TAX BRIEFING NOTES

December 2017

TaxPayers' Alliance

AIR PASSENGER DUTY

What is it?

Air passenger duty (APD) is a levy paid by passengers to depart from UK (and Isle of Man) airports on most aircraft. Onward-bound passengers on connecting flights are not liable, nor those on aircraft weighing under 10 tonnes or with fewer than 20 seats.

It was introduced in 1994 at a rate of £5 per passenger to EEA destinations, and £10 to non-EEA destinations. In 2001 a higher rate for non-economy class seats was introduced. In 2009 EEA and non-EEA bands were replaced with four distance bands (measured from the destination's capital city to London, not the actual flight distance) around thresholds of 2,000, 4,000 and 6,000 miles.

In 2015 the highest two bands were abolished, leaving only two remaining: band A up to 2,000 miles and band B over 2,000 miles. For each band there is a reduced rate (for the lowest class seats), a standard rate and a higher rate (for seats in aircraft of over 20 tonnes equipped for fewer than 19 passengers). Passengers under 16 are exempt.

What's the problem with it?

Flights within the European Economic Area already covered by the EU emissions trading scheme (ETS),[1] meaning that there is practically no emissions-based reason to tax EEA flights. This is because any reduction in emissions from discouraging air travel would simply be replaced by another emitter buying the freed-up permit. The duty is payable per passenger despite there being only a weak link between passenger numbers and CO2 emissions. It takes no regard of the fuel efficiency of the aircraft. So even on non-EEA flights, the environmental case for APD is weak.

APD introduces distortions between air travel and other forms of domestic and EEA transport. There is no equivalent duty on coach or rail passengers. There are consequential losses for suppliers such as airliners, airports and their associated industries together with the welfare loss from those journeys switched.

APD does not remove the distortion between types of consumption liable to VAT (including private transport) and air travel because it is so arbitrary. While purchases of petrol, cars and taxi rides are subject to VAT (if the supplier's revenues are above the VAT threshold), public transport is not.

What should be done?

1. Abolish APD immediately.
2. Switch to an air flight duty limited to non-EEA flights based on emissions, not passengers, for flights not covered by the ETS.

[1] European Commission, *The EU Emissions Trading System (EU ETS)*, 2016 https://ec.europa.eu/clima/sites/clima/files/factsheet_ets_en.pdf

ALCOHOL DUTY

What is it?

There are four categories of alcohol duty: beer; cider and perry; spirits; and wine and made-wine. Alcohol has long been subject to specific and varying taxation, most notably under the Gin Act 1751 following the 'gin craze' depicted by Hogarth's *Beer Street and Gin Lane*.

Spirits duty is the simplest, which is charged by litre of pure alcohol at a single rate. So a 500ml bottle containing 20 per cent alcohol would be liable for half as much duty as either a 500ml bottle with 40 per cent alcohol, or a 1 litre bottle with 20 per cent alcohol.

Wine duty is grouped into bands of alcohol strength (which differ again according to whether the wine is sparkling or still). Wines within a band are charged a duty based on the quantity of the wine, with higher rates applied to bands with a higher range of alcoholic content. This means that the duty per litre of alcohol falls before a 'cliff edge' at each band threshold. Cider duty is levied similarly, with four rates depending on classification as high or low strength and still or sparkling.

Beer duty, however, is levied similarly to spirits, albeit at a much lower rate per unit of alcohol, and with a high strength rate (approximately 30 per cent higher duty) and a low strength rate (approximately 55 per cent lower) in addition to the standard rate.

What's the problem with it?

Alcohol duties are needlessly complicated, economically distortionary and morally oppressive. There is also much evidence that they fail to achieve the aims of the public health lobby, despite their negative impact on the lifestyles of the majority of drinkers without dependency problems.[2] By contrast, evidence suggests that high taxes encourage illicit alcohol markets. HMRC estimated the illicit market share in 2013-14 at 22 per cent for beer, 20 per cent for spirits and 9 per cent for wine.[3]

Because most drinkers, in other words most adults, do not create additional health spending or crime and disorder problems, the case for charging all drinkers with the public spending costs of those problems is very weak. There is no good reason why a law-abiding moderate drinker should pay a greater share of the costs for irresponsible drinkers than a non-drinker. Similarly, there is no good reason why taxes should seek to discourage drinking among people whose drinking is not problematic, especially when taxes have been shown to have very little effect on problem drinkers but nonetheless significantly interfere in the lifestyle choices of moderate drinkers.

Finally, alcohol duties distort patterns of economic activity with negative implications for the nighttime economy and UK supermarket sales which are diverted to lower-tax alternatives such as France.

What should be done?

1. Tax alcohol itself instead of the liquid containing it, removing tax distinctions between what the drink is, how it's made and whether it's sparkling or still.
2. If a distinction between high- and low-strength drinks is to be retained, set a single threshold applicable to all drinks irrespective of incidental factors.

---

[2] Duffy, J.C., and Snowdon, C., *Punishing the majority. The flawed theory behind alcohol control policies*, IEA, June 2014 https://iea.org.uk/wp-content/uploads/2016/07/IEA%20Punishing%20the%20majority%20EMBARGOED.pdf

[3] HMRC, *Measuring tax gaps 2015 edition*, 2015, http://webarchive.nationalarchives.gov.uk/20160618143921/https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470540/HMRC-measuring-tax-gaps-2015-1.pdf

APPRENTICESHIP LEVY

What is it?

The apprenticeship levy is a payroll tax on larger companies which was introduced in April 2017. Its revenues are hypothecated for expenditure on funding apprenticeships. The rate is 0.5 per cent on all payroll bills as defined by employer national insurance contributions and there is a £15,000 allowance, meaning that only employers with a payroll in excess of £3 million pay.

What's the problem with it?

The apprenticeship levy is a pure payroll tax and, like national insurance, operates effectively as an income tax. Income taxes weaken incentives to engage in productive economic activity. In some cases and for some people, it makes the difference between an activity being worthwhile or not. This means that some jobs and promotions are not sought by workers, and some are not created by employers because some investments are not made in the first place. This leads to lower employment, lower incomes and lower productivity. The difference between taxes on consumption and taxes on income is that income taxes also hit investment, which makes them disproportionately damaging to the economy. More directly, it reduces the amount of money workers and investors have to spend on what they value for themselves and their families.

While the levy is not a wholly new and separate parallel system of income tax, it does effectively constitute a new set of rules, rates and thresholds added onto the national insurance system. This further bloats the tax code which leads to inflated numbers of planning and avoidance agents and compliance officials to monitor and understand the system on behalf of taxpayers and HMRC. Almost two thirds of affected companies plan to rebrand existing training schemes to avoid the levy, according to CBI research.[4] Economically, the levy operates as another income tax on workers because labour markets reflect the charge by adjusting wages. In the short term, however, before they can be passed through to wages, changes operate as a business tax on employers. This means that some tax (and wages) is hidden from employees, making it harder for employees to understand what their full compensation and tax liabilities are.

