

The [FT reports](#) this morning that:

*Britain's tax system is progressive and takes significantly more money from the rich than the poor, the Institute for Fiscal Studies, a respected think-tank, said on Monday in research designed to pre-empt "less than ideal" official statistics suggesting otherwise. The target of the IFS's study was the Office for National Statistics' annual publication on the effect of tax on household income, due to be published on Thursday.*

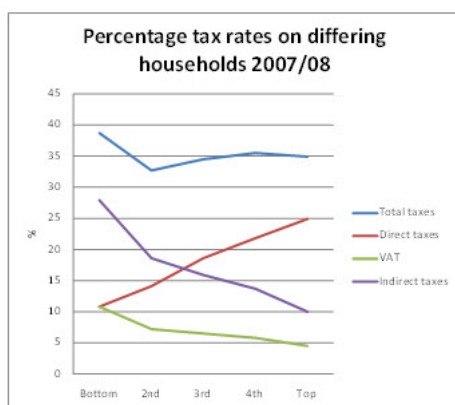
The FT adds:

*One of the largest differences between the IFS work and that of the ONS is over value added tax. Officials say it is regressive, with the poor paying a larger share of their income in VAT than the rich. However, the IFS said the ONS was incorrectly classifying people who were temporarily poor, but still spent a lot of money, as permanently poor. It argued that if the effect of indirect taxes, such as VAT, were considered on the basis of how much people spent, rich and poor tended to pay a similar proportion in tax.*

I [have disputed this issue](#) with the Institute for Fiscal Studies for a long time. I wrote this in 2010, but frankly nothing much has changed in between:

"A new [Tax Briefing](#) from Tax Research UK examines that Institute for Fiscal Studies claim and finds it is a statement of political dogma, but not of fact.

As the Tax Research briefing argues, a regressive tax is almost universally agreed to be one where the proportion of an individual's income expended on that tax falls as they progress up the income scale*[\[i\]](#)*. VAT is a regressive tax. This is shown, quite dramatically, in the graph below which is based on UK official data*[\[ii\]](#)* :

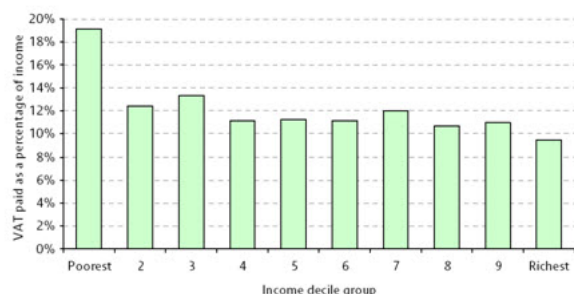


By chance the VAT and total direct tax burdens on the bottom 20% of households ranked by their income are the same. Direct taxes then rise steadily as a proportion of income as incomes rise and both VAT and all indirect taxes combined do the exact opposite, falling as a proportion of income as income rises. So marked is the trend that the overall progressive effect of income tax is not enough to counter the fact that the poorest households suffer such a high rate of overall indirect tax that they end up with the highest average tax rates in the economy as a whole.

The message from this data is unambiguous: the poorest 20% of households in the UK have both the highest overall tax burden of any quintile and the highest VAT burden. That VAT burden at 12.1% of their income is more than double that paid by the top quintile, where the VAT burden is 5.9% of income. VAT is, therefore, regressive.

The IFS dispute this. They produce the following data in evidence:

Figure 10.1. VAT paid as a percentage of net household income

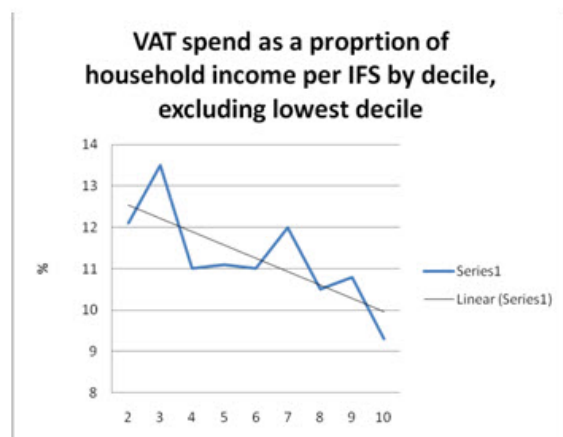


They say of this:

It shows that the percentage of net income paid as VAT varies relatively little across most of the income distribution, with the biggest exception being that the bottom decile group does pay a higher fraction of its net income on VAT than do other income groups.

