Tax, Benefits, Pensions
Keep it simple Part 2: Ten steps to simplicity

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- This report should be read in conjunction Mark Nicholson's report "Keep it simple: UK tax system out of control" Bow Group, January 2006[1]

[1] http://www.bowgroup.org/harriercollectionitems/UK+Tax+System+out+of+Control.1.pdf

PART A: EXECUTIVE SUMMARY

Most voters, taxpayers, politicians and economists would agree with the following propositions:

- Social justice requires a cast-iron safety net for those without full-time paid employment, but one which does not discourage people from seeking employment;
- Social justice requires a cast-iron safety net against pensioner poverty, but one which does not discourage saving or distort investment decisions;
- Taxes have to be raised to pay for public services and to meet social justice objectives, but should be raised in a straightforward and fair manner than minimises disruption to the economy;
- Taxes should be easy to understand, cheap to collect and difficult to avoid.

The leader of any mainstream political party could have espoused these statements. Yet the gap between what this implies a tax/welfare system should look like and the system we in Britain actually have, is vast, dangerous, and widening. And the true human cost of this disconnect makes the political ineptitude that has brought it about unforgiveable.

The British economy has 1.6 m fewer jobs than it should; perverse incentives in the housing market force young families to make do with cramped accommodation while 1 m poorer pensioners have three or more spare rooms; numerous tax loopholes enable the rich to avoid paying their fair share; the triple burdens of creating, administering, and complying with a tax system of such complexity actively discourage millions from engaging in productive economic activity; perhaps most scandalous of all, many of our nation's poorest - those who need money and the necessities it buys most - do not collect their fair share of social benefits, because the complexity of doing so is so great.

Too often the debate about tax in Britain has focused solely on the end - the *size* of the state. There are many respectable arguments for and against big government, and doubtless the argument will run and run. But there are *no* respectable arguments for the burdens imposed by a complex tax system. Thinking politicians of all parties need to join forces and forge a consensus in favour of fundamental reform of the way the government raises money, to bring it into line with the principles in which they claim to believe.

It may as come as a surprise to learn that the entire UK[2] tax, benefits and pensions systems could be replaced on a fiscally neutral basis by ten simple proposals. This is not a menu[3]; it is a consistent, coherent and inter-locking system that will have more net winners (particularly among low- and average earners) than net losers, although in any particular case, the net gains or losses will not be particularly large.

[2] This excludes VAT, which is largely dictated by EU rules.
[3] Thanks to Graeme Leach for this expression

PART A: EXECUTIVE SUMMARY

Summary: Ten steps to Simplicity

1. **Employment and Self-Employment Income:** The personal allowance will be increased to £11,000. Employee's National Insurance and Working Tax Credits will be scrapped and amalgamated into a single income tax rate of 38% on all earned income above the personal allowance.

2. **Business Taxation:** Employer's National Insurance will be scrapped and corporation tax will be increased to 38% on all trading, professional or rental income. Gimmicky tax breaks such as R&D tax credits or the Corporate Venturing Scheme will be scrapped. Business rates will be reduced to 30% of the rateable value, without exemptions for unoccupied business premises.

3. **Reducing the Compliance Burden:** The UK's tax year-end will be set to 31 December. Businesses will pay tax on their accounts profits, subject to pragmatic add-backs; unnecessary complications such as the schedular system and capital allowances will be scrapped.

4. **Investment Income:** There will be no higher rate tax on dividends from, or Capital Gains Tax or Stamp Duty on disposals of shares in UK companies. Non-repayable income tax at 20% will be deducted from all bank and bond interest, with no further tax being due. Gimmicky tax breaks such as ISAs, PEPs and TESSAs, EIS, VCT and Film Reliefs will be scrapped.

5. **Land Value Tax:** Council Tax, Stamp Duty Land Tax, Capital Gains Tax on disposals of land and buildings, Inheritance Tax and the TV licence fee will be scrapped and replaced with a "Land Value Tax" of 1% per annum on the value of all residential properties. The first £70,000 in value per household will be exempt.

6. **Child Benefit and Nursery Funding:** Child Benefit will be increased to £36 per week for children under 5. £60 per week will be paid towards nursery costs for children aged 2-4.

7. **A Basic Cash Benefit:** Adults not in paid work (or earning less than £11,000) will be entitled to a non-contributory, non-means tested, non-taxable Basic Cash Benefit ("BCB") of £80 per week, but will not also be entitled to a personal allowance for tax or PAYE purposes.

8. **Citizen's Pension:** From age 60, the BCB will increase by £3.75 per week for each year of age, up to age 71, at which point it will reach the maximum of £125. At age 66 the payments will be re-branded as "Citizen's Pension".

9. **State Second Pension:** The State Second Pension entitlement will be frozen and phased out over time.

10. **Private Pension Schemes:** Tax relief for private pension contributions will be 38%, but restricted to the first £4,400 gross contributions per annum (£2,728, net of tax).

PART A: EXECUTIVE SUMMARY

Most of the proposals are cost/revenue neutral (benefits, pensions, investment income, land value taxation). Changes that are not inherently cost/revenue neutral are listed below; tax reductions/extra spending in parentheses and additional tax revenues/cost savings as positive figures.

Employment income	£(18.2)bn	Proposal 1
Self-employment income	£(1.5)bn	Proposal 1
Business tax	£(4.1)bn	Proposal 2
Costs of tax collection	£1.5 bn	Proposal 3
Savings in benefit administration	£2.0 bn	Proposal 7
Tax Credits written off	£2.0 bn	Proposal 7
Citizen's Pension	£(0.2)bn	Proposal 8
SERPS/S2P	£2.7 bn	Proposal 9
Inflation/indexation adjustment	£15.8 bn	Workings 7
	£0.0 bn	

Summary of Benefits

The immediate benefits of the proposals discussed in this paper fall broadly under two headings: fairness, and efficiency.

Fairness
Overall, those on low or middle incomes will gain (see Part C: Tax, benefits and the family) and the wealthy will lose a number of tax breaks and loopholes. Pensioner poverty will become a thing of the past. Punishment (in the form of Inheritance Tax) for passing wealth on which tax has already been paid to one's children will be scrapped. The Basic Cash Benefit will put the principle of equality at the heart of the benefits system, in place of a system skewed towards the interests of those who study rules closely, know their entitlements and excel at playing the system.

Efficiency
Perhaps the biggest efficiency gains will stem from the millions of hours currently devoted to form-filling, which can now be put to productive use. Part D explains how the new system will boost employment, and hence the economy as a whole, and gives ideas for reducing the shadow economy and thus broadening the tax base. As a result, it is likely that overall tax receipts will increase, enabling modest tax cuts and/or reductions in government borrowing.

Proposal 1. Employment and self-employment income

- The personal allowance will be set at £11,000;
- Working Tax Credits will be scrapped
- Employee's NI will be scrapped; and
- A standard income tax rate of 38% will apply to all earned income over the personal allowance.

Rationale

The personal allowance of around £5,000 is ridiculously low; so much so that lower-paid workers are simultaneously benefit claimants and taxpayers. This creates a huge administrative burden, as well as uncertainty, and causes a total marginal tax/benefit withdrawal rate of between 70% and 100%[4]. A level of £11,000 will exempt somebody working full time for the National Minimum Wage from tax entirely and corresponds to the level at which the Working Tax Credit for a single earner is abated to nil. Working Tax Credits may have channelled extra money to the poorest families but in all other respects they have been a disaster (see Proposal 7 and Part C: Tax, benefits and the family).

National Insurance is a super-tax on labour and means that employment income is taxed more heavily than any other source of income.

A legitimate aim of taxation is to discourage socially or environmentally harmful behaviour – drinking, smoking, gambling – or at least to raise revenue with minimal damage to the mainstream economy. Another legitimate aim is to ration scarce resources, especially if they are imported. Fuel duties can be justified under any of these heads.

Labour is neither harmful – it is the ultimate source of most wealth and a very efficient way of distributing income – nor is it a scarce resource, nor does it need to be imported; there are 8m people under 65 in the UK who are not in work. NI is also an administrative nightmare for employers to have to run two parallel systems where there is in fact a 99% overlap between what is being charged to tax.

People have been led to believe that NI payments "go towards their pension", which is not actually true, see Proposal 8.

Under the current system, the true marginal rate of income tax, NI and Tax Credit withdrawal for most employees is between 33% and 48%. Taking the more-than-doubled personal allowance into account, a fair and fiscally neutral rate is around 38%. The table on the next page shows the increase in net income for employees at various salary levels under the new system.

[4] see the DWP's Model Tables at http://www.dwp.gov.uk/asd/asd1/TBMT_2005.pdf

Impact

Very low paid and part time workers earning less than the personal allowance will be allowed to claim the BCB (see Proposal 6) but will forego the personal allowance. Instead of paying income tax and losing benefits, they will just pay income tax, which will double their net hourly income.

