Options for tax increases

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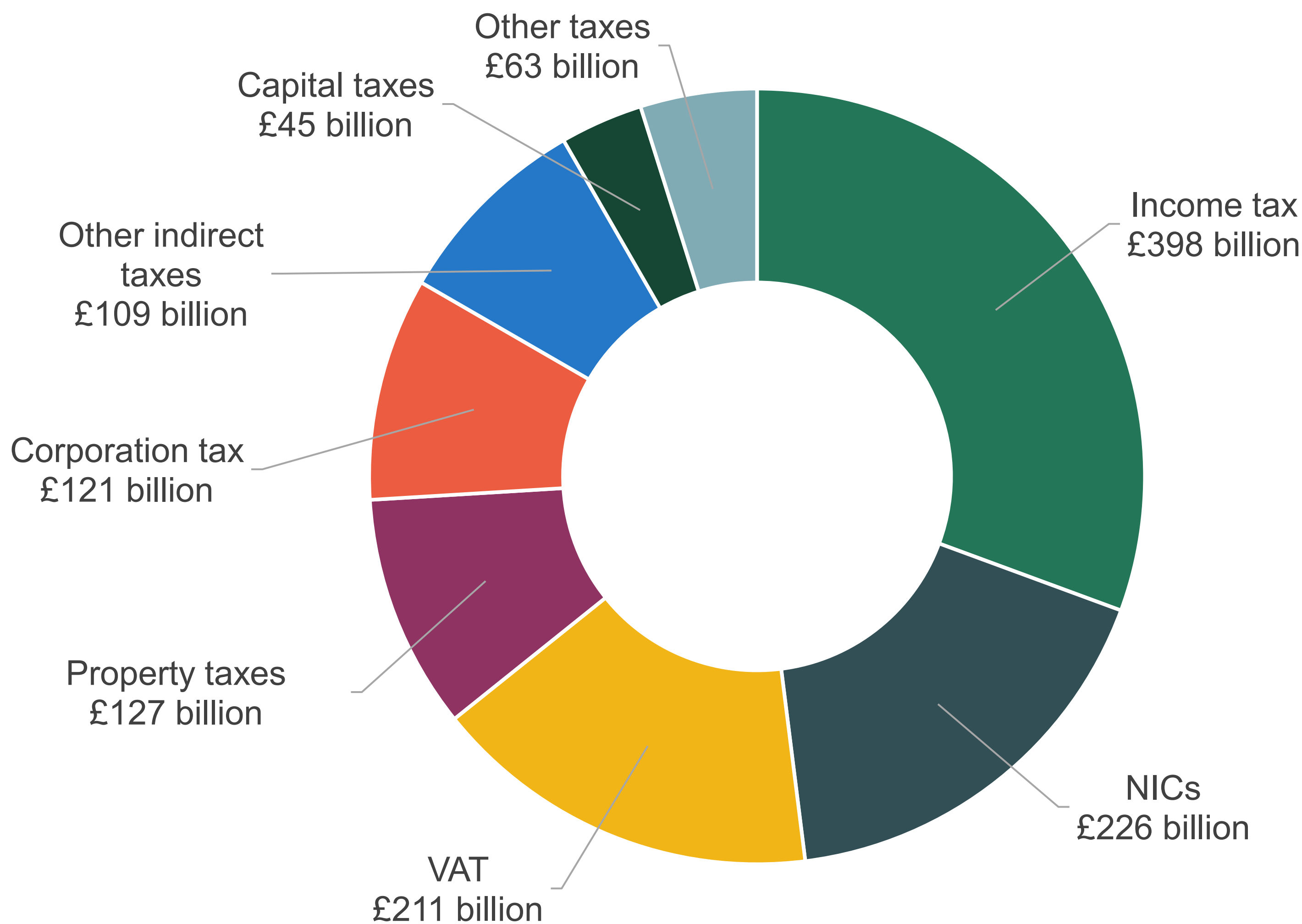
@TheIFS

