Tax After Coronavirus (TACs)

Submission to the Treasury Select Committee

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1. **What are the major long-term pressures on the tax system in the UK, including those arising from changes in working practices, demographics, the environment and other factors? How are these affecting the efficiency of the tax base and the overall level of demand for public services?**

   To properly understand this issue the role of tax in the economy has to be understood.

   In this context it is important to note that tax does not fund government spending, as such. That is because, as is now apparent, the government can always spend what it wishes by simply asking the Bank of England to extend the necessary credit for it to meet the cost. The Bank of England can do so by either:

   - Using quantitative easing[1], or

[1] The Bank of England notes that this creates 'new money' https://www.bankofengland.co.uk/monetary-policy/quantitative-easing#:~:text=Quantitative%20easing%20is%20a%20tool,involves%20us%20creating%20digital%20money.&text=Video%20on%20the%20Bank%20of%20England%20printing%20money.

- Extending an overdraft on the government's Ways and Means Account maintained with the Bank of England[2].

At least £300 billion of funding will be supplied by the Bank of England to the UK government during the course of the financial year 2020/21 using quantitative easing, which type of funding has never yet been reversed[3]. This sum might amount to more than 80% of the deficit this year. Given that deficits of in excess of £100 billion a year are now forecast for the next three years[4], and these forecasts may be optimistic, it is suggested that it is highly likely that this process will be repeated in each of those years as well. The direct relationship between government spending and tax is broken in that case.

Clearly there are limits to the extent to which this process of money creation is desirable if inflation targets are to be met, albeit that it is proving very hard to create inflation of 2% per annum at present, suggesting that insufficient money is being created in this way. Some economists[5] suggests that inflation as a result of this process can only arise when full employment has been reached and there is, as a result, general pressure on wage rates. If this is the case, as seems likely[6], this tangible limit is, unfortunately, a long way from likelihood at present but as and when it is reached additional money can be withdrawn from the economy to balance this central bank money creation by:

- Offering savers the chance to deposit funds with the government, whether through National Savings and Investments or via bond issues ('gilts') (which together comprise most of the so-called national debt, but which sum might more accurately be described as national savings), or
- Additional taxation.

Seen in this way, (which accurately describes how government funding actually works at present) tax is just one of the mechanisms used for balancing the government funding equation and is not the source from which spending is made[7].

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[2] See https://www.bankofengland.co.uk/news/2020/april/hmt-and-boe-announce-temporary-extension-to-ways-and-means-facility

[3] https://www.bankofengland.co.uk/monetary-policy/quantitative-easing

[4] See https://obr.uk/download/fiscal-sustainability-report-july-2020/ page 9

[5] See Stephanie Kelton, 2020, 'The Deficit Myth', John Murray

[6] See the Financial Times editorial, 14 August 2020, https://www.ft.com/content/ae8d8907-a388-4196-9863-190bbf34f181?desktop=true&segmentId=7c8f09b9-9b61-4fbb-9430-9208a9e233c8#myft:notification:daily-email:content

[7] The description used is entirely consistent with the description the Bank of England supplied of all bank credit creation in its Quarterly bulletin of April 2014, with national savings deposits and taxation taking the role of bank loan repayments in their examples.

In this context, and correctly stripped of its direct role in funding spending, tax has six different roles to p[lay within the economy, which are:

1) To ratify the value of the currency: this means that by demanding payment of tax in the currency it has to be used for transactions in the UK;

2) To reclaim the money the government has spent into the economy in fulfilment of its democratic mandate;

3) To redistribute income and wealth;

4) To reprice goods and services;

5) To raise democratic representation - people who pay tax vote;

6) To reorganise the economy i.e. fiscal policy.

It is within this framework for tax that the following comments are provided in answer to your question[8]. The answer requires consideration of three issues:

- Tax in the context of fiscal policy;
- Currently required tax reform to existing taxes;
- Tax reforms to tackle demographic and environmental concerns.

Each is addressed in turn.

a. Fiscal policy

The greatest misunderstanding around tax at present, arising as a direct consequence of the coronavirus crisis, is that there will at some time be an obligation on government to somehow raise tax to cover the deficit of £300 billion or that will arise in 2020/21 and the £100 billion plus deficits that will arise in each of the following three years, as currently forecast. This is not true. There are a number of reasons for this:

[8] Further explanation of this process can be found in Murphy, R. 2019. Tax and modern monetary theory http://www.paecon.net/PAEReview/issue89/Murphy89.pdf and Baker A. and Murphy, R. 2020. Modern monetary theory and the changing role of tax in society https://www.cambridge.org/core/journals/social-policy-and-society/article/modern-monetary-theory-and-the-changing-role-of-tax-in-society/B7A8B0C7C80C8F7E38D20BE4F5099C83

a. To seek to do this at a time when demand is already suppressed due to the impact of the coronavirus on both household and business confidence, which means that demand (and so GDP) is likely to be severely impaired for some time, would have the net effect of further reducing the funds available to fuel that demand, and so would exacerbate the scale of the recession (or even depression) that we are now facing. As such there is likely to be no scope for increases in overall tax revenue for some years to come if the government wishes to see the economy recover to anything like its former level of activity;

b. As a matter of fact, there is no reason to raise funds for this purpose. As already noted, QE will cover most of the 2020/21 deficit, and will probably do likewise in each of the following years. There is no reason at all to reverse these QE arrangements and absolutely no pressure on the government to do so. Nor is there any obvious risk of inflation that suggests that QE might need be reversed. Indeed for more than a decade now inflationary pressure has almost disappeared from the world economy and there is no sign of it returning, anywhere. The chance that this happens to coincide with the period when QE has been in use is likely to not be coincidental at all.

c. There is ample demand for government saving accounts and bonds at present and since the government now has effective near total control of short term interest rates (as a consequence of the size of central bank reserve balances) and long term interest rates (through QE) the government has every opportunity to continue to engineer this valuable position that means that the net cost of interest on national savings deposits and gilts will remain exceptionally small in historic terms for some considerable time to come.

d. Any threat from money markets to destabilise this situation can always be neutered using either short or long term QE: the government can now always out-gun the markets, which was a fact not appreciated before 2009.

It follows that the rational objective for the tax take within fiscal policy is, in this environment, to keep that yield as low as possible in order to stimulate demand, and so encourage economic recovery, leaving QE, the Bank of England and the government savings markets to fulfil the task of balancing the government's funding equation.

b. Tax reform

This removal of pressure on the tax system to raise revenue at this time does, however, give rise to a considerable benefit when it comes to addressing the necessary tax

reforms required to equip the UK with the tax system it needs that might be suitable for the twenty first century. Proposals to achieve these objectives are noted in the answers to questions 3, 5, 6, 7, 8, 10 and 11 of this submission and so are not repeated here.

c. Reforms to tackle demographic and environmental issues

There is a tax reform not mentioned elsewhere in this submission that would assist the government in addressing environmental and demographic issues now.

It is widely recognised that a Green New Deal is now an essential reform programme if the problems of climate change are to be addressed. In work I have undertaken with Colin Hines, the convenor of the UK Green New Deal Group, of which I am member, we have suggested[9] that the cost of this programme may be £100 billion a year, or at least five per cent of UK GDP. The point already made about the need to avoid tax increases being noted, we have proposed that this programme be paid for with borrowing and newly created funds. Whilst there is already a vibrant market for government bonds, to encourage the sale of the bonds to be used for this purpose we have proposed some simple rule changes to ISAs and pension contributions that could ensure that all the funds required for the Green New Deal could come from these two sources, if need be.

Firstly, we have noted that collectively £70 billion a year is saved in different kinds of ISA accounts[10]. If, to secure this tax free status these funds had to be invested in Green New Deal bonds paying an average of around 1.1 per cent, which is the current offering on National Savings and Investment accounts, then we have no doubt that all this sum would be available for investment in the Green New Deal each year.

In addition, if pension rules were changed so that in exchange for the tax relief given on these contributions, which reliefs cost £54 billion a year at present[11], 25 per cent of all contributions had to be invested in Green New Deal related bonds then more than £25 billion could come into the Green New Deal programme from this source as well.
In other words, two straightforward changes in savings rules could provide all the funds required to purchase the Green New Deal bonds that will be issued to finance this programme. It really is that simple.

The point is made to make clear that the alignment of tax reliefs, rates and allowances with broader economic and social policy is possible. And since the Green New Deal is

[9] https://www.taxresearch.org.uk/Blog/wp-content/uploads/2019/12/GNDFunding1219.pdf
[10] https://www.gov.uk/government/collections/individual-savings-accounts-isa-statistics
[11] https://www.gov.uk/government/statistics/registered-pension-schemes-cost-of-tax-relief

both designed to create jobs in every constituency and to help bridge the demographic divide by using the savings of older people in the population to provide jobs for younger generations those issues are also addressed by this proposal.

2. What more can the UK do to protect its tax base from erosion as a result of globalisation and technological change, and what further impacts will the coronavirus pandemic have on our tax base?

The first reform that the UK could adopt to address the issues noted is to require that all multinational corporations trading in the UK publish their annual accounts for filing with Companies House on a country-by-country reporting basis, whether or not they have their head office in this country. The right to demand such accounts on public record in the UK so that the UK public have the right to know whether or not the tax paid by the multinational corporations that they trade with make fair and appropriate payment of tax in the UK as a result of the activity that they undertake here will be entirely within the power of the UK to demand post-Brexit.

The current best example of the potential country-by-country reporting disclosures that might be required of multinational corporations in this way is provided by the 2019 standard on this issue published by GRI (the Global Reporting Initiative)[12] [13]. There can be no doubt that public pressure will provide the best mechanism to create demand for companies to reform their taxation practices, and country-by-country reporting data published on a consistent and reliable basis will provide the public with the information that they need as consumers to bring that pressure to bear.

There would be no significant additional cost on companies to comply with this requirement since the standard is based on, and is a development from, the information that almost all multinational corporations in all major economies must now supply to their tax authorities on a country-by-country reporting basis for tax risk appraisal purposes. As such all multinational corporations should already have the information to deliver this information in their possession already.

The second basis on which reform could be made would be for the UK to adopt a unitary apportionment formula basis for the taxation of multinational corporations. This would remove from debate all the disputes that arise as a result of the existing international tax system which assumes that:

[12] See https://www.globalreporting.org/standards/work-program-and-standards-review/development-of-gri-207-tax-2019

[13] Richard Murphy was a member of the advisory panel that assisted drafting of this standard. He also created the concept of country-by-country reporting in 2003.

a. All the subsidiaries of a multinational corporations are wholly independent of each other for tax purposes, when that is clearly not true; and
b. Market based prices can be found to determine the prices that these interdependent subsidiaries should use when trading with each other, when in the vast majority of cases that is not now true.

