

Liberal Democrats Policy Consultation

Taxation

Consultation Paper 114



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This consultation paper is presented as the interim stage in the development of new Party policy in relation to taxation. It does not represent agreed Party policy. It is designed to stimulate debate and discussion within the Party and outside; based on the response generated and on the deliberations of the working group a full taxation policy paper will be drawn up and presented to Conference for debate. The paper has been drawn up by a working group appointed by the Federal Policy Committee and chaired by Jeremy Hargreaves. Members of the group are prepared to speak on the paper to Party members and outside bodies where requested. Comments on the paper, and requests for speakers, should be addressed to: Kevin Norton, Taxation Working Group, Policy Unit, Liberal Democrats, 8-10 Great George Street, London, SW1P 3AE. Email: kevin.norton@libdems.org.uk

Comments should reach us as soon as possible and no later than Monday, 8 April 2013.

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1. Introduction

1.1 Since our previous consultation session at autumn conference in 2012, our working group has received submissions, taken evidence and discussed the major areas of tax policy that we previously outlined. We are now about two thirds of the way through our work and we have developed policy ideas in almost all major areas. This paper sets out how our thinking is developing and seeks views from within the party.

1.2 We believe Britain's tax system should change to:

- **Help the lowest-paid:** we are proposing that once we have achieved our aim of increasing the income tax threshold to £10,000, it should continue to rise, to the level of full-time work on the minimum wage (currently around £12,100)
- **Be simpler:** by making the process for most people completing personal tax returns very much simpler; exploring allowing small companies to pay tax based on their own accounts, rather than have to prepare a separate tax return, by expensive experts
- **Help small and new businesses to get going:** through possibly rewarding small companies for the burden which administering aspects of the tax system places particularly on them; extending exemptions from paying employer National Insurance contributions for very small companies; building on the good work already done under the Coalition Government in continuing to make complying with HMRC requirements administratively simpler; and possibly helping new small businesses struggling with short-term cashflow issues
- **Ensure the richest pay a fairer share:** through introducing a 'mansion tax'; possibly preventing some people effectively doubling their tax-free allowance, by merging the allowances for income tax and capital gains tax; looking again at situations such as 'non-dom status': and continuing to look at the tax relief for pensions for the wealthiest
- **Ensure big businesses pay their fair share of tax:** by strengthening further the General Anti-Abuse Rule which comes into effect this year with a more radical General Anti-Avoidance Rule which will institute a low-cost system for companies proposing innovative ways to avoid tax to gain or not gain pre-clearance from the tax authorities, as already happens in other countries. This would also have the benefit of reducing the cost of administration for other companies by allowing the repeal of a large volume of highly specific anti-avoidance regulation
- **Prevent problems which contributed to the 2008 financial crisis recurring again:** by reducing the incentive to fund business growth through excessive debt by changing the generous tax treatment of interest payments; and restricting the ability of businesses to offset losses in previous years against profits in the current year to reduce their tax bill
- **Be much greener:** where we still have considerable further work to do as a group, and will be working in close conjunction with the party's 'Towards a Zero Carbon Britain' working group

2. Personal taxation

2.1 Income tax and national insurance contributions together raise just under half of government receipts. As such, personal tax measures are closely scrutinised.

Income tax personal allowance

2.2 Our 2010 manifesto committed us to increasing the personal allowance to £10,000. We are close to achieving that following the Autumn Statement 2012 but want to build on it.

2.3 Current policy aims to increase the personal allowance to the level of the national minimum wage. We believe this remains the right policy for the Liberal Democrats. The national minimum wage (NMW) is considered to be the minimum acceptable wage and it is right that those earning it should not have their earnings reduced by income tax.

2.4 We therefore propose to set the personal allowance at the level implied by the full time minimum wage. Based on current hourly rates, this would equate to roughly £12,070 annually but may increase as the Low Pay Commission reviews wage levels annually.

We recommend increasing the personal allowance to take all earnings below the minimum wage out of income tax

2.5 We also think it is fair to index link the personal allowance to the NMW to ensure in future workers on the NMW pay no income tax.

2.6 This is an expensive policy which will have implications for the money available for other policy areas. However we believe that both the benefit to individuals and the advantages of encouraging economically productive activity and lowering barriers to jobs out-weigh this.