Economic and Social Research Council

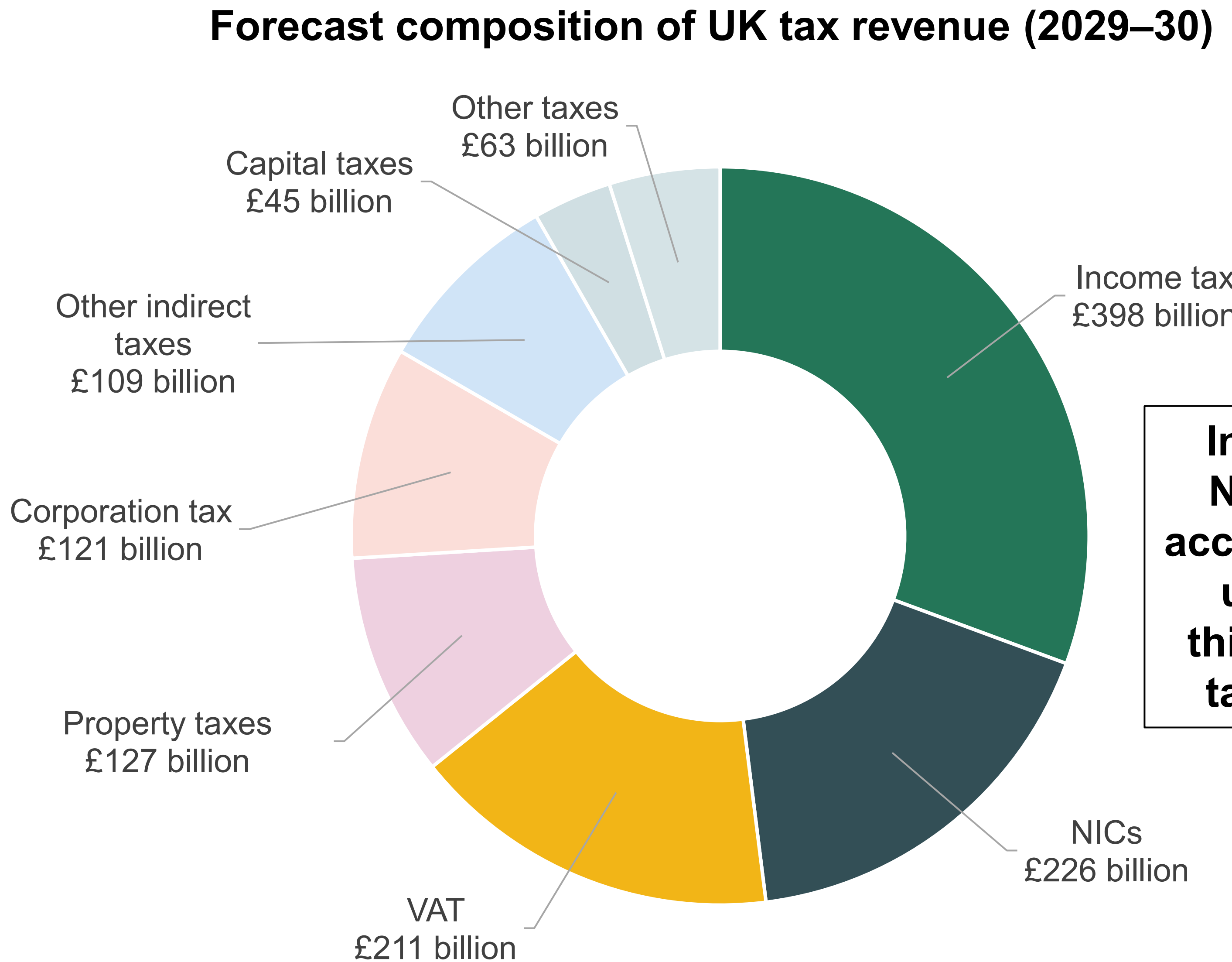
Where does revenue come from?

Forecast composition of UK tax revenue (2029–30)



Source: IFS Green Budget 2025, Fig. 4.1

The ‘big three’