A unitary apportionment basis for the taxation of a multinational corporation assumes it is a single entity and is managed as such. Its single profit is then apportioned to the countries where it trades based on a formula. The most common formula weights profit before tax (P) on the basis of where third party sales (S), employees (E) and tangible assets (A) are located on the basis of the following formula to determine the profit attributable to a location (L) as opposed to the corporation as a whole (C):

$$P_L = P_C \times (S_L/S_C + E_L/E_C + A_L/A_C)/3$$

Other options are available, for example to allow for environmental extraction, but this is the usual default option that is discussed.

It is, of course, possible to claim that the result is arbitrary, but so too is the existing system.

In addition, it can be claimed that a formula could not be agreed, but nor is it required that transfer prices be agreed between countries now.

What is apparent is that this basis of tax provides a viable and continuing system for corporate taxation on an international basis when the existing system is unsustainable because it is based on assumptions that have no relationship to the real world, whereas those underpinning unitary taxation reflect the economic reality of there being a single entity under common control, which is what a multinational corporation is. It is for this reason that the UK should adopt this basis of tax, even if it would be a pioneer in this field. Doing so would provide multinational corporations based in this country with the certainty that they need on the taxation liabilities that they might owe in this country.

3. Do these pressures need to be met with tax reform, and if so, is this the right time for reform?

If the UK is to provide business with some certainty then it needs to transform its corporation tax system. This would demonstrate that it is a pioneer that is willing to provide multinational corporations with the basis of certainty that they need to plan and

develop whilst they concentrate on more important issues of future concern to them, like their adaptation to climate change.

The last two decades, during which tax planning has been seen as a basis for corporate profit generation, are now being seen as part of a model of business activity that belongs to another era (the BC, or 'before Covid' era). In the AC ('after Covid') era business has other priorities, which will include both basic survival and the demands for meeting zero-carbon targets that will shift corporate management focus from tax onto other issues.

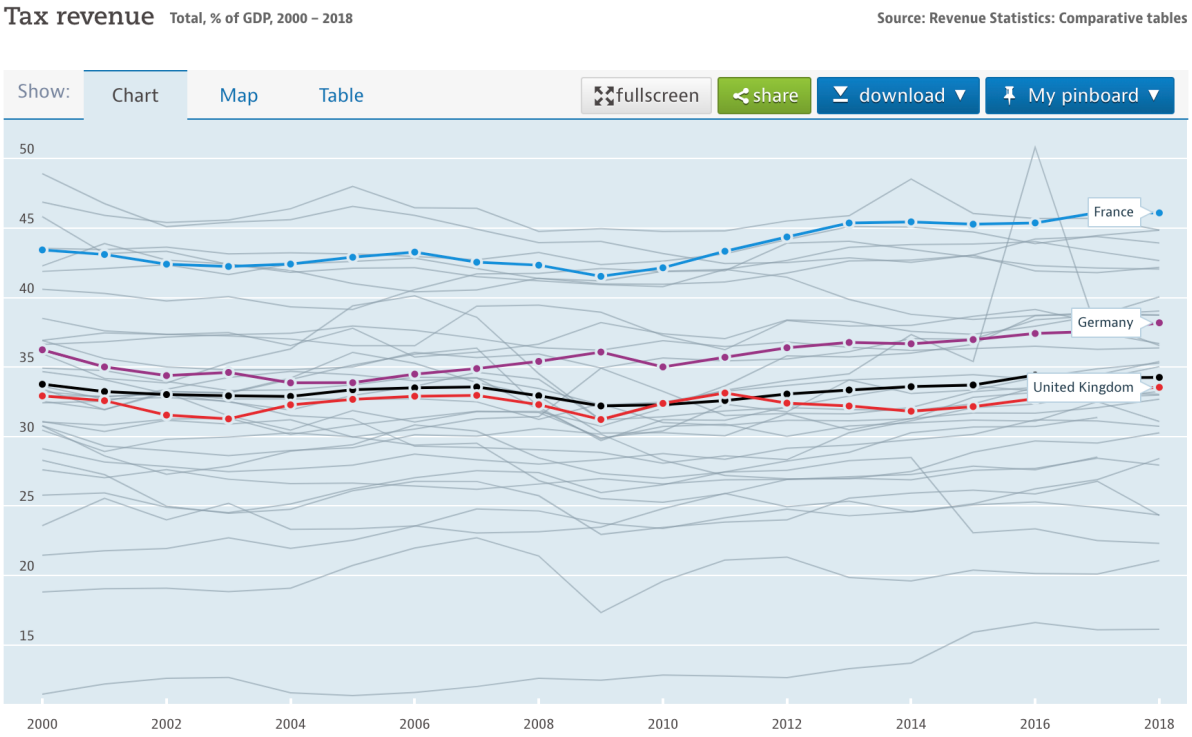
Businesses representatives frequently say that what they want with regard to tax is certainty: the noted reforms could provide this and provide competitive advantage to the UK and its businesses as a result. These reforms, and the other tax reforms noted in this submission, are an essential part of that new approach to tax in the AC era.

4. What overall level of taxation can the economy bear without undesirable or counterproductive harm to economic growth?

Total UK tax in come as a percentage of GDP has varied relatively little over the last twenty years:

Source: Author calculations based upon HM treasury and Office for Budget Responsibility budget reports over the period

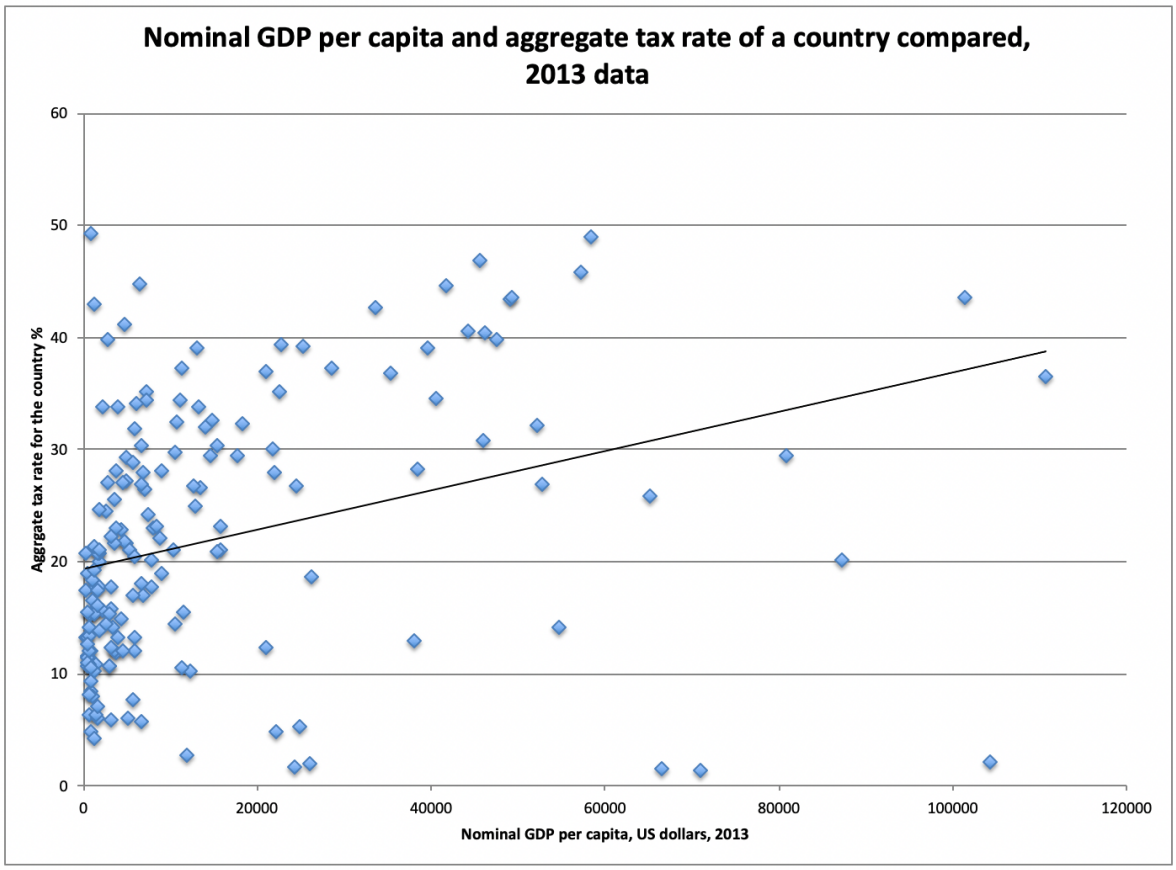
This revenue is low for a country like the UK by international standards. Data from the OECD for 2000 – 2018 provides the following data for all member states (the black line, which is very close to the UK throughout the whole period ,is the OECD average) with France and Germany being highlighted for the sake of comparison:



Source: Organisation for Economic Cooperation and Development[14]

As is apparent from this data, France and Germany do not appear to suffer for having higher overall tax rates than the UK. There is, in fact, strong evidence that the higher the aggregate total tax paid in a country the higher is its GDP per capita. The following data relates to the year 2013 and shows this relationship for 175 countries and was included in my book 'The Joy of Tax' (Random House, 2015):

[14] https://data.oecd.org/tax/tax-revenue.htm accessed 11-8-20



As the trend line makes clear, the relationship is strongly positive. There is, as a result, no clear evidence that there is an obvious overall limit to the level of taxation that the UK economy can bear without undesirable or counterproductive harm to economic growth.

What, however, is also clear, is that the ability to pay additional tax varies considerably across the economy. Research undertaken in April 2020 by the author of this submission[15] showed that in the period from 2011 to 2018 the total national income of the UK was £13.1 trillion. In that same period the increase in net wealth was £5.1 trillion. It is stressed that this latter figure is not for total wealth, but the increase in the value of that net wealth in that period.

