# The Taxing Wealth Report 2024

Every politician's guide to "How to pay for it"[1]

## Value added tax reform:

## Abolishing VAT exemption for financial services


Brief summary

This note suggests that:

- Reform of the UK taxation system to ensure that those with the highest incomes and wealth pay their fair share of tax does not only require that direct taxes (income tax, national insurance, corporation tax, capital gains tax and even inheritance tax) be considered. It also requires that the role of indirect taxes (such as value added tax) in creating inequality as a consequence of their unreasonably subsidising the consumption of the wealthiest in society should also be taken into account.
- The VAT exemption that the financial services sector enjoys means that this tax is not charged on the supply of financial services to those who consume them in the UK.
- The UK Office for National Statistics estimates[2] that 48.6% of UK wealth is owned by the top 10% of wealth owners and 67.4% is owned by the top 20% per cent of wealth owners. In that case the benefit of this VAT exemption is going almost entirely to those in the higher echelons of wealth owners, and most likely of income earners.


[1] This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See https://www.financeforthefuture.com/taxing-wealth/. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future 2023.

[2] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020


The Taxing Wealth Report 2024 is a joint project between:

Finance for the Future and Sheffield University Management School

- In that case the withdrawal of this relief, which has been made possible by Brexit, should now take place.
- The withdrawal of this relief would, according to HM Revenue & Customs, result in an additional £16.3 billion of tax revenue being raised a year. Against this must be offset the tax lost from insurance premium tax if VAT was to be applied to that sector. This would amount to £7.6 billion, leaving a net sum of £8.7 billion of VAT to be recovered. That change with regard to insurance premium tax is likely to be neutral with regard to those on lower incomes.

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| The proposal | To abolish the VAT exemption on the supply of financial services that currently exists in the UK. |
| Reason for the proposal | 1. To increase the prospect of vertical equity[3] in UK taxation when the current exemption for VAT charges on financial services provides a benefit very largely enjoyed by the wealthiest in society.<br><br>2. To raise additional sums in additional tax revenues.<br><br>3. To reduce wealth inequality in the UK which this exemption increases. |
| Estimated tax that might be raised as a result of the recommendation made | There are unlikely to be many behavioural consequences to this recommendation. The business community might well welcome it. Most people will not be impacted. The cost of insurance premiums pre-VAT might well reduce, leaving overall premiums unaffected. Most people in the UK, excepting those with significant income and wealth, incur few costs of the type that this change would impact.<br><br>The current estimated cost of this tax relief is £16.3 billion per annum, but if the exemption on insurance was removed as a part of this recommendation insurance premium tax would have to be abolished, reducing the |

[3] Vertical tax equity requires that as a person's income increases the amount of tax paid on it will always increase irrespective of its source, with a progressive tax system resulting as a consequence.

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| | cost of the exemption to about £8.7 billion, which is the suggested sum that might be raised.<br><br>This tax should not impact the international status of the City of London as exports of financial services in the course of business should remain zero rated for VAT purposes. |
| Ease of implementation | Relatively straightforward. Most financial services business are already VAT registered with regard to some of their activities meaning that this change should not be difficult to implement. |
| Likely difficulties that might result from implementation | Few. |
| Likely time required to implement the change | At least two years notice might be required to make this change |
| Consultation period required. | A reasonable consultation period will be required. |

## Background

Value added tax (VAT) can be applied to a supply of goods and services in the UK in one of four different ways. Three involve a charge to VAT being added to the value of the supply made at differing rates[4]:

| Rate | Rate of tax charged | Impact |
|---|---|---|
| Standard rate | 20% | A VAT charge of 20% is added to the charge made for the supply of goods and services e.g., if the value of those goods and services is £100 then a VAT charge of £20 is added and the customer must pay £120 for their supply. |
| Reduced rate | 5% | A VAT charge of 5% is added to the charge made for the supply of goods and services e.g., if the |

[4] https://www.gov.uk/vat-rates

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| | | value of those goods and services is £100 then a VAT charge of £5 is added and the customer must pay £105 for their supply. |
| Zero rate | 0% | No VAT is added to the value of a supply, but it is deemed that it has been for the purposes of the administration of the tax. |

Unsurprisingly the standard rate of VAT is applied to most goods and services.