Under the new system, workers on low to average wages will have significantly higher net incomes as follows:

Earnings	Employee, single, not contracted-out	Self-employed, single
	Tax saved (2004-05 rates)	
£11,000	£1,823	£1,635
£15,000	£1,623	£1,315
£20,000	£1,373	£915
£25,000	£1,123	£515
£30,000	£873	£115
£35,000	£295	£(514)
£40,000	£239	£(571)
£45,000	£389	£(421)
£50,000	£539	£(271)
Average	£920	£302

The savings made by the self-employed will be lower as they pay 3% lower NI contributions than employees. Taxing self-employment income in exactly the same way as employment income will save a lot of pointless arguments with HMRC over a taxpayer's employment status. The self-employed will still benefit from the easing of the compliance burden and, if they are also employers, from the fact that Employer's NI will be scrapped.

Receipts (2004-05)	
Current PAYE receipts[5]	£108.7 bn
Employees' NI (see Workings 1)	£35.1 bn
Tax credits ("negative income tax" element) [6]	£(4.4)bn
Total	£139.4 bn
Expected receipts (see Workings 2)	£121.2 bn
Reduction in tax burden on the self-employed[7]	£1.5 bn

[5] HMRC Tables 2.8 and 2.9
[6] Of total £13.8 bn entitlement shown in HMRC's Annual Report for 2004-05, £4.4 bn is included in HMRC's Table 2.9 as "negative income tax" and the rest is treated as benefits.
[7] 5m self employed @ £300 each.

Proposal 2. Business taxation

- Employer's NI will be scrapped (see Workings 1)
- Corporation tax will be increased to the same rate as income tax of 38%.
- Business rates (42.6% of "rateable value"[8], half rates for unoccupied premises) will be harmonised at 30%, whether occupied or not and SDLT will be scrapped (see Proposal 5).
- Gimmicky tax breaks such as R&D Tax Credits and the Corporate Venturing Scheme will be scrapped.

Rationale

Scrapping Employer's NI will cut the cost of labour and hence boost employment – see Workings 1

Setting corporation tax at the same as income tax seems fair and certainly makes things much simpler. Having wildly disparate tax rates positively invites avoidance (by channelling earned income through a limited company), and to save the need for higher rate income tax on dividend income (bearing in mind there will be no basic and higher rates, just one uniform rate, see Proposal 3) or the dreaded "Section 419" tax.

Business rates are just over 40% of the "rateable value" of all business premises, or around 4% of the capital value of the premises. To confuse the issue, there are discounts for small businesses and a 50% reduction if the premises are unoccupied, with yet more forms and administration. If it is agreed that leaving perfectly good business premises vacant is a bad thing, why reward it via this reduction? In any event, the rate seems unduly high, so it makes sense to harmonise business rates at 30% for all business premises, whether occupied or vacant.

Pharmaceutical companies and Formula 1 teams, who between claim the bulk of the Research & Development tax credits, are just continuing to do what they do best. There is more madness involved here; for some reason only *companies* can claim R&D tax credits, not sole traders or partnerships. R&D spending actually *fell* in 2004-05 to £13.5 bn[9]; the value of the R&D tax credits was around £1.4 bn, so it seems presumptive in the extreme to claim that R&D tax credits boost R&D spending.

Impact

The knee-jerk reaction is that UK plc does not want to see corporation tax rates increased from 30% to 38%. People do not appear to realise that UK plc pays as much in Employer's NI as it does in corporation tax. The overall effect of the measures suggested above will be to *reduce* the tax burden slightly. Thus post-tax profits will increase slightly, but more importantly pre-tax profits will increase by a quarter.

[8] It is in fact a super-tax on actual or deemed rents paid/earned by businesses
[9] FT 25/3/06

The measures will not necessarily increase the total tax burden on companies currently paying at the small companies' rate of 19%. Small employers who pay out more than 75% of their gross profits (before salaries) as salaries, and in particular companies caught by IR35 will pay less in tax than presently. The break-even point for companies with profits between £300,000 and £1.5m (taxed at a marginal rate of 32.75%) will be lower and the break-even point for companies currently paying corporation tax at 30% is where salaries are 60% or more of gross profits.

Most investment (market research, product development, plant and machinery, staff training etc) is paid for out of pre-tax profits. If pre-tax profits increase by a quarter, then it is not inconceivable that investment will increase by a quarter. Further, ultimately, the cost of all inputs is 99% labour. Employer's NI adds around 8% to the cost of labour, so scrapping Employer's NI will reduce the cost of labour by 8%. Thus if UK plc has a quarter more money to spend on something that is 8% cheaper, the two measures, taken together will boost investment by a third, with a corresponding boost to employment (see Part D: Additional gains)

Assuming that the bulk of R&D costs are salaries, if R&D tax credits and NI are scrapped simultaneously, the pre-tax cost of R&D will probably fall slightly[10], so there is no reason to assume that R&D spending will continue to fall.

Although the headline corporation tax rate will increase, it will still be broadly comparable with other large European economies. Under the new system, they will have the worst of both worlds – high Employer's NI rates *as well as* corporation tax rates of 33.3% (France), 37.25% (Italy) or around 38% (Germany - 25% corporation tax plus 13% *Gewerbesteuer*)[11]. Thus the UK is uniquely placed to steal a march on the other large EU economies; if not in terms of the headline corporation tax rate, then at least in terms of scrapping Employer's NI.

Current receipts 2004-05	
Corporation tax[12]	£33.6 bn
Employer's NI[13]	£30.7 bn
Business rates[14]	£18.7 bn
R&D Tax Credit refunds (to small companies)	£(0.5)bn
SDLT (see Proposal 5)	£1.6 bn
	£84.1 bn
Expected receipts (see Workings 3)	
Corporation tax	£65.8 bn
Business rates	£14.2 bn
	£80.0 bn

[10] Large company pays £100 salary plus £12.80 Employer's NI and claims extra tax relief at 30% on 25% x £112.80; the R&D rebate is £8.46, £4.34 less than the NI paid. A small company claims extra relief at 19% on 50% x £112.80, so gets R&D rebate of £10.72, again less than the Employer's NI.
[11] FT 6/4/06
[12] HMRC Table 11.2, 2004-05
[13] See Workings 1
[14] Public Sector Finances Databank, Table C4

Proposal 3. Reducing the compliance burden

Rationale

As mentioned in the executive summary, taxes should be easy to understand, cheap to collect and difficult to avoid. There are various aspects of our system that are an unnecessary burden on UK plc and particularly irritate overseas businesses and hence make the UK less attractive for inward investment. The tax systems of other countries provide plenty of ideas on what can be done to simplify taxes on a fiscally neutral basis while easing the compliance burden.

Recommendations

The UK's tax year-end of 5 April should be re-set to 31 December, in line with all other civilised countries in the Northern hemisphere. Ireland, whose tax system is very similar to ours, chopped off the 2001-02 tax year on 31 December 2001, and since then has used the calendar year, without any apparent harm being done to the economy. Nobody is crying out for the 5 April year-end to be reinstated.

The UK is unusual in that completely different bodies administer different taxes. Although nominally all under "H M Customs & Revenue", the truth of the matter is that there is little communication between departments. Each business will submit its accounts, income/corporation tax returns, PAYE returns and VAT returns to one office. VAT quarters will be harmonised with the year-end. If a business uses a year-end other than 31 December, it will be required to prepare two PAYE returns a year (similar to the fifth quarter for CT61 returns). With its accounts it will submit a reconciliation showing how the salaries per the accounts tie in to the PAYE returns and the turnover to the VAT returns. Thus one civil servant will be able to spot the worst discrepancies straight away and will also keep an eye on revalued properties and the value used for Business Rates. New businesses will only have to register once with their local office.

The costs of running a payroll will be minimised. The P35 will be a spreadsheet showing relevant details, which HMRC can re-run and compare with the total PAYE paid. Employers will no longer have to deal with SMP, SSP or Student Loan Repayments. If employers want, they can treat employees as part-time, in other words, withhold a flat 38% from all salaries and arrange for the DWP to pay them the BCB – mathematically, employees will be neither better nor worse off. The nonsensical system of having to report expenditure with a private benefit separately will be scrapped. Employers will add these back to their taxable profits, exactly the same as for private expenditure that is added back in sole trader or partnership accounts. Only non-taxable entities will have to report these separately.

In most countries, a company (or indeed a group) is deemed to be carrying on a single business; there is no need for the Schedular system. The capital allowances system is another huge area of friction; in exchange for accelerated tax relief on certain assets, the depreciation on other assets is disallowed entirely.

Other countries manage perfectly well by allowing the accounts depreciation for tax purposes, so there is no reason why the accounts profit should not be assumed to be the taxable profits, subject to pragmatic adjustments for private expenditure; depreciation, revaluation and realisation gains and losses on capital assets (mainly freeholds and shares); interest income that was received net of tax (see Proposal 4) and income from abroad which has already suffered tax.