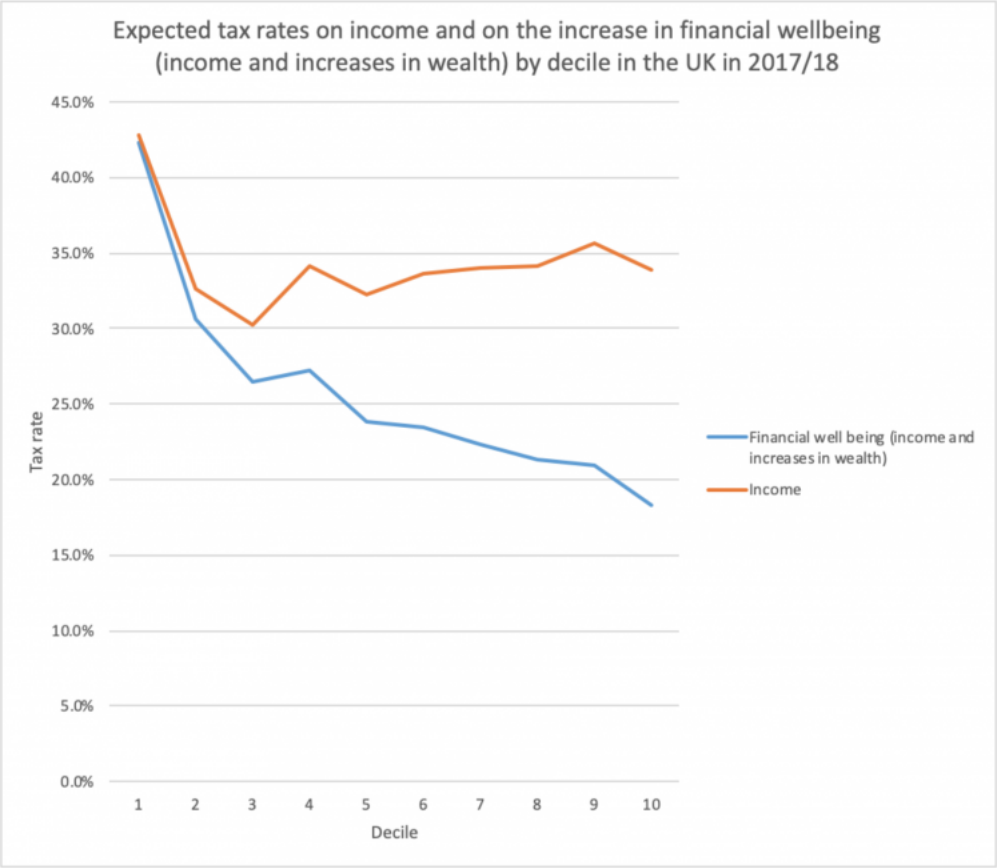
That research then showed that the overall effective tax rates on income during this period were unlikely to have averaged more than 29.4%, but those on wealth increases did not exceed 3.4%.

It then noted that if these rates had been equalised it would, at least in principle, have been possible to raise an additional £174 billion in tax revenue per annum from the owners of wealth.

[15] Available at http://www.taxresearch.org.uk/Documents/WealthTaxData420.pdf

Finally it was noted that because there had been no attempt at equalisation of tax rates on income derived from work and wealth and because the distribution of the ownership of wealth varies substantially across the UK, including by age and gender, the effective tax rate of the 10% of those in the UK who are in the lowest earning group of income taxpayers exceeds 42% of their combined income and wealth gains in a year, but the equivalent effective tax rate for those in the highest ten percent of UK income taxpayers ranked by earnings is less than half that at just over 18 percent.

Graphically this is represented as follows:



Sources: Author's calculations based on Office for National Statistics, HM Revenue & Customs and HM Treasury data

It is, as a result, suggested that there is considerable additional capacity for tax to be raised from those who own most of the wealth in the UK, many of whom are in that top ten per cent of income earners.

At the same time, it is also noted that those with the lowest levels of income in the UK have the least capacity to pay any additional taxes, and that there might be considerable

advantage from reducing the tax rates that they pay. This is not just for social reasons resulting from the reduction of the impact of inequality in the UK: the benefit would also be to the economy as a whole because those with the lowest levels of income have the highest marginal propensity to consume in society and when there is a shortage of demand in the economy (as is likely to the case for a number of years) providing those with that highest propensity to consume with additional income is one of the most effective measures for stimulating economic activity that can be taken.

As noted in the answer to question 8 of this submission, much of the tax advantage to those with wealth comes from:

- The lower tax rates applied to income from investments and savings when compared to those charged on the return to human endeavour;
- The favourable tax treatment afforded to capital gains;
- The opportunities that corporation tax rates that are lower than those on earned income paid to individuals provide to those who can take advantage of them by not needing to live off their current earnings;
- The absence of any very effective wealth tax in the UK;
- The considerable advantage that tax allowances, reliefs and depictions provide to those with wealth in the UK.

The resulting necessary reforms to the tax system are discussed in the answers to questions 2, 3, 5, 6, 7, 8, 10 and 11 of this submission.

5. Which areas of the tax system are most in need of reform, and which are best left alone?

As noted in the answers to questions 2 and 3, there is an urgent need for reform of corporation tax in the UK.

As noted in the answer provided to questions 8, there is also an urgent need to reform the exemptions, allowances and reliefs provided within many of the UK's taxes that have between them a current annual cost of at least £425 billion of tax foregone, little of which is explained or justified by HMRC or HM Treasury, and few of which are appraised for their economic, social or fiscal effectiveness.

As noted in the answer to question 10, the UK tax system needs radical reform if it is to become truly progressive and appropriately and fairly tax income from varying sources as if they were of equal worth in the hands of the recipient (which as a matter of fact they are) when the current tax system heavily penalises income generated from work.

As noted in questions 1 and 11, the reasons for charging tax, and so designing appropriate tax systems, have to also now be properly understood within the framework of a twenty first economy where the government has its own currency and central bank, meaning it is no longer reliant on either tax or financial markets to fund its expenditure. As noted in the answer to question 11, this requires substantial rethinking of the management approach to, and actual management of, taxation, and that demands reform within HMRC itself.

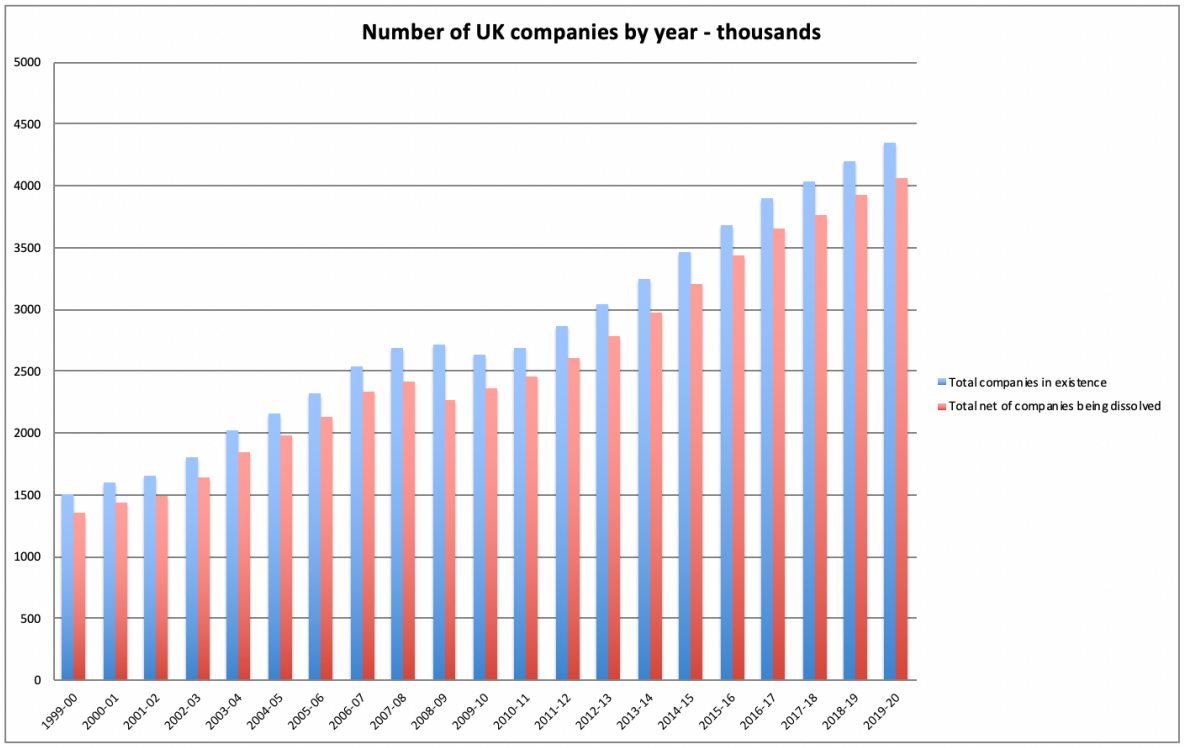
There are, in addition, two other aspects of tax reform not mentioned elsewhere which need to be noted here. These are the need for the reform of company law regulation within the UK and the need for enhanced automatic information exchange within the UK economy to prevent tax abuse. Each is dealt with in turn.

a. Company law regulation

There is a dispute as to the true scale of the UK tax gap. HMRC has suggested it to be around £30 billion per annum for more than a decade[16]. My research suggests it to be considerably higher[17]. My research suggests that much of the UK tax gap might occur within the UK's missing companies[18].

The number of companies in the UK has risen significantly during the present century:

[16] https://www.gov.uk/government/statistics/measuring-tax-gaps
[17] https://www.taxresearch.org.uk/Documents/PCSTaxGap2014.pdf and https://www.socialistsanddemocrats.eu/publications/european-tax-gap
[18] http://www.taxresearch.org.uk/Documents/Intheshade.pdf



Source: Companies House data

Over the years 2007-08 to 2017-18 (the most recent for which data is available[19]) HMRC data suggests that on average only 40% of companies had trading income whilst over the period 2007-08 to 2011-12 just 58% of companies were asked to submit tax returns by HMRC[20]. If this trend has continued, and the data is remarkably consistent over time, it is likely that HKRC now has no knowledge at all of the activities of approximately 1.8 million companies in the UK and that another near 800,000 report themselves to have no income although it would seem that HMRC undertake almost no checking to prove that this is the case. Why this is the case is hard to explain.

My research, based on Companies House data[21], suggests that 93% of companies dissolved and removed from the Companies House register are 'struck off' each year i.e. no formal oversight of the process of removal takes place and reliance is instead placed on a statement from the directors that the company has not traded prior to dissolution, excepting in those 47% of such cases where the Registrar of Companies had to initiate the striking off because the company had failed to comply with its legal obligation to file accounts or a Confirmation Statement (formerly, the Annual Return).

[19] https://www.gov.uk/government/statistics/corporation-tax-statistics-2019
[20] Based on answers to parliamentary questions noted in http://www.taxresearch.org.uk/Documents/Intheshade.pdf
[21] ibid

Over the last five years Companies House data shows that an average of 472,000 companies have been removed from the register of companies each year. The above noted data suggests that nothing might be known about the last trading of more than 200,000 of these each year, and this assumes that all other companies have, of course, been honest in the declarations that they have made.

This is a system that appears to be designed, if only by omission, to facilitate tax evasion, and it seems that HMRC pays no attention to it, concentrating its efforts on the tax returns it gets and not those it does not receive. This provides significant opportunity for abuse in the UK economy that means that the shadow economy is very likely to be much larger than that HMRC records, as VAT tax gap data would also imply. This issue now needs to be addressed within the UK economy.