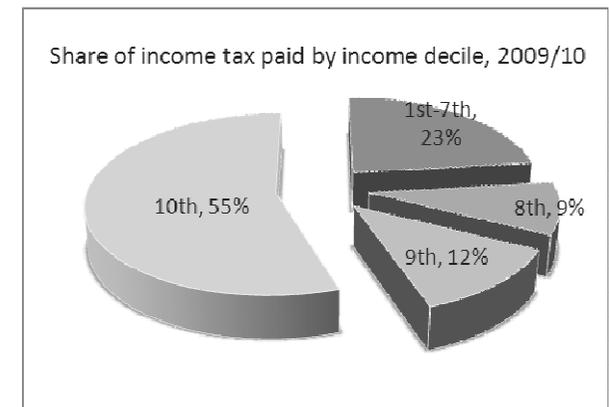
Q1. Do you agree with increasing the tax free threshold to the level of the NMW over the course of the next parliament? If not what other level should it be at? Do you agree with continuing to increase the personal allowance in line with the NMW to prevent NMW earners being brought into the tax net?

Income tax rates and tax bands

2.7 Income tax rates are currently 20%, 40% and 45%. We are minded to leave these rates

unchanged although we would recommend they are kept under review over the course of the next parliament to ensure they are appropriate.

2.8 Based on income tax liability statistics, the richest 10% of UK taxpayers account for 55% of all income tax receipts, while the least well off 70% of UK income taxpayers account for 23% of the total income tax take (as shown in the pie chart). In fact almost 90% of UK income taxpayers do not pay the higher or additional rate. As such, income tax is broadly progressive when considered in isolation.



2.9 As a result of decisions taken in successive budgets, the numbers of higher rate taxpayers will increase to almost five million by 2015. In the long term, we do not wish to continue to

increase the number of higher taxpayers further.

Q2. *Do you agree that rates of income tax, including the additional rate of 45%, should remain unchanged?*

2.10 Dividend income is subject to lower rates of income tax to reflect the fact that corporation tax is paid on profits before they are distributed to shareholders. This applies to small investment shareholdings in large multinationals as well as controlling shareholdings in family businesses. We consider that the lower dividend tax rates should continue to apply to qualifying shareholdings in family companies. Shares held in ISAs would remain not taxable.

Q3. *Would you favour applying the standard rates of income tax rather than these reduced rates to share investments? How would you distinguish between small share investments and qualifying shareholders in family companies?*

Pension tax relief

2.11 The government incentivises certain investments through reliefs from income tax. The largest such relief is pension tax relief – the tax foregone on registered pension schemes is

£31bn – and this relief disproportionately favours the wealthy.

2.12 The Coalition has moved to restrict this relief. (Labour allowed £250,000 to be saved, tax free, in pensions per annum while in government). This Government has moved to reduce the excessively generous relief so that the annual pension relief (i.e. the amount of income that can be invested in a pension tax free) has been limited to £40,000 and the lifetime allowance to £1.25m.

It is important to incentivise saving for old age but the reliefs continue to be too generous

2.13 We are considering further reductions in the annual and lifetime allowances – perhaps to around £30,000 and £1m respectively. If we introduced such changes, we would propose to leave reliefs at these levels for some time, to allow a period of certainty in pension planning.

Q4. *Do you agree with further limiting reliefs for pensions? And do you agree with the levels proposed?*

2.14 A further option could be to change the limit for the lump sum that may be taken tax free from a person's pension pot on retirement. Currently, a taxpayer may take 25% of their pension pot as a tax free lump sum withdrawal. However any change in this area needs to be carefully considered in light of the financial plans that people have already made.

Q5. *Do you support changing the amount available as a tax free lump sum? What would be a reasonable level – either in terms of a reduced percentage or a fixed amount?*

Other tax reliefs

2.15 In Coalition, we have sought to reduce the level of reliefs available for taxpayers to lower their tax bill and crack down on tax avoidance. This has been largely successful. However, for any future reliefs provided, we want to see 'sunset clauses' included. Under these clauses, the relief would be given a lifespan after which it would expire. This would improve the likely effectiveness of reliefs and minimise the loss to the Exchequer over time.

Q6. *Do you agree that reliefs should include a sunset clause? Are there any particular reliefs you would wish to see ended immediately?*

Taxation

National insurance contributions

2.16 National insurance contributions (NICs) from employees and employers notionally fund pension and unemployment benefit payments. However in reality the revenues raised through NICs are not sufficient and governments have long treated NICs as an additional income tax.

2.17 At present the Coalition Government is consulting on the administration of income tax and NICs – income tax is calculated on an annual basis, while NICs is calculated weekly. We support this consultation and, pending the outcome, broadly agree with measures to simplify the system through aligning the two taxes over time, which would reduce the burden for employers that must administer it.

Q7. Would you agree with moving to a similar basis for calculating income tax and IT, ie based on annual income? Would you support a full merger of the two tax items or prefer to see income tax and NICs continue to remain separate? What do you think about the additional areas which might become subject to NICs if the two taxes were merged?