The filing deadline for Companies House, HMRC and the due date for payment of corporation tax will be harmonised at (say) ten months after the year-end. Corporation tax instalment payments will be based on the lower of last year's and this year's profits, the same as for individuals under Self Assessment. Groups will pay on a group basis.

The Construction Industry Scheme ("CIS") is a bizarre scheme that parallels the VAT system and overlaps rather clumsily with PAYE and income tax/corporation tax. Under the scheme sub-contractors who are neither employees nor proper businesses have 18% tax deducted from payments made as a rough approximation of their overall tax liability. The scheme will be scrapped. Legitimate sub-contractors will continue to paid gross, everybody else will go on the payroll. If a worker is neither a registered business nor has a PAYE code, he will be taxed at 38% on all payments.

Impact

The compliance burden on UK business will be significantly eased. Tax advisors and solicitors will have to find other ways of occupying their time. Admittedly, however simple the rules are, there will still be complicated areas and marginal situations where tax planning is required, but the lines between evasion and avoidance will be much clearer. As it takes three private sector workers to sort out the red tape and nonsense generated by one civil servant, the saving to UK plc will be many times the saving to the taxpayer of £1.5 bn.

In addition, a simpler tax system with cheaper labour (via the scrapping of NI) will make the UK a far more attractive location for inward investment.

HMRC has 100,000 employees and running costs of £3 bn[15]. The new system will be so simple that half of these employees will no longer be needed. One quarter will be needed for routine work, a quarter to sniff out and tackle tax evasion, saving £1.5 bn.

[15] HMRC Annual Report for 2004-05

Proposal 4. Investment income

- "Plain Vanilla" interest income from bank accounts or corporate bonds will be taxed at source at 20% with no further income tax being due[16].
- Dividends from UK shares will be exempt from further tax, as company profits will be taxed at the same rate as personal income (see Proposal 2).
- Sales of shares will be exempt from Capital Gains Tax or Stamp Duty. There will be no relief for capital losses.
- Gimmicky tax breaks such as TESSAs, PEPs, ISAs and EIS or VCT relief will be scrapped (unnecessary)

Rationale

There are various taxes levied on savings and investment income and the underlying capital, for example: Stamp Duty and Capital Gains Tax on sales of shares; higher rate tax on dividends; income tax on interest income and benefits withdrawal for people who have some savings (effectively a tax on capital). On the other hand, there are various tax reliefs designed to encourage savings and investment (above and beyond tax relief for pension contributions), for example: EIS and VCT reliefs; reinvestment relief for capital gains; PEP, TESSA, ISA accounts; Film reliefs etc.

The revenues raised by taxing savings and investments are broadly equal and opposite to the "cost" of the tax breaks. Wealthier taxpayers pay the taxes and benefit from the tax breaks. Thus, it makes more sense to reduce each side of the equation as far as possible.

Take for example interest income:

- Tax-exempt savings accounts boost the net interest income of higher rate taxpayers by two-thirds (5% interest net of 40% tax is 3%, 5% tax-free is 5%) but of basic rate taxpayers by only one-quarter (5% interest net of 20% tax is 4%, 5% tax-free is 5%).
- Means testing of benefits punish poor people very savagely for having saved in the first place.
- With inflation of 2.5% and nominal interest rates at 5%, it seems fair to say that only half the nominal interest that you earn is profit; the other half is compensation for fall in purchasing power.
- Most households pay more non-tax deductible interest (on their mortgages) than they ever receive as deposit interest; broadly speaking those who have paid off the largest mortgages will probably earn the most deposit interest later in life.
- Out of total bank accounts and corporate/Treasury bonds in issue of (say) £1,500 bn, a meagre £2.6 bn is collected in tax on the interest. HMRC's Table 3.8 for 2003-04 shows total taxable interest income of £9.8 bn. If £1,500 bn bank deposits and Treasury and corporate bonds pay interest at 4% and 20% non-repayable tax were deducted[17], regardless of residence or status of the recipient, the take would be £12 bn, less a one-fifth margin of error = £9.6 bn.

[16] Does anybody still remember the "composite rate" system? That worked perfectly well in practice for decades, despite having no statutory basis.

[17] As recommended by the EU Savings Tax Directive.

UK plc will pay corporation tax at the same rate as income tax, so there will be no need to charge higher rate tax on dividends. Ultimately, dividends from companies in treaty countries with a sensible corporation tax/withholding rate will be exempt as well. Out of around £60 bn paid out in dividends in 2004-05, only £4.3 bn was collected as higher rate tax (25% of cash dividends received), because three-quarters of dividends are paid to non-residents, other UK companies, unit trusts, investment trusts, pension funds, basic rate taxpayers or people who simply do not declare dividend income.

Capital Gain Tax receipts are less than a tenth of what one would expect (£1.1 bn against average growth in value of FTSE All Share index of £50 bn per annum), because most shares are owned by pension funds, unit trusts and investment trusts; because they are held in ISAs and PEPs; because they are owned by non-residents; because the gain falls under the annual exempt amount; because the gain is covered by losses brought forward, March 1982 rebasing or can be sheltered by reinvestment relief or, just as likely, because some people simply do not declare capital gains.

EIS and VCT reliefs are probably pointless, if not counter productive. Good investment opportunities will attract capital anyway. A poor investment opportunity dressed up with a tax break will attract capital – and then lose it. Under the new system companies will be able to surrender losses to individual as well as corporate shareholders, so investors can claim up to 38% tax relief on the amount they subscribe if the company fails. Do not forget that *all* shares will be exempt from capital gains tax, not just EIS or VCT shares and that there will be no further tax on dividends (see Proposal 3). EIS and VCT reliefs will therefore be completely superfluous.

Impact

If an evader can choose between 20% tax or trying to earning interest tax-free with an offshore accounts and risk paying the full 38% when he is caught out, he is more likely to choose to suffer the 20%, which may involve the repatriation of funds to the UK.

Taxes on investment income and the corresponding tax breaks are an irritant; they raise little net tax overall and are not even redistributive; they impede the efficient allocation of capital that would occur in a truly free market. The taxation of investment income can be reformed and simplified on a completely fiscally neutral basis that encourages liquidity and removes distortions, ensuring a better allocation of capital overall.

The new system will also greatly simplify the preparation of tax returns; most investment income will no longer have to be reported on the tax return.

Current receipts[18]	
Higher rate tax on dividends	£4.3 bn
Bank interest - TDSI	£2.6 bn
Stamp Duty on share sales	£2.5 bn[19]
Rental income (@ average rate 31%)	£1.8 bn
Capital Gains Tax[20]	£1.2 bn
Other investment income	£0.6 bn
EIS and VCT reliefs	£(0.4)bn[21]
Film reliefs	£(0.5)bn
Total	£12.1 bn
Expected receipts	
Non-repayable tax deducted from interest	£9.6 bn
Rental income (@ 38%)	£2.2 bn
Other investment income (overseas div's exempt)	£0.3 bn
Total	£12.1 bn

[18] HMRC Table 3.7 for 2002-03. They admit that the figures are very approximate.
[19] See Proposal 5
[20] HM Treasury – Public Sector Finances Databank, Table C4. Total CGT £2.3 bn, 50% allocated to share sales and 50% to property sales – see Proposal 5.
[21] HMRC Table 1.5

Proposal 5. Land value tax

- Council Tax, Stamp Duty Land Tax, Inheritance Tax, the TV licence fee and Capital Gains Tax on the sale of land will be scrapped and replaced with…
- … a Land Value Tax ("LVT") on residential properties at 1% of current market value, subject to a nil rate band of £70,000 per household/dwelling

Rationale

The main aim of this report is to show how the current tax system can be reformed on a fiscally neutral basis such that most people are neither significantly better nor worse off. This is a golden opportunity to replace five hideously complicated and/or arbitrary taxes (and one arbitrary benefit) with a simple, fair and economically efficient tax.

There are excellent economic arguments in favour of an annual tax as a fixed percentage of the value of your home:[22]

- Housing is a normal good, in other words, the value of your home is a fairly fixed multiple of your lifetime average income. Thus such a tax is "fair" in the sense that it is an extension of income tax, the least unfair of all taxes;
- It encourages efficient use of housing. Once the children have left home, there are only sentimental reasons why older couples or widowed pensioners should not trade down into smaller properties, freeing up larger homes for young families;
- The current house price bubble has been due in part to increases in demand. Such increases can be dampened by introducing a land value tax, especially for under-utilised second or holiday homes;
- LVT is not a new idea and several countries already have it - see www.landvaluetax.org.uk or www.labourland.org;
- LVT is difficult to avoid. You cannot stick a house into a briefcase and take it to the Cayman islands.

