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RESEARCH NOTE 39

TAXPAYERS' ALLIANCE RESPONSE TO THE CONSERVATIVE TAX PLAN

The TaxPayers' Alliance always welcomes any plan to reduce the burden on British businesses or ordinary taxpayers, but the plans announced by the Conservatives today are disappointing.

The Conservative Party's plan provides a tax break of £2,500 per job created for those unemployed for more than 3 months (£1,250 for those hired part-time – between 16 and 30 hours a week). The scheme is said to be self-financing as £8,100 per job created would be saved by not needing to pay unemployment benefits to those returning to work under the scheme, and one third of the jobs created would not have been created anyway.

The British economy would be better served by cuts in taxes on consumers or general cuts in business taxes that would ease the burden on all firms, now and in the future. Such tax cuts should be financed by cuts in wasteful spending.

We will also be looking at the Government's plans when they are announced, we will be analysing the Liberal Democrat's plans shortly. The Conservative scheme is disappointing for a number of reasons, which are set out below.

Comment from the TaxPayers' Alliance

Matthew Elliott, Chief Executive of the TaxPayers' Alliance, said:

"We are in a serious economic crisis that demands bold and radical tax cuts, not tinkering around the edges that will do little for firms struggling to survive. While ordinary people and British businesses will welcome any tax cut, this plan is far too complex and timid. Big, headline tax cuts are needed, and they are needed now."

Small scale

The Conservatives expect the total saving for business to be £2.6 billion and the scheme is only planned to last until "hiring data shows that there has been a sustainable upturn in the rate of new recruitment in the economy."¹

Particularly as an emergency measure, £2.6 billion is an extremely small tax cut – only around 0.5 per cent of the £550 billion that the Government raised in 2007-08. Corporation tax alone typically raises well over £40 billion a year, although revenues are likely to fall during the crisis, and businesses pay a range of other taxes – including over £20 billion in business rates and employers' national insurance contributions of around half the £100 billion raised in NIC overall.

The Conservative plan is significantly smaller than plans announced by the Liberal Democrats or the cuts that the Government is rumoured to be considering for the Pre-Budget Report.

Complex

The Conservative Party's proposals are complex. In order to claim the credit, firms need to establish a number of things:

- That they have hired someone who has been unemployed for more than three months (13 weeks).
- That the employee has not worked for that company in the previous year.
- That they had made no redundancies in the three months before, and three months after, claiming the credit.
- That they had claimed for a maximum of 20 per cent of their workforce. While extremely small firms with, for example, three employees will enjoy a 1 percentage point cut in employers' NIC, they would not be able to take advantage of this new scheme.

The established direction of Conservative tax policy had been towards simplification. For example, cuts in the headline rate of corporation tax were to be funded by abolishing the complex system of reliefs. This measure clearly reverses that direction and increases the complexity of the tax system. This would have a number of consequences.

- It increases costs, both for firms attempting to satisfy the authorities that they have fulfilled the criteria for the credit and for the authorities enforcing the rules.

¹ Conservatives, 'Tax cuts for new jobs: Keeping Britain Working', 11 November 2008, http://conservativehome.blogs.com/torydiary/files/tax_cuts_for_new_jobs.pdf

- It distorts firms' behaviour. For example, firms might hire someone who had been unemployed for four months, rather than another who had been unemployed for two months, because of the incentives created under the new scheme. This serves no real social purpose and might result in someone less suitable for the role being hired.
- This new relief will favour certain firms, particularly those that are already doing well and adding staff. This distorts the economy by favouring particular industries and could lead to a less well-balanced recovery.

Not focussed on preventing job losses in the first place

While other tax measures previously announced by the Conservatives – the VAT holiday and the 1p employers' NIC cut for the smallest firms – are designed to help struggling businesses, the plans announced today do nothing to help prevent companies shedding workers.

This is because the proposed relief is not available to firms that are losing employees – any firm that makes redundancies three months before or after claiming is ineligible. It only affects those firms that are growing their workforces. While it is important to increase the number of new hires, with unemployment rising rapidly, a major priority has to be limiting the number of firms going out of business and limiting job losses in struggling firms and industries.

It would be better to focus efforts on reducing the number of people facing the trauma of becoming unemployed during this crisis. Creating incentives for the relatively small number of firms looking to grow their workforces to do so more quickly is only a part of the answer.

Alternatives

Robust action to cut wasteful spending could provide for a substantial funded tax cut. The TaxPayers' Alliance has made some suggestions, in the past, about how this could be done, for example:

- Scrapping the Regional Development Agencies, which TaxPayers' Alliance research has shown to have done little for regional economies. This would have saved £2.3 billion in 2006-07.²
- Freezing Civil Service recruitment. Over ten years this could save £3.3 billion in annual spending.³

² Farrugia, B. *'Structure of Government No. 3: The Case for Abolishing Regional Development Agencies'*, The TaxPayers' Alliance, August 2008

³ Sinclair, M. *'Budget 2008 Report'*, The TaxPayers' Alliance, March 2008



- Scrapping ID cards would save as much as £20 billion. This could provide for temporary tax cuts or be used to cover the initial years of a permanent cut.⁴

There are several potential tax cuts that could lower costs for all businesses or put money back in the hands of consumers; these three examples would all cost around £10 billion:⁵

- Cutting the basic rate of income tax by 3p.
- Cutting the rate of employers' national insurance contributions by 2 percentage points.
- Cutting VAT by two percentage points. Cuts by more than 2.5 percentage points would require a change in European Union law but a 2 per cent cut could be put in place by the British Government.

Cutting the general rate of employers' national insurance contributions would lower business costs and make it more affordable for firms to keep people in employment, or take on new workers.

Cutting VAT or the basic rate of income tax would put money back in the hands of ordinary families.

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⁴ Gaskarth, G. 'The Cost of Big Brother Government', The TaxPayers' Alliance, July 2008

⁵ HMRC, 'Tax expenditures and ready reckoners', Table 1.6, March 2008