# Indirect and business taxes

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# Overview

- VAT
- Sin taxes
- Transport taxes
- Business taxes

# VAT

- Main rate of VAT cut from 17.5% to 15%
  - For 13 months: from December 2008 to January 2010
- Costs £12.4bn
- If and when retailers adjust prices…
- Prices of goods subject to full VAT fall by 2.1%
  - Prices of exempt (NOT zero-rated) items should also fall, but by less
  - Offset by increased excise duties
- These are just over half of consumer spending
  - Just under half if alcohol, tobacco and road fuel excluded
- Overall RPI falls by about 1.2%
  - Maybe 0.1% higher if account for exempt items; 0.2% lower if account for duty rise
  - CPI falls by a bit more

# VAT cut – an effective fiscal stimulus?

Cutting VAT for 13 months does two things:

1. Puts £12.4bn into people's pockets: how much will they spend and how much save?
2. Reduces prices in 2009 relative to 2010 and beyond: bring spending forward to 2009?

1. How much of the giveaway will people spend?

- WRONG: "income tax cuts might be saved; VAT cuts only gives money to people if they spend"
  - Can still be saved: buy the same amount at a lower price and pocket the difference
- Will people save up for future tax rises?
  - How far-sighted are people?
  - Future tax rises might hit different people
  - Would public spending cuts force people to spend more of their own money instead?
  - Big future tax rises not a prominent feature of yesterday's announcement!
- Will forward-looking consumers spread the benefit of a one-off giveaway over a lifetime?
- People who are credit constrained might spend it
  - Temporarily low income, especially young: would like to spend more now and pay later, but can't borrow (more)
  - Government in effect gives them a loan; will tax them (or others) later to pay for it
  - Access to credit an unusually big issue at the moment?

# VAT cut – an effective fiscal stimulus?

2. Take advantage of the temporary tax cut by buying things while the tax rate is low
   - White goods, furniture, clothes, electronics, cars, holidays,…
   - How easily can people substitute between spending this year and next?
   - This is a distortion as well as a stimulus: people would really prefer to buy next year
   - Spending brought forward means spending less in 2010 – will the recession be over by then?

- £12.4bn costing seems to assume that neither of these effects happen
  - None of the giveaway spent: people buy the same amount at a lower price
  - No consumption shifting into 2009
  - If this is the assumption, £12.4bn is an overestimate, though also some extra cost in 2010