It is stressed that the consequence is not just tax lost: this failing to regulate companies undermines the level playing field that is necessary for fair competition within the UK because it permits abuse that undermines honest companies. A pro-business policy from any government would seek to tackle this abuse for reasons of upholding fair competition as well as for the reason of maintaining tax revenue. It is very hard to understand why such laxness in regulation is permitted by both HMRC and Companies House.

This issue could be addressed by automatic information exchange, as noted in the next section.

b. Automatic information exchange

Automatic information exchange of data on potentially taxable income from banks and other agencies to HMRC has a very long history in the UK. For example, banks have reported interest paid to UK taxpayers to HMRC for very many decades, whilst PAYE ensures that employers provide information on the payments that they make to their employees on a regular basis. The principle is as a consequence well established, understood and, most importantly, is widely accepted.

The idea of automatic information exchange has been more widely adopted in recent years, in particular with regard to attempts to tackle tax haven abuse. As a result it is now accepted that international automatic information exchange is normal. So, for example, it is now the case that a UK tax resident customer of a bank in the Cayman Island will not only have information supplied to HMRC with regard to their personal bank accounts, but the Cayman bank in question will also be responsible for supplying information to

HMRC on their other financial interests and data on the activity of those interests e.g. information will be supplied on the companies that they own and the trusts of which they are a beneficiary. As a result it is possible to trace whether they might have income arising from those sources.

Although this is now the case with regard to tax havens and other countries the same is not true within the UK itself. So, for example, whilst there has been some recent improvements in transparency from payment platforms (credit card suppliers, PayPal, etc) to HMRC it remains the case that a bank or other regulated financial services sector supplier does not need to supply annual information to HMRC on all those companies to whom they supply services or account facilities in the UK, including data on:

- The companies and trusts that they serve;
- The services that they supply;
- Account numbers, if appropriate;
- Beneficial ownership of the entity;
- Officers of the entity;
- Annual sums deposited in accounts by the entity.

If this information had to be supplied by banks and other regulated financial services entities annually for all their clients then the likelihood that corporate tax abuse of the type noted previously in this answer could be curtailed would increase significantly.

If banks also had to report all those persons with irregular deposit patterns within their bank accounts over a minimum sum then it is also likely that those moonlighting in self employment might be identified.

In addition, if all financial services advisers who assisted on capital transactions had to supply HMRC with data of transactions they had assisted with in a year (in essence, in many cases, by supplying copies of client account statements) non-reporting of a great many capital transactions would cease.

And, if rental agents had to supply copies of their landlord client accounts then abuse in that sector would also be reduced.

Research in the USA[22] has shown that when a taxpayer is aware that a source of income is being declared to their tax authority the rate of tax compliance increases considerably.

[22] http://darp.lse.ac.uk/papersdb/Slemrod_(JEP07).pdf

The whole purpose of this recommendation is to encourage that compliance on the part of taxpayers within the UK tax system when this is too low at present.

It is suggested that these issues are the priority for reform within the UK tax system, and will require considerable and sustained effort over a number of years to deliver.

6. What reforms should be considered in response to the pressures on the tax system?

These issues are addressed in the answers to questions 2, 5, 7, 8, 10 and 11, in particular and are not repeated here.

7. What is the role of tax reliefs in rebuilding the economy and promoting economic growth and efficiency? Does the current regime of tax reliefs perform this role well?

The current system of tax reliefs in the UK is disorganised. It lacks policy focus. Few of the reliefs provided are subject to any regular appraisal as to their economic justification. They frequently undermine the integrity of the tax system as a whole (see the answer to question 8 for amplification in this issue). Based on recent research these allowances and reliefs might in total cost £425 billion a year, spread across taxes as shown in the table in the answer to question 8. Collectively they do as a consequence represent the single biggest expenditure element in the whole of the government's budget. Despite that they attract almost no scrutiny at all. This is a situation that requires reform.

It is not the suggestion of this submission that all current tax reliefs, exemptions and allowances are inappropriate. There are some reliefs that would, almost inevitably, survive in any tax system, such as the individual personal allowance for income tax purposes, although no judgement is implied in saying so on its current level, availability and the restrictions that apply to it. Nor is comment offered on current tax rates, or the rates at which tax relief is made available (although this issue is addressed to some degree in the answer to question 10). Instead the intention is to note the policy issues inherent within the current framework of allowances and reliefs, of which there are many that need addressing. The issues that arise relate in particular to:

- The lack of economic logic to the allowances and reliefs provided;
- The inappropriate social consequences of the allowances and reliefs provided, most especially with regard to inequality;
- The spillover impacts of allowances and reliefs provided;
- The impact of allowances and reliefs on the so called 'tax-planning industry' and the consequent loss of tax morale;

- The failure to monitor the cost of tax reliefs and allowances and the resulting failure to ensure that they provide appropriate value for money;
- A failure to align allowances and reliefs with broader economic policy goals.

Each of these issues will be addressed in turn.

a. The lack of economic logic to the allowances and reliefs provided

As noted in the answer to Question 1, if tax is to be properly understood within a modern fiat currency economy, its primary function is to collect revenue to negate the inflationary risk arising from government spending and its secondary function is to impact the delivery of government social, economic and fiscal policy.

In the context of tax's primary role of controlling inflation, the preponderance of allowances, reliefs and exemptions available within the UK tax system does not help the control of fiscal policy within the economy. This is because their take up is unpredictable, and even the measurement of their use is in some cases hard to appraise because allowances, reliefs and exemptions can effectively eliminate the requirement to report the information needed to undertake that appraisal. If tax is to fulfil its primary goal as a tool of fiscal policy it is desirable that the number of tax reliefs, allowances and exemptions be kept to the minimum possible to achieve the goals of taxation as a whole, taking into consideration the impact of tax on the government's social and economic agendas. There is no indication that this is the case at present.

It should also be noted that the logic underpinning many allowances, exemptions and reliefs is now known to be economically inappropriate. For example, many allowances (including pension tax reliefs, ISA tax reliefs, additional income tax allowances for savings income and many investment related reliefs in income tax and capital gains tax) are based on the logic that saving is a necessary pre-condition of investment within the UK economy. This is now known not to be the case. Almost all investment is now funded by bank credit, which the Bank of England has acknowledged since 2014 to be created without reference to the availability of bank deposits[23]. In addition, very little of the sum that is described as being invested in the stock market is actually used to fund new share issues by companies registered on that exchange, meaning that almost none of the significant amount of savings direct towards equity investment does actually result in new economic activity. The funds saved in that way do, instead, mainly fuel increases in share prices. It is very questionable therefore whether those tax incentives designed to encourage saving are economically well directed at present.

[23] See https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/quarterly-bulletin-2014-q1.pdf

b. Inappropriate social consequences of the allowances and reliefs provided, most especially with regard to inequality

A large number of the allowances and reliefs provided within the tax system are targeted at those who have the means to save. This does, for example apply to the reliefs for pension contributions paid, ISA reliefs, tax exemptions for financial services within VAT, reinvestment and other allowances within capital gains tax, and others. The combined cost of these allowances is considerable. Such reliefs and allowances have the effect of increasing the financial net worth of those already able to afford to save and as such have the net consequence of increasing financial inequality within the UK, which has significant social consequences and economic cost. When many of these reliefs are also poorly targeted with regard to their economic consequences in that they do not actually promote investment, as noted previously, their desirability, given the cost involved, has to be questioned.

c. Spillover impacts of allowances and reliefs provided

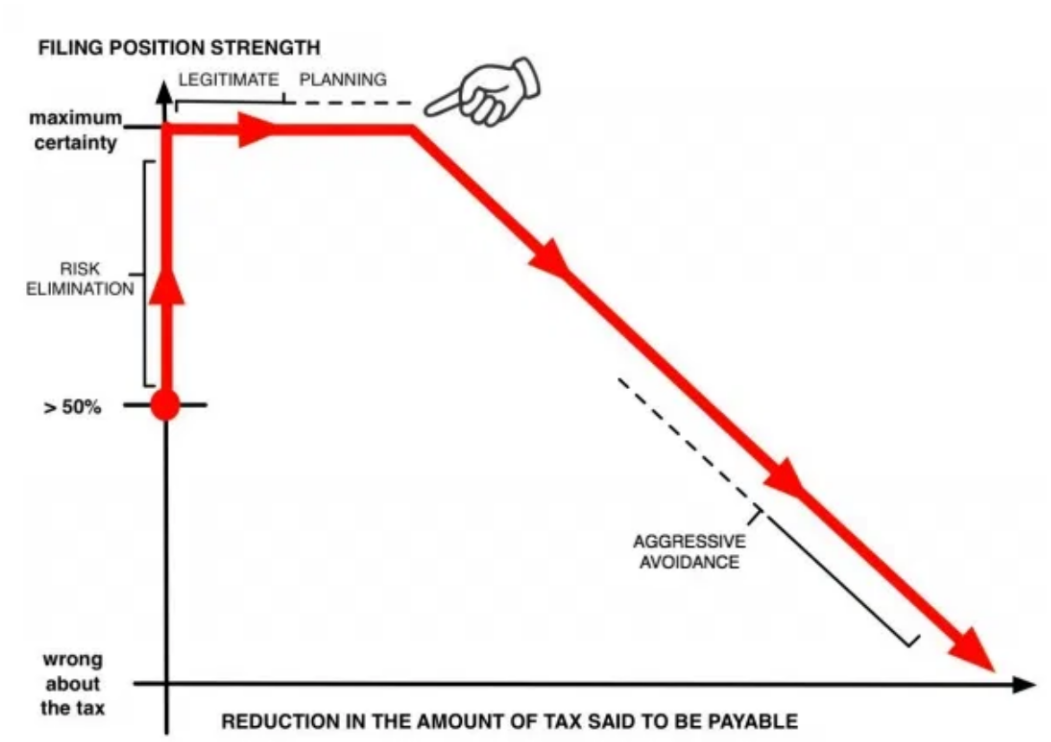
Since this point is noted in answer to Question 8 it is not repeated here, but the risk that poorly designed tax reliefs, allowances and exemptions can create tax spillover effects that undermine the integrity of the tax system as a whole is high, and is the result of the poor design of many of them that requires rectification.

d. The impact of allowances and reliefs on the so called 'tax-planning industry' and the consequent loss of tax morale;

To understand this issue the difference between the entirely legitimate tax advice industry and the activity of abusive tax planning has to be understood. This has been best explained by UK based tax barrister David (now Clair) Quentin[24].

As they have explained, if there is no risk of a transaction being challenged by a tax authority - because it is completely compliant with the letter and spirit of UK tax law - then even if it reduces the amount of tax to be paid by a taxpayer it cannot be considered to be tax avoidance. This is explained in this diagram from Quentin:

[24] http://jota.website/article/view/142



A person who is uncertain of the law is represented by the red circle on the vertical axis. If they take advice from their tax authority or a professional tax adviser they might as a consequence considerably reduce their tax risk by increasing the certainty that their affairs are legally compliant: this explains the red line up the Y, vertical, axis. Tax advice reduces legal uncertainty, in the first instance. This is a socially useful activity.