On a closer inspection, the UK already has several competing and overlapping taxes that roughly approximate to LVT as follows:

The "Guide to Council Tax 2006/07" shows that Council Tax in the London Borough of Waltham Forest is basically a poll tax element of £500 plus a land value tax element of 0.35% the home's value, capped at around £750,000. See also www.counciltaxreform.org. House prices in LBWF are probably 50% higher than the national average and Council Tax is 10% higher, so the nationwide picture is probably more like £500 poll tax element plus 0.5% of property value.

Council Tax Benefit ("CTB") is designed to compensate for the poll tax element that ensures a minimum level of tax. The total CTB paid out is £3.6 bn, claimed by around 5m households or £14 per week per claimant household[23]. There is a high correlation between Council Tax bands and CTB claimants – around 75% of people in Band A are entitled, 50% in Band B and 25% in Band C[24]. As usual, there are problems with poor take-up,

[22] See for example the report by the National Institute of Economic and Social Research, FT 27/1/06
[23] DWP Quarterly Statistical Summary, January 2006
[24] Figures for 2001, DWP.

fraud and error and the fact that it is means-tested, contributing yet another 6% to 13% to the marginal tax/benefits withdrawal rate of low and part time earners.

The nil rate band for Inheritance tax ("IHT") is £275,000; above that it is charged at 40% on the value of the deceased's estate. Only the richest 6% of estates are liable to IHT[25]. The richest 5% of households own 43% of all "marketable wealth"[26]. The total value of UK wealth (homes, investment properties, shares, bank accounts etc.) is around the £6,000 bn mark. Thus the richest 6% of households are on average worth £1.8m each. Assuming everybody lives to an average age of 70, each year 30,000 estates would be chargeable to IHT. Assuming no IHT planning whatsoever, this would mean IHT of £610,000 per estate x 30,000 estates, a yield of £18.3 bn. The total take was actually only £2.9 bn in 2004-05, or £100,000 IHT per estate, suggesting that the average total estate of the richest 6% was only £525,000[27]. The average value of the main residence of the richest 6% is at least that much. The rest must have been salted away via tax planning. So, IHT is basically a one-off tax on the value of your home on death. IHT taxes the parts that Council Tax can't reach.

The TV licence fee raises £2.8 bn gross (less maybe 10% collection costs), roughly as much as IHT or CGT and adds 10% to the average Council Tax Bill. As a particularly unfair poll tax that falls heaviest on single person households and home owners (tenants are more likely to be non-payers), the TV licence fee will be scrapped[28].

LVT is designed to ensure efficient use of available housing, in other words to encourage/enable people to move into the "right size" home, be that larger or smaller. Therefore, it would be hypocritical to charge SDLT at savage rates up to 4%, a tax that may be legally due by the purchaser but is economically borne by the vendor. If pensioners decide to trade down from a £500,000 house to a £200,000 flat in order to cut their LVT bill by two-thirds, they should not be fined £20,000 for doing so.

Impact

Owners of the cheapest one-fifth of properties will pay no LVT whatsover and owners of cheaper properties will pay less LVT than they did Council Tax/TV licence fee. Those in the the middle will be indifferent. Owners of more expensive properties will of course pay much more in LVT, but this is not unfair. Higher earners will have a marginal income tax rate that is 3% lower, and will not have to pay tax on capital gains or dividends; non-working spouses will be entitled to the BCB of £4,160 per annum; LVT will just be IHT, CGT and SDLT in easily affordable instalments.

Pensioners will be allowed to roll up unpaid LVT with interest to be repaid on death/sale.

Scrapping IHT will be warmly welcomed by the richest 6% of households who actually have to pay it, as well as with the next tier of households who have to worry about it and engage in complicated and expensive avoidance schemes. Conversely, it will be

[25] Gordon Brown, Budget speech 22 March 2006.
[26] http://www.statistics.gov.uk/cci/nugget.asp?id=2
[27] £525,000 less £275,000 x 40% = £100,000.
[28] Apparently, it is now officially a tax and has thus been removed from the RPI shopping basket.

unpopular with those on the Left who believe that the tax system should be designed to punish the wealthy, even if the tax raised from the exercise is minimal.

Scrapping CGT on long-term property investments will ensure more liquidity in the housing market; especially for owners of holiday and second homes who may have to pay higher LVT bills.

Scrapping SDLT will be very popular with home buyers/sellers and conveyancing solicitors who have to fill in fairly nightmarish 80-page SDLT forms for anything but the simplest transaction.

Recent research from the IPPR[29] that found that "There are almost a million 'asset-rich income-poor' pensioners - who own more than £100,000 of housing wealth but are on means-tested benefits" and "Half of retired people living on less than £128 a week have three or more spare rooms." Under the current system, there is little advantage to such pensioners in trading down to a smaller property, as the income generated from the equity released would be wiped out by the loss of means tested benefits (primarily Pensions Credit and Council Tax Benefit). Under the new system, no older pensioner need live in poverty anyway, but they will not be discouraged from trading down; there will be no SDLT hit; no loss of means tested benefits and interest income will be taxed at half rates.

Even if only 10% of all pensioner households were to trade down over the next five years, this would mean an extra 150,000 houses coming on to the market each year; which is roughly the number of new houses built every year. The overall effect of this will be to boost pensioner incomes and make it much easier for first time buyers and families living in flats to find a family home.

Current receipts[30]	
Council Tax	£20.2 bn
less Council Tax Benefit[31]	£(3.6)bn
Stamp Duty Land Tax[32]	£4.9 bn
Inheritance Tax	£2.9 bn
TV licence fee (net of collection costs)	£2.5 bn
Capital gains tax[33]	£1.1 bn
Total	£28.0 bn
Expected receipts	
Land Value Tax (see Workings 4)	£28.0 bn

[29] http://www.ippr.org.uk/pressreleases/?id=2135
[30] HM Treasury – Public Sector Finances Databank, Table C4, unless stated
[31] Department of Work & Pensions, Table 3, 2004-05 estimated outturn
[32] Total Stamp Duty and SDLT is £9.0 bn, but £2.5 bn relates to pure Stamp Duty. I have allocated one quarter to businesses (see Proposal 2) and three quarters to households.
[33] 50% of CGT receipts have been allocated to share disposals and 50% to land and buildings.

Proposal 6. Child Benefit and nursery funding

- Child Benefit will be a flat £18 per week for every child aged 5 – 16.
- Child Benefit will be at higher rates of £36 for children under 5 and £24 per week for children aged 17 - 18[34].
- Child Tax Credits, IS/JSA related child allowances and all other child-related benefits will be scrapped.
- £60 per week will be paid towards nursery costs for children aged 2 – 4 where both parents or the lone parent is working; various parallel systems for subsidising nursery care will be scrapped.
- Ultimately, the £60 will be extended to all children aged 2 – 4 at nursery, whether their parents are working or not; the extra cost does not justify the hassle of actually policing this, and as soon as finances allow, the £60 will be increased to cover the full costs of a nursery place.

Rationale

The whole system seems to be geared towards the "Mummy stays at home with John and Janet while Daddy goes to work" model that may have been valid decades ago, but does not reflect the modern reality that the employment rate is the same for men and women.

Nowadays, most couples are both working before they have children and although Child Benefit of £18 per week is probably a fair contribution to the incremental cost of having a child in the household, extra food, clothes, toys etc, the real – and for many couples insurmountable – financial barrier to having children is not that bit of extra food, but rather the loss of the mother's wages for the few years that she takes off work. Statutory Maternity Pay (£106 for a laughable 6 months) will of course be rolled into the BCB. The BCB is only £80 per week, so Child Benefit for children under 5 will be at a higher rate of £36 per week.

It is almost universally accepted and expected that children over the age of 5 should be entitled to a free State education; this is not seen as a subsidy for working parents but an investment in each child's future and in the quality of the future workforce. 80% of married mothers and 57% of single mothers whose youngest child is aged 5 or over are in work[35], so at this age Child Benefit will revert to £18 per week.

Modern reality demands that state funding for pre-school children should be increased, broadened and simplified. There are currently various overlapping systems to help parents pay for nursery fees, including Child or Working Tax Credits, the Nursery voucher scheme, whereby a higher rate taxpayer saves £89 a month but a basic rate taxpayer saves only £72, and Early Years Funding, of £11 per day for children aged three or over. The entry for "Under Fives" under the heading Education and Training in the Public Sector Expenditure survey for 2005 shows a total cost of £4.1 bn. The total cost of all the schemes mentioned above is much higher, but the bulk of this is already taken into account elsewhere, for example under Child Tax Credits.

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[34] So the fairly ludicrous means-tested "Education Maintenance Allowance" will be superfluous
[35] Table 1 "Families and work" Annette Walling, ONS, spring 2004

Impact

Whether and how soon a mother wishes to go back to work after having children is of course an intensely personal decision. The BCB will enable a mother to stay at home for longer if she so wishes; and improving nursery funding will enable her to return to work sooner if she so wishes.