Boosting youth employment

2.18 Intergenerational inequality is causing increasing concern, with young people having

great difficulty finding reasonably paid jobs and getting into the housing market.

2.19 We would like to find ways to help young people, particularly to find their way into the employment market, and are considering whether some relief from income tax or NICs for younger workers would be wise.

Q8. Do you think the tax system should be used to provide higher take home pay for younger people? Or should resources be focused on other areas outside the tax system, such as housing?

Applying NICs on benefits-in-kind

2.20 Unlike income tax, NICs is charged only on earned income. It is not levied on other forms of income such as savings, dividends and benefits-in-kind.

2.21 We do not support extending NICs to savings or dividend income as this would act as a disincentive to investment and saving, which should be encouraged.

2.22 However benefits-in-kind are often taken in lieu of income and we are considering whether they should be subject to NICs. There are many schemes available – often called ‘salary sacrifice schemes’ – which allow employees to take benefits without any NICs liability.

Q9. Do you agree that NICs should be applied to benefits-in-kind? And are there other forms of income where you think NICs should be applied?

2.23 Pension contributions made by employers are also exempt from NICs. Any move to apply NICs on these contributions would most likely lead to reduced pension contributions from employers and/or increased contributions from employees.

Q10. Do you think that pension contributions made by employers should be subject to NICs?

NICs and older people

2.24 At present all those in work pay both income tax and NICs, except for those of pensionable age. Since NICs are in most respects an additional tax on earned income, this treatment could be viewed as anomalous and as distorting the employment market between younger and older staff. In addition, NICs are not levied on pension income.

Q11. Should we review the NICs position in relation to older people?

Simplifying tax returns

2.25 We have previously proposed introducing a simplified tax return for the majority of self

assessing taxpayers (roughly 9m) who must submit tax returns.

2.26 The simplified form would be no larger than a postcard, would contain pre-populated information that is already known to HMRC and would therefore require taxpayers to confirm the information is correct. This would significantly reduce the time spent completing such forms.

2.27 These simplified tax returns would also include information on where tax receipts are spent and would be a relatively straightforward step given that the Coalition has already committed, in Budget 2012, to creating a Personal Tax Statement for around 20m taxpayers from 2014-15.

2.28 For those taxpayers with complex tax affairs, it would still be necessary for them to prepare a detailed tax return.

Q12. Do you agree with such a measure to make paying tax more straightforward? Are there any other suggestions that could reduce the administrative burden for the taxpayers who must file tax returns?

Taxing worldwide income

2.29 Currently, UK resident and domiciled individuals are taxable on their worldwide income. We would build upon the existing approach of the Coalition Government to seek to reach agreement with other countries to enable automatic exchange of information, so that the ability to evade taxation on foreign income is reduced.

2.30 US citizens are liable to US taxation on worldwide income regardless of whether they are resident in the US. We are not persuaded that a similar approach in the UK for UK citizens not resident in the UK would be practical to implement and unlikely to raise significant amounts of tax.

Q13. Do you agree with this approach to worldwide taxation?

Non-doms

2.31 We believe the 'non-dom' status is excessively generous in allowing people who live in the UK for many years - and even for their descendants - to avoid paying a fair level of UK tax.

2.32 The status exists in order to attract highly skilled workers to work here for relatively short

periods of time. We recognise the positive contribution they can make to the UK economy – the Government estimates that in 2009/10 non-doms contributed £8.1bn in income tax, CGT and NICs – but this is still considerably below what would have been contributed had they been here and not able to benefit from this status. A balance needs to be struck between attractiveness and ensuring a fair contribution of tax. We believe eligibility to hold this status should be further limited and removed from descendants.

Q14. Do you agree that these changes to non-dom status are fair and proportionate? What would be a reasonable time period for someone to claim non-dom status?

3. Wealth taxation

3.1 As outlined above, we want in general to move taxation away from income (where it disincentivises economic activity, but is currently predominantly focussed) and on to accrued wealth. We set out in this section the proposals we are considering for taxing wealth.

Reforming capital gains tax

3.2 Capital gains tax is levied on the gains received from the transfer of assets, in other words on the gains achieved by someone in selling something at a higher price than they bought it.

Because there are separate allowances from income tax and capital gains, a person may earn as much as £20,040 in a single year tax free

3.3 Taxpayers may earn gains of up to £10,600 p.a. before paying CGT, as a result of a tax free allowance (separate to the personal allowance for income tax).