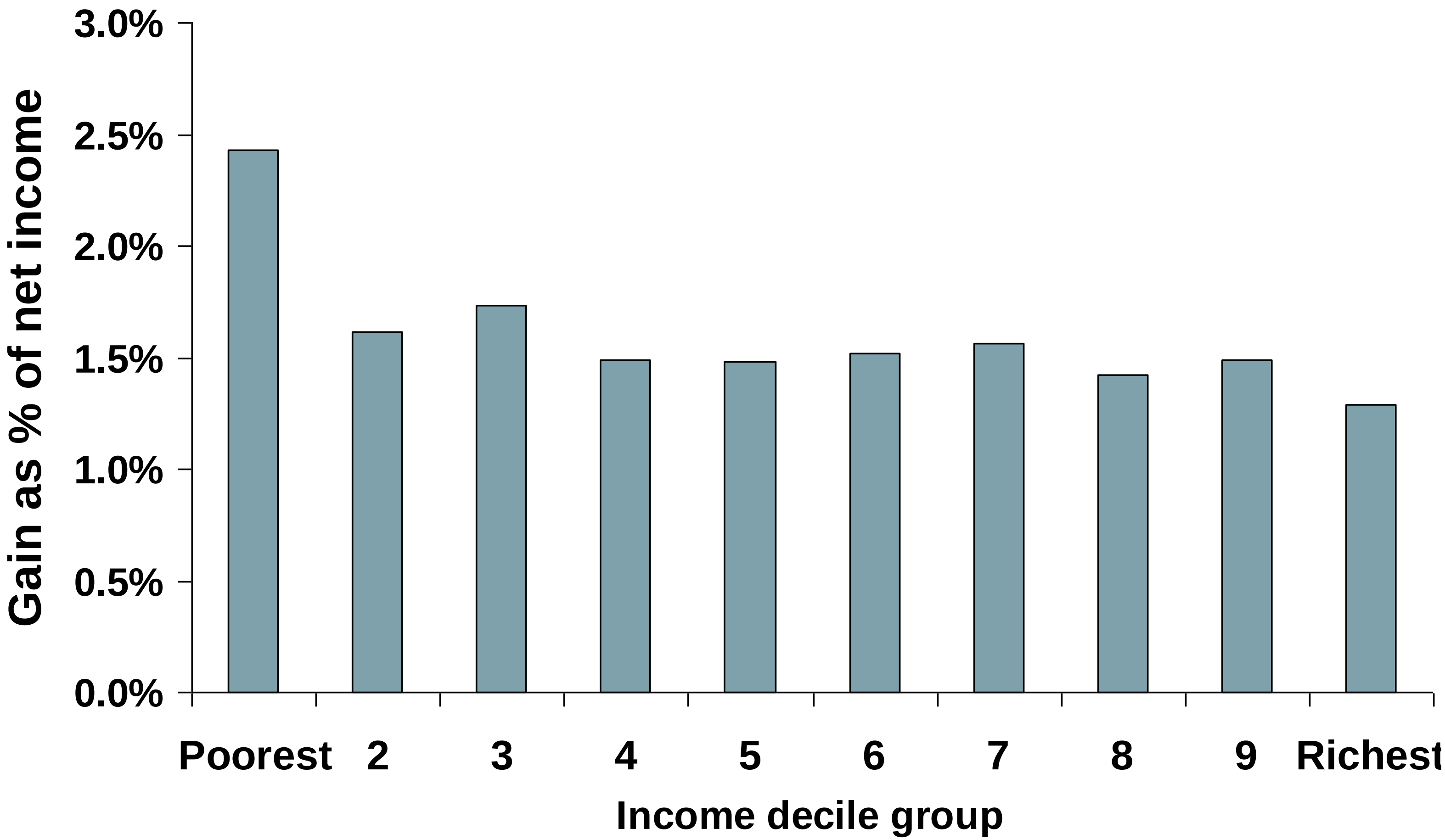
- People will buy more things at a lower price
  - Total (VAT-inclusive) spending could go up or down
  - But firms are selling more and receiving the same (VAT-exclusive) price, so produce more and employ more people, at least in 2009

# VAT cut – helping the rich or the poor?

- Gains are proportional to spending on VATable goods and services
- Low-income households gain most as a percentage of income
  - Many have high spending relative to their income
- High-spending households gain most as a percentage of spending
  - No VAT on many necessities – a bigger share for poorer households
- Which is a fairer / more enlightening picture?
- Spending can't exceed income forever!
  - So why might households with low income this year have high spending this year?
  - May be permanently poor, happen to have high spending needs this year
    - ➢ Income-based picture is accurate
  - But maybe (more likely?) spending better reflects lifetime income: current low income is temporary
    - ➢ Spending-based picture is accurate
  - Much low income is temporary (volatile earnings, unemployment, study, child-raising, retirement,…)
  - If spending is smoother than income, might be a better guide to lifetime living standards