Keeping within current expenditure levels, it seems fairest to pay a flat £60 per week towards the nursery costs of each child aged 2 - 4. £60 only covers half the cost of a full time nursery place in London but it probably covers a larger percentage elsewhere. Further, if a parent goes back to work part time, the £60 might well cover the bulk of these costs.

The subsidy will be cheap and simple to administer. Increasing the subsidy to eventually cover the full costs of a nursery place for all children from the age of 2 will be relatively cheap overall;

- It will only be paid to registered nurseries, and working mothers pay more tax than non-working mothers, a lot of it will come back to the State in the forms of tax receipts;
- If the age at which a child is entitled to a free State education comes down, then the age at which Child Benefit reverts from £36 to £18 per week will come down as well.

Current payments (2004-05)	
Child benefit (incl. Child Trust Fund)[36]	£9.8 bn
Child personal allowances (from Proposal 6) [37]	£3.7 bn
Child Tax Credits[38]	£3.1 bn
Nursery funding[39]	£4.1 bn
Total	£20.5 bn
Expected payments	
Children aged 0 – 4, 3.5m @ £36 per week	£6.5 bn
Children aged 5 – 16, 9.1m @ £18 per week	£8.6 bn
Children aged 17 – 18, 1.4m @ £24 per week	£1.8 bn
Less 2% fall in number of children since 2001 Census	£(0.3)bn
2,100,000 children aged 2 - 4	
65%[40] of young mothers in employment =	
1,365,000 @ £60 x 50 weeks =	£4.1 bn
Total	£20.5 bn

[36] HMRC Annual Report 2004-05
[37] Department of Work & Pensions, Table 3, 2004-05 estimated outturn, unless stated.
[38] £13.8 bn entitlement less £4.4 bn negative income tax x one-third, see Proposal 6.
[39] Public Expenditure Statistical Analyses, 2004-05 estimated outturn.
[40] Assuming that the percentage of young mothers in work increases to typical rates where the youngest child is 5+

Proposal 7. A Basic Cash Benefit

- All income style benefits will be replaced with a non-contributory, non-means tested, non-taxable Basic Cash Benefit ("BCB") of £80 per week for every adult aged 23 or over who earns less than £11,000 per annum;
- BCB claimants will not also be entitled to a personal allowance for tax purposes;
- For the avoidance of doubt "every adult" includes existing key benefit claimants, younger pensioners, non-working spouses, full-time mothers, students, actors "resting" between jobs, tramps, surfers and ex-convicts;
- People aged 18 – 22 will be entitled to a BCB of £52 per week;
- From the age of 60, the BCB will increase by £3.75 per week for each year of age, to dovetail with the Citizen's Pension at age 66 (see Proposal 8).
- There is an 80% overlap between Housing Benefit claimants and social tenants. Social rents will be set on the basis of needs and ability to pay; there will therefore be little need for a parallel system of Housing Benefit;
- Claimants of Incapacity Benefit will also be entitled to the BCB of £80 each;
- There will be no changes to extra benefits paid to the truly disabled who are genuinely incapable of doing any work whatsoever; or could work, but face insurmountable discrimination by employers, or who simply face extra costs to enable them to cope with daily life.

Rationale

Currently, there are around 5 m claimants of "key benefits"[41] and 2.7 m people aged 65 or under who receive the Basic State Pension. 7.8 m people aged 65 or under will be entitled to the BCB. The tiny balancing figure consists presumably of married mothers (see Part C) and students (see below). This hopefully puts paid to the misconception that a "Citizen's Income" or "Universal Benefits" will be unaffordable.

It is quite clear that if BCB claimants work part time that the BCB should be tapered away, however, it is much simpler and cheaper to deal with this via the PAYE system, which will be achieved by not also allowing them to claim the personal allowance against employment income.

Under the current system, there is little motivation for many benefit claimants to take up employment. Although Working Tax Credits are supposed to encourage work, on the whole they merely encourage people to earn or work just over the low threshold that triggers WTC, but to go no further than that; the marginal tax rate plus benefits withdrawal is then close to 100% of gross wages earned.

Further, unemployed young people receive much more generous benefits than students, which actively discourages them from training or studying.

Social landlords allocate council housing on the basis of needs at the time of application, but tenancies seem to be for life. Social rents are just over half of market rents, so there is little motivation to move out again once you have found a job and/or your children have

[41] DWP Quarterly Statistical Summary October 2005. The phrase is a tacit admission that IS, JSA and IB are interchangeable.

grown up. Turnover in the social sector is thus very low and waiting lists are correspondingly long. Because the bulk of social tenants cannot afford to pay the headline rent, there is a parallel system of Housing Benefit, with yet more form filling and means testing.

Impact

Under the new system, somebody who earns less than £11,000 will be able to claim the BCB of £4,160 per annum and waive the personal allowance for tax/PAYE purposes; a BCB claimant will pay income tax on all earnings but not also suffer benefits withdrawal – these net payments are included in Workings 2 – so at least doubling the net wages that they earn for each hour worked. At a taxable income of £11,000 (the true personal allowance), the tax paid (38% x £11,000) is equal to the BCB claimed.

For a more detailed exploration of the rationale and impact of such a benefit system, please refer to Christopher Monckton's invaluable article of 1993[42]

The rate for 19-22 year-olds will be halfway between the rate for 17-18 year-olds and the adult rate, i.e. £52 per week or £900 per term. There will be no need for a separate system for student grants. Together with the fact that tuition fees don't have to be repaid until you start work, this seems to make Higher Education perfectly affordable to all and to be fair as between students and NEET's[43]. Students will have "used up" 65% of their tax-free personal allowance if they claim the £52 per week BCB, so will be given a PAYE code with a reduced tax-free personal allowance of £3,850 (on an annual earnings basis), so that they can earn up to £3,850 tax-free per annum with holiday/weekend jobs.

Many on the Right have called for the reinstatement of the Married Man's Allowance. Paying a non-working spouse £80 BCB per week have exactly the same effect; the total tax bill for a working spouse who earns £22,000 minus the BCB paid to the non-working spouse will net off to nil.

Tenants in social housing will be allocated to Categories according to current circumstances, for example Category 1 for single pensioners and the severely disabled who pay 10% of market rents, through Category 3 for lone parents up to Category 10, for couples who pay full market rent. Tenants' circumstances will be reviewed regularly, which will encourage the "better off poor" to move out of social housing into the private sector, freeing up social housing for those stuck on the waiting lists.

The new system will be blindingly simple. All you will need to claim is your passport, proof that you have been resident in the UK for at least ten years (or whatever), your NI number and a sworn statement that you are not working, or at least, not working and

[42] http://www.citizensincome.org/filelibrary/Archived%20Bulletins/1993%20Bulletin%2016%20July.pdf. Christopher Monckton worked in Margaret Thatcher's Policy Unit in the 1980s, but his approach has been welcomed across the political spectrum – from Lynne Jones MP (Lab) to the Green Party.

[43] Not in Education Employment or Training

claiming the personal allowance. The BCB will be paid into bank accounts[44] by direct debit, which should help reduce fraud.

A simpler system must also mean savings to the taxpayer in terms of running costs, which are quite significant. The DWP has 120,000 employees, and there may be as many again working for local authorities, Job Centres, Citizens' Advice Bureaux, DfES etc administering all the overlapping and parallel systems. If a quarter are retained to administer the new system and a quarter to sniff out benefits fraud, 100,000 civil servants costing £20,000 each will no longer be needed, or a £2 bn saving.

Lynne Jones MP (Lab, Birmingham Selly Oak) puts the cost of administering means-tested benefits at 10% of the benefits paid out; means-tested benefits under the current system are about £45 bn. Even if the true cost is 5% rather than 10%, a £2 bn saving seems realistic.

One might expect to find Tax Credit spending in the normal DWP or HMRC tables. In fact, it is tucked away in HMRC's Annual Report "Trust Statement". The entitlement figure of £13.8 bn has been used as the basis for benefit spending, rather than the £15.8 paid out. £2 bn overpaid tax credits have been hidden under "Debtors", on the pretence that these are largely recoverable. The new system will not have any such overpayments. Assuming that annual overpayments of £2 bn can be avoided, this saves an additional £2 bn that will otherwise have to be written off every year.