The government has a stated intention of lifting people out of tax by raising the personal allowance for income tax. But the apprenticeship levy applies an allowance according to the size of the company, not the income of the employee. This means that low paid staff in companies with payrolls over £3 million are hit but the highly-paid will be exempt so long as their employer's total payroll is under £3 million.

What should be done?

1. Abolish the apprenticeship levy immediately.
2. Alternatively, at least replace it with an equivalent increase in income tax or national insurance.

[4] CBI, *Helping the UK thrive CBI/Pearson Education and skills survey 2017*, July 2017, http://www.cbi.org.uk/index.cfm/_api/render/file/?method=inline&fileID=DB1A9FE5-5459-4AA2-8B44798DD5B15E77

BANK CORPORATION TAX SURCHARGE

What is it?

The bank corporation tax surcharge is an additional tax on banking profits calculated on the same basis as corporation tax. It was introduced in 2016 at a rate of 8 per cent on profits over £25 million.

What's the problem with it?

Bank profits are a measure of a bank's efficiency with the resources it employs. Using profits to measure the special risks to taxpayers from the banking sector is an arbitrary and therefore distortionary approach which weakens the sector, deterring investment and destroying jobs. Profitability in the sector should be encouraged, not penalised. Given the importance of banking and financial and business services in general to the British economy, this is a reckless approach to good tax design.

Different rates always give rise to tax avoidance opportunities which in turn breeds economically wasteful complexity from the inevitable anti-avoidance measures which are introduced to prevent the avoidance. Avoidance measures have already been introduced to this effect.[5]

What should be done?

The bank corporation tax surcharge should be abolished immediately, leaving the bank levy to reflect the special risks arising from the banking sector until they can be fully addressed by regulatory powers for the Bank of England.

[5] HMRC, *Bank Corporation Tax surcharge*, Policy paper, 8 July 2015, https://www.gov.uk/government/publications/bank-corporation-tax-surcharge/bank-corporation-tax-surcharge

What is it?

The bank levy is a tax on bank liabilities. It was introduced in 2011 following the financial crisis as a way to charge banks for the implicit bailout guarantee they enjoyed from the government. There is a standard rate, originally planned to be 0.075 per cent but subsequently repeatedly raised to 0.21 per cent on long-term liabilities together with a short-term liabilities rate of half the standard rate.

In 2021, the bank levy will no longer apply to non-UK liabilities of UK banks, removing a distortion favouring non-UK banks (who already only pay on their UK liabilities). The rate will also fall to 0.1 per cent.

What's the problem with it?

Research from the Bank of International Settlements has shown that the bank levy has prompted banks to shift risks on balance sheets from liabilities to assets. It has also shown that total risk reductions have been concentrated on low risk institutions which pose little or no threat to financial stability with little change among riskier banks.[6] Following the crash, banks were already reducing both their assets and liabilities to increase their margin for error. This led to lower than expected receipts from the levy, which in turn prompted repeated increases in the rate (initially 0.07 per cent, subsequently revised up to 0.075, then 0.078, then 0.088, then 0.105, then 0.130, then 0.156 and finally 0.210 per cent). This suggests that the rate was not set for the economically neutral reason of pricing risks to taxpayers but instead to raise revenues from an electorally unpopular target.

Fundamentally, the regulatory approach of strengthening powers of the Bank of England to wind up failing banks is a better tool for managing risks to taxpayers from banks. Full regulatory powers to ensure that bank losses fall on shareholders and bondholders instead of taxpayers, often called a 'bail-in', would mean there is no longer a justification for a specific tax on banking. Given the importance of banking and financial and business services in general to the British economy, the best tax and regulatory approach to manage the specific risks from the sector is important.

What should be done?

The bank levy should be removed from non-UK liabilities of UK banks sooner than the 2021 planned date. Bail-in and wind-up powers should be set to ensure no remaining risks are left with taxpayers and the bank levy should be abolished when this objective has been met.

[6] Gambacorta, L., et al, *The effects of tax on bank liability structure*, BIS Working Papers No 611, Bank for International Settlements, February 2017, http://www.bis.org/publ/work611.pdf

BUSINESS RATES

What are they?

Non-domestic rates, commonly known as business rates, are a tax on the annual rental value of most non-domestic properties. Business rates, along with the community charge (or 'poll tax'), were established in 1990 to replace the rates system. Rates were set out in the Poor Law 1572 and General Rate Act 1967, but pre-existed those acts.

Properties are valued every five years (although the 2013 revaluation was delayed until 2015, meaning new valuations were applied in 2017 instead of 2015) and a rate, or 'multiplier', is set annually for England. The standard rate for 2017-18 is 47.9p, meaning that the liability for a property with a 'ratable value' of £10,000 would be £4,790.

What's the problem with them?

Business rates can be seen as fulfilling two tax functions. The first is to tax the value of the land on which business premises sit. The second is to tax the value of the buildings and any other improvements made to the land. The first leads to very little economic distortion and destruction. The second, by contrast, is highly destructive. The effect of the second dominates.

Taxing the unimproved value of business *land* is relatively unproblematic. Taxing the increase in the rental value of a premises caused by an improvement of nearby facilities or demand will do little to discourage such improvements. Introducing any tax harms incentives but, because owners are largely not responsible for demand or nearby facilities, taxing unimproved land value should not prompt much reduction in their provision.

By contrast, the tax on the value of improvements and buildings is highly problematic. It distorts property use away from commercial use in favour of residential use and other production inputs, because the consumption value of business property is taxed, like all other inputs, through VAT. Taxing its consumption through business rates prompts businesses to reduce their use of commercial property and prompts landowners to shift property away from double-taxed commercial use to relatively untaxed residential use.

To make tax neutral between commercial and non-commercial use, non-commercial use must be untaxed if the consumption goods and services it is used to produce are themselves taxed. The distortions caused by the arbitrary nature of business rates harm productivity and prosperity, leading to lower incomes and fewer jobs.

What should be done?

1. Rule out rises in business rates.
2. Reform business rates to exempt the value of buildings and improvements from the rating, resulting in 'business land rates' to replace business rates.

CAPITAL GAINS TAX

What is it?

Capital gains tax (CGT) is a tax on the gain in value of most assets between purchase and sale.

A personal allowance is deducted from 'chargeable gains', and the rest is then taxed. From 1988 to 2008, the rate was the same as the taxpayer's income tax rate. In 2008 it was simplified into a single 18 per cent rate until 2010, when a higher 28 per cent rate was added. The higher rate was paid on gains over the income tax higher rate threshold when taxable income and chargeable gains are combined. So those paying higher rate income tax would pay the higher rate of CGT on all their gains above the CGT personal allowance. In 2016, the rates were cut to 10 and 20 per cent except for residential property, which remain at 18 and 28 per cent.

