

Funding the Future

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The Tory leadership race really is starting to look like the silly season for policy ideas. Michael Gove's [suggestion that we get rid of VAT](#) and replace it with a 'simple sales tax' is the latest such idea.

Value added tax is an idea embraced by more than 150 countries around the world. The only major exception is the USA. China has one. The USA doesn't have a VAT because sales taxes are local in the USA and they just can't get their heads around how to make VAT work as a result.

There is a reason why so many countries have VATs. They work. When there is a need for a broad and diversified tax base (and there is) then a tax on sales is always going to happen. They may be regressive, but that can be addressed, at least in part. And when this tax raises over £150 billion a year in the UK we are not getting rid of something like it.

Gove's simple sales tax will, I suspect, be very different from VAT. VAT is complicated because it is always charged when required but most VAT registered traders can reclaim the VAT they are charged when paying over what they owe to HM Revenue & Customs. As a result VAT is not an expense for them. The tax only hits when it reaches a non-VAT registered person. That's a consumer - like you, or me. The merit of all this complexity is that VAT does not distort business decision making, much (and I know there are exceptions). And the VAT charge should be the same however many times goods change hands during the production process before reaching the consumer, and from wherever they come. Imports should carry VAT in full in most cases. The tax is at least neutral in this sense.

The problems implicit in Gove's plan are fourfold. If his sales tax is 'simple' it will be charged on everything. So get ready to welcome sales tax on food then, for example. This tax is, then, much less likely to be fair then. In fact, we can be sure it will be more regressive: it will be paid in higher proportion by those on low income than high income.

Second, there is no guarantee of there being a tax reduction. A sales tax may be at a lower rate, say 5%, But it is charged right throughout the supply chain. Suppose goods

change hands five times before reaching the end consumer. A 5% tax could actually increase end price by more than 27% in that case. Prices matching current VAT are likely. Reductions may well be few and far between. I am not saying there will be none: I am simply saying there will be big winners and losers.

Third, there is the massive bias in favour of imports to consider. Suppose something is made in the UK. By the time everything is assembled, through several layers of supply chain, sales tax of maybe 20% might be included in the price. An almost identical product can, though, be bought from Europe, where they would have VAT still. There would be no VAT charge for the European exporter of that product and they would have just 5% sales tax to pay in the UK. So their product would be substantially cheaper than the UK made equivalent. This tax would then massively undermine UK business and favour imports.

And, fourth, it would also bias against exporters. That's because only the final exporter would not charge the sales tax. All the sales tax on the way through the production process would be a cost. UK exports would, then, be much higher than EU (and other country) equivalent domestically made products. So our exporters would not be able to compete because of Gove's sales tax.

As incompetence in tax design goes suggesting a sales tax takes some beating. But Gove has done it, with a guarantee to destroy British jobs built into the idea. Maybe he was high at the time he thought it worth suggesting. Those who are stone cold sober will not see anything of merit in what he is proposing.