Current payments (2004-05)[45]	
Housing Benefit (55% paid to social tenants)	£7.1 bn[46]
Income Support (under 60)	£10.0 bn
Jobseeker's Allowance	£2.2 bn
Less child personal allowances (see Proposal 6)	£(3.7) bn
Incapacity Benefit	£6.7 bn
Tax credits[47]	£6.3 bn
Maternity allowance, SPP and SMP	£1.5 bn
Other small benefits	£0.5 bn
Total	£30.6 bn
Expected payments/savings	
BCB (see Workings 5)	£30.6 bn
Savings in benefit administration costs	£2.0 bn
Tax Credit overpayments	£2.0 bn

[44] Any bank that makes it difficult for BCB claimants to open a basic account will have its banking licence withdrawn. These accounts need not allow overdrafts but should at least allow Direct Debits, thus saving poor people a few quid on their utility bills!
[45] Department of Work & Pensions, Table 3, 2004-05 estimated outturn, unless stated.
[46] Total HB is £13 bn. Around 25% is paid to pensioners, 20% to private tenants and 55% to social tenants
[47] Total entitlement per HMRC's Annual Report for 2004-05 £13.8 bn, less £4.4 bn treated as negative income tax, per HMRC Table 2.9. Two-thirds treated as normal benefits and one-third as Child Benefit

Proposal 8. Citizen's Pension

- The basic state pension, the Pensions Credit and sundry other age-related benefits will be scrapped/amalgamated;
- From the age of 66, the BCB (see Proposal 6) will transmute into a "Citizen's Pension"[48], non-contributory, non-means tested, non-taxable, independent of gender, marital history or status of £106.25 per week, increasing by £3.75 a week for every additional year of age (the "escalator") up the age of 71, when it reaches a maximum of £125 per week (the "plateau").

Rationale

It is fair to say that the UK pensions system is hideously complicated.

The Basic State Pension – with complicated rules for entitlement, and which is insufficient to guarantee any acceptable minimum living standard - is unfair to women because it is earnings related, so women on average only receive three-quarters of the Basic State Pension. On the other hand, it is unfair to men as they have to work five years longer and die younger. Under the new system, men and women, married or single, will be treated exactly the same.

The BSP is thus overlayered with a panoply of schemes subsidised, taxed, regulated and administered by the State.SERPS/S2P; Contracted out pensions; Employer's final salary schemes; Personal pension schemes/defined contribution schemes; the Pensions Credit[49], Social security benefits (e.g. Housing Benefit); other age-related benefits and in future Lord Turner's NPSS etc.

These schemes are really based on two assumptions, one valid, one not:

- That the most unfortunate 20% in society who reach retirement age without even having managed to buy their own home were in no position to save for retirement. There has to be a cast iron safety net for such pensioners. However, this is smothered with means testing, which discourages people on low- to-average incomes from saving privately.
- That the remaining 80% of retirees (including by definition many on low- to average incomes), who have the foresight to buy their own home with, and to pay off, a repayment mortgage (rather than just pay the interest on an interest-only mortgage) in order to build up assets and ensure that they can at least live rent free in retirement, are not economically rational enough to also put some money away for retirement[50]. Tax subsidies for pensions add at least 2% to the rate of income tax, suffered by all, but the relief is badly targeted and benefits mainly higher rate taxpayers and the insurance industry (see Proposal 10). Those in the middle lose out on both sides of the equation.

[48] There will of course be no real difference between the BCB and the Citizen's Pension, you can choose any age you like at which it is renamed.
[49] Around a third or a half of those entitled are too proud, intimidated, naive or lazy to claim
[50] "We are not stupid. We know what we are doing", according to Prof. Tim Congdon 7/3/05

Age-related benefits include the 25% of Housing Benefit paid to pensioner households. Around 20% of pensioner households are in social housing and claiming Housing Benefit; to compensate for the fact that Housing Benefit for social tenants will be scrapped, single pensioners in social housing will fall into Category 1, meaning they only pay 10% of market rents (see Proposal 7).

Impact

According to the IPPR, "'living in poverty' would mean an income of less than £210 for a retired couple, and £128 for a single retired person."[51]. With a Citizen's Pension, no older pensioner and no pensioner couple would be living in poverty. This will especially benefit women without a full contributions record, who often slip through the Pensions Credit net.

Even if the increase in the income of poorest pensioners is modest, a Citizen's Pension will greatly enhance pensioner *dignity* because they will not need to fill in endless intrusive forms for Pensions Credit, Housing Benefit and Council Tax Benefit.

For the medium term impact, please refer to the invaluable PPI/NAPF interim report on the Citizen's Pension of late 2004[52], which, on the basis of international evidence, concluded that a Citizen's Pension encouraged rather than discouraged private pension saving, even in countries which do not give tax relief for pension contributions.

Current payments (2004-05)[53]	
Contributory Retirement Pension	£41.3 bn
Pension Credit (guarantee credit)	£5.1 bn
Housing Benefit (25% of total)	£3.3 bn
Widow's and bereavement benefits	£0.9 bn
Winter fuel payments	£2.0 bn
Carer's allowance	£1.1 bn
Over 70s payments	£0.5 bn
Over 75s TV licence[54]	£0.4 bn
Pension Credit (savings credit)	£0.9 bn
Total	£55.5 bn
Expected payments	
Citizens' Pension (see Workings 6)	£55.7 bn

[51] http://www.ippr.org.uk/pressreleases/?id=2135
[52] http://www.pensionspolicyinstitute.org.uk/news.asp?p=100&s=2&a=0
[53] Department of Work & Pensions, Table 3, 2004-05 estimated outturn
[54] The TV Licence fee will be scrapped – see Proposal 5.

Proposal 9. State Second Pension and Contracting out

- Existing SERPS pensions will continue to be paid out under current rules. To do otherwise would amount to a massive fraud;
- Accrued entitlement to SERPS, or S2P as it is now known will be frozen at current values. No further entitlements will accrue;
- SERPS/S2P will be non-taxable.

Rationale

Everyone who has paid NI contributions, but is not yet receiving a pension, will be sent a statement from DWP showing what their NI record is, and to what SERPS/S2P they will be entitled, expressed in £ or as a percentage of the BCB of £80 per week.

If the Second State Pension and NI are scrapped, it goes without saying that contracting out will be scrapped as well, as there will be nothing out of which you can contract.

Impact

There will probably be more unpleasant surprises that pleasant ones, but at least everyone will have some certainty and if necessary will be able to start saving accordingly.

SERPS/S2P currently costs £7.4[55] bn per annum. Assuming that the cost of SERPS/S2P fades to nothing over the next fifty years, the simplistic answer is that the additional saving will be £150m a year.

Actually, and actuarially, at a discount rate of 4%[56], the NPV of an infinite number of annual payments of £7.4 bn is £185 bn. The NPV of a series of payments reducing from £7.4 bn to nil over fifty years is £117 bn. The difference of £68 bn multiplied by 4% is £2.7 bn, so in theory the saving is £2.7 bn per annum.

Annual saving	£2.7 bn

[55] DWP Table 3
[56] A fair discount rate for Government liabilities/borrowings

Proposal 10. Private pension schemes

- Income tax relief at the full 38% for private pension contributions will be reduced to the first £4,400 of contributions;
- Private pensions will be paid after income tax at the normal rate of 38%, subject to transitional arrangements (see Workings 2);
- The requirement to take an annuity at age 75 will be scrapped. If the member dies before he takes his pension, the fund will be paid to his heirs after deducting 38% quasi-PAYE.

Rationale

Tax relief for pension contributions is largely pointless and probably counter-productive.

- Some countries give little or no tax relief for pension contributions, and the amount saved is not materially lower;
- Higher rate taxpayers can afford to contribute a larger slice of their income and obtain double the amount of tax relief; these are people who probably could and would have saved up anyway;
- For basic rate taxpayers, the relief is not a relief but a deferral; the fact that the pension fund can grow tax-free is irrelevant as they would not pay tax on dividends, interest or capital gains from investments held directly or in an ISA anyway. What little tax saving there is, is wiped out by the fact a significant part of their fund is swallowed up in administration fees, up to 30% of the final fund value;
- Thus ultimately, half the value of the tax relief accrues to wealthier taxpayers and half to the insurance industry;
- The NPSS will exacerbate this; in the short term it will be an additional burden on employers and eat into profits; in the medium term it will lead to lower salaries;
- The tax relief for pension contributions adds about 2% to the overall tax rate, suffered by all, including those who cannot afford to opt in or to make contributions, who thus lose out on both sides of the equation (lower salaries and higher taxes);
- The £215,000 limit for tax relievable contributions means that the richest 500,000 taxpayers would be able to buy up the entire FTSE All Share index within two decades and claim tax relief;
- The upper limit for tax relievable contributions should be set so that it is within reach of the average taxpayer, once he has paid off the mortgage. Further, the total value of shares and the amount of corporate and Treasury bonds in issue is such that even if one-third of taxpayers made the maximum contribution of £4,400 gross, fairly soon *all* quoted shares would be in pension funds and all interest paid out on corporate or Treasury Bonds would be recycled as pensioners' annuity income.

If, as at present, one third of employees and the self-employed make contributions[57], there will be no significant overall change in the amount of tax relief for private pension contributions (£15 bn - £25 bn) but the value of the relief will be spread more evenly.

[57] HMRC Table 3.8

Background

While it is important to consider the tax/benefits position of a single employee or UK plc as a whole, it is equally important to consider the impact that the changes will have on families at various income levels.