Rate payable above allowance (£11,300 in 2017-18)	Basic rate taxpayers (%)	Higher rate taxpayers (%)
Residential property	18	28
Assets other than residential property	10	20

What's the problem with it?

It's a double tax that causes two significant economic problems. First, it 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. Secondly, it discourages investment by reducing post-tax returns.

It's tempting to think that setting CGT at the same rate as income tax would make the tax system neutral between income and capital gains, discouraging avoidance. But this is fundamentally and conceptually flawed. Most capital gains are *already* effectively post-tax. To understand why, imagine you own a company which you founded with no capital. This company now has no prospects of any future activities and has ended trading, but during your ownership its bank balance grew to £100,000. You have two options. One is to wind the company down and the £100,000 surplus would be treated as income. Or you could sell the company to someone else who would have the same options. But no buyer would pay £100,000 because of the tax payable on extracting the cash.

To keep things simple, let's assume there is only one income tax rate of 40 per cent, one CGT rate of 20 per cent, and no allowances. If you took the income, you'd receive £60,000 after tax. If you sold the company, the buyer would only pay at most £60,000 to avoid a loss. Your supposedly 'pre-tax' capital gain would be £60,000 which would then be subject to the 20 per cent capital gains tax. So capital gains are usually already effectively 'post tax'. A further CGT liability of 20 per cent (£12,000) wouldn't equalise the treatment. They're already the same with no CGT.

What should be done?

1. Abolish capital gains tax entirely when possible.
2. In the meantime, scrap the higher 20 per cent rate, and the 18 and 28 per cent rates on residential property to simplify the system. This would eliminate the need for entrepreneur's relief by extending its 10 per cent rate to all investors and assets.

CLIMATE CHANGE LEVY

What is it?

The climate change levy is a tax levied on most non-residential users of most forms of energy. It was introduced in 2001 as part of the government's climate change programme. Users can participate in climate change agreements which reduce liabilities for the levy by 65 per cent and, for electricity since 2013, by 90 per cent. Eligibility is based on the energy intensiveness of the activity and the extent of import penetration into the UK market. Exemption from the levy for electricity produced from renewable sources was abolished in 2015.

What's the problem with it?

The climate change levy is bureaucratic, incoherent and distortionary at the disadvantage of UK economic interests.

Bureaucratic

Climate change agreements require energy users to meet certain criteria (set on a sectoral basis). These agreements privilege energy use in activities which are intensive and competitive across national borders. The intention is to ameliorate the destructive distortionary effects of the levy but the reluctance to use a price mechanism instead of regulatory compliance reveals the problem with the levy itself.

Incoherent

The levy was introduced as a measure to address climate change. But it is charged on energy consumption rather than emissions and is even charged on renewable electricity use. Solid fuel use is charged at a lower rate than gas, measured by emissions and electricity is charged at the same rate regardless of the source. Some activities are also covered by both the EU emissions trading scheme and the climate change levy. This means that emissions saved by the climate change levy will not affect total emissions but instead simply transfer to other activities[7]. Finally, it applies only to non-residential use instead of all use, despite residential use for heating already benefitting from the reduced rate of VAT.

Distortionary

Because it does not apply equally to all users of energy, the climate change levy distorts economic activity away from uses which are liable in favour of uses which are not liable (such as residential use in the UK, or industrial use outside the UK). It also distorts activity away from low-energy to high-energy use, even though the objective is to reduce emissions not energy use.

What should be done?

Abolish the climate change levy, leaving the EU emissions trading scheme to address emissions policy.

---

[7] HMRC allude to this in their policy paper on the removal of the renewable exemption from the CCL, 'no direct impact on the achievement of UK Carbon Budget targets, as emissions from electricity generation are capped through the EU Emissions Trading System'. HMRC, *Climate Change Levy: removal of exemption for electricity from renewable sources*, 8 July 2015, https://www.gov.uk/government/publications/climate-change-levy-removal-of-exemption-for-electricity-from-renewable-sources/climate-change-levy-removal-of-exemption-for-electricity-from-renewable-sources

CORPORATION TAX

What is it?

Corporation tax is levied on the profits of companies. It was introduced in 1965 and replaced the practice of taxing companies on their income as if they were real people.

The main rate was initially 40 per cent before rising to 52 per cent. After many years of stability, the rate was steadily cut between 1982 and 1991 to 33 per cent. Another rate-cutting period began in 2008 when it was reduced from 30 to 28 per cent. It is now 19 per cent and a further cut to 17 per cent is scheduled for 2020. A small companies rate (for those with profits under £300,000) set between one and two fifths lower than the main rate existed until 2015, when the main rate fell to match the small companies rate of 20 per cent.

What's the problem with it?

Complexity

The explosion of tax complexity in recent decades owes much to the conceptual difficulties with trying to accurately attribute and therefore tax value creation in an increasingly globalised and information-driven economy. When corporate profits arose largely from the manufacture, distribution and retail of goods, usually in the same country, allocating them was relatively simple. But the well-publicised tax affairs of Starbucks UK with coffee grown in Africa, bought in Switzerland, roasted in the Netherlands and sold under a royalty to the US company illustrates how ill-suited corporation tax is to a modern, globalised economy. Few of these stages have tradable prices, hence the need for complex 'transfer pricing' rules to determine the pricing to transfer value between linked companies. The system is riddled with rules designed to patch up fundamental flaws like this.

Efficiency

Profit is a measure of how efficiently a company operates. The value its operations provide to shareholders, measured in sales less the value consumed in costs, not only provides investors with income but also serves as a measure of efficiency and waste. Taxing profits weakens this measure and weakens the incentive for investors to manage companies well.

Investment

The difference between taxing profits and taxing distributions is investment. As the long-term source of growth, investment is the last thing the tax system should target.

What should be done?

1. Abolish corporation tax and tax distributed income instead (see *The Single Income Tax*).[8]
2. In the meantime, cut corporation tax to 10 per cent while raising dividend tax rates.

[8] Heath et al, *The Single Income Tax*, 2020 Tax Commission, 2012, www.2020tax.org/#report

COUNCIL TAX

What is it?

Council tax is charged by local authorities to the occupiers of residential property.

Council tax was introduced in Great Britain in 1993 to replace the community charge (commonly known as the 'poll tax'), which replaced domestic rates in 1990 in England and Wales (and in 1989 in Scotland). Rates date from at least 1601. Domestic rates have not been replaced in Northern Ireland. Council tax is applied to residential properties in eight bands based on 1991 property valuations (nine bands on 2003 values in Wales). Local authorities set local rates but the ratios and valuation bands are set centrally (by the Scottish and Welsh administrations outside England).

