Tax reforms to secure a recovery from coronavirus

June 2020

TaxPayers' Alliance

Executive summary

Coronavirus is the most significant new health emergency in a lifetime. But its economic fallout could dwarf the great recession. To maximise the chances of bouncing back, the government should pledge that there will be no austerity for taxpayers but instead a package of reforms to sharpen the supply side of the economy, both to fix long-term problems and to enable the economy to best adapt to longer-term consequences from the pandemic on both consumer preferences and corporate operations. The enormity of the emergency means bold, ambitious reforms are needed fast.

In 2012, the TaxPayers' Alliance launched its landmark tax reform proposal *The Single Income Tax*. We recommended a substantial, thorough package of tax reforms designed with the whole system in mind to be phased in by 2020. But rather than an eight-year horizon, significant reform should now be implemented immediately to provide much-needed support to the economy as it pulls out of the pandemic. But instead of just cutting tax rates, whole sections of Britain's enormous 25,000 page tax code should be jettisoned entirely by abolishing entire taxes and scrapping rates to create a leaner, more efficient system.

The five **key recommendations are**:

1. **A restart for jobs:**
   Employer national insurance should be entirely abolished with immediate effect and replaced with a temporary payroll tax of 10 per cent on wages and salaries (above £4,500 per employee) from October. This would cut a typical payroll tax bill by 38 per cent this year, meaning that fewer companies will have to lose staff and more will be able to hire.
2. **A stimulus for staff:**
   Employee national insurance should be entirely abolished with immediate effect and replaced next year with a basic rate surcharge of 10 per cent on PAYE income tax. This would make a worker on average wages £1,622 better off this year and £300 better off next year.
3. **A catalyst for capital:**
   Capital gains tax should be abolished entirely with immediate effect. This could grow the economy by 3 per cent.
4. **A fillip for factories:**
   Corporation tax is particularly damaging to investment and **the government should extend their increase of the annual investment allowance from £200,000 to £1 million by increasing it again to £5 million**. This would deliver a tax cut on investment worth £5 billion, boosting it by up to 8 per cent.
5. **A release for movers:**
   Stamp duty land tax makes it harder to move home, despite many people now reassessing where they want to live and work. All **homes under £1 million should be taken out of stamp duty by raising the threshold with immediate effect**. This would increase transaction numbers by 31 per cent, or 220,000.

Using estimates calculated before the pandemic was known, these measures would amount to tax cuts worth £100 billion this year, falling to £51 billion next year, before adjusting for dynamic effects on economic activity. However, the true impact on receipts is likely to be substantially lower than these estimates because of their powerful effect on economic activity and the impact of the pandemic.

Coronavirus aftermath

At the time of writing, coronavirus has caused almost 40,000 covid-19 deaths, or over 60,000 excess deaths. The virus has had a substantial impact on our health and many experts believe that these figures would be substantially greater were it not for the government's interventions. The impact on the UK economy is also enormous and is already in a "recession like we've never seen before" according to the chancellor, Rishi Sunak.

Supply and demand

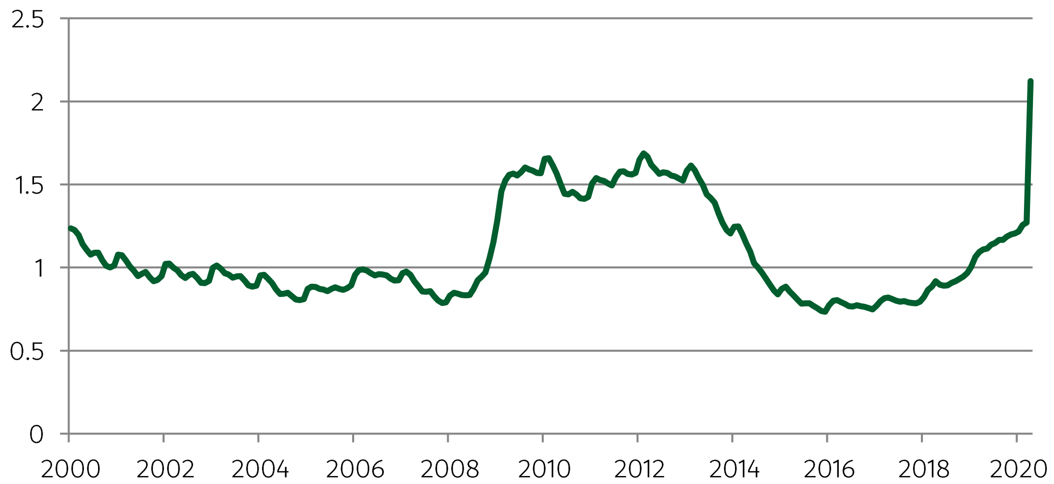
That recession is a policy outcome by virtue of it being an inevitable consequence of the public health measures taken to control the virus. But as the virus becomes ever more contained and the measures are lifted, much of the lost demand will be likely to return. Furloughed staff will return to their jobs, suspended spending patterns will to some extent return and deferred spending decisions will begin to be executed.