Thereafter they might also make other choices permitted, and even encouraged, by law that reduce the amount of tax that they might pay e.g. they might make payment into a pension or claim permissible tax reliefs for expenses that they have actually incurred. Both are permitted if relevant rules are complied with, even if less tax is paid as a result. This explains the horizontal red line across the top of the chart. Advice that has these reliefs and allowances are available to a taxpayer is entirely legitimate, and is, once more, a useful activity for tax advisers to undertake. It is reasonable to presume that a claim for a tax relief when claimed within the spirit of the law is a socially appropriate action.

However, a point is then reached where further reduction in tax paid is not possible without uncertain tax positions being adopted. An uncertain tax position is one where, for example, a transaction is represented as being something that it might not be, or is one which is at least open to either legal or factual challenge. The point when such positions are adopted is that where the line begins to slope downwards. Thereafter, uses

are made of the law which are clearly open to doubt as to their legal validity: many marketed tax avoidance schemes are of this type. The activity undertaken is no longer within the spirit of the law. Instead, that law is abused.

The inflection point where tax expenditure becomes tax avoidance is clearly marked by the pointing finger on the diagram. As a person descends down the slope on the right-hand side of the diagram the uncertainty in the position that they have adopted increases until what is described as aggressive tax avoidance is being undertaken.

The provision of numerous, unmonitored, and often ambiguous tax exemptions, reliefs and allowances encourage this process of submitting uncertain tax positions within tax returns supplied to HMRC. This happens for a number of reasons. Firstly, the simple existence of the opportunity to reduce tax is an incentive to sum to abuse. Secondly, whenever there is legislation there is room for interpretation, which can create the opportunity for abuse. Thirdly, such are the differentials in the tax rates available as a consequence of some of these allowances and reliefs that the temptation to represent a transaction as falling within the scope of them is so great that some will fabricate evidence to support such a claim. Fourthly, there is widespread awareness that the number of tax investigations into claims made is now very low in numerical terms , and this encourages abuse. Fifth, because there are some within the tax abuse profession who are willing to provide legal cover for these activities the risks to some taxpayers (and, in particular, corporate taxpayers) from partaking in these activities is very low. Sixthly, since if appropriate tax advice has been taken in advance the risk of tax penalties resulting from the submission of such false positions is limited, the risk advantage from abusing tax reliefs, exemptions and allowances lies very largely with the taxpayer.

It is not suggested that all aggressive tax planning would be eliminated if tax reliefs, allowances and exemptions were eliminated, but since almost all tax planning takes place at the boundaries between different parts of the tax system a reduction in their number would undoubtedly reduce the opportunity for abuse. It should be noted that greater activity on the part of HMRC would also help, as is noted in the answer to question 11.

8. What are the areas for simplification?

In 2018/19 tax year there were tax reliefs of £425 billion in total granted in the UK over a range of taxes, as noted below. This figure does include items like the income tax personal allowance, basic exemptions from national insurance contributions and VAT allowances, but the point to be made is that all these allowances massively reduce the potential tax yield from every UK tax, as the following table shows:

Tax revenues for 2018 – 19 tax year taking the cost of tax reliefs and allowances into account

Tax	Gross notional tax revenues when the cost of tax reliefs and allowances is taken into account	Cost of tax reliefs and allowances	Net tax receipts reported by the Office for Budget Responsibility
	£'bn	£'bn	£'bn
Income tax	336	151	185
National insurance contributions	221	87	134
Excise duties	49	0	49
Corporation tax	84	29	55
VAT	244	99	145
Business rates	30	0	30
Council tax	34	0	34
Other taxes	145	59	86
Other non-taxes	51	0	51
Total	1,194	425	769

Sources: Author calculations based on HM Treasury (2018)[25]and HMRC (2019)[26]

If consideration is to be given to tax simplification then the place to start is by reviewing these tax reliefs, exemptions and allowances. In particular, the interaction between these allowances and reliefs and the objectives of fiscal policy, tackling inequality and repricing market failure all need to be considered.

In this context the adoption of an approach called tax spillover analysis has much to recommend it. It is appropriate to note that this methodology has largely been pioneered Professor Andrew Baker of the University of Sheffield[27] and me. A note on this approach is attached as an appendix to this submission.

[25] HM Treasury (2018) The Budget 2018, London: HM Treasury

[26] HM Revenue and Customs (2019) Estimated Cost of Principal Tax Reliefs (January 2019), London: HMRC

[27] See Baker, A. and Murphy, R. 2019. The Political Economy of 'Tax Spillover': A New Multilateral Framework https://onlinelibrary.wiley.com/doi/abs/10.1111/1758-5899.12655

Tax spillovers as defined by the International Monetary Fund in 2014, were understood as the effects one country's tax rules and practices had on others. They were thought to be caused by and confined to reductions in corporation tax, primarily arising between different countries. My research with Andrew Baker showed that spillovers, consisting of tax policies and practices that do harm to, or undermine tax bases and the functioning of tax systems overall (often unintentionally), were a much broader and diverse phenomenon than had been previously thought. The work showed how harmful spillover effects went beyond corporation tax and could arise from the interactions between different areas of tax policy and administration within the same country, and so could be domestic as well as international. The framework that we have created for qualitatively assessing a country's overall tax spillovers, that both diagnoses existing spillovers and identifies potential policy remedies and reforms, is designed as a mechanism to make tax systems less internally inconsistent and to secure tax bases. That is why it would be appropriate for the UK to undertake such an exercise now.

There are a number of reasons for governments and their agencies to assess spillovers in this way. Firstly, they might be seeking to raise additional tax revenue without increasing tax rates, or extending the tax base. Second, they may be seeking to uphold the rule of law. Third, they may be trying to improve fiscal management of the economy. Fourth, they may be seeking to ensure that the incentives and other arrangements to encourage particular behaviours built into the tax system work to best effect. Fifth, they might be seeking to promote economic and social justice by making sure that everyone pays their share of the taxes owing, creating a level-playing field. Sixth, governments may be concerned about the investment they are making in tax authorities and wondering whether those funds are being used to best effect. Finally, they may be concerned about their international tax relations and the way international tax competition might erode their tax base and limit their fiscal autonomy. In short, spillover assessment can present an overall picture of how taxes and their administration interact with other parts of the tax system and with what consequences. We would be pleased to provide further evidence on this issue if you require it.

Based on a sample review of the UK tax system that we have undertaken using our tax spillover methodology[28] we noted the following:

a. Key findings

We have considered spillovers in three categories: domestic spillovers; international risks

[28] See https://onlinelibrary.wiley.com/action/downloadSupplement?doi=10.1111%2F1758-5899.12655&file=gpol12655-sup-0002-Appendix.docx

generated for other countries; and vulnerability to international spillovers. The assessment found that the UK creates significant spillover risks for its own tax base and the tax bases of other states, as well displaying some vulnerability to international spillovers, though some of these are self-inflicted.

- *The UK suffers from substantial domestic tax spillover effects. A balanced tax system would have a significant number of areas where such effects were not evident and where there would be evidence of areas of taxation reinforcing other areas of taxation. In practice there are no such areas of reinforcement within the UK domestic tax system. All domestic spillover risks were rated at least at 3 out of 5. Five is the highest risk rating awarded. 23% of risks were at level 3. 33% were at level 4 risk and 44% were at the highest level of risk. This suggests there is substantial room for reductions in harmful domestic spillovers.*

- *A review of international risks generated by the UK suggests it aggressively pursues international tax competition, symptomatic of a stated intent to reduce corporation tax to the lowest level in the G20 and a political discourse that lauds tax competition.*

- *The UK has some vulnerability to international spillover effects though most of this vulnerability is self-inflicted, and results from difficulty in recovering the tax owed to it by multinational companies. The UK's reluctance to embrace alternative bases for the assessment of corporation tax, such as the European Union Common Consolidated Corporate Tax Base, contributes to this, as does its continued acceptance and facilitation of a number of tax havens in its Crown Dependencies, and overseas territories*

b. Primary domestic spillovers

- *The UK income tax base is undermined by excessive complexity resulting from the provision of many exemptions, allowances and reliefs, and by providing favour to income earned from wealth rather than from work, all which incentivise the under reporting of income.*

- *The UK corporation tax system undermines income tax by offering lower tax rates across all income ranges and provides a considerable incentive to incorporate.*

- *The UK corporation tax system undermines the effectiveness of both the income tax and corporation tax system because HM Revenue & Customs, does not automatically require the submission of a corporation tax return by companies. As many as 600,000 companies a year may be exempted from doing so as a consequence, whilst a further 400,000 regularly fail to submit corporation tax returns that they are requested to supply, with few penalties being effectively imposed as a result.*

- *The corporation tax base is undermined by UK company law that does not usually hold directors and principle shareholders of companies liable for the tax debts of a company following insolvency. Corporation tax (and other taxes) owing can be evaded by directors who deliberately use the shield of limited liability to prevent settlement.*

- *UK corporation tax is undermined by the continuing failure to develop effective mechanisms for taxing digital companies.*

- *The UK capital gains tax system potentially undermines other parts of the UK tax base because it provides considerable incentive for income to be re-categorised as capital gains largely because of the disparity in rates.*

- *The capital gains tax base is undermined because many asset sales are not subject to automatic information exchange from those who manage them on behalf of vendors, resulting in widespread under declaration.*

- *The UK capital gains tax system is undermined by generous capital gains allowances within UK corporation tax that mean most merger and acquisition activity within such companies is exempt from a UK capital gains charge.*

- *The social security system inflates the reporting of self-employment by offering lower rates to those who declare themselves to be self-employed.*

- *Tax administration has been undermined by UK cuts in real expenditure on its tax authority in the past decade. Tax office closures are reducing advice on and monitoring of correct tax returns.*

- *The UK's income tax and participation in international agreements are both undermined its continued facilitation of secrecy jurisdictions. These locations do not as yet undertake effective automatic information exchange with the United Kingdom because of the limited extent to which they collect information.*

- *The UK's company and trust administration undermines its corporation tax base because there is no requirement for the disclosure of the beneficial ownership of companies incorporated with the company registrar, meaning that there is no proof of identity of ownership for a very large number of companies, resulting in money laundering and tax evasion risks. Furthermore, the disclosure required of most UK Ltd companies on public record is very limited. No information with regard to profit or tax paid is disclosed. The opportunity for error or nondisclosure to be drawn to the attention of the tax authority by members the public is limited.*

- *Lax UK company administration undermines the tax base generally because*

approximately 400,000 companies a year do not file the information required of them by the UK Registrar of Companies. Very few prosecutions arise.