Income tax, NICs & VAT account for just under two thirds of total tax revenue

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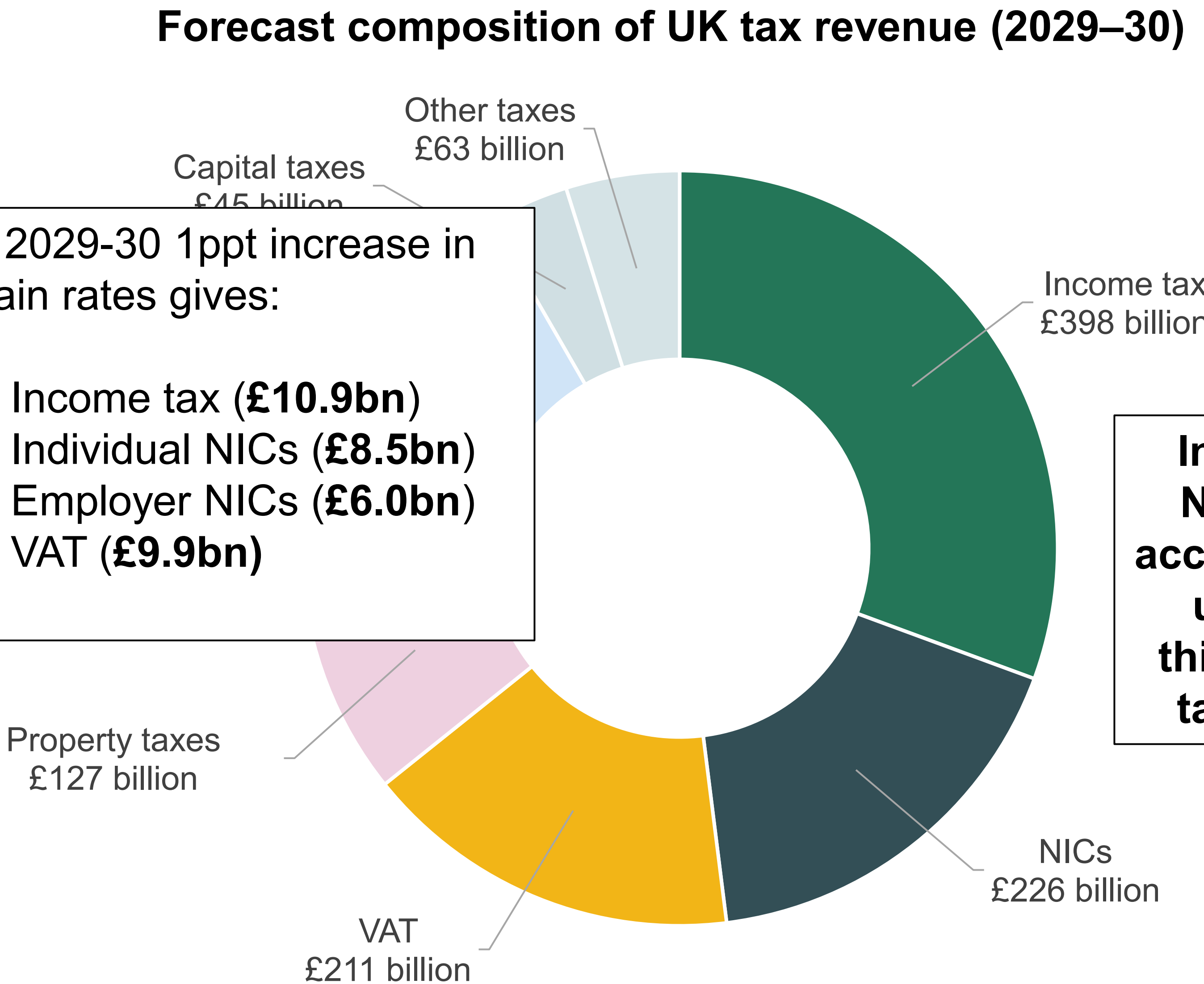

In 2029-30 1ppt increase in main rates gives:

- Income tax (**£10.9bn**)
- Individual NICs (**£8.5bn**)
- Employer NICs (**£6.0bn**)
- VAT (**£9.9bn**)

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The big three

Labour Party manifesto 2024:

> ‘Labour will not increase taxes on working people, which is why we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT.’

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- Seems to rule out all increases to NICs and VAT
- More wiggle room on income tax…
- Could broaden base or reduce thresholds
  - Freeze ends April 2028; extending to April 2030 yields **£10.4bn** (on current inflation forecasts)
    - **BUT** including NICs would break manifesto promise
    - Vagaries of future inflation determine scale of tax rise

I can’t believe it’s not NICs

Another option would be to create a new tax altogether:

- E.g. apprenticeship levy (2015) / health & social care levy (2021)
- Could raise big money
- But would add unnecessarily to complexity

Beyond the big three

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Manifesto ties the Chancellor’s hands on ‘big three’.

Could the answer be the next biggest four?

