Time for change: AAT alternatives to tax rises

4 September 2018

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2. Introduction

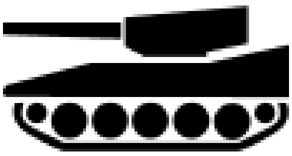
In recent weeks, the Prime Minister has said the NHS will receive £20bn extra per year from 2023. Defence spending faces a £21bn shortfall over the next ten years according to the Public Accounts Committee and £23bn could be lost from government revenues between now and 2030 because of declining income from fuel duty as drivers switch from petrol and diesel fuelled cars to electric vehicles[1]. Similarly, billions of pounds of revenue are being lost because of the increasing trend of self-employment in the gig economy.

These changes are considerable but pale into insignificance against general government gross debt of £1,763.8bn at the end of March 2018[2]. This is equivalent to more than 85% of UK GDP. It is worth noting that the European Commission considers anything above 60% to be “excessive” according to the Protocol on the Excessive Deficit Procedure. The UK has exceeded this 60% reference point since 2010 and with plans to spend a record £813 billion in 2018-19, there can be little doubt that an excessive deficit looks likely for the foreseeable future.

Against the backdrop of an excessive deficit, rapidly falling tax receipts and increasing demands, the traditional responses of increasing taxation, increasing borrowing or a combination of the two, remain the dominant narrative.

AAT suggests an alternative to tax rises or increased borrowing to address these issues. Instead, a range of measures, as outlined below, could provide a simpler, fairer alternative for raising revenue.

Some of these changes carry considerable risk of political and media criticism and this is acknowledged throughout this report. However, if the benefits are properly communicated to the electorate, it is unlikely that many people would oppose changes that free up substantial funds to invest in schools, education and defence whilst avoiding uncomfortable tax rises or passing bigger debts on to our children and grandchildren via the excessive UK deficit.



[1] **Financial Times, 26 June 2017:**
https://www.ft.com/content/0dc01356-58b9-11e7-9bc8-8055f264aa8b
[2] **Office for National Statistics, 2018:**
https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicspending/bulletins/ukgovernmentdebtanddeficitforeurostatmaast/march2018

3. Savings proposals

Marriage allowance

AAT acknowledges the obvious political sensitivities around making changes to this allowance but suggests that given the annual payment is of a reasonably small sum of money (a maximum that amounts to less than £250 a year) removing the allowance is not going to influence an individual's decision to marry and is in no way an indication as to whether or not a political party supports the concept of marriage.

AAT further notes that this is taken up by less than half of those who are eligible, the primary beneficiaries are men (84%) and over a third of recipients (35%) are above state pension age.

It is estimated that the annual cost of the allowance, taking into account the fact it can be backdated, was £385m in 2015/16.[3]

This is more money than the entire annual expenditure of the Department for International Trade, more than total government investment in making transport accessible for the disabled (£300m over 12 years[4]) and sufficient to pay for two new hospitals to be built every year[5]. This allowance should therefore be removed.

In contrast, the original Married Couples Allowance, which continues to cost in the region of £200m a year, should be allowed to continue given the cost of its operation reduces year on year as it is restricted to those where at least one person in the couple was born before 6 April 1935.

Annual saving: £385m

Stamp Duty

The new Stamp Duty subsidy for first time buyers, effective since November 2017, means that first-time buyers can claim a discount (relief) so they don't pay any tax up to £300,000 (less than the average cost of a home in London) and 5% on the portion from £300,001 to £500,000.

Despite the ups and downs of the property market, evidence suggests the number of first time buyers has been increasing every year for more than a decade.[6] This brings into question the need for a system that singles out only one group of home buyers but also makes an analysis of the Government's subsidy difficult given the number of first time buyers have been increasing anyway.

For more than a year, AAT has been recommending that switching Stamp Duty liability from the buyer to the seller would be a simpler, fairer, more effective system which would remove every single first-time buyer across the country from Stamp Duty liability whilst crucially also helping those already on the property ladder to move up.