- *Whilst the UK does undertake an annual tax gap appraisal this is limited in scope and has largely been used to justify the success of the tax authority within budgetary constraints, rather than targeting resources to deliver a more effective tax system.*

c. *Primary international spillover risks generated by the UK*

- *The UK's company and trust administration regime poses significant threats to a number of elements of the tax systems of other countries because it often fails to: identify the beneficial owners of companies; rigorously enforce the delivery of accounting data; require adequate disclosure of company trading data.*

- *As a consequence, the UK is very unlikely to be able to supply the data other countries require of it under automatic information exchange arrangements.*

- *The UK's domicile rule undermines the income and corporation tax base of other countries by making the UK an attractive haven for wealthy people.*

- *The UK's continued support for a number of secrecy jurisdiction undermines automatic information exchange and the income and corporation tax bases of other countries by creating incentives to relocate for tax purposes.*

- *Competitive cutting of corporation tax to the lowest in the G20, together with the favouring of territorial taxation, patent box arrangements, limited close company rules, relaxed controlled foreign company rules, and special arrangements for treasury functions located in tax havens, all pose significant threats to the tax bases of other countries.*

- *The UK undermines the integrity of international agreements in all countries. While it has adopted country-by-country reporting it is reticent to support the publication of this data, hindering the effectiveness of the appraisal of tax paid by UK multinational companies around the world.*

- *The UK undermines corporation and income tax bases in other countries to a significant extent because it does not require the submission of corporation tax returns from companies incorporated in the UK but then claim they trade solely outside of the UK. This produces an administrative blind spot that creates potential information shortfalls for tax authorities in other countries, as to what income or corporation tax maybe owing to them from these companies.*

d. Primary UK vulnerabilities to international spillovers

- *The UK's corporation tax base is undermined by the difficulty it has in recovering tax owed to it by multinational companies, mainly owing to reluctance to consider alternative bases for the assessment of corporation tax, such as that proposed in the European Union Common Consolidated Corporate Tax Base.*

- *UK corporation and income tax bases are undermined by the company and trust regimes of many tax havens and secrecy jurisdictions, because it remains very difficult to ascertain with any degree of confidence the ownership of many company and trust arrangements in such places.*

- *The UK's company and trust administration arrangements are undermined by the company and trust arrangements of tax havens, because their very existence make effective reform of the UK's own company and trust arrangements more difficult.*

- *The UK's tax system as a whole is undermined by inadequate application of international agreements, especially automatic information exchange (AIE), including the inability and failure of many jurisdictions to supply information required under this arrangement.*

- *The tax politics of many tax havens, including those for which the UK is responsible, also spillover to undermine the tax politics of the UK. This leads to political assertions that the UK cannot raise its own standards, because it would lead to a loss of the tax base to those tax haven locations.*

e. Key recommendations

1) *Given their role in undermining the income tax base in particular, all allowances and reliefs offered should be systematically evaluated to determine: their cost; their economic effectiveness; the benefits arising from continuing to offer them; any impact of their withdrawal. Where a benefit cannot be established, a plan for the removal of tax reliefs should be considered.*

2) *Domestic spillovers could be reduced by introducing greater equality of the treatment of income from earned and unearned sources, including introducing additional income tax charges to compensate for the absence of social security charges on investment income.*

3) *Given its distortionary effects in generating considerable domestic and international spillovers, the UK should consider abolishing its domicile rule for all taxation purposes.*

4) *The UK's minimum corporation tax rate should be moved closer to U.K.'s basic rate of income tax as the current discrepancy places the income tax base under strain, and could be raised further to reflect the benefits to those who use limited liability, as well as to fulfil its defensive social purpose.*

5) *To reduce the international spillovers it generates, the UK should consider reforming those elements of its corporate tax regime designed to artificially induce the relocation of profits, which generate significant spillover threats for other countries. This could include: raising the rate of corporation tax; and overhauling its lax controlled foreign company rules, its treasury company regime and its patent box arrangements.*

6) *Due to its generosity, the UK's capital gains regime for companies involved in mergers and acquisition arrangements, potentially undermine the capital gains tax base and pose some threats to other countries tax bases, and should therefore be reviewed.*

7) *To prevent the potential undermining of the corporation tax base, the UK should require every UK registered company to file a corporation tax return annually.*

8) *To enable the relevant jurisdictions to collect tax owing, the UK should consider removing the exception from filing a corporation tax return provided to companies who claim to trade only outside the UK. This would also enable the UK to better comply with its obligations under automatic information exchange agreements (AIE).*

9) *Capital gains tax can pose threats to other tax bases that could be reduced if: the annual allowance for capital gains tax was reduced in value; and the exemption for the sale of domestic residences, whether owner-occupied or let, were reviewed.*

10) *To enable income arising from investment sources for taxation purposes to be better identified automatic information exchange should be introduced to the handling of the sale of assets, and applied to lawyers, estate agents, financial advisers, banks and others dealing in shares and securities.*

11) *To prevent administrative laxity posing spillover threats domestically and internationally the culture and objectives of the UK's tax authority should be assessed in terms of: the current focus on cost minimization; the ability to provide equivalent services to all taxpayers; perceived favourable arrangements to large companies; adequate stakeholders representation in management and decision making structures; potential for improved tax gap measurement; increased resources in funding, staffing and training.*

12) *To prevent tax administration undermining international agreements (AIE) and corporation tax bases, the UK Registrar of Companies should not be permitted to strike companies from the register when they fail to file documentation, but should instead be legally obliged to pursue that information from persons responsible for its delivery.*

13) *The UK should commit to securing all the information necessary to fulfil its obligations under international tax agreements and should also require that all crown dependencies and overseas territories follow similar steps to become tax transparent.*

9. Is there a role for windfall taxes in the post coronavirus world?

The only reason why a windfall tax might be proposed at present is to repay the national debt.

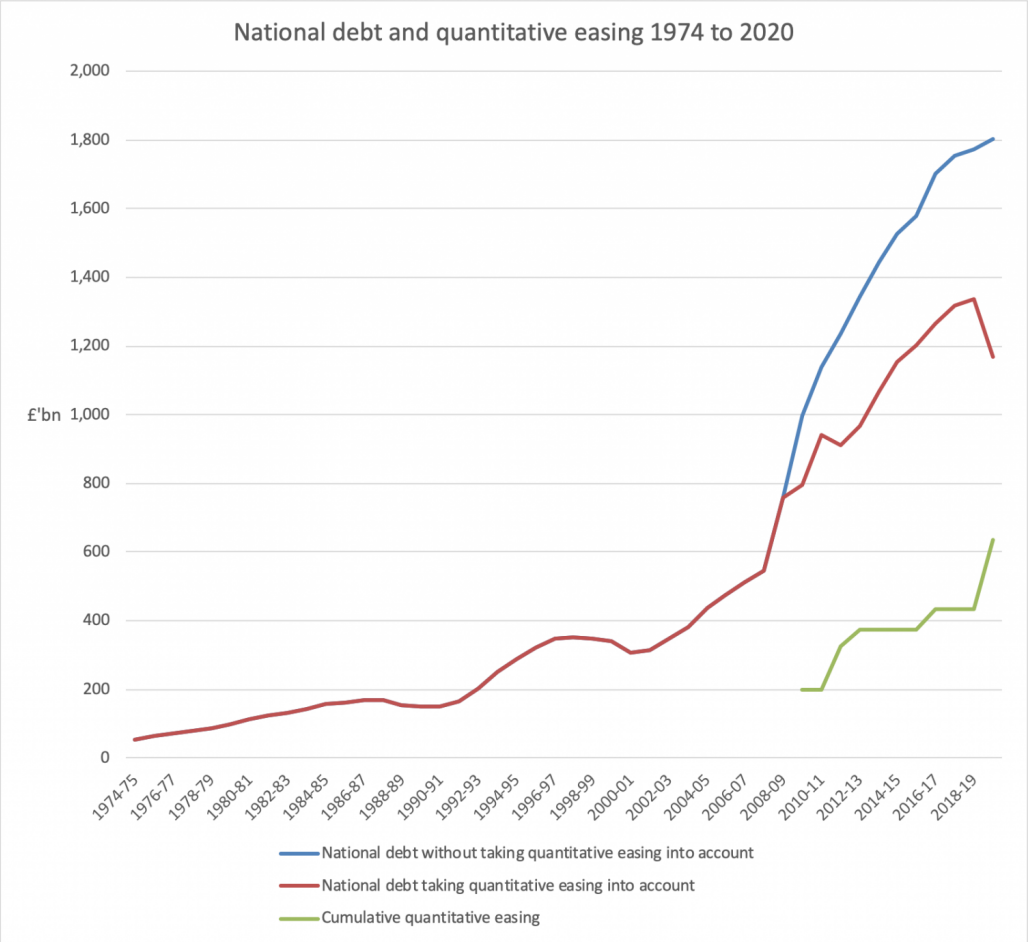
As was noted by the Chancellor of the Exchequer[29] in a reply to his predecessor in parliament on 8 July 2020:

> *Sajid Javid (Bromsgrove) (Con)*
> *I commend my right hon. Friend's statement and the actions he has taken to ensure that we get the strongest possible recovery. He has been absolutely right thus far to spend "whatever it takes"—something he set out clearly back in March—but he will be acutely aware that interest rates will not stay low forever and that we will eventually need to bring our national debt back under control in order to sustain recovery, continue to create jobs and keep taxes low. So may I encourage him to set out new fiscal rules in his autumn Budget with the aim of getting our national debt down as a proportion of our national income by the end of this Parliament.*
>
> *Rishi Sunak*
> *I thank my right hon. Friend for his kind support and also his advice. He is of course absolutely right, and I hope that he was heartened by what he heard me say in the statement about the importance of returning our public finances to a sustainable footing in the medium term. We can and will do exactly that. He is right to highlight the sensitivity of our debt to interest rates, which was why he was right to introduce into our fiscal framework the notion of an interest service rule, and that is something that I will look at keenly in the coming months.*

[29] https://hansard.parliament.uk/commons/2020-07-08/debates/BE9ECA8F-A74C-4431-88C7-3CE4E524DA7E/EconomicUpdate

The logic of this exchange is inherent in the calls for a windfall tax: its only aim would be to reduce the level of the so-called UK national debt, which might be better called UK national savings for the reasons noted in answer to question 1. However, this is unnecessary because there is no need to repay UK national debt, which has steadily increased since 1694. In addition, as latest budget forecasts show[30] the anticipated cost of servicing this debt is also falling over the next few years, even as it notionally increases in value.