Property valuation band for council tax	Wales		Scotland		England	
	Band upper limit (£)	Ratio to band D (%)	Band upper limit (£)	Ratio to band D (%)	Band upper limit (£)	Ratio to band D (%)
A	44,000	67	27,000	67	40,000	67
B	65,000	78	35,000	78	52,000	78
C	91,000	89	45,000	89	68,000	89
D	123,000	100	58,000	100	88,000	100
E	162,000	122	80,000	131	120,000	122
F	223,000	144	106,000	163	160,000	144
G	324,000	167	212,000	196	320,000	167
H	424,000	200	212,001+	245	320,001+	200
I	424,001+	233	-	-	-	-

What's the problem with it?

Council tax discourages residential property improvements and construction.[9] To the extent that council tax mimics a consumption tax similar to VAT on other consumption goods, council tax is not especially a problem in this way any more than VAT is on other areas of consumption. But that doesn't mean it is not harmful, just that it is not especially harmful. It also falls on occupiers who may find bearing the burden of increases difficult to plan for if (like pensioners) they are on fixed incomes.

Council tax breaches three of the four principles of taxation identified by Adam Smith in 1776. It is inconvenient, because it does not coincide with a transfer of cash (unlike VAT or income tax). It is inequitable, because it is not proportionate to either the value of the property or the income of the taxpayer. And, to some extent, it is uncertain, because the level cannot easily be predicted in advance. While income tax rates and VAT have remained relatively stable over the past 20 years, council tax rates have varied markedly, especially at the local authority level rather than national averages, which mask the extent of rises experienced by those unfortunate enough to live in the worst local authority areas.

Most starkly, the system is plainly nonsensical. Properties are assessed in bands based on what they would have been worth over a quarter of a century ago.

What should be done?

Councils should cut their rates, at least in real terms (after adjusting for inflation).

[9] VOA, *Council Tax band changes*, 22 January 2016, https://www.gov.uk/guidance/council-tax-band-changes

FUEL DUTY

What is it?

Fuel duty is an excise duty on hydrocarbon oils, biofuels and road fuel gases such as liquid petroleum gas.

Petrol duty was introduced in 1908 at 3d (old pence, equivalent to 1.3 new pence) per gallon. Between 1978 and 1980 diesel was charged a higher rate than leaded petrol, and then again between 1982 and 1994 it attracted a higher rate than unleaded. After 1994 the diesel and unleaded rates were aligned. Between 1982 and 2000 a lower rate (by as much as 18 per cent) applied to diesel than leaded petrol. In 1988 the rate for unleaded was introduced at lower level than leaded petrol, to encourage motorists to switch. By 2000, the leaded rate was withdrawn when its sale was banned. Unleaded and diesel rates were aligned in 2001 and have remained so ever since.

In December 2008, fuel duty rose from 50.35p to 52.35p a litre. In April 2009, it rose again to 54.19p. In September it was increased yet again to 56.19p and then to 57.19p in April 2010. After the election, the coalition government increased it once more to 58.19p in October and then 58.95p in January 2011. Finally, in April 2011 it was cut to its current level of 57.95p.

What's the problem with it?

It's far too high and it's economically damaging. There is some justification for fuel duty in principle. The degradation of local air quality and the contribution to climate change are both reasonable arguments for some level of particular tax on motoring fuel and all fuel, respectively. The problem is that these arguments only support a level of fuel duty much lower than the current rate.

Department for Business, Energy and Industrial Strategy assumptions for short-term traded carbon values in the emissions trading scheme reflect the cost of reducing carbon emissions elsewhere. Applying these to the emissions factor for petrol implies a carbon tax per litre of 1p in 2015, rising to 18p in 2030 (both at 2016 prices), when a single global carbon price is scheduled. Combined local and national road spending could justify another 19p. This 37p total should serve as a maximum, however, because the impact on local air quality and congestion is very weakly correlated with fuel combustion.[10] Road pricing (including congestion charges) deal with congestion while local emissions regulations (such as low emissions zones) are much less blunt tools than a national (or even local) fuel duty.

In addition to the economic damage all taxes inflict on the economy, fuel duty above the 37p a litre level indicated above has two specific problems. First, it distorts economic patterns of consumption and production. Secondly, it prevents workers from accessing potential jobs. This restricts economies of scale, reduces competitiveness and hinders industrial specialisation, resulting in lower income levels.

What should be done?

1. Cut the rate by 5p a litre.
2. Guarantee no rate rises until inflation brings the rate down to 37p in 2016 prices.

[10] See Meakin in Booth et al, *Taxation, Government Spending & Economic Growth*, IEA, 2016, https://iea.org.uk/publications/taxation-government-spending-economic-growth-in-brief/

Additional information

International Energy Agency data shows the UK had the highest rate of fuel taxes among 35 countries[11]

Country	Fuel duty (local)	Fuel duty (USD)	Fuel duty (% of UK)
Australia	0.392	0.295	33
Austria	0.482	0.535	60
Belgium	0.619	0.687	77
Canada	0.338	0.264	30
Chile	317.00	0.484	55
Czech Republic	12.840	0.522	59
Denmark	4.137	0.615	69
Estonia	0.423	0.469	53
Finland	0.681	0.756	85
France	0.624	0.693	78
Germany	0.655	0.727	82
Greece	0.670	0.744	84
Hungary	120.000	0.430	48
Iceland	69.860	0.530	60
Ireland	0.588	0.653	74
Israel	3.056	0.786	89
Italy	0.728	0.808	91
Japan	56.300	0.465	52
Korea	781.890	0.691	78
Latvia	0.411	0.457	51
Luxembourg	0.462	0.513	58
Mexico	0.000	0.000	0
Netherlands	0.744	0.859	97
New Zealand	0.671	0.468	53
Norway	5.820	0.722	81
Poland	1.669	0.443	50
Portugal	0.618	0.686	77
Slovak Republic	0.515	0.572	64
Slovenia	0.545	0.605	68
Spain	0.462	0.513	58
Sweden	5.575	0.661	75
Switzerland	0.735	0.764	86
Turkey	2.177	0.799	90
United Kingdom	**0.580**	**0.887**	**100**
United States	0.143	0.143	16

[11] OECD, *Tax Administration 2015 - Comparative Information on OECD and Other Advanced and Emerging Economies*, 2015, Table 4.A4.6, http://www.oecd.org/ctp/consumption/Table-4.A4.6-Taxation-of-premium-unleaded-(94-96%20RON)-gasoline-(per%20litre)-2015.xls

INCOME TAX

What is it?