HM Treasury forecasts its new first-time buyers policy introduced last November is already costing £560m a year and will rise to £670m by 2021-2022. [7]

Switching Stamp Duty liability from the buyer to the seller would therefore save the taxpayer £670m a year by 2021 whilst protecting the £9.3bn[8] currently raised because although those paying will change, the amount will not.

The only homeowners having to pay more than at present would be downsizers who in most cases are older homeowners, with little or no mortgage to pay and significant equity. Downsizers are therefore likely best placed among all homeowner types to pay a little extra, certainly better placed than first-time buyers who are typically the younger generation.

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[3] **Parliamentary Question, 2017:**
https://www.parliament.uk/written-questions-answers-statements/written-question/lords/2017-03-27/HL6306
[4] **Department for Transport Press Release, July 2018:**
https://www.gov.uk/government/news/next-steps-towards-a-fully-inclusive-transport-network
[5] **Papworth NHS Hospital, opens September 2018, cost £165m**
[6] **Halifax First-Time Buyer Review (January 2018):**
https://static.halifax.co.uk/assets/pdf/mortgages/pdf/2018-01-27-number-of-ftb-highest-since-2007-HPI.pdf
[7] **HM Treasury, November 2017:**
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661428/Autumn_Budget_Policy_costings_document_web.pdf
[8] **[8] Office of National Statistics, June 2018:**
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/730387/Quarterly_SDLT_2018Q2_Main.pdf

Those with an interest in housing for the older generation, such as retirement developer McCarthy Stone, have called for Stamp Duty for “last movers” who downsize to be scrapped. This would cost hundreds of millions of pounds both in in lost duty and in administrative costs and would be far from straightforward to implement and monitor. It would again be an additional, costly intervention that benefits only a small group, like the Government’s first-time buyer exemption, rather than benefitting the majority of home owners and potential house owners as a switch in liability would achieve.

Annual saving: **£670m**

Aligning pensioner benefits

Pensioner benefits have become a sacred cow amongst political parties, primarily due to increased voter turnout amongst the older generation. This is evidenced by voter turnout statistics from the 2017 General Election which show 64% of 25-29 year olds voted compared to 77% for those aged 60-69[9].

The effect of increased turnout, and therefore increased political value, is adequately demonstrated by the various parties 2017 election manifesto commitments to protect universal pensioner benefits irrespective of their cost or effectiveness. The Conservative Party did go as far as to suggest the Winter Fuel Allowance (WFA) would be means tested for higher rate taxpayers but even this commitment was scrapped because of their post-election agreement with the Democratic Unionist Party.

Considering the increased demand for public service spending and the deficit, as outlined in the introduction to this paper, as well as increased pensioner incomes and increased recognition of the importance intergenerational fairness, AAT believes the time has come for a more rational, facts led debate around universal pensioner benefits.

Raising the age of eligibility for certain pensioner benefits such as free eye tests and free prescriptions to match the state pension age (and ensuring they rise with any rise in the state pension age), as well as removing the WFA, would save a substantial sum of money for the taxpayer, continue to ensure all pensioners enjoy free eye tests and prescriptions, provide greater clarity to all as to when eligibility begins and help address the issue of intergenerational fairness. There is already a clear precedent in the form of free bus passes which are only provided upon reaching state pension age (except in London).

- Prescriptions & eye tests

Everyone aged over 60 is entitled to free prescriptions and eye tests despite often having many more years before retiring or becoming eligible for the state pension.

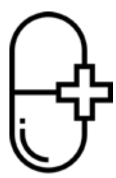
90% of the 1bn prescriptions issued in 2016 were provided at the tax payers expense rather than the individual recipient i.e. because they were young enough, old enough, qualified due to a low income or had a long-term health condition that qualifies for free prescriptions.