In addition, that debt is currently misstated by UK official statistics, including those issued by the Office for National Statistics. That is because, as the UK Whole of Government Accounts show[31], UK government debt should be stated net of quantitative easing. If this is the case the pattern of UK national debt growth is as follows, based on Office for Budget Responsibility data:



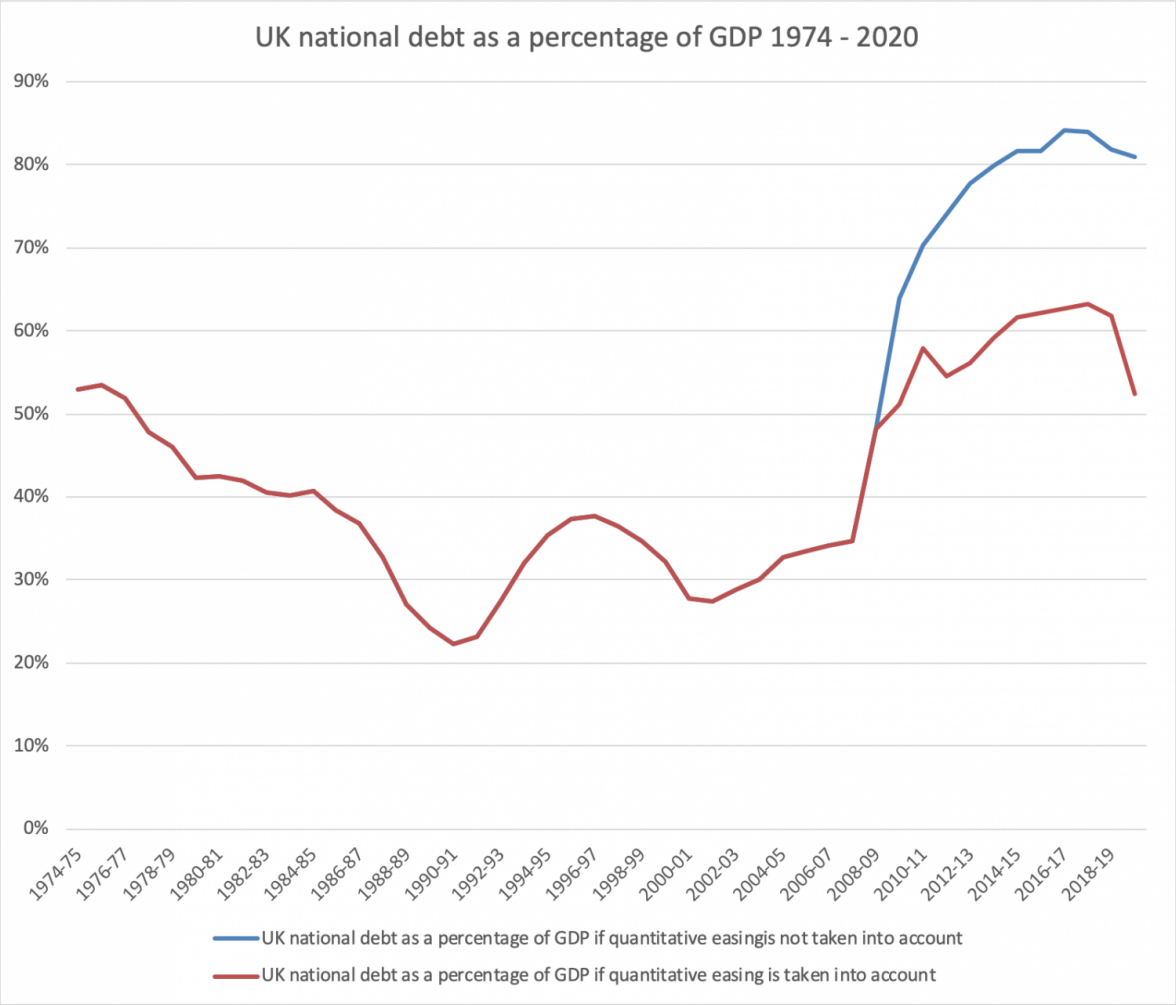
The data reflects quantitative easing until March 2020. UK national debt is not now around £2 trillion as a result, but something like £1.4 trillion (precise current estimates

[30] The Office for Budget Responsibility, March 2020

[31] https://www.gov.uk/government/publications/whole-of-government-accounts-2017-to-2018 note 20

are hard to establish at present, and whilst gross debt might now have increased by £200 trillion a further £100bn or more of quantitative easing has also happened, bringing the total gilts in government ownership to £735 billion).

As a percentage of GDP this had the following effect:



As will be, noted once quantitative easing is allowed for UK national debt is not at exceptional levels.

The UK has never repaid any part of its quantitative easing programme and there is no obligation, legal or otherwise, for it to do so. Nor is there any prospect at present of there being suitable market conditions for such reversal to take place when new government bond issues are likely to absorb the markets capacity for bond acquisitions. As a result, it is reasonable to presume that existing gilts subject to quantitative easing have been monetised, whatever the official pronouncements on this issue.

In this circumstance, there is, first of all, nothing particularly abnormal about the current financing arrangements of the government: current net debt to GDP ratios are well within normal boundaries whilst, secondly, because of likely continuing quantitative easing they will remain so. There is, then, no reason for a windfall tax.

There is another dimension to this issue. This is that to find a suitable base for a significant windfall tax would be hard. According to the Office for National Statistics UK wealth is currently as follows:

	£ billion		
	July 2012 to June 2014	July 2014 to June 2016	Percentage Change
Property Wealth (net)	3,806	4,516	19
Financial Wealth (net)	1,564	1,630	4
Physical Wealth	1,130	1,230	9
Private Pension Wealth	4,385	5,354	22
Total Wealth (including Private Pension Wealth)	10,886	12,730	17
Total Wealth (excluding Private Pension Wealth)	6,500	7,376	13

A number of issues are immediately apparent:

- Most property wealth is homes. This does not provide a cash base for imposing a tax charge;
- Pensions are tax incentivised and so will be hard to tax.
- £700 billion of net financial wealth is ISAs and so tax incentivised, and so will be hard to subject to a wealth tax;
- Physical wealth is as much cars and furniture as anything else - and is very hard to value as a tax base;
- There is then, at most, £900bn of available tax base.

When most discussion of windfall taxes refer to rates of tax in low percentage rate terms the capacity for a windfall tax in the UK is, in that case, very limited.

10. What is the right balance between taxation of work, savings/pensions and wealth?

As noted in the answer to question 4, there is substantial evidence that income from wealth is substantially under-taxed in the UK. There are a number of reasons for this:

- Lower tax rates are offered on savings income of various sorts, including dividends (although in this last case the differential has been reduced);

- Lower tax rates are offered on capital gains and significant additional allowances are available for offset against this source of income;
- Income that can be reallocated to a company tends to enjoy lower tax rates than would be charged if liability was assessed upon the directors / shareholders of the company in question;
- The incorporation of a trade of a sole trader or partnership usually permits the avoidance of National Insurance liabilities that would otherwise be due;
- There are substantial tax reliefs and allowances that are only available to the wealthy, many of which increase inequality in the UK, whether inadvertently or otherwise.

Examples of tax reliefs and allowances that achieve the last noted increase in inequality include:

- The cap on National Insurance contributions that reduces liability on earned income above approximately £50,000 per annum;
- The very generous pension tax relief is that still remain available to many higher rate taxpayers, meaning that contributions that many such taxpayers may attract relief at double the rate available to those persons who pay basic rate income tax;
- Similarly generous reliefs to higher-rate taxpayers for some other tax-deductible expenses e.g. contributions to charitable causes;
- Generous tax exemption schemes for those with wealth e.g. ISA reliefs of £20,000 a year which have never been capped to an overall limit, meaning that there are now ISA millionaires, which means that the tax system inevitably fuels greater inequality in the UK;
- Incentives, allowances and reliefs within capital gains tax which tend to encourage the concentration of wealth e.g. the remaining Entrepreneur's Relief, EIS relief and generous reliefs for let property as well as a blanket exemption for gains arising on a person's primary residence, whatever its value, which inevitably biases that particular relief in favour of those who can afford expensive property;
- Business property and agricultural property reliefs within inheritance tax, the case which has not been clearly made;
- Generous exemptions within Value Added Tax which tend to have a bias towards those with higher incomes e.g. exemptions for private school fees, private healthcare costs and the acquisition of second properties and rental properties, as well as the blanket exemption on VAT charges for financial services, most of which are consumed by those already wealthy, which exemptions tend to make an already unfair tax much more regressive;
- Caps on council tax charges, which tend to make this tax deeply regressive, particularly with regard to those on the lowest incomes.

Other examples can be supplied. The combined consequence of these reduced rates and generous allowances and reliefs is the substantial under-taxation of income from wealth noted in the answer to question 4.

It is not possible to be comprehensive with regard to the ways in which these issues can be addressed, because substantial reform is required if the UK tax system is to become both progressive, and a mechanism for addressing the substantial, and growing, inequality within the UK is to be created, but the following suggestions for reform are now made:

1. The cap on national insurance contributions should be removed;
2. Income on all sources, with earned, or unearned, should be subject to exactly similar rates of income tax so that there is no bias against earned income;
3. Capital gains tax should be charged at income tax rates;
4. The annual allowance for capital gains tax purposes should be significantly reduced;
5. Close company provisions should be re-introduced into commonplace tax practice so that profits retained, and not distributed, within closely held limited companies that cannot be justified for commercial purposes should be apportioned to the membership and be subject to tax of income tax rates to prevent tax abuse;
6. The UK corporation tax rate should be aligned to that of the average within the OECD, implying a rate of at least 25% at present, applicable to all small companies (to reflect the advantages that limited liability provides) with a higher rate being due by large companies, with a rate of 30% being suggested;
7. An investment income surcharge of 15% should be introduced on all investment income received by a UK resident person in excess of £5,000 per annum, excluding pensioners, where a higher sum should be permitted, with that charge representing a contribution equivalent to national insurance due on earned income;
8. A capital gains tax charge on the last disposal of a residential property by a person during the course of their lifetime (having made due allowance for surviving spouses and civil partners) should be introduced, with the charge being due whenever reinvestment in a replacement principal private residence does not take place within 12 months of a disposal occurring;
9. Inheritance tax should be replaced by a gift receipts tax;
10. Higher rates of council tax should be charged to make this a truly progressive tax, with the tax rates due on lower value properties being reduced to compensate;
11. Tax avoidance should be tackled through a general anti-avoidance principle that would replace the existing and inadequate general anti-abuse rule;
12. A wealth tax should be considered.

Unless issues such as these are considered there will be an inappropriate balance between taxation of work, savings/pensions and wealth in the UK.

11. What is the best way to tackle tax reform, including what changes might be needed at HMRC to support implementation, and how should the Government consult with stakeholders and parliament?