3.4 Some people are able to shift the form of their earnings between income and capital gains, effectively allowing them to double their tax-free allowance. A solution may be to move to a combined single tax free allowance, which the taxpayer would be able to use against income tax and/or capital gains. (We would probably wish to retain a small separate CGT allowance to avoid capturing small shareholders who sell their shares in a particular year). While heavily caveated, HMRC estimate that abolishing the CGT allowance could increase tax revenues by roughly £2.6bn.

Q15. Would you agree with creating a single allowance for income tax and capital gains? If so, how do you think it might best be done?

Rates of CGT

3.5 Current party policy supports aligning CGT and income tax. This would mean levying rates of 20%, 40% and 45% on capital gains, while re-introducing indexation so as not to tax gains that arise solely from inflation.

3.6 Applying taxpayers' marginal rates on gains from capital investment would minimise incentives to shift forms of income between earned income and investment income.

Having different tax rates for income and capital incentivises people to seek to change the form of their earnings to achieve the lowest rate

3.7 We are not currently considering changes to entrepreneurs' relief, which allows entrepreneurs qualify for a reduced rate of CGT (10%) on the sale of qualifying businesses.

Q16. Do you think rates of capital gains tax should be aligned to income tax rates with indexation? Or do you prefer the current system with lower rates and no indexation?

CGT on death

3.8 Under the current rules, CGT is forgiven at death and is not paid by the deceased's estate. This creates a perverse situation whereby someone selling property or financial assets prior to death must pay CGT but the exact same assets are not liable if disposed of at death. In both cases, the value is then liable for Inheritance Tax.

3.9 The independent Mirrlees Review recommended this relief from CGT should be

removed and, based on government estimates, would raise additional revenue of roughly £490m. (This would not affect someone's main home, which would continue to remain exempt from CGT).

Q17. Do you think the CGT exemption should be removed?

Inheritance tax

3.10 We are considering moving from inheritance tax to an accessions tax system, where the tax is paid by the recipient(s) of an estate based on their income, rather than by the deceased's estate based on the value of the estate. Many believe that this would be a more equitable form of taxation and result in a greater distribution of wealth amongst the UK population. A number of other countries, including Ireland, use such a system. However there are many practical difficulties with an accession tax, particularly around record keeping and policing lifetime gifts.

3.11 We do continue to support party policy to increase the seven year exemption from IHT for gifts to fifteen years. In other words, only gifts made at least fifteen years before the death of the donor would be completely IHT free.

3.12 We also propose to change the current system under which relatives can be liable for paying IHT before they have received the income which will be due to them and which is being taxed. Re-sequencing this will prevent the current situation in which receiving a large legacy can ironically cause severe short-term hardship.

Q18. Do you believe reform of IHT is necessary? Would you support an accession tax or prefer alternative reforms?

Q19. Do you agree with extending the period for IHT to fifteen years?

Net wealth tax

3.13 There has been some suggestion of using a net wealth tax to target the wealthy. For instance, the French operate such a system.

3.14 Our mansion tax proposals target a similar (though not identical) group as property is a significant component of UK wealth. However net wealth tax covers a wider set of assets. It would require taxpayers to self-assess their net worth (which may be very difficult for illiquid assets) and would generally be quite complex to administer. And HMRC, in policing the system, may have to visit homes to test whether

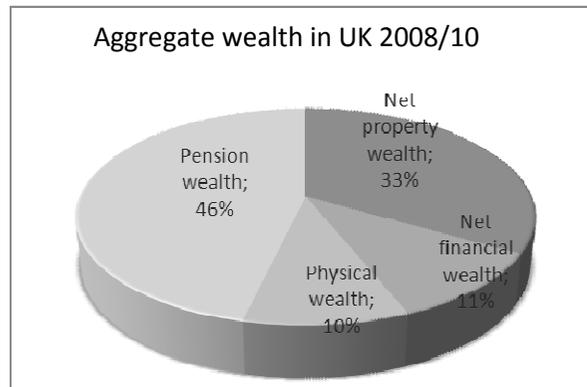
asset values of jewellery, paintings etc were correct.

Q20. Would you support a French style net asset tax?

4. Property and land taxation

4.1 As already outlined, we support shifting the burden of taxation from wealth creation (earned income and profits) onto wealth accumulation, as the least damaging form of taxation.

4.2 A significant component of UK net wealth – 33% according to the most recent ONS survey on UK wealth – is property and the value is derived principally from the land on which the property is built.



Land Value Taxation

4.3 A land value taxation (LVT), which was reaffirmed as Party policy ‘for the longer term’ in 2006, has the potential to be a significant source of public revenue.

