregates Levy, Landfill Tax, EU Emissions Trading System, Carbon Reduction Commitment and the Carbon Floor Price are all classed as environmental taxes. The ONS also includes Fuel Duty, VAT on Fuel Duty, Renewable Energy Obligation, Vehicle Excise Duty and Air Passenger Duty in its definition. In 2003, a congestion charge was also implemented in London.

14 http://www.hmrc.gov.uk/rates/corp.htm