- Corporation tax
- Council tax
- Business rates
- Fuel duties

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Corporation tax

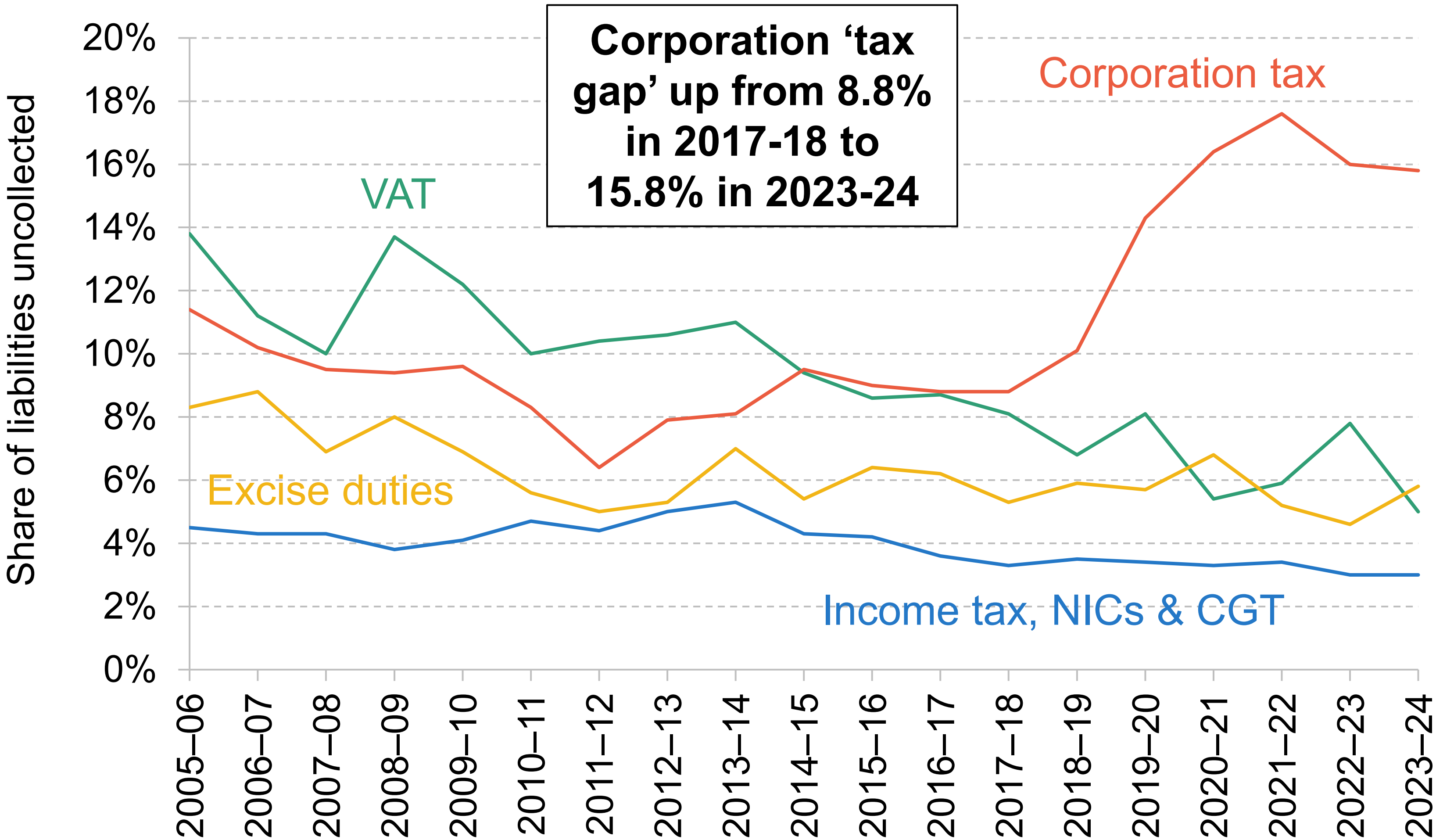
Corporate Tax Roadmap 2024 published alongside last Budget

- Committed to maintaining almost all major features of the tax
- Very little scope for significant revenue increases
- Bank surcharge left ‘under review’ by the *Roadmap*
  - Doubling the rate would raise only around **£1bn**

Corporation tax compliance

Potential scope to improve compliance.

The corporation 'tax gap'



Corporation tax compliance

Revenue to be had from improving compliance.

- Entirely driven by smaller companies (40% tax gap in 2023-24)
- Corporation tax gap represents **£24bn of lost revenue in 2029-30**
- Returning the gap to 2017-18 level **could raise £10 billion**
- But may be easier said than done

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- **Council tax**
- **Business rates**
- Fuel duties

Council tax & business rates

Council tax

4.3% annual increases (in England) already baked into the OBR forecast

- Would need to increase by more to raise additional revenue
- Additional 1% increase would yield **£0.5bn** in 2029-30

Could increase rates at the top. If band D rates don't change:

- Applying 2017 Scottish reforms to England yields **£1.9bn**
- Doubling rates on band G & H properties yields **£4.2bn**
- But based on out-of-date valuations

Revenue would go to local authorities, not HMT

Business rates

(Modest) reform under way; but looks to be revenue-neutral

Reforming property taxation

Arguably the worst designed part of the tax system:

- Council tax still (absurdly) based on 1991 property values
- Business rates distort production decisions & drag on growth
- Stamp duty land tax leads to misallocation of property

Chancellor should take steps towards:

- Land value tax on commercial properties (if feasible)
- Proportional tax on up-to-date residential property values
- Would replace business rates, council tax and SDLT

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- Corporation tax
- Council tax
- Business rates
- **Fuel duties**

Fuel duties

Haven’t been increased in cash terms since Jan 2011.