There are a number of critical factors that must be addressed if there is to be effective tax reform in the UK. A number of these issues were addressed in my book 'The Joy of Tax' published in 2015 and little has changed since then. This section does, therefore, draw on the recommendations in that book.

a. Understanding the role of tax in the economy

As noted in the answer to question 1 of this submission, the role of tax within the economy is widely misunderstood when there is a fiat economy in use in a society which has its own central bank and currency, as is the case in the UK. In such an economy tax does not fund government spending which can be, and always is, funded by central bank borrowing in the first instance. Tax is in that case not a funding mechanism but is instead primarily a mechanism used to control inflation with the overall scope of the fiscal policy of a government, but which has an important (but secondary) role of assisting delivery of the government's social, economic and fiscal policies.

b. Appropriate goals must be set for the tax system

If the proper role of tax within the economy is understood, as noted previously and in question 1, then the significance of tax within the delivery of the social, economic and fiscal goals of the government has also to be understood. This then requires that the government create policy for the overall tax system, functioning as a whole and not within its individual parts, to achieve these objectives. These policy goals should be published, with performance criteria being established for each. It does, of course, follow that reporting against these criteria would be essential. In this way the importance of tax as something of much greater significance than a money raising mechanism would be emphasised.

c. The importance of political support for the tax system, both domestically and internationally, has to be constantly reiterated

The UK is an aggressive proponent of international tax competition. This is evidenced by its continuing support for its tax havens; the continued existence of the domicile rule; its aggressive stance on corporate tax rates; its opposition to international corporate tax

reform; its objection to enhanced tax transparency in the form of public country by-country reporting and its willingness to support the tax aggressiveness of the City of London's financial services sector. These measures all undermine the effectiveness of international tax cooperation.

As importantly, these measures when coupled with numerous UK measures that imply that paying tax is not a socially necessary requirement (for example, the promotion of tax free savings accounts, as if tax paying is a socially undesirable activity) suggest a lack of political support for the UK tax system. The failing has been consistent across party politics. This has a significant spillover impact (see also the answer to question 8). If it is believed that tax paying might be optional then the likelihood of tax compliance is reduced. As it is, HMRC consistently estimate[32] that at least 40% of self-employed taxpayers under-report their income and it is quite likely that other sources of income and gain that might only be known to HMRC on the basis of a voluntary disclosure might be similarly under-declared.

This situation is only likely to change when there is a significant change in attitude towards tax payment in the rhetoric and actions of UK politicians within and outside parliament.

d. The funding for HMRC has consistently fallen in real terms for a period of more than a decade, as has the number of staff it has employed. This needs to be reversed.

The policy of cost reduction has been pursued by the senior management of HMRC, who have consciously modelled its management priorities on those of a corporate entity. This has resulted in a policy of cutting costs in pursuit of apparent microeconomic productivity gains without consideration of the macroeconomic consequences. This has been a mistaken management policy that needs reform.

One consequence of this policy is that many aspects of HMRC's work are now considerably under-resourced. For example, the number of tax compliance investigations has fallen by at least 25% in the last four years whilst tax compliance visits from HMRC officers to inspect the books and records of VAT registered traders, which were at one time one of the most effective enforcement measures that existed, have now all but ceased due to a lack of resources, and the physical distance that now exists between tax offices and taxpayers that make such visits logistically difficult.

[32] https://www.gov.uk/government/statistics/measuring-tax-gaps

It is essential that HMRC be provided with the resources it needs to increase its compliance activities. This will increase tax revenues and, as a consequence, tax morale amongst those who wish to be compliant and who feel at present that their efforts are undermined by those who cheat. It is generally accepted that the revenue yield on every £1 spent on tax compliance by HMRC is between seven and ten times that cost, and in that situation cuts in spending have been a false economy.

e. HMRC's tax reporting has to improve

Recent research undertaken by me in association with Prof Andrew Baker of the University of Sheffield for the World Bank and International Monetary Fund funded Global Initiative for Financial Transparency, based in Washington DC, suggests that the standard of tax reporting by HMRC (and HM Treasury as well as the Office for Budget Responsibility) is inadequate and does not encourage proper scrutiny of tax within the UK. In particular:

- The budget set for each tax for each year does not specify:
    - The anticipated number of taxpayers;
    - The tax rate, split by bands, which it is anticipated will be paid by taxpayers;
    - The value of tax allowances and reliefs which will be offset against potential tax revenues in each year, specified by the number of taxpayers claiming each relief, the tax rate at which they will be claiming each individual relief, and the anticipated cost split by tax rate for each material tax relief, exemption or allowance when materiality is set within the context of the tax itself and with any relief costing more than £200 million per annum being considered material;
    - A budget is not set for the tax gap, either in total or by component element, giving no indication as a result how this issue is to be managed;
- The budget does specify anticipated yields by tax, but it is hard to compare outcomes with expectations, not least because different government sources frequently quote different sums for actual taxes collected, both by tax and in total, for each year;
- Annual reporting of the costs of exemptions, allowances and reliefs does not take place and nor is comparison with the budget made and as such there is no indication given that these costs are under control or even subject to review;
- HMRC does not specify a budgeted cost for its activities by tax for each year, and as such it is hard to work out whether its resources are effectively allocated;
- The annually published tax gap is published on a 'bottom up' and not 'top down' basis in the main, making it unsuitable for the appraisal of tax within its social,

economic and fiscal roles and implying that HMRC does not take these issues into consideration in the management of the UK tax system.

f. The management culture of HMRC might need to change

Tax reform necessarily requires the approval of Parliament, but also requires broad-based consent if it is to be accepted by society at large.

This will involve consultation processes. However, it is likely that such processes will be insufficient if, as is currently the case, those appraising the resulting opinions offered do not reflect a broad base of opinion within society at large.

The current board of HMRC is basically made up of civil servants (by no means all of whom have tax expertise) and representatives of large business. There is, at present, no representative of those employed by HMRC on its board. Nor are employees more generally, the self-employed, small incorporated businesses, pensioners, charities, those claiming benefits, retailers who operate VAT, or other relevant interest groups within society represented on the board of HMRC, meaning that its membership is not a fair representation of taxpayers at this point in time.

If HMRC is to reflect the taxpaying community, as it should, then its currently constituted board is not fit for purpose. Nor does that board provide the skill set required to consider tax within the context of its macroeconomic, social, fiscal and microeconomic policy objectives. This is a major weakness in the current structure of HMRC and is an impediment to tax reform.

Appendix 1

Tax spillover methodology

Based on the work of Prof Andrew Baker of The University of Sheffield and Prof Richard Murphy, then of City, University of London

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Our qualitative evaluation framework seeks to assesses the relationship between four direct taxes within and between tax jurisdictions to a get broader sense of the risks and vulnerabilities particular regimes generate and face in their entirety. These are: personal income tax (PIT); corporate income tax (CIT); capital gains tax (CGT); and social security contributions (national insurance) (SCR). Value added tax (VAT) and excise duties are both indirect taxes and not the subject of overt tax competition, so are not considered here. We also assess four endogenous features of tax systems: tax politics; tax administration; company and trust administration; and international agreements.

The qualitative evaluation framework we have developed is a toolkit for conducting spillover assessments. Assessors do this by answering a series of questions about how tax policies and practices in the jurisdiction concerned have implications for other areas. In every case they do so normatively, making just one simple assumption, which is that no part of the tax system should undermine another part of that system, or of another tax system.

To help in this exercise we have created an extensive questionnaire for each area of concern, which indicates the areas and issues that should be considered in informing the allocation of scores on a 1 to 5 scale. In reaching judgements, professional assessors can cross reference a range of information sources, - interviews with stakeholders, the administration of questionnaires, analysis of legal documentation and legislation, available and applicable quantitative data, to create a picture of behaviours and processes. Written notes talking back to the questionnaire can detail the information used to answer questions and inform scores, creating the basis for a longer discursive qualitative report within a common structured framework, that sets out spillover risks and vulnerabilities in each jurisdiction. It is this longer qualitative report that we present here for the UK as a prototype country level spillover evaluation.

Figure 1

Country X	Issue impacting upon										
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax competition	Tax Politics	Company and trust administration	International agreements	Total	Sub totals
Issue being considered	Income tax										
	Corporation tax										
	Capital gain tax										
	Social security										
	Tax Politics										
	Tax administration										
	Company and trust administration										
	International agreements										
	Total										

Assessors complete three appraisal grids that each resemble figure 1, and for each square on the grid the assessor awards a grade on a 1 to 5 scale. For the domestic grid (which is that which is primarily of concern in this submission) they begin in the top left corner, working across horizontally to consider how the tax or policy area listed in the rows, starting with income tax (top of y axis), is impacted upon by the areas listed in the columns (x axis). For example, for the second box on the first row, the assessor asks 'is this country's income tax base undermined by its corporation tax system?' If they think it does then the score is either 5 or 4, depending upon the severity of that threat. Alternatively, if they think that corporation tax reinforces the income tax base, then the appropriate score is 1 or 2. Where there is no impact either way the score is 3. A domestic spillover assessment provides a reading of the degree to which a tax system is balanced, asking whether different elements support, or undermine each other.

For the international risk grid, the assessor evaluates the potential risks the issue being considered - (rows on the y axis,) generate for the various taxes and policy areas of other countries listed in the columns (on the x axis). This reverses the pattern of asking how the policy area (rows on the y axis) under consideration is affected by areas in the columns, as in the case of the domestic and international vulnerabilities grids. The rows effectively act as the dependent variable in domestic and international vulnerability grids, but become the independent variable on the international risk grid. These different forms of assessment are necessary because states can be both aggressors and generators of risk, but also vulnerable to spillover risk, to varying degrees. The framework provides a comprehensive reading of the diverse elements of spillover as a multi-faceted and multi-directional phenomenon.

The following five-point scale is used for both the domestic spillover and international vulnerability grid, with a score of 5 indicating the highest risk/ vulnerability and threat of a harmful spillover effect.

5.The tax base or policy area being considered is heavily undermined by and vulnerable to the area it is being compared with.
4. The tax base or policy area being considered is to some extent undermined by and vulnerable to the area it is being compared with
3. The tax base or policy area being considered is neither undermined nor reinforced by the area it is being compared with and has limited vulnerability
2. The tax base or policy area being considered is to some extent reinforced by the area it is being compared, and has little vulnerability
1. The tax base or policy area being considered is significantly reinforced by the area it is being compared with and is secure.

For international risks generated the following scoring system is used.

5. The area being considered undermines this element of the tax system in other countries to a considerable extent.
4. Some features of the area being considered undermine elements of this aspect of the tax system of other countries to some extent.
3. Some features of the area being considered can have detrimental effects on this area of the tax system in other countries, but this is limited.
2. The area being considered has limited impact on this element of the tax system in other countries, with few signs of harm.
1. The area being considered poses no threats or risks to this element of the tax system in other countries.

For all of the grids, higher scores are generally indicative of poor performance, - either high degree of vulnerability to harmful spillover risk, or the aggressive generation of spillover risks for others.