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IFS-CIOT debate

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Is it time for a windfall tax?



Economic
and Social
Research Council

What is a windfall tax?

Typically:

- One-off, retrospective tax on a group that has received a windfall

A tax could have some of those features but not others:

- One-off tax not related to specific windfall, e.g. one-off wealth tax
- Tax on windfall that isn't one-off and retrospective, e.g. Labour hasn't ruled out possibility of taxing oil & gas companies next year too

Windfall taxes in the UK

Actual:

- 1997 – privatised utilities
- 1981 – banks

Proposed:

- N. Sea oil & gas (now and e.g. 2008)
- Pandemic profits
- One-off wealth tax
- Banks after financial crisis

Economically efficient?

- Broadly, efficient if doesn't induce changes in behaviour to reduce tax
- If based on past outcomes, can't reduce liability → potentially efficient
- But behaviour also affected by expectations/uncertainty about future tax
- Would a 'one-off' tax make people worry about other 'one-off' taxes?
- Not necessarily just a repeat of the same tax
- Part of wider concern about uncertainty and unpredictability in tax
- Effects on expectations/uncertainty not all-or-nothing
 - Credible narrative for why there's a truly one-off justification?
 - Promise that tax will be one-off?

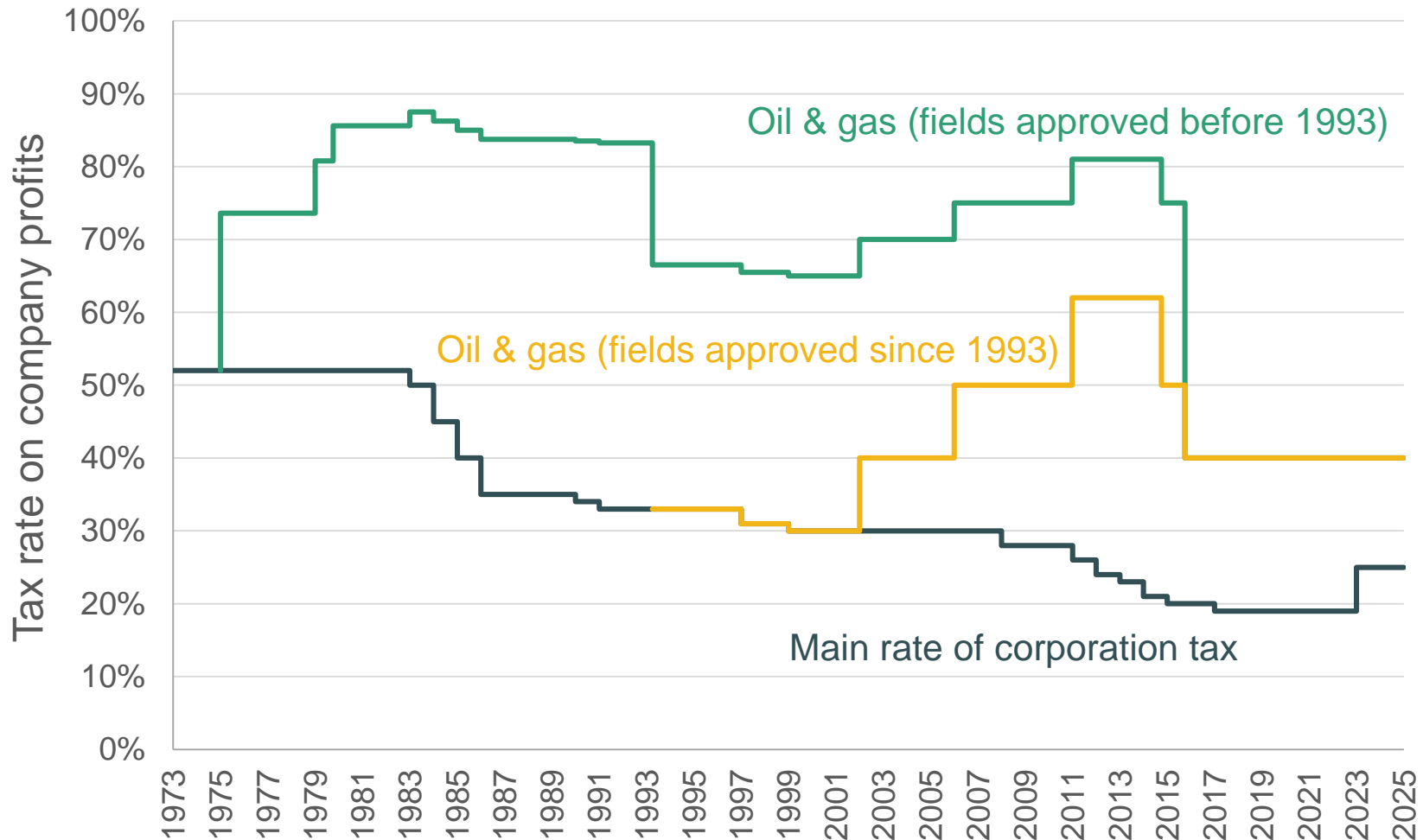
Fair?

- Shareholders benefited from good fortune they did nothing to earn
 - As long as announce promptly: shareholders change!
- Retrospective
 - But maybe reflects unforeseen events that couldn't be legislated for?
- One-sided
 - No-one proposes windfall subsidies when the oil price falls!
- Arbitrary
 - Tax some windfalls, not others

North Sea taxation is different

- Companies do pay more tax when make bigger profits
- If think that doesn't go far enough, why not simply increase tax rates?
- General answer: higher tax rates would discourage UK investment
 - Windfall tax is a way to tax brute luck more than productive activity
- But North Sea oil & gas is an unusual case:
 - Location fixed → international competitiveness doesn't matter
 - Close to cash-flow tax → high rates shouldn't discourage investment
- So can tax *all* North Sea profits at a high rate

North Sea taxation is different



Note: Excludes royalties paid until 2003 on fields approved before 1982. Source: IFS Taxlab.

Conclusions

- Windfall tax can be an economically efficient way to tax the fortunate
 - But only to the extent it doesn't increase worries about future taxes
- Is it fair?
 - ✓ Taxpayers did nothing to earn their good fortune
 - ✗ Arbitrary, one-sided and retrospective
- Usually better to say in advance how much tax should be paid in different circumstances
 - Need a strong reason to deviate from that
- North Sea oil & gas could bear permanently higher tax
 - But stability and predictability would also be nice!