Income tax is levied on most personal income and provides the largest receipts of any tax, over a quarter of the total. It was first introduced in Great Britain (but not Ireland) at 10 per cent on annual incomes above £60 in 1799 to fund the Napoleonic wars. It was withdrawn in 1802 then reintroduced in 1803 and lasted until 1816, one year after the battle of Waterloo. In 1842, income tax was once again reintroduced on incomes over £150. Rates soared during the world wars. The standard rate rose from 6 per cent to 30 per cent between 1914 and 1918. By 1939 the standard rate was still 29 per cent but by 1945 it had risen to 50 per cent while the top rate rose from 70 per cent payable on incomes over £50,000 to 98 per cent on incomes over a much lower £20,000. A 98 per cent rate on 'unearned' income returned between 1973-74 and 1978-79.

The current basic rate is 20 per cent, the higher rate is 40 per cent and the additional rate is 45 per cent, having been introduced at 50 per cent in 2010 and cut to its current level in 2013. A further effective rate of 60 per cent exists on incomes above £100,000 by double the level of the personal allowance. Technically, the personal allowance is reduced by £1 for every £2 of income earned in excess of £100,000. This was also introduced in 2010, and its convoluted structure was (almost certainly) chosen to disguise the existence of such a high rate.

What's the problem with it?

Income tax weakens incentives to engage in productive economic activity. In some cases and for some people, it makes the difference between an activity or investment being worthwhile or not. This means that some jobs and promotions are not sought by workers, and some are not created by employers because some investments are not made in the first place. This leads to lower employment, lower incomes and lower productivity. The difference between taxes on consumption and taxes on income is that the income taxes also hit investment, which makes them disproportionately damaging to the economy. More directly, it reduces the amount of money workers and investors have to spending on what they value for themselves and their families.

The progressive and differential rate structure creates complexity, not just because of the rates and thresholds themselves but also because of the anti-avoidance measures which are required to tackle unwelcome attempts to take advantage of different rates.

What should be done?

1. All taxes on income (including national insurance, capital gains tax and corporation tax) should be replaced over time with a single tax on all income at a single rate of 30 per cent. See our report *How to abolish national insurance* for detailed plans which ensure that all taxpayers, including pensioners, could be better off with a well-designed reform.
2. In the meantime
    a. The higher rate of 40 per cent should be cut in steps.
    b. The 45 per cent additional rate should be abolished immediately.
    c. The 60 per cent effective rate above £100,000 should be abolished immediately.
    d. The personal allowance should be increased and then formally tied to earnings growth.
    e. The higher rate threshold should be increased and then formally tied to earnings growth.

INHERITANCE TAX

What is it?

Inheritance tax (IHT) is an estate tax charged on the estates of the deceased. The probate duty was introduced in 1694 and was replaced in 1889 by estate duty. That was replaced in 1975 by the capital transfer tax which included lifetime gifts in its scope. In 1986, lifetime gifts were removed (subject to partial tax on gifts made within seven years of death) and it was renamed as inheritance tax. Rates initially ranged from 30 to 60 per cent but in 1988 all were abolished except the 40 per cent rate, which remained unchanged ever since.

What's the problem with it?

Inheritance tax is distortionary, unfair and very unpopular.

The structure of inheritance tax means that it is distortionary in several ways. Exemptions for items such as agricultural property, heritage assets and certain business assets prompt people to take, buy and sell assets to avoid tax, sometimes outweighing other objectives. This distortion of decision-making generates a net loss to society. Exemptions for lifetime gifts encourage premature transfer of assets, leading people to transfer assets earlier than they would ideally like. Finally, it discourages saving on your heirs' behalf in favour of immediate consumption or cash transfers. A new, special higher threshold specifically for residential property encourages people to invest in houses instead of other assets, adding inflationary pressure to house prices while reducing the capital available for other uses, such as business investment.

The scope for avoidance through tax planning means that often inheritance tax is a tax on unlucky people whose benefactors either died unexpectedly early or who felt unable to afford professional advice. It is also levied at a difficult time for families, on the death of a relative.

Unsurprisingly, given that many people hope to be able to bequeath to their children an inheritance, and payment is associated with a death in the family, inheritance tax is highly unpopular. A 2015 YouGov poll found that 59 per cent thought inheritance tax was unfair, compared to just 22 per cent who thought it was fair.[12] No other tax is that unpopular.

What should be done?

1. Abolish inheritance tax entirely.
2. In the meantime, remove the residential property distortion by raising the standard threshold to match it (from £325,000 to £500,000) and halve the rate to 20 per cent.

[12] YouGov, *YouGov / Times Red Box Survey Results*, March 2015, https://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/j9x8nbtks7/TimesRedBoxResults_150318_taxation_Website.pdf

INSURANCE PREMIUM TAX

What is it?

Insurance premium tax (IPT) is a tax on general insurance premiums. It was introduced in 1994 at a single rate of 2.5 per cent. A second higher rate was introduced in April 1997 on travel, household appliances and some motor vehicle insurance. The history of the rates is shown below. Dates vary between years.

Rate	1994	1997	1999	2011	2015	2016	2017
Standard	2.5	4.0	5.0	6.0	9.5	10.0	12.0
Higher	-	17.5	17.5	20.0	20.0	20.0	20.0

What's the problem with it?

False equivalence to VAT. Most economists agree that taxes should normally treat different economic activities neutrally, to minimize the harm a tax system imposes on an economy. The problem is that insurance premiums are not the equivalent figure to neutrally compare, economically speaking, insurance with other activities. The economic value of a tomato, for example, is found in the whole price of that tomato. All the costs and profit involved relates to bringing the tomato to the retail outlet. But the economic value of insurance does not relate to the whole premium. Much of the price of insurance premiums is merely akin to making deposits into a savings account, with the insurance function there to make sure everyone has enough 'saved' for when they need the money. It's just as irrational to think of insurance premiums as equivalent to normal goods and services in this way as it would be to do so to regular bank accounts.

The problem is that chancellors have done exactly that. Philip Hammond said IPT was 'half the rate of VAT' in his 2016 autumn statement, as if to explain the next sentence in his speech: a rise from 10 to 12 per cent. But over half the value of insurance premiums is accounted for by payouts, so the equivalent rate should have been cut, not raised, to make it equivalent to VAT.

The problem is the same with any arbitrary tax on specific items. As well as making holidays, homes and electrical goods more expensive for households to insure, over-taxing insurance means that there will be too little insurance. The increase to 12 per cent in June 2017 exacerbates this problem.

Another problem is that sectors with high payout ratios are disproportionately taxed. The rate of IPT required to be genuinely equivalent to VAT at 20 per cent in property insurance would be around 8 per cent, for example, while in motoring insurance, the equivalent rate would be 3 per cent.

What should be done?

1. Scrap the rise to 12 per cent and instead cut the rate to make it equivalent to VAT.
2. Scrap the higher rate of 20 per cent.
3. Reform IPT by allowing insurers to deduct their payouts from their total VAT base while raising the rate to the same as VAT.

NATIONAL INSURANCE

What is it?