4.4 In addition to being economically efficient, LVT may:

- Dampen speculation in the property market, if introduced at a national level.
- Encourage sustainable economic activity, primarily in the construction sector. Since it introduces a ‘holding charge’ for owners of under-used sites, incentivising development where it is needed and approved.
- Help close the inter-generational divide. It stimulates employment for younger people in the workforce and helps the housing market operate more efficiently.
- Have adverse consequences for the limited number of ‘asset-rich, income-poor’ but these people can be protected.
- Reduce avoidance because it depends on an unchangeable physical location: help

restore a regional balance to the UK economy, because a national LVT would be less of a burden to low-value areas away from London.

4.5 A recent poll by Ipsos MORI¹ indicates that LVT could be made a vote-winner, although no property tax is popular on the whole. The policy can be made more palatable by a combination / selection of the following:

- Deferral for pensioners etc
- Using income tax / corporation tax systems to collect LVT (as happened with ‘Schedule A’ until 1960s), thus avoiding separate billing
- Tax-free ‘homestead allowance’ (ie value below which tax would not be due) for owner-occupiers, transferable with income tax allowance
- Exempting low value properties (residential and business) and social housing

Q21. Do you agree that we should aim to have a significant national LVT?

¹ http://www.landvaluescape.org/LVT%20poll_report.pdf

Efficient use of government properties

4.6 The government owns very significant holdings of property across the UK. The tax system could be used to encourage efficient use of existing government property through land value taxation. Individual departments would be liable, to HMT, for a land value tax. This may also serve as a pilot exercise for a broader land value tax.

Q22. *Do you support introducing a land tax for government land?*

Mansion tax

4.7 The mansion tax is a well-known and widely supported policy, which would ensure owners of expensive properties pay more tax. The mansion tax would be 1% on the value of residential properties above £2m. Previously, it was estimated such a tax would raise £1.7bn for the Exchequer.

A mansion tax makes sense: it raises significant revenue and hits the wealthy who can afford to pay more

4.8 Other countries have introduced property taxes, such as Ireland, where a tax of 0.18% is levied on property values to €1m and 0.25% of values above €1m.

4.9 We are considering whether the mansion tax would be best operated based on the value of undeveloped land. This would incentivise the use of currently unused residential land where development has been approved, for reasons set out above, and slightly reduce the number of existing residential property owners who would be liable. It would be expected to raise similar levels of revenue.

Q23. *Should we have a high value property (or mansion) tax at all? If so, should it be based on property values or land values? Is £2m the right threshold for such a tax?*

4.10 We also think there may be merit in a mansion tax based on the value of land or property owned by someone, rather than the value of a specific site (ie linked to an individual person rather than to an individual property). If successfully designed, this would ensure taxpayers with multiple properties would be liable for the mansion tax on the cumulative value of their holding above £2m. We propose to continue exploring finding an appropriate way to do this.

Q24. *If possible, would you agree with a mansion tax based on an individual's holdings rather than a specific site?*

Stamp duty land tax

4.11 While recognising the current 'slab' system of stamp duty land tax is inefficient, measures to make the tax more progressive would lead to a loss of government receipts or penal rates in order to protect absolute revenues. Over the long term we would wish to improve SDLT but it is not our immediate priority.

Q25. *Do you agree, given current economic conditions, reforming SDLT should not be an immediate priority?*

5. Business taxation

5.1 Private businesses are a crucial component for growth, improved living standards and a balanced economy. In Coalition Government, we have introduced significant reforms to improve the UK economy's competitiveness and to ensure the UK remains a leading location for business investment. We recognise also that creating a stable environment is crucial to businesses being able to make long term investment decisions.

Corporation tax

5.2 The Coalition Government has steadily reduced the rate of corporation tax. The rate was 28% at the end of the Labour Government in 2010. Following the announcements in the Autumn Statement 2012, the headline rate of corporation tax will be 21% from April 2014.

We've cut corporation tax to help businesses in Britain

5.3 This rate of corporation tax is highly competitive when compared to our closest competitors – it is the lowest headline rate

amongst the G-8 economies. As a result, we believe it is wise to leave the rate unchanged over the next parliament and focus on other measures to boost competitiveness. Two possible models are to choose a low basic rate of corporation tax with few reliefs, or a relatively high rate with a large number of reliefs. We believe that the UK government has taken the right view in promoting a low rate with a relatively simple structure of reliefs.

Q26. *Do you agree with leaving rates of corporation tax rates unchanged?*

Cutting administration costs

5.4 Companies collect substantial tax revenue on behalf of HMRC, for example payroll related taxes and VAT. The cost of collection can impose a significant burden on business, particularly micro-businesses (with fewer than 10 employees).