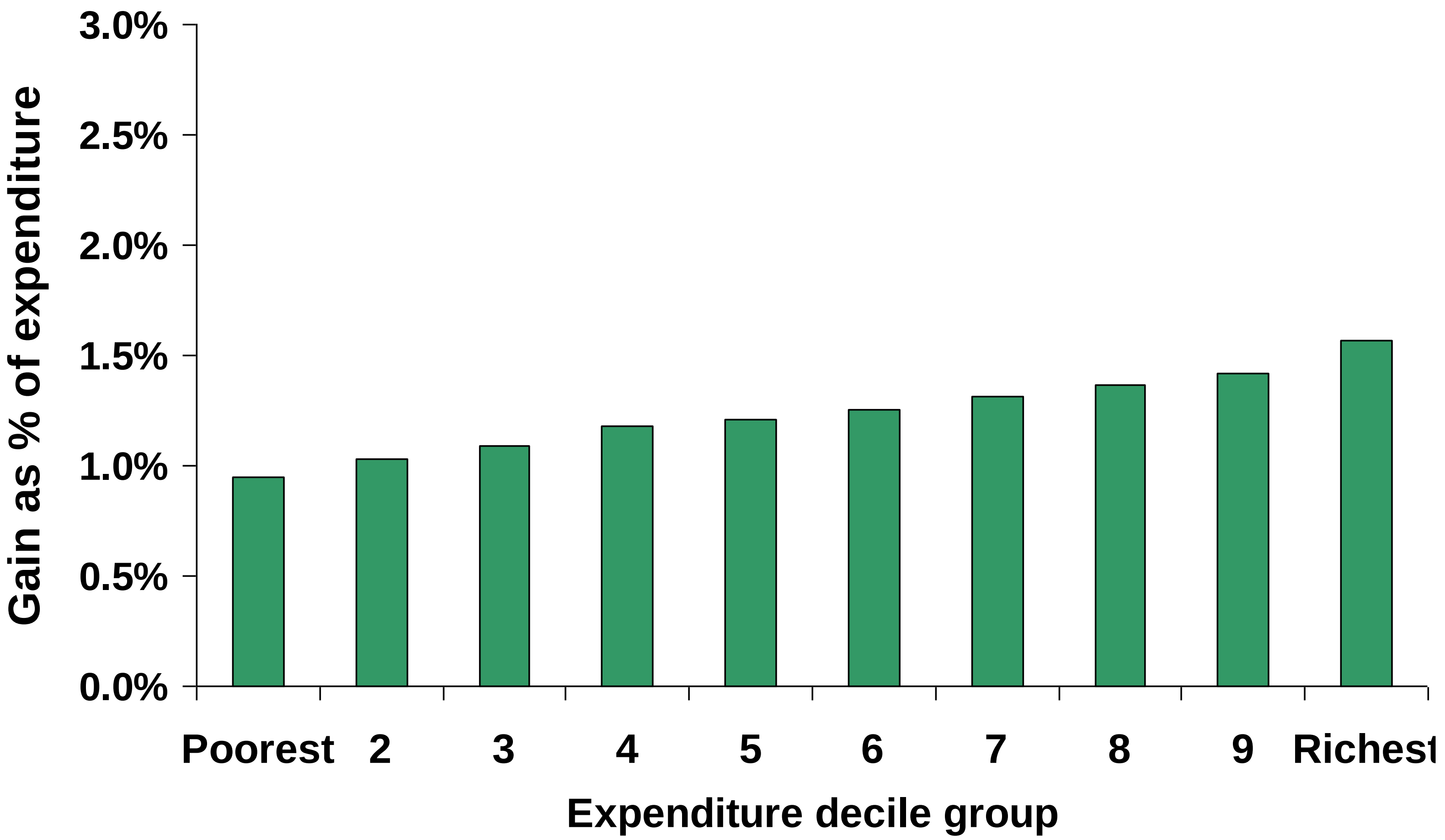
# Gains: % of income, by income level

## VAT + duty changes



# Gains: % of spending, by spending level

## VAT + duty changes



# Cigarettes and alcohol

- Increase in duty rates
  - Cigarettes up by 2% of price: about 17p per pack
  - Pint of beer up 3p, bottle of wine 13p, bottle of spirits 53p (roughly)
- Raises about £1bn
- Price increase similar to reduction caused by VAT change
- But duty increases permanent, whereas VAT cut temporary
- Tobacco duty rise is on top of inflation-uprating in 2008 and 2009
- Alcohol duty rise is on top of 6% real increase in 2008 and 2% each year thereafter until 2013

# Transport taxes

- Fuel duty: 2p nominal increase (previously postponed) to take effect next month
  - As with cigarettes and alcohol, temporarily offset by VAT cut
- Vehicle Excise Duty: reforms watered down
  - Will still be more bands + different first-year rates from April 2010; will still apply to existing cars
  - But rise for more polluting cars is smaller than original plans
  - And cuts for less polluting cars delayed until April 2010
- Air passenger duty: reforms watered down
  - Abandoned switch from per-passenger to per-plane tax
  - Sensibly relate to distance from London instead of EEA / non-EEA split
  - Aviation also being brought within ETS from 2012

# Business tax measures

- Rise in small companies' corporation tax rate from 21% to 22% delayed until 2010
- Exemption of foreign dividend income for large and medium-sized companies
  - Subject to TAAR and various other safeguards
- Temporary increase in threshold for tax on empty business properties
- Measures to help firms (esp small firms) with cash-flow problems
  - New loan guarantee schemes
  - Facility for firms in difficulty to defer payment of taxes
  - Funds for equity capital injections
- Temporarily allow carry-back of £50,000 of losses against profits from last 3 years instead of 1

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