National insurance is a collection of taxes on earned income and provides the second largest receipts after income tax, delivering HM Treasury almost a fifth of the total. It was introduced by the National Insurance Act 1911 as a contributory system of payments linked to benefits but, with the exception of a handful of minor maternity and bereavement benefits, this link now largely only exists in the form of accounting fictions.

National insurance is split into employer and employee contributions. It is levied weekly instead of annually, on a per-job instead of per-person basis. Both charges are levied on employee pension contributions but neither are on employer contributions. Definitions of employment status and allowable expenses vary slightly between income tax and national insurance due to the different legal basis of the two charges.

A separate lower earnings limit exists beneath the lower thresholds for payment. People earning above this level are treated as if they had paid national insurance for the purposes of benefits eligibility even if they have not paid any national insurance contributions.

The employee charge is 12 per cent up to an upper earnings limit, above which the rate is 2 per cent, while the employer rate is charged at 13.8 per cent with no threshold. Self-employed pay a lower rate of 9 per cent employee contributions and a weekly contribution (which is being abolished from April 2018) but are exempt from employer contributions. A separate system operates for share fishermen and some women who married before April 1977 are entitled to a special, lower rate of 5.85 per cent.

What's the problem with it?

Like any income tax, national insurance weakens incentives to engage in productive economic activity. In some cases and for some people, it makes the difference between an activity being worthwhile or not. This means that some jobs and promotions are not sought by workers, and some are not created by employers because some investments are not made in the first place. This leads to lower employment, lower incomes and lower productivity. The difference between taxes on consumption and taxes on income is that the income taxes also hit investment, which makes them disproportionately damaging to the economy. More directly, they reduce the amount of money workers and investors have to spending on what they value for themselves and their families.

National insurance contributions are effectively a pair of duplicate income tax systems. This creates a bloated tax code which leads to inflated numbers of planning and avoidance agents and compliance officials to monitor and understand the system on behalf of taxpayers and HMRC. Economically, the employer charge operates as another income tax on workers because labour markets reflect the charge through adjusting wages. In the short term, however, before changes are passed through to wages, changes operate as a business tax on employers. This means that some tax (and wages) are hidden from employees, making it harder for employees to understand what their full compensation and tax liabilities are.

What should be done?

1. All taxes on income (including national insurance, capital gains tax and corporation tax) should be replaced over time with a single tax on all income at a single rate of 30 per cent.
2. In the meantime:
    a. National insurance should be renamed immediately to reflect its genuine tax function.
    b. Rules on the basis of the charges and expenses and earnings definitions should be aligned with those which apply to income tax.
    c. Both rates should be cut first to 11 per cent and then 10 per cent.
    d. The starting age for employee national insurance should be raised from 16 to at least 26.

Additional information

The TaxPayers' Alliance has campaigned vigorously to abolish national insurance for many years. In addition to numerous opinion pieces and press comments, we also undertook the following activity:

2011 *Abolish National Insurance* report was published and the key recommendation was to abolish national insurance.[13]

2012 *The Single Income Tax* recommended a comprehensive overhaul of the tax system including abolishing national insurance. Produced by the 2020 Tax Commission, a joint project with the Institute of Directors, the report explored the history, economics, politics and ethics of tax reform and recommended replacing all taxes on income with a single tax.[14]

How to abolish National Insurance explored in detail how to abolish national insurance as part of a plan to introduce a single income tax to ensure that all taxpayers, including pensioners, could be better off with a well-designed reform.[15]

2013 Our giant payslip stunt illustrated the full effect on payslips of national insurance. It was unveiled on College Green, Westminster.

2015 *What are you really paying?* video explained the effect of national insurance with a cartoon and simple language.

2016 *Merging Income Tax and National Insurance* urged the chancellor to abolish national insurance in his autumn statement.[16]

2017 *Fees, loans and tax* is a forthcoming report which will recommend raising the starting rate on employee national insurance instead of loosening repayment terms on student loans.

---

[13] Meakin, R., *Abolish National Insurance*, TaxPayers' Alliance, 2011, https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI_Income_Tax_merger.pdf
[14] Heath et al, *The Single Income Tax*, 2020 Tax Commission, 2012, www.2020tax.org/#report
[15] Meakin, R., *How to abolish National Insurance*, TaxPayers' Alliance, 2012, https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/3305/attachments/original/1489138957/How_to_Abolish_National_Insurance_formatted.pdf?1489138957
[16] Meakin, R., *Merging Income Tax and National Insurance*, TaxPayers' Alliance, 2016, https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI_Income_Tax_merger.pdf?1478013137

PETROLEUM REVENUE TAX

What is it?

Petroleum revenue tax is a tax on the profits from oil extraction from fields where consent was given before 16 March 1993. It was introduced under the Oil Taxation Act 1975 but was effectively abolished in the 2016 budget when the rate was set to zero. The reason it was set to zero rather than abolished was to enable companies to access their tax history so they can carry back trading losses.

What's the problem with it?

At a zero rate, there is no problem with PRT.

What should be done?

Commit to maintaining a zero rate.

SOFT DRINKS INDUSTRY LEVY

What is it?

The soft drinks industry levy, popularly known as the sugar tax, is a flat-rate tax of 18p a litre on soft drinks with a sugar content of at least 5 grams in 100 millilitres. A higher rate of 24p a litre will apply to drinks with at least 8 grams in 100 millilitres. The levy will apply to alcoholic drinks with an alcohol content under 1.2 per cent (ie, exempt from alcohol duties) but not drinks where no sugar is added. Pure fruit juices and drinks with at least 75 per cent milk are exempt. The levy is planned to be introduced in April 2018. The objective is to influence people's decisions about their diets in a way that will improve health.

What's the problem with it?

The soft drinks industry levy is ineffectually designed, economically harmful and morally questionable.

Ineffectual

It is highly likely that taxing the sugar content of drinks with added sugar will reduce consumption of drinks which fall under the levy. But it is far from certain what effect the levy will have on overall consumption of sugar, still less on the quality of diets, given the alternative choices that people may make such as switching to high sugar (but untaxed) fruit juices or other sugary or otherwise unhealthy foods. Some may simply switch to cheaper brands. Obesity rates have been increasing, but this has been happening while sugar consumption has been falling.

Economically harmful

As well as the compliance costs involved with levying any tax (for both tax authorities and businesses), consumers are likely to suffer a welfare loss due to switching to inferior brands or alternative sugar sources to avoid the levy. To the extent that consumers absorb price increases, their spending power will be reduced as resources are transferred to the public sector.[17]

Morally questionable

Perhaps more than any other 'sin' tax, using the tax system to influence the lifestyle choices of adults raises questions about the moral acceptability of interventions. Health authorities may offer advice and education on health issues. But where behaviour has no effect on other people, it becomes highly questionable whether it is justified for government to resort to tax as a means of enforcing its advice.