OBR forecast assumes :

- RPI indexation will resume next year
- And ‘temporary’ 5p cut (in place since 2022) will come to an end
- A combined cash increase of more than 20% by 2029-30

Chancellor needs to go *beyond* that to raise extra revenue.

Leaving duties frozen would *cost* **£5.4 billion** in 2029-30.

Reforming motoring taxation

Govt. policy that no new petrol or diesel cars will be sold from 2030

In the long run that entails:

- Loss of almost all the £24bn collected through fuel duties
- And much of the £9 billion raised from vehicle excise duties

Govt. <u>needs a plan</u> to deal with this.

Congestion imposes costs (makes ongoing motoring tax desirable).

Good option would be road pricing:

- Charge per mile driven
- Ideally higher in congested areas and times

Taxes on wealth and savings

Taxing returns to capital

Returns to capital can take many forms, e.g.:

- Rental income from property (actual and imputed)
- Interest income
- Dividend income
- Capital gains

Could be tempting for the Chancellor:

- Might look like she isn't taxing 'working people'
- Taxed (usually) at lower rates than employment income

Taxing returns to capital

Chancellor could increase rates on capital returns. In 2029-30:

- 1ppt increase in dividend tax rates yields **£0.4bn**
- 1ppt increase rates charged on interest income yields **£0.2bn**
- Abolition of business assets disposal relief: **£0.9bn**
- HMRC estimates CGT increases *reduce* revenue
  - Behavioural response highly uncertain

Rate increases imply a trade off:

- Reduce gap between tax on employment and capital incomes…
- …although increase other gaps
- **BUT** worsen disincentives to save and invest (& other distortions)

Taxing returns to capital

Good end goal:

- Fix the tax base, including:
  - Give full deductions for saving & investment
  - End forgiveness of CGT at death (yields **£2.3bn** in 2029-30)
- Align rates across different income and gains

Would leave the tax system fairer & more growth-friendly

Time for a wealth tax?

Three reasons to avoid an annual wealth tax:

1. Has all the disadvantages of distorting saving & location decisions
2. Doesn’t tax high returns to capital
3. Big practical difficulties (e.g. valuing businesses)

International experience not encouraging

- Most countries that had them no longer do

Better to focus on fixing existing taxes

Taxing pensions

For income tax:

Contributions (exempt) → **Returns** (exempt) → **Withdrawals** (taxed)

Coherent approach with some desirable features:

- Avoids some penalties on saving
- Allows some people to reduce tax penalty for volatile incomes
- Provides revenue when needed (retirees make more use of NHS)

Taxing pensions

Chancellor *could* cap relief on contributions (e.g. to 20%):

Contributions (relief capped) → **Returns** (exempt) → **Withdrawals** (taxed)

- Could raise as much as **£22bn** in 2029-30
- But would be unfair and distortionary
- Would also raise major practical challenges around DB pensions

Some better options for revenue:

- NICs relief on employer contributions costs **£30bn** in 2029-30
  - 1% employer NICs on employer contributions: **£1.5bn** in 2029-30
- Tax-free 25% is poorly targeted at under-saving

All the rest

Other options for revenue

Many smaller taxes that could yield revenue, e.g.:

- Inheritance tax
- Tobacco & alcohol duties
- Air passenger duty
- Insurance premium tax
- Gambling taxes
- Environmental taxes

Some of those sillier than others (IPT deserves a special mention).

Could add up to substantial money, but hard to get very large amount.

One area where *could* get big revenue in medium term:

- Genuine economy-wide carbon tax

Conclusions

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- Well known that Labour manifesto rules out most changes to ‘big 3’
  - Less discussed: next four (corporation tax, council tax, business rates & fuel duties) all difficult too.
- Still possible to raise tens of billions without breaking Labour’s manifesto promise on the ‘big three’
  - Although not without taxing ‘working people’
- But restrictions increase risk of choosing more damaging options
- Almost any tax increases will drag on growth
  - But that impact can be softened if the Chancellor pursues sorely needed reforms (e.g. capital income & property taxes)