Some, however, have lost their jobs already while others will find their jobs no longer exist, partly because spending patterns (such as consumption associated with commuting) may have shifted permanently and partly because others served employees who are now unemployed.

Employment after coronavirus

Already, the claimant count for unemployment benefits has soared by 856,500 to 2.1 million in April.[1] By 24 May, another 8.4 million employees[2] have been furloughed at taxpayers' expense, plus a further 2.3 million claimants of the self-employment income support scheme, and the proportion of these who are likely to join the unemployment register grows the longer the crisis goes on.

Chart 1: monthly UK claimant count, January 2000 – April 2020 (millions)

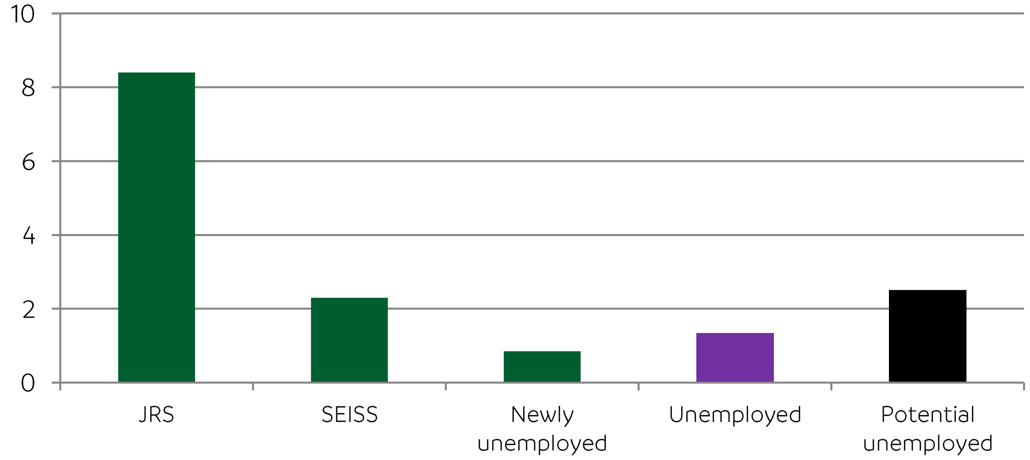


The 1.3 million unemployed estimated by the most recent Labour Force Survey account for just 10 per cent of the total now unemployed or furloughed. Furloughed employees in the jobs retention scheme (JRS) account for 66 per cent while the self-employed claimants of the self-employment income

[1] ONS, *Claimant count and vacancies time series*, 19 May 2020, www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/claimantcountandvacanciesdataset, (accessed 24 May 2020).
[2] HMRC, *HMRC coronavirus (COVID-19) statistics*, 19 May 2020, www.gov.uk/government/collections/hmrc-coronavirus-covid-19-statistics, (accessed 27 May 2020).

support scheme (SEISS) account for another 18 per cent. Even if only a tenth of these furloughed staff and half of new claimants fail to retain their jobs, unemployment could potentially swell by another 1.5 million to 2.8 million (see chart 2).