The current government has always made great rhetoric about the measures it is taking to support and reward "hard working families. On a closer examination this is pure rhetoric; whether by accident or design, the UK's tax and benefit system discourages marriage and minimises rewards to hard work.

Consider the examples on the following pages of Ms Welfare, Mr & Mrs Low Pay and Mr & Mrs Average under the current system;

If Ms Welfare starts working – probably at a low wage – she will face a marginal tax/benefits withdrawal burden of 70% to 100%[58] up to a gross income of £20,000 or so; hardly an incentive to start work.

If Ms Welfare's low-earner boyfriend on wages of £240 per week moves in, the household's cash income after housing costs increases by a mere £85 per week, barely one-third of his gross wages. They are financially discouraged from forming a family.

If Mr Low Pay struggles up the ladder to become Mr Average on £24,000 per annum, and decides it is time to buy a home for the family, the family's net cash income after paying off an average mortgage does not increase at all.

Finally, the real financial barrier that prevents Mr & Mrs Average from having children, is the loss of her wages for a few years before the children are at school and she can go back to work. For many average income couples who have just started paying off a mortgage, this is an impossible proposition. If Mrs Average gives up work to have children, their net income after mortgage repayments falls by half.

Impact

Although Ms Welfare's net cash income may fall slightly in the short term, the shortfall can easily be made up by claiming maintenance from the absent father or working one day a week, even at the NMW[59]. She will not lose any benefits, although the whole of her wages will be taxable. The costs of the necessary nursery place(s) will be largely covered (see Proposal 6). 55% of single mothers actually have a job, so this cannot be an unreasonable burden.

If Ms Welfare's low earning boyfriend moves in, the household's net income increases by £160 per week, they will keep two-thirds rather than one-third of his gross wages.

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[58] see the DWP's Model Tables at http://www.dwp.gov.uk/asd/asd1/TBMT_2005.pdf
[59] 8 hours x £5.05 less 38% tax = £25

If Mr Low Pay struggles up the ladder and out of social housing etc, the family's net weekly income will increase by a quarter after mortgage repayments, rather than staying much the same under the current system.

Under the new system, not only will Mr & Mrs Average be better off by £48 per week before they have children, the *fall* in income (after mortgage repayments) that they suffer, should she take a few years off work is only a quarter of their "pre-child" income (as opposed to half under the current system); hopefully enough to enable them to afford to have "2.4 children" (if they so wish).

In fact, for a few years, Mr and Mrs Average's net income will be higher than their gross income; once the children are old enough to go to school, their net income will be roughly equal to Mr Average's gross wages, i.e. their taxes and benefits net off to nil. At this stage, Mrs Average will go back to work like 80% of married mothers whose youngest child is aged 5 or over[60].

Conclusion

It is broadly agreed that a stable family unit with at least one working parent is an important factor in ensuring positive outcomes for children, in terms of health, education, employment and avoiding a life of crime. The tax/benefits system proposals suggested here will make some inroads into the depressing statistic that more than a quarter of children grow up in a single-parent household - divorce law is probably as much to blame[61] - but surely anything is better than nothing!

Ms Welfare[62]

The weekly benefits claimed by "Ms Welfare" (unemployed, single, two children under 5) under the current and the new system can be summarised as follow:

Cash benefits *less* expenses	Current System[63]	New System	
Income Support/BCB	£56	£80	
Child Benefit	£28	£72	
Tax credits	£73	N/a	
Welfare foods	£6	£6	
Less Local Authority rent	£(53)	£(30)	Category 3 – See Proposal 7
Housing Benefit	£53	N/a	
Less Council Tax/LVT[64]	£(15)	£(4)	See Proposal 5
Council Tax Benefit	£15	N/a	
Cash income	£162	£140	*Fall* of £22

[60] Table 1 "Families and work", Annette Walling, ONS, 2004
[61] See Dr Andrew Lilico's article at http://www.bowgroup.org/harriercollectionitems/Signed%20Off%20Crossbow.pdf
[62] Jill Kirby "The Price Of Parenthood", CPS, 2005
[63] The "current" figures are based on 2004-05 rates and allowances
[64] Assuming her council flat is worth half the average home in the UK, _ x £179,000 = £90,000, £90,000 less £70,000 exempt band = £20,000 x 1% LVT = £200, = £4 per week.

Mr and Mrs Low Pay[65]

The weekly net cash income of Mr and Mrs Low Pay (he earns half the average wage, £12,000, she is at home with two children under 5) under the current and new systems is:

Cash benefits *less* expenses	Current System	New System	
Net salary	£190	£223	
Tax credits	£96	N/a	
Mrs Low Pay, BCB	N/a	£80	See Proposal 6
Child Benefit	£28	£72	
Welfare foods	£6	£6	
Less Local Authority rent	£(53)	£(70)	Category 7 – See Proposal 7
Less Council Tax/LVT[66]	£(20)	£(10)	See Proposal 5
Cash income	£247	£301	*Increase* of £54

Mr and Mrs Average[67]

The weekly net cash income of an average couple (he earns £24,000, she earns £18,000) before housing costs is as follows:

Current system	Childless	2 children under 5	
Mr Average, net wage	£345	£345	
Mrs Average, net wage	£268	£0	
Tax credits	£0	£11	
Child Benefits	£0	£28	
Mortgage repayments	£(120)	£(120)	
Council Tax	£(20)	£(20)	
	£473	£244	*Fall* of 48%
New system			
Mr Average, net wage	£366	£366	
Mrs Average, net wage	£295	£0	
Mrs Average, BCB	£0	£80	See Proposal 6
Child Benefits	£0	£72	
Mortgage repayments	£(120)	£(120)	
LVT[68]	£(20)	£(20)	See Proposal 5
	£521	£378	*Fall* of 27%

[65] Jill Kirby, *op cit.*
[66] Assuming their council house is worth 2/3 of the average home in the UK, 2/3 x £179,000 = £120,000, £120,000 less £70,000 exempt band = £50,000 x 1% LVT = £500 = £10 per week
[67] Jill Kirby, *op cit.*
[68] Assuming an average value house in the UK, worth £179,000, £179,000 less £70,000 exempt band = £109,000 x 1% LVT = £1,090, = £20 per week.

PART D: ADDITIONAL GAINS: ECONOMIC GROWTH

The workings for each Proposal contain the economist's usual assumption of *ceteris paribus*. Of course, wages and prices, and hence profits will adjust; it is impossible to forecast all these effects and how they interact. However, some things are fairly certain:

Firstly, when Employer's NI is scrapped, labour will be cheaper and UK plc will have 25% more pre-tax profits available to spend on labour (see Proposal 2). Assuming the price-elasticity of demand for labour is unity, scrapping NI, which adds 8% to the average wage bill, will increase the number of employees by 8%. UK plc currently employs 20 m people, if this increases by 8%, that's an extra 1.6 m jobs. If, as is likely, the demand for labour is price elastic, then an 8% price reduction will lead to a much greater increase in demand for labour. Using David B Smith's formula[69], scrapping Employer's NI is an important step to full employment.

Secondly, under the new system, returns to labour will be greater. Benefit claimants will net twice as much for each hour worked; average earners will see their net salaries rise by over 5%; the net marginal salary of higher earners will increase by 5%. Thus there will be a greater supply of labour, even without any changes to headline wages and salaries. Around 1% of man hours in the private sector will be diverted from form filling to productive work, generating taxable income.

This leads to one inescapable conclusion. If UK plc is looking to add at least 1.6 m employees and many more benefit claimants are ready for work and if average and higher earners are willing to work 5% more (assuming price elasticity of supply is unity), then surely the level of employment will increase to more or less full employment.

Even if only 1.6m NMW jobs are created at £11,000 per annum, this might not raise any PAYE but will save £6.7 bn in benefits. Assuming UK plc makes the same mark-up on salaries as it does generally, i.e. 50%, the extra turnover will be £26.4 bn; extra VAT will be £1.6 bn[70] and extra corporation tax on the net mark-up will be £3 bn. The total saving/extra revenue will be £11.3 bn.

This extra growth is 2% of GDP, so not unrealistic. Smallish changes in unemployment over a year mask the fact that each year, hundreds of thousands of jobs are lost (for example, to India and China) and hundreds of thousands are created. The overall increase in employment of 1.6m will manifest itself in a year or two if the rate of job losses is slowed and the rate of job creation is increased.

[69] See Workings 1

[70] VAT is around 6% of GDP, or alternatively, goods account for one third of GDP and are taxed at 17.5%

LVT will be administered by one single body and will be paid by the owner, not the occupant, so it will be easy to do "data mining" to identify people who own more than one property, and who probably have rental income. If HMRC have nothing better to do, they can trawl the Yellow Pages for painters and decorators and see whether any of them are actually registered for tax. Rather than engage it interminable PAYE inspections that raise a little extra tax on largely technical matters, HMRC staff should be trawling building sites, restaurants and other places where PAYE evasion is rife.