Unfortunately, the precise cost of free prescriptions to pensioners is no longer known as the data is not collected. However, it was £4.5bn over a decade ago in 2007 when the information was last collected and is therefore likely to be considerably higher still today.

The cost of free eye tests for the over 60's is more than £100m a year and again this is difficult to justify for the same reasons as above – many aged between 60 and retirement age are still working, earning a reasonable income and could easily afford to meet this cost. £100m may appear to be a small sum but it is five times greater than the £20m Government recently allocated for funding to help isolated people and those suffering from loneliness[10].

It is also worth noting that those on low incomes who might be affected by this change (those currently aged between 60 and the state pension age) would be protected because those on low incomes (anyone with savings of less than £16,000 and anyone in receipt of income related benefits) receive free prescriptions and eye tests anyway. Any change must be aligned to the state pension age rather than a specific figure of 65,66 or 67 to ensure it rises in line with any changes to the state pension age in the future i.e. to ensure it is future proofed.

Annual saving: £1bn (minimum)



[9] **How Britain voted at the 2017 General Election, YouGov:**
https://yougov.co.uk/news/2017/06/13/how-britain-voted-2017-general-election/
[10] **£20m investment to help tackle loneliness, 18 June 2018:**
https://www.gov.uk/government/news/20-million-investment-to-help-tackle-loneliness

- Winter Fuel Allowance (WFA)

Every November, millions of elderly people are automatically given between £200- £300 tax free by the Government in the form of WFA.

There have been increasing calls for WFA to be removed from wealthier pensioners (higher rate taxpayers) or that it should at least be classed as taxable income and taxed accordingly.

The removal of WFA from over 200,000 higher-rate taxpayers would be effective in saving the Government money (approximately £250million) but this does not consider the significant costs of administrating such a change. There are strong arguments for scrapping WFA completely. Firstly, the payment is very poorly focused, it is not spent on fuel but is instead a cash payment to be spent on whatever the individual likes.

It also fails to consider the significant changes to both pensioner income and to myriad steps to address fuel poverty.

Pension Credit now ensures a minimum level of income for pensioners on a low income or struggling to make ends meet. This ensures a guaranteed minimum level of weekly income (£163 for single pensioners and £248.80 for a couple). In addition, energy companies are required by law to pay a combined £640m a year on energy efficiency measures, a large part of which is made available to those in fuel poor households, to help them reduce their bills, heat their homes and keep warm. Furthermore, 5m prepayment meter and vulnerable households are protected by Ofgem's "Safeguard tariff" which protects them from overpaying for their energy or from any unjustified price rises. This was not the case when WFA was introduced in 1998 and so further undermines arguments for its retention. Given the reasons for introducing WFA have now largely been addressed, serious consideration should be given to ceasing payment of WFA to all households, irrespective of income.

Annual saving: £2bn

- The Christmas Bonus

This bonus payment of £10 to every recipient of the State Pension each December was introduced in 1972 as a single "one-off" measure. The fact it has been maintained indicates the political difficulty in removing something once given, or perhaps more significantly the fear of being heavily criticised by the media and opposition parties (irrespective of who those opposition parties are) because of the almost irresistible PR and political opportunities created by taking money away from pensioners and benefit recipients at Christmas time. Any such opposition to its removal ignores the fact that the amount paid to the individual is negligible, that most recipients are unaware that it is due, what it is for or why they receive it.

These facts suggest removal would be worth considering, as would the fact it costs taxpayers £160m a year that could usefully be spent elsewhere. For example, GPs are leaving the NHS faster than they can be replaced and £160m would pay for over 300 new GPs to be recruited, trained and placed[11]. Similarly, this saving could pay for over 2,000 NHS nurses[12]. When given the choice of more doctors and nurses or £10, few are likely to opt for this cash payment.