Chart 2: unemployed and furloughed UK workers (millions)



Optimistic economic forecasters assume that economic activity will rebound as soon as the virus is beaten, with only a one-off reduction in economic activity and temporary employment and fiscal consequences. But there is a risk that the economic slump could last much longer, leaving a scarred economy and devastating health, financial and wellbeing consequences.

Scale

Coronavirus, both directly through disease and indirectly through wider effects, including government interventions, has had a huge impact beyond the shocking loss of life. Civil liberties have been curtailed, fiscal support for businesses and employees introduced, public transport use has reduced and road space has been reallocated all on a scale and at a pace never before seen.

Bold, powerful action will be needed to reinvigorate the economy in the aftermath of the virus to avoid a prolonged, painful slump which entrenches the structural weaknesses of the economy which have long existed. The pressing need to take radical action requires a package of reforms that ordinarily would appear daunting and nowhere more so than in the tax system.

Substantial tax cuts are required to sharpen incentives and confidence. That means the time for bold tax reform has arrived. Rather than cutting a rate here or raising a threshold there, the government should augment the power of tax cuts by abolishing whole taxes entirely, and replacing them with simpler alternatives when necessary.

Debt, deficit and fiscal policy

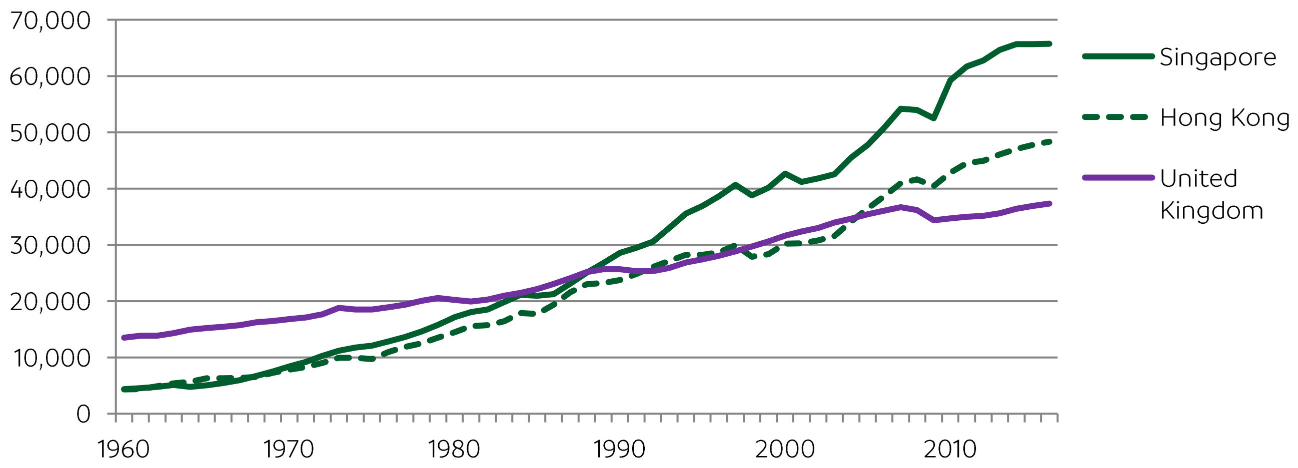
The weakness of the economy during a contraction that is likely to be the largest ever has led to preparation to inflate economic output, such as the EU's recovery fund. The primary purpose of the tax measures we propose is not to increase aggregate incomes through loosening fiscal policy but instead by enhancing economic efficiency. Reducing 'tax drag' and simplifying tax administration will sustainably raise productivity and therefore incomes, but at a time when there is a risk of a recessionary spiral the fiscal loosening they involve is less concerning than ordinarily.

Loosening fiscal policy may be required and is highly likely to happen one way or another, so it is crucially important that it is done in the right way. Reforming taxes with a view to a recovery in jobs and investment is preferable to a spending splurge which would entrench long-term economic problems caused by government waste, over-spending and excessive taxation. Only prudence on spending can acceptably balance ledgers after the crisis.

