The tax system

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The recession has hit Government's tax receipts severely, and major structural reform would be required to raise significant extra sums

The last three years have seen a strong decline in the Government's tax revenues: from £549bn in 2007/08 to £508bn in 2009/10. This has been a striking reversal of fortune for the public finances. In the 2007 Budget, the Government had projected that tax receipts would rise over the following three years – to reach an estimated £616bn by 2009/10. All told, the Government has received £164bn less than it had expected to get from taxpayers over this period.

The role of the financial crisis in this trend, through its impact on corporate profits, the property market and the availability of consumer credit, can be seen in the decline in receipts from three particular taxes (from 2007/08 to 2009/10):

- Corporation tax receipts have fallen from £46.9bn to £36.0bn
- Stamp duties receipts have fallen from £14.1bn to £7.7bn
- VAT receipts have fallen from £80.6bn to £70.0bn.

Although the total size of the tax take has shrunk, the overall balance between different taxes remains broadly unchanged. Income tax, national insurance contributions (NICs), VAT and corporation tax, remain way and above the largest slices in the UK's tax pie. Combined, these taxes account for two-thirds of expected revenue of £541 billion in 2010/11.

WHICH TAXES COULD BE RAISED?

Clearly this has implications for any decision to raise taxes to help restore the health of the public finances. Increases in the rates of these four taxes can raise quite a lot of money:

ESTIMATED DIRECT EFFECTS OF ILLUSTRATIVE TAX INCREASES IN 2011/12:

Income tax:

- 1p on basic rate: £4.75bn
- 1p on higher rate: £0.78bn

National Insurance:

- 1% pt on main employees rate: £3.6bn
- 1% pt on employers rate: £4.3bn

VAT:

- 1% pt on standard rate: £4.75bn

Corporation tax:

- 1% pt on main rate: £0.75bn

HM Revenue & Customs

By way of comparison, increasing the rates of duty on alcohol, tobacco and road fuel by one percentage point would raise only £0.36bn in total.

MEASURES ALREADY ANNOUNCED

The Labour Government had announced a number of measures to raise tax revenues from 2010-11:

- From April 2010 a new higher rate of income tax of 50% will be introduced on income over £150,000 [£1.47bn]
- From April 2010 the income tax personal allowance will be gradually withdrawn, for individuals with incomes above £100,000. The allowance will be reduced by £1 for every £2 above this income limit, until completely withdrawn [£3.05bn]
- From April 2011 the rates of NICs will be increased by 1 percentage point, for employees, employers and the self-employed – though the NI threshold for employees will be increased to mitigate the impact of this change on individuals with lower earnings [£2.91bn + £3.06bn]

Taken together it is estimated that, if implemented in full, these would have raised £10.49bn by 2011-12.

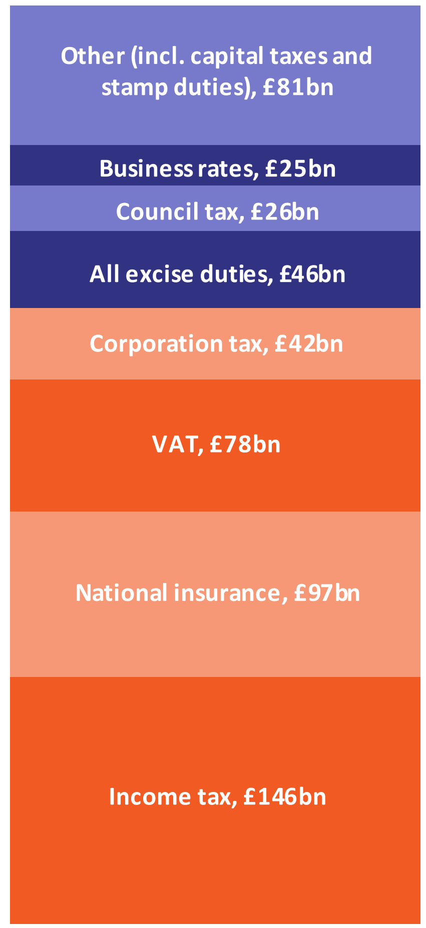
STRUCTURAL CHANGES

It seems likely that there would have to be structural changes in the tax system to raise significantly more money than this in future years, a point made by the Institute of Fiscal Studies (IFS) in their 2010 Green Budget. Some examples of this type of change are:

- Abolishing the zero and reduced rates of VAT which apply to selected goods and services (over £24bn)
- Applying capital gains tax to the sale of a person's principal private residence (around £3.7bn)
- Removing the lower rate of corporation tax which applies to small companies (around £3.2bn)

None of these quite radical options appeared in the election manifestos of the three major parties, but they illustrate the difficult choices before a new government tasked with restoring the health of the public finances.

Four taxes account for two-thirds of tax receipts
Tax revenue in 2010/11



HM Treasury