5.5 We wish to support micro-businesses and recognise this financial cost through paying them a small payroll bureaucracy allowance. The exact value of the rebate would need to be carefully considered as well as measures to ensure it was not abused.

To help small businesses with the cost of collecting taxes, we will give them a tax rebate

Q27. *Do you agree it is right to compensate micro businesses for the cost of tax collection? Do you agree with the idea of an allowance or rebate?*

Q28. *What level of rebate do you think would be appropriate? And what size of company should be eligible?*

Boosting employment

5.6 Small businesses are crucial to Britain's economic recovery, and we particularly want to encourage micro-businesses, which are often new businesses starting up. We are therefore considering extending an existing (but limited) scheme that offers an employer relief from NICs for such companies taking on additional employees.

Q29. *Do you agree with a NICs exemption for very small companies? Or are there better ways to incentivise businesses to hire – either through the tax system or other measures?*

Helping start-up companies

5.7 One policy being considered is to assist small start-up companies who are struggling with early cashflow through a scheme that would allow them to 'sell' their losses to HMRC. We recognise it would need to be carefully designed to prevent abuse and so as not to support failing businesses that have no prospect of being successful.

5.8 Cashflow difficulty is one of the most common reasons for start-up companies to fail. Under this scheme, they would be able to use their losses against other tax liabilities (the value of the losses would of course have to be discounted). It would also mean that should the company be successful and make profits, it would immediately pay corporation tax as it would not have losses available to offset against profit.

Q30. Do you think this is a reasonable policy? What might be the potential advantages and disadvantages?

5.9 Small and micro businesses also struggle with many other aspects of dealing with government administration, especially HMRC. We are considering ways in which micro-business tax returns and accounts could be

made simpler and less stressful, allowing small companies to avoid the need for an accountant.

5.10 One possibility is to allow micro-businesses to pay corporation tax based on their accounting profit rather than having to separately calculate taxable profit based on different tax rules. Of course, it would be necessary to consult on this to ensure it does not significantly harm the exchequer position or companies.

Q31. Would you support allowing small businesses to pay corporation tax on their accounting profit?

Q32. Do you think HMRC could usefully provide a form of online pre-clearance of accounts to avoid the fear of an audit later down the line?

Q33. What would be the most useful simplification of tax bureaucracy which would most help small companies?

Supporting sustainable economic development

5.11 The current taxation system allows interest payments on debt to be used to reduce profits and thus corporation tax. However by contrast returns to equity (dividends) are made from after tax profits.

The financial crisis was the result, in large part, of excessive borrowing. We favour measures to make debt financing less attractive.

5.12 This incentivises companies to use debt rather than equity, which is a more sustainable form of finance. Indeed favouring debt over equity contributed to parts of the economy including the private equity sector being excessively leveraged, which in turn contributed to the financial crisis.

5.13 We believe the system should be changed to disincentivise the use of excessive debt financing. This would promote longer term investment in companies. It would also limit instances of foreign companies, and particularly private equity groups, being able to acquire UK companies through borrowing against the value of the UK company.

Q34. Do you agree? What would be the negative implications of restricting the levels of debt that UK companies could borrow tax-free?

Taxation

Supporting manufacturing

5.14 Liberal Democrats in Coalition successfully lobbied for a temporary increase in the annual investment allowance for companies (ie the amount a business may write off against its tax bill in a year) to promote investment. The allowance was increased, in the Autumn Statement 2012, for two years to £250,000.

Q35. Are there other tax-related measures that we should demand to support the manufacturing sector?

Business rates

5.15 Business rates are charged based on the rental income of the business property. The system of collection is being reformed to allow councils to keep a greater share of the revenues – previously almost all business rate income was collected and then simply remitted to central government.

5.16 We support the reforms and wish to evaluate their effectiveness in devolving revenue raising powers to local authorities.

5.17 However our current policy is to create a system based on site values rather than rental values, within a single Parliament. We would devolve rate setting to local authorities, subject

only to some degree of equalisation between areas.

Q36. Do you agree? Or would you favour business rates being fully devolved, as was the case pre-1990?

Limiting corporate losses

5.18 In the UK, a company may carry forward losses to set against future profits to minimise its taxable profit and therefore the corporation tax due. Many other countries operate a similar system. However we are inclined to think that the UK system is inappropriately generous as many other countries only allow losses to be used against profits for a limited period (ie a stricter, time limited regime). An option is to allow companies to offset losses against only a portion of profits in any given year – this would mean that where a company made a profit, it would be required to pay some tax (even if it is reduced by brought forward losses).

Q37. Do you think company should be allowed to carry forward their losses indefinitely? If not, would you rather see losses time limited or allow only a portion of profits to be offset with prior year losses?