HMRC will check that full PAYE has been paid when it reviews the accounts. If not, the salaries will simply be disallowed as a tax-deductible expense[71]. In marginal situations, employers will prefer to err on the side of caution and deduct full 38% PAYE from salaries, which will tend to boost PAYE receipts. An employee who is legally resident in the UK will be able to claim the BCB to compensate for this.

When somebody on benefits takes on a part time job, he is better off working for £3 per hour cash in hand than being paid £6 legally and losing nearly all of it in tax and benefit withdrawal. The employer is happy to forego the corporate tax deduction for the £3, so both parties come out ahead. Once an employer has got that far, he might decide to divert some income into an untaxed pot which is used to pay such wages, this is where the real tax evasion comes in, it is just the end of a slippery slope. A simpler and fairer tax and benefits system will no longer reward this strategy, so compliance will improve.

The shadow economy is estimated to be more than 10% of GDP[72], or £120 bn per annum. If VAT and income tax can be collected on even one quarter of this, it will increase revenues by £30 bn x 44%[73] = £13.2 bn

Companies and groups will pay tax on their accounting profits, so the onus will be on the company to provide explanations if the tax paid is less than accounts profits x 38% and expenses paid to non-tax treaty territories will as a general rule be disallowable. The burden of proof will be on businesses claiming an expense as a deduction to show that they can identify the supplier; HMRC will be able to use this information to test whether the supplier is under-declaring income. Such sensible measures will improve receipts, although it is impossible to forecast by how much. There will no longer be any advantage in reclassifying income between Schedules or entities to take advantage of lower rates as all income will be charged at the same rate.

The likely additional revenues from the boost to the economy and by broadening the tax base will be in the order of £20 bn - £30 bn, sufficient to maintain government spending at its current level without going into the red, or sufficient to cut the headline income/corporation tax rate by 2% - 3%.

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[71] Some companies have successfully claimed salaries as an expense way in excess of the amounts shown on the P35; this only works because corporation tax and PAYE are monitored by completely separate offices.

[72] Guardian Unlimited – 11 January 2005

[73] Income/corporation tax plus 6% for VAT.

PART E: WORKINGS

Workings 1. National Insurance

Ignoring minor sources such as Class 1A, 2, 3 and 4, NI can be broken down further as follows:

Employees' NI - 45%	£35.1 bn	£35.1 bn (see Proposal 1)
Employers' NI - 55%	£43.0 bn	
Of which		
UK plc – 71.4% of employees		£30.7 bn (see Proposal 2)
State – 28.6% of employees[74]		£12.3 bn
		£78.1 bn

National Insurance will be scrapped as a separate tax.

Rationale

Most basic rate employees genuinely believe that they only pay 22% tax; the NI element "goes towards their pension". This is quite simply not true; current NI goes towards paying current pensioners. The Basic State Pension system on its own is incapable of providing a safety net against pensioner poverty anyway, see Proposal 8. In truth, NI is a super-tax on employment; whatever the price-elasticity of supply and demand for labour are, the effect of NI is to increase the cost of labour to employers, reduce the net wages earned and to reduce employment levels.

Studies have been carried out comparing total payroll taxes[75] with unemployment levels[76], and although there are many other factors in play, the "line of best fit" shows that unemployment is basically one-fifth of the NI burden as a percentage plus a residual 1.5%. The total NI burden in the UK is around 20%, one-fifth of that is 4%, 4% plus 1.5% equates to a 5.5% unemployment rate, which is not far off the official figure for UK unemployment.

Impact

Scrapping Employer's NI will tend to boost employment levels, see Part D.

Scrapping Employer's NI on State employees' salaries will have absolutely no effect whatsoever, as the tax revenues lost to the Exchequer are equal to the amount saved by the State *qua* employer.

The Citizen's Pension will be non-contributory (see Proposal 8), so there will be no need to maintain NI records and contracting out will end.

[74] Labour Force Survey Winter 2005-06
[75] i.e. above and beyond normal income tax
[76] Allister Heath and David B Smith "At a price! The true cost of public spending" Politeia, 2006

Workings 2. PAYE on pension and employment income

PAYE and Employee's NI is the single largest source of revenue, so it is important to forecast the likely receipts very carefully.

PAYE – employees (1)

The incremental approach says that

i) 20 m employees earning more than the personal allowance will be on average £920 better off (see table in Proposal 1); 5 m employees earning less than the personal allowance, will be on average £1,200 better off (i.e. BCB less income tax exceeds the income tax due under the older system). Taking the two together PAYE receipts will fall by £24 bn.

ii) Of £60 bn employer and private pensions paid out, currently only £45 bn is subjected to tax, largely at 22%, total receipts £10 bn. Taxing £60 bn in full at 38% raises £23 bn, which will *increase* the total take by £13 bn, less £1 bn transitional relief - see Pensioners (2), total increase £12 bn.

iii) £23 bn BSP and SERPS/S2P was reported to HMRC for 2004-05, largely taxed at 22%, so the tax raised was £5 bn. The CP will be non-taxable, so this will lead to a fall in PAYE receipts of £5 bn.

iv) Contracting out costs £11 bn and will be scrapped. Allocating 45% of this to employees will increase PAYE revenues by £5 bn.

The incremental approach suggests that PAYE receipts will thus fall by about £12 bn from 2004-05 total receipts of £139.4. The more detailed working on the following pages suggest a fall of similar magnitude

Employees (2)	£99.9 bn
Pensioners (1)	£12.8 bn
Pensioners (2)	£3.7 bn
Pensioners (3)	£4.8 bn
	£121.2 bn

PART E: WORKINGS

PAYE – employees (2)

The latest version of HMRC's Table 3.6 is for 2003-04, so the personal allowance of £11,000 has been reduced by 5% for one year's earnings growth and the tax liabilities/net BCB calculated accordingly.

Employees earning less than the personal allowance will be entitled to the BCB, but will have to pay tax on all their wages. The workings for Proposal 7 assume that employees and BCB claimants are mutually exclusive; this is of course not the case, workers on low wages will also claim the BCB but the PAYE that they suffer will reduce the cost of this. This should strictly be classed as benefit spending but for simplicity these have treated as negative income tax.

Range of total income (lower limit)	Number of individuals (thousands)	Mean income	Tax less BCB per employee	Total
£4,615	1,220	£4,860	£(2,115)	£(2.6)bn
£6,000	864	£5,850	£(1,739)	£(1.5)bn
£7,000	877	£6,620	£(1,446)	£(1.3)bn
£8,000	1,740	£8,020	£(914)	£(1.6)bn
£10,000	1,770	£9,850	£(219)	£(0.4)bn
£12,000	2,660	£12,400	£750	£2.0 bn
£15,000	3,820	£16,100	£2,156	£8.2 bn
£20,000	4,860	£22,900	£4,740	£23.0 bn
£30,000	2,930	£33,400	£8,730	£25.6 bn
£50,000	630	£51,300	£15,532	£9.8 bn
£70,000	304	£69,200	£22,334	£6.8 bn
£100,000	206	£103,000	£35,178	£7.2 bn
£200,000	61	£206,000	£74,318	£4.5 bn
£500,000	10	£455,000	£168,938	£1.7 bn
£1,000,000	4	£1,350,000	£509,038	£2.0 bn
Total	21,956	(as at 2003-04)		£83.6 bn

The table covers 22m employees, so pro-rating up for the fact that there are now 25 m employees would give total receipts of … £95.2 bn

Adding 5% for one year's nominal wage growth would give expected receipts for 2004-05 of … **£99.9 bn**

PAYE - pensioners (1)
Pension income will be subject to 38% in full – the personal allowance is "used up" by the fact that pensioners are entitled to a higher non-taxable Citizen's Pension.

Pensioners with higher employer/private pensions will be able to waive the higher CP and claim their existing basic state pension entitlement (pegged for sake of argument at the BCB rate) and instead and pay tax at 22% or 40% on all their SERPS and employer/private pension.

The next table therefore only covers normal pensioners, who will rather have around £2,000 extra non-taxable CP and pay a higher rate of tax on their small employer/private pension.

Range of total income (lower limit)	Number of pensioners	Mean private pension	Tax at 38%
£4,615	232	£3,120	£0.3 bn
£6,000	293	£3,170	£0.4 bn
£7,000	474	£3,110	£0.6 bn
£8,000	780	£4,180	£1.2 bn
£10,000	698	£5,480	£1.5 bn
£12,000	809	£7,100	£2.2 bn
£15,000	825	£9,020	£2.8 bn
£20,000	682	£12,800	£3.3 bn
Total	4,793		£12.2 bn

Adding 5% for one year's nominal pensions growth would give expected receipts for 2004-05 of … **£12.8 bn**