Tax burden

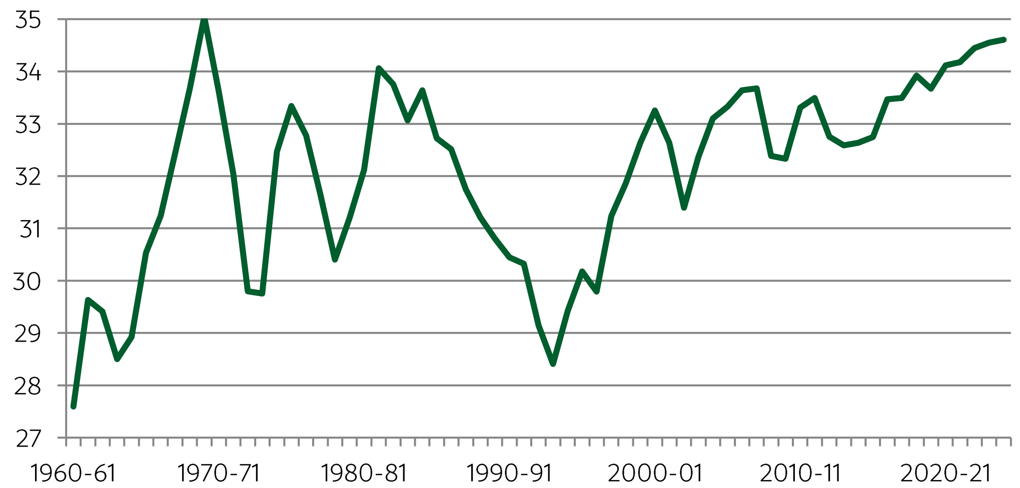
There is a well-established relationship between the tax burden, economic growth and productivity, with lower-tax economies out-performing those with higher taxes. For example, European Central Bank research found that raising the tax burden by 1 percentage point reduces growth by 0.13 per cent.[3] The relative performance of incomes in low-tax Singapore and Hong Kong to the UK's is startling.[4]

Chart 3: GDP per capita in selected economies, 1960-2016 ($, 2011 prices)



But recent TaxPayers' Alliance research has shown that the UK's tax burden has been stuck at a 50-year high and was already at risk of deteriorating even further before the pandemic. The latest OBR forecasts show the burden steadily growing to 34.6 per cent of GDP by 2024-25.[5] This would create the highest tax burden in 55 years.

Chart 4: national account taxes, 1960-61 to 2024-25 (per cent of GDP)



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[3] Afonso, A. & Fuceri, D., *Government Size, Composition, Volatility and Economic Growth: ECB Working Paper 849*, European Central Bank, 2008.
[4] Maddison Project Database, *GDP per capita, 1940 to 2016*, 2018, ourworldindata.org/grapher/maddison-data-gdp-per-capita-in-2011us-single-benchmark?time=1940..2016&country=HKG+SGP+GBR, (accessed 25 May 2020).
[5] OBR, *Public finances databank*, 27 April 2020, obr.uk/data, (accessed 25 May 2020).

TaxPayers' Alliance

Recommendations

To avoid creating a negative cycle that turns the pandemic into an economic depression, the government should pledge that there will be no austerity for taxpayers. It should implement an ambitious, reforming agenda to radically simplify the tax system and sharpen the supply side to enable growth and productivity to return the economy to health. Where possible, entire taxes should be ditched and where not, whole rates should be scrapped.

1. A restart for jobs: employer national insurance

The government should announce that employer national insurance will be entirely abolished with immediate effect, with only payments due by the end of May still payable. It should announce a temporary payroll tax of 10 per cent on wages and salaries above £4,500 per employee commencing in October to represent wages and salaries paid until April 2021, when it would double to £9,000 for the full year, payable on the same earnings as defined for PAYE income tax payments. It should also announce that it intends to phase the temporary payroll tax out by 2026 by reducing the rate by 2 percentage points each year from April 2022.

This would cut the tax on employment from 13.8 per cent to 10 per cent, provide employers with a much needed four-month tax holiday and substantially simplify the administration of the system, by eliminating the national insurance rule book.