Annual saving: £160m

[11] **BMA costings for a GP (including living expenses) of £498,000:**
https://www.bma.org.uk/-/media/Files/Word%20files/News%20views%20analysis/pressbriefing_cost_of_training_doctors.docx
[12] **National Audit Office, Managing the supply of NHS clinical staff in England:**
https://www.nao.org.uk/wp-content/uploads/2016/02/Managing-the-supply-of-NHS-clinical-staff-in-England-Summary.pdf

Inheritance tax simplification

Business & Agricultural Property Reliefs
With regard to Inheritance Tax, many users of Business Property Relief (BPR) do not own a business in just the same way that many users of Agriculture Property Relief (APR) are not farmers. The £1bn+ cost of tax relief currently given through BPR and APR would likely be reduced if it were properly focused on businesses and farms instead of incentivising particular assets to be held primarily, and often purely, for tax reasons.

Although AAT disagrees with much of the 2018 Resolution Foundation report relating to inheritance tax, it does agree with their proposal to restrict BPR to small family businesses where the beneficiary receives at least 25% of the business and the donor had a demonstrable working relationship with the company. Likewise, restricting APR by ensuring at least 80% of the beneficiary's assets comprise of agricultural property is an idea with merit that should be explored further.

AIM Shares
The exemption that permits certain AIM companies to benefit from BPR - making the shares exempt from IHT if they are held for at least two years and at death - is an anomaly that should be ended.

BPR was introduced in 1976 to make sure successful family businesses did not have to pay large tax bills to retain control of the business. BPR was not designed as an avoidance measure or to promote AIM listed shares. There is no sound basis for allowing such an exemption to continue and AAT therefore recommends this also be removed.

Charitable Exemption
The charitable exemption is an unnecessary complexity that adds little, if any, value. There is no evidence to suggest the exemption has led to an increase in charitable giving since it was introduced six years ago. As a result, AAT suggest that the OTS give serious consideration to recommending it be removed.

Although HMRC figures show that the cost of IHT relief for charitable donations rose by 79% to £840m in the five years to April 2017 i.e. since the 2012 introduction of the charitable exemption, this substantial additional cost to the taxpayer does not equate to any more charitable giving than would have been the case otherwise. It simply means that some estates are gaining substantial tax savings. AAT therefore recommends that this exemption be removed.

Annual saving: £1.5bn

Car usage

The OBR suggests revenue from car usage could be up to £23bn less by 2030 based on the switch to electric vehicles. Replacing fuel duty and VAT on fuel with a tax on usage modelled on existing pay as you drive (PAYD) insurance systems would therefore appear worthy of consideration.

PAYD currently bases insurance costs on the distances travelled, the time of travel and the type of roads used e.g. a motorway vs quiet country roads. The technology already exists, was trialled by thousands of Aviva customers between 2005-2008 and is now being offered by several start-up insurance companies such as Just Miles who provide drivers with a free onboard telematics box. There would be costs involved in providing telematics boxes, although this is something Government could require car manufacturers to provide in the future, but PAYD is likely to be a good way of protecting this much needed revenue whilst also being fairer than the existing blanket approach.

The Department for Transport and HM Treasury would need to undertake detailed analysis but PAYD could be set at a level that protects however much is likely to be lost from changing driving habits and would thus save £9-£23bn.

Annual saving: £9bn

Pension Tax Relief

Earlier this year, RSA produced a report that stated basic rate tax payers, 75% of those claiming any relief, pay more into pensions (51%) but get only 32% of pension tax relief.

By contrast, higher rate payers get 53% of relief, despite contributing only 41%, while additional rate payers, make only 8% of contributions but get 15% of relief.

The report goes on to state that pensions relief costs the taxpayer £30.5bn, of which more than a third (£11.8bn) is spent on people earning more than £70,000.

The RSA recommended that a new 30% flat rate of pension relief would solve the problem as it would be, "*progressive, cost-neutral and leave three-quarters of earners better off.*"[13]

Like the RSA, Pensions Policy Institute and various others, AAT supports the replacement of the existing 20%, 40%, 45% pension tax relief with a single flat rate alternative.