What should be done?

Plans to introduce the levy should be scrapped immediately.

---

[17] See TaxPayers' Alliance, *Sugar tax briefing*, 2016, http://www.taxpayersalliance.com/sugar_tax_briefing

STAMP DUTY LAND TAX

What is it?

Stamp duty land tax (SDLT) is a tax on the purchase of property payable by buyers. It was introduced in 2003 but replaced stamp duty, which was first introduced in England in 1694.

A single 1 per cent rate of stamp duty above a threshold existed from 1984 to 1997, when two new thresholds and rates (1.5 and 2 per cent) were added. The rate was paid on the whole transaction amount. Higher rates were raised to 3 and 4 per cent by 2000. In 2011, two further thresholds and rates were added for residential properties (5 per cent above £1 million and 7 per cent above £2 million). In 2014, the system on residential property was switched from a 'slab' (rate payable on the whole amount) to a 'marginal' one (where the higher rates are only payable on the amount over the threshold). SDLT on commercial (or mixed) properties switched to a marginal system in 2016. The new rates are listed in the table below. Additionally, rates are 3 percentage points higher if the buyer owns another property. First time buyers are exempt on the value payable on the first £300,000 on properties up to £500,000.

Rate payable above threshold	2%	5%	10%	12%
Residential thresholds (£):	125,000	250,000	925,000	1,500,000
Commercial (or mixed) thresholds (£):	150,000	250,000	N/a	N/a

What's the problem with it?

The 'incidence' (who is economically worse off, as distinct from who is required to pay the money) of SDLT depends on whether we are thinking about who 'pays' the tax after it has already been put in place, or who 'pays' when it is introduced (or withdrawn, or the rates are altered).

Because buyers factor in their SDLT bill when deciding how much to pay for a property, the buyer 'pays' when considering transactions on their own. Buyers start off with cash worth the value of the property and the value of the SDLT and then end up with just the value of the property. A seller, by contrast, swaps a property for cash of the same value. But when SDLT is introduced or raised, property owners immediately 'pay'. Instead of increasing their overall budget, buyers allocate some of their overall budget for SDLT, leaving less left over for the purchase. This means that prices fall to account for the reduced demand from buyers, reducing the value of property. So the cost falls on both buyers and sellers and adds up to much more than the tax receipts HMRC receives.

The big problem with SDLT is that its incidence on buyers means that it reduces people's willingness to buy property, which 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. This gets in the way of the housing market reallocating homes when circumstances change. 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.[18]

What should be done?

1. Abolish SDLT entirely when possible.
2. In the meantime, extend the £300,000 first time buyer threshold to all, halve the 5 per cent rate, abolish the 10 and 12 per cent rates and scrap the 3 per cent additional homes surcharge.

[18] Hilber, C., *Written evidence to the treasury select committee*, 2 May 2016, http://personal.lse.ac.uk/hilber/evidence/Hilber_Evidence_HMTreasuryCommittee_2016_05.pdf

STAMP DUTY ON SHARES

What is it?

Stamp duty on shares refers to two taxes on the purchase of most shares and some other financial instruments payable by the buyers. Most bond transactions are exempt. *Stamp duty reserve tax* (SDRT) applies to electronic transfers of shares. It was introduced in 2003, replacing stamp duty which was first introduced in England in 1694. Stamp duty still applies to paper share certificates over £1,000 in value.

A standard rate of 0.5 per cent has applied since 1986, when it was halved from 1 per cent, having been halved two years previously from 2 per cent. Stamp duty historically applied to land and buildings (at various rates) but in 2003 this ended with the introduction of the new, separate stamp duty land tax. In 2014, shares listed on the London Stock Exchange's alternative investment market and high growth segment became exempt from SDRT.

What's the problem with it?

Stamp duties reduce the efficiency of stock markets for UK companies, with a disproportionately large burden on marginal investment projects, and they distort merger and acquisition activity, encouraging overseas ownership. Liability on equity transactions but not debt encourages a bias towards using debt.

It makes raising capital more expensive in two ways. First, to raise capital, investors must pay the stamp duty bill as well as the investment sum. Secondly, by shifting the balance between investments away from equity, it reduces the size of the market which then leads to investors demanding a higher return to reflect the increased chance of being unable to sell their shares quickly and easily. This effect is particularly acute for smaller companies because their shares are traded less frequently so investors price in anticipated 'flight to liquidity', which makes capital more expensive.

Efficient capital markets enable companies to grow, creating jobs and prosperity. Harming their efficiency is a particularly destructive way of raising tax revenue, not only hitting the (primarily pension) funds which own most shares, but also the whole economy due to the destructive effects mentioned above.[19]

What should be done?

Abolish stamp duty entirely and without delay. A partial reduction or phased abolition would not be justified given the relatively small impact on public finances (stamp duty on shares accounts for well under 1 per cent of total revenues).

---

[19] Oxera, *Stamp duty: its impact and the benefits of its abolition*, May 2007, https://www.oxera.com/getmedia/b086dc91-b10b-4003-b9b7-7668ab8c876a/Stamp-duty%E2%80%94its-impact-and-the-benefits-of-its-abolition.pdf.aspx?ext=.pdf

TOBACCO DUTY

What are they?

Tobacco duty is a levy paid on tobacco products. Different systems operate for cigarettes, cigars, hand-rolling tobacco and other products.

Since 20 May 2017, cigarettes are subject to a minimum duty of £280.15 per 1,000 (or £5.60 for a pack of 20). Above a retail price of £7.63 for 20, a further duty of 16.5 per cent applies to the additional retail value above that level. Cigars, hand-rolling tobacco and other tobacco products are all subject to a flat duty per kg of product. From November 2017, they are £270.96/kg for cigars, £221.18/kg for hand-rolling tobacco and £119.13/kg for other products. They are scheduled to rise by RPI plus 2 per cent every year until the end of the parliament, except hand-rolling tobacco which is scheduled to rise by RPI plus 3 per cent.

What's the problem with it?

Tobacco duty is needlessly complicated, economically distortionary and morally oppressive. It is also associated with large 'grey' markets caused by attempts to avoid or evade high rates in the UK.

The relationship between public expenditure and tobacco consumption is weak for two reasons. First, many smokers do not acquire lung cancer or other major health problems due to smoking, so the case for charging all smokers with the public spending costs of those problems is weak. Secondly, smokers who do suffer major health problems due to smoking are more likely to die prematurely, reducing expenditure on state pensions and other age-related benefits. A premature death is obviously a cost to smoking, but it is a cost borne by the individual smoker, not other taxpayers.

HMRC's estimates the illicit trade to account for 35 per cent of hand-rolling tobacco consumption in 2014-15 and 7 per cent of cigarette consumption.[20] This tax disincentive to avoid legitimate tobacco products puts at risk the health of smokers.