And they then use this claim to justify the fact that in their opinion VAT paid is not regressive with regard to income.

The slight problem for them is that this overlooks the very obvious fact that it is. Replotting their data and excluding the bottom decile as they would like the following graph can be drawn:



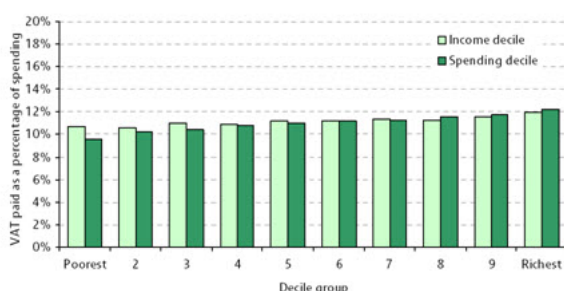
*The linear regression shows a clear downward trend that makes very clear VAT is regressive.*

*Surprisingly the IFS ignore this obvious fact and go on to claim:*

*However, looking at a snapshot of the patterns of spending, VAT paid and income in the population at any given moment is misleading, because incomes are volatile and spending can be smoothed through borrowing and saving. Consider a student or a retiree: their current income is likely to be quite low but their lifetime earnings could be relatively high. The student may borrow to fund spending, whilst the retiree may be running down savings. Similarly, many people in the lowest income decile will be temporarily not in paid work and able to maintain relatively high spending in the short period they are out of the labour market. Because their spending is higher than their current income, these people will be paying a high fraction of their current income in VAT. Similarly, those with high current incomes tend to have high saving, and so appear to escape the tax, but they will face it when they come to spend the accumulated savings. Because of this ‘consumption smoothing’, expenditure is probably a better measure of living standards (and households’ perceptions of the level of spending they can sustain).*

*And they then claim that comparing VAT with spending shows that VAT is progressive:*

Figure 10.2. VAT paid as a percentage of household expenditure



*However, this requires that a number of further conditions hold. First, the poor must have savings, and as I show, they don't. Second, they must have access to borrowing, and as I show, they don't (except for doorstep lenders). Third, the consumption patterns of the rich must be the same as the poor, and they're not. In fact, the consumption patterns of the rich (for school fees, private health, leisure travel, second homes and financial services products) are all VAT free, unlike the consumption patterns of the poorest. In addition, the IFS has to abuse all known notions of measure for progressivity to reach this conclusion.*

*The result is that far from the IFS claim being justified, it is very obviously wrong, and very poor quality research. As a matter of fact VAT is regressive.*

*The IFS claim is, however, consistent with persistent IFS recommendations that VAT be*

*increased (to replace corporation tax, for example, and on food and children's clothing to pay for "desirable tax reductions") all of which, together with their recommendations that Inheritance Tax be abolished and tax on interest income be abolished suggest a systematic bias towards making recommendations that favour redistribution of taxes from those who work for a living or who are the poorest in our country towards those with wealth and who enjoy income from capital.*

*None of which makes it easy to see how the IFS can sustain the claim that [\[i\]](#) it:*

*maintain a rigorous, scientific approach to research, while offering scope for timely, independent, well-informed contributions to public debate.*

*The [full paper is available here.](#)"*

*And what worries me is that the Institute for Fiscal Studies now says it is to do a five-year study into inequality. I have [already publicly stated my concerns about this](#). But what this continuing claim by the IFS, made on the basis of false claims as to what progressivity is, reveals that they are institutionally unsuited to undertake this work. They have a bias against objective appraisal of poverty. It's not a good basis for undertaking research on the issue.*