Bank levy

5.19 The bank levy is forecast to raise roughly £2.8bn per annum from financial institutions. It is levied on banks' riskier debts (at a rate currently of 0.13%) as a way to promote more conservative forms of financing.

Q38. Do you agree with a bank levy? Or are there other tax measures you might prefer to see applied on banks?

6. Tax evasion and avoidance

6.1 There has been intense public scrutiny of the tax affairs of many of the largest businesses operating in the UK and whether they pay their 'fair' share of corporation tax. It is important that the public have faith in the tax system and believe HMRC is policing the system, for all taxpayers, effectively.

General anti-avoidance rule

6.2 The Coalition has introduced a general anti-abuse rule, which outlaws wholly artificial and aggressive tax avoidance by individuals and companies in the UK.

6.3 However we continue to believe that the government should go further and promote a broader anti-avoidance rule. This would state some clear principles that we expect people to respect, and have a pre-clearance system that would allow individuals and businesses certainty around their tax affairs. These safeguards will prevent the risk of someone being penalised for taking a step that they reasonably believed was acceptable at the time. Such a system would also promote simplicity by allowing the removal of a large quantity of

specific anti-avoidance regulation in the extremely cumbersome UK tax code.

Q39. Do you agree that the GAAR, once implemented, should be further strengthened? And do you agree with the trade-off for taxpayers of a pre-clearance system to provide certainty?

HMRC

6.4 The UK tax authorities are expected to police the tax system and ensure that individuals and companies pay the right amount of UK tax.

We need to give HMRC sufficient resources to police the tax system

6.5 In light of the significant tax gap (roughly £35bn; ie the difference between tax actually collected and that, which in HMRC's view, should be collected) identified as well as the on-going controversy around tax avoidance, we support significantly expanding the resources of HMRC. Such investment demonstrates a good return in terms of increased tax income. However resources must be targeted at those areas which generate significant yields.

6.6 We also support HMRC taking a more aggressive approach with large corporate taxpayers – as it often appears small businesses suffer audits and inspections, while HMRC does favourable deals with the largest companies.

Q40. Do you agree that HMRC should be provided with additional resources? What other changes would you like to see made to the way HMRC goes about its job?

Transparency

6.7 In order to help HMRC to monitor multinational groups' transfer prices, we are considering an additional tax return disclosure that identifies a company's intra-group transactions. With this information, HMRC would be able to quickly identify those UK companies who are most likely to use transfer pricing to reduce their UK profits.

6.8 In addition, certain countries offer tax rulings which are extremely generous (eg that only a very low level of tax is due on profits in that country). We wish to make it obligatory for UK companies to report such tax rulings to HMRC.

6.9 With both these measures, HMRC will be able to more accurately direct resources to those UK companies who are most likely to use

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transfer pricing to minimise their UK corporation tax.

Q41. Do you agree with these measures? And what other measures to increase transparency would you like to see?

Cracking down on tax havens

6.10 We wish to see significant action taken against tax havens and, in particular, for Britain to lead in the fight against tax havens over which it has significant influence.

6.11 Agreements have been put in place with some territories under which UK residents must pay tax on their holdings in tax havens. We support further such agreements and wish to consider what other measures could reasonably be taken to crack down on tax havens.

Q42. What further actions would you like to see us take against tax havens?

Penalties for tax advisors

6.12 For those advisors who promote aggressive avoidance schemes, we wish to introduce measures that penalises them as well as their clients.

Q43. Do you agree with this approach?

Q44. Do you have any suggestions for how best to penalise advisors and how we might define 'aggressive' avoidance?

7. Environmental taxation

7.1 One of the fundamental challenges facing Britain is to manage the shift to an economy which both promotes environmental sustainability and which exploits the opportunities of environmentally sustainable growth. The working group on 'Towards a Zero Carbon Britain' is leading the party's work in this area, and we are in discussion with them about how the taxation system can play its part in this shift.

7.2 At this stage, we note that a number of models of environmental taxation deserve consideration. In addition, we note that energy costs have risen significantly for households as a result of higher input prices.

7.3 The first seeks to raise funds from environmentally targeted taxes. The most likely form of revenue raising green taxation is a carbon tax. This would most likely lead to higher costs for consumers of energy and other carbon intensive users but the revenue raised could be used to reduce taxes elsewhere.

7.4 An alternative is to create behaviour modifying but revenue neutral green taxes. For instance, Centre Forum suggests reforming

annual vehicle excise duty with a one-off registration charge based on emission levels raising similar receipts.

7.5 Finally, it may be possible to incentivise green behaviour through, for example, reliefs. For instance, council tax discounts could be provided for energy efficient homes.