There also is no good reason why the rate of duty should differ between tobacco products. If the aim is to raise revenue then income taxes and VAT offer much more efficient routes which do not distort consumption patterns. But if the aim is to distort consumption patterns and reduce tobacco consumption then there should be no tax implication to whether the tobacco comes in a bag, a cigarette, a cigar, or any other form.

What should be done?

1. Freeze overall tobacco duty rates with any rises in lower rates at least matched by cuts in higher rates.
2. Tax tobacco at a uniform, single rate, by abolishing the needlessly complicated three elements to duty on cigarettes and separate rates for cigars, hand-rolling tobacco and other products with a single rate per kilogram of tobacco (although for administrative simplicity this rate could be applied per 1,000 cigarettes as approximately equivalent).

[20] HMRC, *2016 Measuring Tax Gaps*, 2016, https://www.gov.uk/government/statistics/measuring-tax-gaps

TV LICENCE FEE

What is it?

The TV licence fee is a tax on receiving live broadcast television. Broadcast receiving licences were introduced by the Wireless Telegraphy Act 1904, and were made permanent by the 1924 act. When the BBC introduced television services in 1936, it was covered under the existing licence. Broadcasts were suspended during the second world war and, when they were reintroduced in 1946, separate TV licences were also introduced. Colour licences were introduced in 1968 and black and white licences remain in place, although the number had fallen to under 10,000 by 2015.[21] Radio licence fees were abolished in 1971.

TV licence fee receipts are hypothecated to the BBC.

What's the problem with it?

The licence fee means that television viewers who do not care for or who object to BBC output are compelled to fund the BBC to gain permission to watch non-BBC material. In addition to questions about whether this is a proper role for the tax system, it also diverts funding away from television output that viewers would have chosen in favour of BBC output.

What should be done?

The TV licence fee should be abolished and replaced with a BBC charge. Viewers would use equipment to descramble BBC TV signals and access to the BBC iPlayer and online content. Payment of the charge would not be required to view broadcasts from other organisations.

[21] TV Licensing, *Black and white TV still going strong*, http://www.tvlicensing.co.uk/about/media-centre/news/black-and-white-tv-still-going-strong-NEWS22

VALUE ADDED TAX

What is it?

Value added tax (VAT) is a tax on the purchase price of most goods and services.

VAT was introduced in 1973 to replace purchase tax, a 33.3 per cent tax on goods classed as 'luxury' which was introduced in 1940 to discourage waste. The standard rate was cut from 10 to 8 per cent in 1974, when a higher 25 per cent rate (on petrol and some consumer goods) was introduced. This was halved in 1974 and the two were merged into a single 15 per cent rate in 1979. It was raised to 17.5 per cent in 1991 and again to 20 per cent in 2011 after a temporary cut to 15 per cent between December 2008 and December 2009. An 8 per cent reduced rate (mainly on domestic energy) was introduced in 1994 and cut to 5 per cent in 1997.

Businesses (including the self-employed) must register if turnover of non-exempt sales exceeds the threshold (£83,000 in 2017-18). VAT paid on firms' purchases is deducted from VAT charged to customers.

What's the problem with it?

VAT operates much like income tax but with two key differences: it doesn't tax savings/investment, and lower (and zero) rates are applied to types of consumption rather than people's incomes. In the same way that income tax reduces the incentive to work, so too does VAT. People's 'real incomes' (incomes after adjusting for prices) are reduced by income tax and value added tax alike. It doesn't immediately matter whether we make people poorer by reducing their after-tax incomes or increasing the after-tax prices of the things they buy.

VAT's consumption tax base means that it is more economically efficient (or, more accurately, less inefficient) than income tax. But the different rates applied to different types of goods and services distort consumption patterns and create the opportunity for tax avoidance. The famous legal case to determine whether a Jaffa Cake is legally a chocolate-covered biscuit (subject to standard VAT) or a cake (zero-rated) is an example of the problem.

Compared to a sales tax (a tax levied on retailers' sales), VAT places a much greater administrative burden on businesses for two reasons. First, all businesses along a supply chain must levy the charge, not just retailers. Secondly, businesses need to monitor their purchases as well as sales to deduct the VAT they have paid from their bills. The upside is that the incentive for retailers to evade tax is reduced by the extent of deductions. This tradeoff is why economies with high consumption taxes tend to favour a VAT while those with lower ones have a sales tax.

What should be done?

1. No increases.
2. No rates rises.
3. No item reclassifications.
4. Reform must be substantial to be worthwhile.

VEHICLE EXCISE DUTY

What is it?

Vehicle excise duty (VED) is a levy paid to drive or park vehicles on public roads. A locomotive duty was introduced in 1889. VED was introduced in 1921 and the revenues were initially hypothecated to road spending, prompting the duty to be known as 'road tax'. This link was broken in 1937, however.

Three groups of charges apply, based on the date of registration of the vehicle: on or after 1 April 2017; before 1 March 2001; and between those dates.

VED on cars registered since April 2017 has an initial one-off rate in the first year based on bands of CO2/km emissions, with a discount for alternative fuel cars. Rates in subsequent years are based on whether the list price is above a threshold (£40,000 in 2017-18) and whether the power is petrol/diesel, electric or alternative.

Cars registered before April 2017 pay one of 13 bands based on CO2/km emissions (with lower rates for alternative fuel cars) unless they were registered before March 2001, in which case only two rates apply, based on whether the engine size exceeds 1549cc.

Four bands apply to motorcycles and two to tricycles, based on engine size. Light goods vehicles pay a single rate except some historic vehicles which comply with Euro 4 or Euro 5 emissions standards. Heavy goods vehicles pay VED and HGV road user levy based on the weight, number of axles and suspension type. The first-year rate on diesel cars registered from April 2018 will be calculated as if the car were in the VED band above, except those certified as next-generation clean diesels.

What's the problem with it?

Taxing vehicle ownership is arbitrary and the current system is needlessly complex. The revenue raised would be less economically damaging if taken from overall consumption through VAT, or from income through income tax. Concerns about emissions, meanwhile, are already addressed through fuel duty. Congestion has almost no link with vehicle ownership because it is highly specific to certain times and locations. Congestion charges and other road-pricing mechanisms are much better designed to address congestion.

VED discourages vehicle ownership, which affects low income households more, with worrying implications for employment, particularly in areas which cannot sustain frequent and dense public transport networks.[22]

What should be done?

1. Freeze VED immediately (but link the HGV road user levy to road use costs).
2. Abolish VED entirely as soon as possible (but retain HGV road user levy).

[22] Wellings, R., *Time To Excise Fuel Duty?*, IEA, 2012 https://iea.org.uk/wp-content/uploads/2016/07/Time%20to%20excise%20fuel%20duty_0.pdf