An employer with 50 employees, on the threshold between being a small or medium-sized enterprise, currently pays £9,740 a month in employer national insurance. The restart for jobs would eliminate this bill for four months and then replace it with a £8,843 monthly bill from October. The total saving for this example company would be £44,345 this year and £10,766 without the one-off four month suspension. This would provide a meaningful saving as well as a much simpler system to administer, with the rules defined by income tax law for PAYE.

The OBR estimated in March employer national insurance receipts of £83 billion this year. Given the rapid rise in unemployment and furloughed staff numbers, it is highly likely that receipts will be significantly lower than this forecast. Nonetheless, if we assume the tax cut enjoyed by the company in our example above reflects the aggregate effect, then this proposal would reduce receipts this year by £24 billion to £59 billion. Next year's would be reduced by £8 billion. These numbers should be treated with caution for two reasons, however. They ignore the implication that all these numbers are much larger than the real numbers because of the economic contraction. Secondly, they do not attempt to account for the dynamic economic response reflected in other tax receipts from the economic activity they will generate.

2. A stimulus for staff: employee national insurance

The government should announce that employee national insurance will be entirely abolished with immediate effect. In its place from April 2021 a basic rate surcharge of 10 per cent should be applied to PAYE income tax. Eligibility for benefits currently assessed on recent national insurance contributions could be based on the claimant's status at the date of abolition until the basic rate surcharge is introduced, after which they should be based on that.

This would cut the second income tax, which is all national insurance is in practice, on workers from 12 per cent to 10 per cent, provide employees with a ten-month tax holiday and substantially simplify the administration of the system, by eliminating the national insurance rule book.

A worker on average earnings of £25,724 would enjoy a tax cut this year of £1,622. The proposed basic rate income tax PAYE surcharge next year would recoup £1,322 of that, meaning the average worker would be better off by £300 overall next year.

The OBR estimated in March that employee national insurance receipts will be £67 billion this year. Given the rapid rise in unemployment and furloughed staff numbers, it is highly likely that receipts will be significantly lower than this forecast. Nonetheless, if we assume the tax cut enjoyed by the company in our example above reflects the aggregate effect, then this proposal would reduce receipts this year by £56 billion to £11 billion. Using HMRC estimates for national insurance changes for next year produces a forecast of £20 billion reduction in revenues (relative to the OBR's forecast for next year of £70 billion). These numbers should be treated with caution for two reasons, however. They ignore the implication that all these numbers are much larger than the real numbers because of the economic contraction. Secondly, they do not attempt to account for the dynamic economic response reflected in other tax receipts from the economic activity they will generate.

3. A catalyst for capital: capital gains tax

The government should announce that capital gains tax will be abolished entirely with immediate effect. Capital gains tax weakens the financial incentives to reallocate economic assets when the current owners are no longer the best people to own them. This means, for example, that control of start-ups is retained by founders for too long. Entrepreneurs don't start as many new companies and more mature companies are controlled by people better suited to managing companies in their earliest stages. It also discourages investment by reducing post-tax returns. It should be abolished.

Abolishing capital gains tax would have a powerful effect on investment which in turn would lead to increased productivity and higher incomes. Research has found that when Switzerland abolished its capital gains tax, it caused its economy to become between 1 and 3 per cent larger.[6] Neither Belgium, Hong Kong nor Singapore have a capital gains tax.

Alternatively, meaningful simplification could be achieved by reducing all rates to 10 per cent. This would make entrepreneur's relief redundant and simplify the system.

The OBR estimated in March that capital gains tax receipts will be £11 billion this year. Given the heavy falls in asset values, it is highly likely that receipts will be significantly lower than this forecast. Indeed, HMRC estimates that raising the rate would reduce receipts for next year, although the relationship would revert to normal for 2022-23.

4. A fillip for factories: corporation tax

Corporation tax is one of the most important factors influencing investment. Investments are made in the hope of earning a return but investors are interested in actual returns after tax has been deducted, not what the return would theoretically have been had no tax been levied. Reducing the burden by cutting the rate therefore improves the viability of investments. Unfortunately, the effect of recent welcome rate cuts have been to a large extent cancelled out by tighter rules on when the tax is payable, increasing the burden back up while the rate cuts lowered it.