Q45. Which of these options do you favour in order to move towards a zero carbon Britain?

8. Local taxation

8.1 Britain's system of local taxation to fund services provided by local authorities is now widely-recognised as unsatisfactory.

Council Tax

8.2 Residents currently contribute to the costs of their local authority by paying council tax based on the notional value of their property in 1991, grouped into eight bands. Such outdated, crude values have made council tax extremely unfair, with some 3 million properties already in the 'wrong' (too high) band. It has other failings, particularly that the upper band (band H) does not differentiate between properties worth £320,000 and £100m and it is only three times the level payable by those in band A (the lowest band). The tax due also does not reflect ability to pay.

Local Income Tax

8.3 It has been a long standing policy of the Liberal Democrats to replace Council Tax with a Local Income Tax. This would, clearly, reflect people's income, but would generate other consequences, for example very much increased payments from properties shared by several people in work. Past experience has also

made clear that the change to LIT can be a difficult proposition to explain and it would also require a well-functioning collection system.

A fairer local taxation system

8.4 We support the introduction of the mansion tax, which would require perhaps the 1% most well off to pay more. Liberal Democrats continue to believe that any on-going property-based local taxation should move towards being on the basis of land values, for reasons set out in that chapter.

Q46. Beyond this, we would welcome views on the best future balance between land or property-based local taxation, and local taxation on an income basis.

9. Indirect taxation

9.1 VAT is a very significant revenue raising item for the government, accounting for roughly 17% of government receipts. Many of the rules relating to VAT are set by the EU, as VAT is an EU wide tax, and significant reform therefore requires European wide agreement.

Value added tax

9.2 The headline rate of VAT is 20%, which is consistent with levels applied by our European trading partners. The UK applies reduced rates of VAT on certain items, while exempting 'essentials'. We are not minded to recommend changes to the rates of VAT.

9.3 The system is highly complex and has been criticised for failing to take account of how modern economies operate. There are EU level reforms under discussion and we support efforts to modernise the system of VAT.

9.4 In general, although the reduced rates for some items throws up numerous anomalies of different treatments for slightly different types of goods, in practice it is extremely difficult to make changes to these without throwing up further other anomalies (as the 2012 Budget and debate following it showed). We do not

therefore generally propose to suggest further individual changes to VAT rules.

Q47. Do you agree with this approach to VAT?

9.5 More immediately, in relation to VAT, we support applying a reduced rate of VAT on home repairs and maintenance. This would be expected to stimulate demand for home improvements, helping boost growth and employment in the building industry, and remove the current environmentally unhelpful incentive for building new homes over repairing existing ones.

9.6 We also support moves to relieve charities of the cost of irrecoverable VAT that they currently bear.

Q48. Do you agree with reducing the rate of VAT for home improvements? Do you think there should be any other changes (either increases or decreases) to VAT rates on specific goods and services?

9.7 Finally, from the experience of other countries such as Italy, it appears that extremely high rates of VAT on luxury items does not generate significant revenue and, in fact, often will drive purchases of such items overseas. As such, we are not considering a 'super VAT' or similar.

Q49. Do you agree with this approach?

10. Guiding principles

10.1 In developing the policies being considered above, we continue to believe that Liberal Democrat tax policy should respect the following principles.

Progressiveness

10.2 The tax system as a whole should be progressive with those most able to afford to pay, doing so.

Simplicity

10.3 It is universally agreed that the UK tax system is excessively complicated. Complexity leads to higher compliance costs for taxpayers, confusion and greater opportunities for tax avoidance and evasion. Measures to simplify the system should be sought as a priority.

10.4 Indeed the Coalition Government has established the Office of Tax Simplification and its work should be supported and recommendations implemented where reasonable and proportionate. In addition, HMRC's processes should be more transparent to taxpayers.

Making work pay

10.5 The burden of tax currently falls heavily on income earned from work rather than unearned wealth. As has been argued in previous Liberal Democrat tax policy papers, this can act as a disincentive to work.

10.6 The Liberal Democrats support moves to shift taxation from income to wealth and, therefore, policies that are consistent with this aim.

Promote environmental sustainability

10.7 Liberal Democrats support environmentally sustainable economic development. The tax system may be used to incentivise 'green' behaviour – whether through incentives to promote 'good' behaviour or additional taxes to change 'bad' behaviour.

Decentralisation

10.8 Localism is a key principle of the Liberal Democrats, with power (including tax raising powers) devolved to local government. Achieving this aim does not necessarily require new taxes but may involve devolving revenue

raising powers for existing taxes to local government.

10.9 Increased localism would also help bring about a more dynamic and regionally balanced economy.