However, AAT does not support a flat rate of 30% as proposed by the RSA, 28% as proposed by the Resolution Foundation[14] or 25% as reportedly considered by HM Treasury on several occasions in the recent past[15].

Instead AAT recommends a 20% flat rate meaning a reduction for higher earners, protection for basic rate payers (as they will continue to receive the same level of relief as now) and a £13bn annual dividend for the taxpayer. There is no evidence that an increase in the 20% basic rate to 25%, 28% or even 30% will lead to increased saving amongst basic rate taxpayers and so investment in this area is unlikely to deliver a significant positive change.

Think tanks and commentators often put forward suggestions as to how the money could be better spent on alternative pension provision but it is not necessary for these savings to be reinvested in pensions policy. This £13bn could instead go to other priority areas such as the NHS, education or more generally plugging the increasing hole generated by changing work, shopping, travelling and living arrangements.

Annual saving: £13bn

Closing the Gender Pay Gap

There are numerous reasons why closing the Gender Pay Gap is a worthwhile objective. Not just because it's the right thing to do, leads to a more diverse and inclusive workforce, broadens the skills base and can improve staff satisfaction and retention but because it will substantially add to UK GDP. In fact, McKinsey estimate it could add £150 billion to UK GDP by 2025 and add 840,000 women to the workforce[16].

Much more needs to be done to achieve this. Pay gap reporting requirements could be substantially tightened (covering partners, including part-time workers, recording ages and having much clearer penalties for non-compliance) and be extended to companies employing 50+ people (as recommended by the European Commission in 2014, AAT in 2017 and the BEIS Select Committee in 2018) rather than the mere 1% of British companies with 250+employees who are currently covered.

Reporting requirements can only go so far, demanding action to change and to do so within a reasonable timeframe is essential if these financial and other benefits are to be realised.

Annual saving: £billions

[13] **RSA, Venturing to Retire, 18 April 2018:**
https://www.thersa.org/about-us/media/2018/top-10-handed-40-of-pension-tax-relief-rsa-warns
[14] **Resolution Foundation:**
https://www.resolutionfoundation.org/app/uploads/2018/05/A-New-Generational-Contract-Full-PDF.pdf
[15] **Chancellor considers introducing flat rate relief, 2016:**
http://home.bt.com/lifestyle/money/investing-pensions/reports-chancellor-to-cut-pension-tax-relief-in-2016-budget-11364034471159
[16] **McKinsey, September 2016:**
https://www.mckinsey.com/global-themes/gender-equality/the-power-of-parity-advancing-womens-equality-in-the-united-kingdom

4. Next Steps

If implemented, the above recommendations would deliver over £27bn in annual savings for the taxpayer.

This does not represent an exhaustive list of changes that could be made.

Although AAT acknowledges that there are many other areas where substantial savings could be delivered, we believe the recommendations made within this document are sufficient to demonstrate that increased taxes or increased borrowing are not the only options for policymakers when considering how to deliver greater investment to priority areas such as health and social care, education or deficit reduction.

The proposals also show that improvements, not just to intergenerational fairness but in delivering greater fairness overall, can be made without necessarily costing the taxpayer any more money.

These solutions help to reduce gender and income inequalities and benefit us all by removing the need for painful tax rises that so many can ill afford.

As highlighted at the outset, AAT acknowledges that whilst all these proposals make financial sense, can lead to greater fairness overall and help create a simpler, more effective tax system, some of these recommendations would raise significant political challenges.

These challenges are far from insurmountable. Effective communication is key both with the electorate and media but also with other political parties.

Cross-party support is probably too much to hope for, for any Government seeking to make savings, but it may be more forthcoming if the reallocation of spending is highlighted in advance i.e. clearly explaining where the money saved will be invested and why.

AAT's recommendations are not a panacea but do offer a worthwhile, credible and thought-provoking contribution to the UK taxation and investment debate.

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