Corporation tax is particularly damaging on returns which companies would otherwise invest in their businesses. If those investments make a return, that return will again be liable to corporation tax, making it effectively a tax on investment. This aspect has been powerfully described as a 'factory tax' by the Adam Smith Institute, who calculated that its abolition would generate 8 per cent more investment, increase labour productivity by £2,214 per worker and catapult the UK's ranking from 33 to joint number 1 in the OECD for best treatment of fixed capital investment.

The government has recognised the problem of taxing investment by temporarily increasing the annual investment allowance (AIA) from £200,000 to £1 million. They should go further and increase it again to £5 million, as recommended by accountants BDO.

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[6] Clemens, J. Lammam, C. & Lo, M., *The Economic Costs of Capital Gains Taxes in Canada*, Fraser Institute, October 2014.

Alternatively, a more powerful effect on investment could be achieved by abolishing the limit entirely, which would encourage larger investments from major companies as well as smaller investments from SMEs.

Previously, the TaxPayers' Alliance estimated that raising the AIA to £5 million would deliver tax cuts worth £4.3 billion this year and £5.3 billion next year.[7] The Adam Smith Institute estimated that abolishing the limit altogether would lower revenues by £9 billion, though this could be higher in the first year.[8] These numbers should be treated with caution for two reasons, however. They ignore the implication that all these numbers are much larger than the real numbers because of the economic contraction. Secondly, they do not attempt to account for the dynamic economic response reflected in other tax receipts from the economic activity they will generate.

5. A release for movers: stamp duty

Stamp duty land tax (SDLT) on property buyers reduces people's willingness to buy property. This in turn means that people fail to move homes when it suits their requirements, such as for a new job or to reduce their housing costs when adult children have left home after education. Growing companies find it harder to recruit the right employees, older home-owners stay in family homes which could be better suited to younger, growing families, and workers who do take new jobs sometimes accept longer, less pleasant commutes because SDLT means it's just not worth moving.

A cut in stamp duty would be a popular way to enhance the supply side of the economy by enhancing mobility in both housing and labour markets. This will be particularly important in the aftermath of coronavirus because it is likely that people will have reassessed where they want to live. Some will have increased the importance of living near to their workplace to minimise the need to travel while others may have found that they wish to live somewhere less busy. It is therefore more important than ever that the tax system stops frustrating owners from reallocating housing among each other.

The government should cut stamp duty by raising the threshold to £1 million with immediate effect so that most buyers pay no stamp duty at all and those who do pay less.

Alternatively, more comprehensive simplification could be achieved by abolishing the tax altogether. This would unleash those in more expensive homes, particularly in London and the south east, who are currently constrained by stamp duty to move. This would deliver further benefits to housing and job markets as well as providing a more substantial increase in associated economic activity for services such as estate agency, conveyancing and removals.

TaxPayers' Alliance research last year found that such a rise would increase transaction numbers by 220,000, or 31 per cent in the first year. That is equivalent to the total dwelling stock of Manchester, Leeds or Bristol. Some of that impact would be a temporary one-off effect, but an estimated 135,000 extra transactions, or 19 per cent, would happen every year on an on-going basis. That is equivalent to the total dwelling stock of Nottingham or Doncaster.

In March, the OBR estimated stamp duty land tax receipts of £13 billion this year and £14 billion next year. In November, the TaxPayers' Alliance estimated that raising the threshold to £1 million would equate to a tax cut worth £4.4 billion this year.[9] Given the outlook for asset values and the impact on transaction numbers during the coronavirus restrictions, it is highly likely that actual values will all be significantly lower than these forecasts.

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[7] TaxPayers' Alliance, *Brexit: tax changes in a no-deal scenario*, October 2019.
[8] Dumitriu, S. & Serodio, D., *Abolishing The Factory Tax How to Boost Investment and Level Up Britain*, Adam Smith Institute, 19 February 2020.
[9] Meakin, R., *Raise the stamp duty threshold to £1 million,* TaxPayers' Alliance, November 2019.