The reduced rate of VAT is applied to domestic energy supplies and some other supplies deemed essential e.g., sanitary products and children's car seats.

Zero rating applies to food, children's clothing and some other items, mainly related to charitable activities.

A VAT registered business (which is in broad terms one is one making VAT chargeable supplies of more than £85,000 a year) has to add these charges to the sums it bills its customers and pay over the sums collected to HM Revenue & Customs. It has some recompense for doing so: it is permitted to reclaim from HMRC the cost of VAT charged to it (which means that, in effect, zero rated businesses and their customers are in receipt of a tax subsidy).

The fourth category of charge that can apply to the goods and services that a business might supply to its customers is VAT exemption. When a business supplies VAT exempt goods and services than there is no VAT charged added to the charge that they make. Superficially this looks similar to supplying VAT zero rate goods and services. It does, however, differ because a business making VAT exempt supplies cannot reclaim the VAT charged to it in the course of its trade.

VAT exemption applies to a range of goods and services including:

- Land, although this is a complex area. Domestic rents are, for example, VAT exempt whereas commercial rents can be subject to VAT.
- Insurance. Almost all insurance transactions are exempt from VAT, but many are subject to Insurance Premium Tax instead.

- Postal services provided by the Royal Mail are VAT exempt, but other equivalent services are not.

- Education and training when provided by an eligible body like a school, college or university is VAT exempt, but most that is supplied by for profit organisations e.g., professional training courses, is not.

- Finance. Most supplies of financial services are exempt from VAT but those such as bookkeeping and accountancy, debt collection, management consultancy and some investment and almost all finance and taxation advice are usually not. Banking and pension services are the main beneficiaries of this exemption.

- Health and welfare. Healthcare is a complex area for VAT. Exempt supplies include those provided by a qualifying institution like a hospital, hospice or nursing home as well as health services provided by registered doctors, dentists, opticians, pharmacists and other health professionals.

- Investment gold is exempt from VAT.

- Some sports activities are exempt, but like education this exemption largely applies to sport and related education services supplied by certain eligible bodies.

- Gaming, including betting and gaming, bingo, and lotteries are normally exempt from VAT, although the rules are complex.

- Culture. Some admission charges to public and other bodies are exempt subject to specific conditions.

- Qualifying events held by charities are VAT exempt.

- Funerals are VAT exempt, as are a range of other items of less significance.

## Recommendation

It is recommended that the VAT exemption from the supply of financial services be removed.

This recommendation would not have been possible if the UK was still in the European Union, but it has left and since no major political party is recommending a return at present changes in VAT exemption rules can now be made by the UK.

In 2023 HM Revenue & Customs estimated[5] that the cost of the VAT exemption made available to the financial services industry was £16.3 billion a year. Against this must be offset the tax lost from insurance premium tax if VAT was to be applied to that sector. This would amount to £7.6 billion[6], leaving a net sum of £8.7 billion of VAT to be recovered.

The reason for making this recommendation is that the charges to which this exemption apply relate to the management of wealth and the vast majority of UK wealth is held by a very few people. The UK Office for National Statistics estimates[7] that 48.6% of UK wealth is owned by the top 10% of wealth owners and 67.4% is owned by the top 20% per cent of wealth owners. In that case the benefit of this VAT exemption is going almost entirely to those in the higher echelons of wealth owners, and most likely of income earners. This cannot be justified and as such the exemption should be withdrawn to increase vertical tax equity.

[5] https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/structural-tax-relief-statistics-january-2023

[6] https://obr.uk/economic-and-fiscal-outlooks/ accessed 26-7-23

[7] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020