HOUSE OF COMMONS

Treasury Committee

Oral evidence: The UK's tax burden, HC 1165

Monday 28 February 2022

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Harriett Baldwin; Anthony Browne; Gareth Davies; Dame Angela Eagle; Emma Hardy; Kevin Hollinrake; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1-108

Witnesses

I: Rhiannon Kinghall Were, Head of Tax Policy, Macfarlanes LLP, Stuart Adam, Senior Research Economist, Institute for Fiscal Studies, Professor Stephen Millard, Deputy Director for Macroeconomic Policy, National Institute of Economic and Social Research, and Jon Richardson, Head of Tax Policy, PwC.

II: John O'Connell, Chief Executive, TaxPayers Alliance, Suren Thiru, Chief Economist, British Chambers of Commerce, and Alfie Stirling, Director of Research and Chief Economist, New Economics Foundation.

Examination of witnesses

Witnesses: Rhiannon Kinghall Were, Stuart Adam, Professor Stephen Millard and Jon Richardson.

Q1 **Chair:** Good afternoon and welcome to the Treasury Select Committee hearing on the UK's tax burden. We are very pleased to be joined by four witnesses this afternoon. I am going to ask them to very briefly introduce themselves to the Committee, and could I please start with Stuart, who is joining us remotely?

Stuart Adam: I am Stuart Adam, a senior economist at the Institute for Fiscal Studies. Apologies that I am having to join you remotely. As you will have gathered, I have come down with covid. I'm okay; the main symptom is that I'm coughing all the time, so I'll try to mute when I'm not talking.

Chair: Okay. We will battle through. We wish you well with that, and thank you for making the extra effort to be with us today.

Rhiannon Kinghall Were: I am Rhiannon Kinghall Were, head of tax policy at Macfarlanes.

Professor Millard: I am Stephen Millard, the deputy director for macroeconomic modelling and forecasting at the National Institute of Economic and Social Research. I am also a visiting professor at Durham University Business School.

Jon Richardson: I am Jon Richardson, head of tax policy at PwC. I have over 30 years' experience of advising companies on a range of tax affairs.

Q2 **Chair:** Well, we have the right people; that's good to know.

May I start with you, Stephen, and look at the macro question about tax? The Chancellor has set out his stall. He has said, "I'm having to raise taxes now, because we have gone through the pandemic etc., but my endeavour is to reduce them by the time of the next general election." Can you talk us through what is a very difficult question, because there's lots of uncertainty out there? How realistic, generally, do you think that is, and if he manages to pull it off to a significant degree, what will have happened and gone right in order for him to have achieved that?

Professor Millard: You are correct: that is a very difficult question. Before I answer it, I would like to take this opportunity publicly to express my sympathy for the people of Ukraine at the moment. It is a horrendous time for them.

To come to your question, it is a difficult one. Am I able to cut taxes at any particular point in time? I guess the answer to that depends really on what you think of as a sustainable fiscal position. One way of thinking about that is that I want to be in a position where, if things were to go very badly wrong—I were to have a covid shock or something similar—I would have the space to then be able to borrow and spend money, as indeed the Government did at the time of covid. Given that, what you would want to be doing, I think, is to steadily reduce the level of debt at times when you can. In line with that, the Government set their fiscal targets, if you like, last year and they said that by the end of the Parliament they wanted public sector net debt to be falling—on a sustainable downward path. At the time the OBR came up with their report in October 2021, this was actually the case: the Government was in a position where the net debt was coming down in 2024-25. Since then, the fiscal position has actually improved, so in a way there is even more scope, more room, to reduce—

Q3 **Chair:** We think it's in the order of £20-odd billion on the day-to-day spending target—is that right? It was £17 billion originally and it's a bit more on the latest figures we have had, so it's £25 billion or something.

Professor Millard: Exactly—something like that. So the room is there. The question then is: would you actually want to use that room to reduce taxes? There are reasons why you might not. The first is that, although the room is there, it wouldn't take much for the room suddenly to vanish. A rise in interest rates would see interest rates going up and slightly smaller than expected GDP growth over that period, and the wriggle room would be gone. Indeed, the £17.5 billion that was there in October represents only one sixth of the typical GDP forecast error over that period of time. You would not have to make that bad a mistake on GDP for the £17.5 billion just to vanish.

One more thing: even if the wriggle room is there—we are okay, we think it will still be there at the end of the Parliament—the question is whether we would wish to use that wriggle room to reduce taxes, rather than just to reduce the level of debt. Again, I come back to what I said initially, which is that what you want is for debt to be falling in good times, so that you then have the fiscal space when you need it. When a covid shock comes along, you want to be able to ramp up debt at that point, but you can only do so if the debt is coming down during good times.

Those are the issues that the Chancellor needs to think about when thinking about whether to cut taxes at the end of the Parliament.

One more thing, if I may, is that one thing that economists—indeed, people generally—think is very important is stability. It is relatively straightforward to argue, I think, that having stable and predictable taxes over a long period is better from the point of view of households and businesses being able to plan and so on than taxes going up and coming down again. Given that there have been some significant rises in taxes, it would seem unusual policy to say, "Okay, these tax rises will happen, but two years down the track I'm going to cut taxes again." That is not the kind of stability in taxes that we think is good for households and businesses.

Q4 **Chair:** Would that be an argument against, for example, using that additional headroom that you spoke about for one year only to unwind, say, the national insurance increases on a temporary basis? Would your view be that that will be further sign of taxes moving around, which in itself is detrimental?

Professor Millard: That would certainly be my view. My view is that what we need is longer-term thinking about what level of taxes we want—we might come back to that later in the Committee—how we best achieve that level and how we ensure stability as much as we possibly can in taxes. Raising the levy that is coming in next year, deciding to reverse it for a year and it possibly coming back, again, does not strike me as the most sensible thing to do.

Q5 **Chair:** Understandably, you framed your analysis in terms of the existing fiscal rules. Do you think that they have been set about right or, if you went back in time, do you think you would set them more loosely?

Professor Millard: Again, that is a difficult question. I think that they are about right. I will come back to what I said initially, which is that what we want is for public sector debt to be falling in good times, precisely to create that wriggle room for bad times. So, a target that is ensuring that public debt is falling at the end of the Parliament seems to be an important thing to do. There is of course the issue about—

Q6 **Chair:** What about the day-to-day spending target? The neutrality—

Professor Millard: Yes, I would agree that that is a good target. I would also agree that setting aside up to 3% for public investment is a good target. You might want to set aside more; you might want to set aside less. I guess that is a question about what you believe the efficiency of public investment to be. Certainly, a fiscal target that is predictable, stable and bringing the debt down over time is the important thing.

The other thing about the fiscal targets is that they seem to keep getting reset. We have had, I think, six resets in the last 15 years. I am not sure that that is an ideal situation that we want. The National Institute for Economic and Social Research has written a monograph on the topic of a fiscal framework. The bottom line of the fiscal framework is that you have almost timeless big-picture things, but the OBR would assess the extent to which you could move away from the timeless target for the debt, in the light of events.

At end of the day, these targets are a means to an end. We want to be in a position where, when problems such as covid hit the economy, the Government are in a position to spend the money to help support people. Equally, when times are good, Government want to be in a position to let businesses and households get on with what they are doing, safe in the knowledge that the tax framework they are operating under will not suddenly change.

Q7 **Chair:** You mentioned interest rate rises; I think a 1% increase is about £20-odd billion, which is a huge cost. Inflation, which you have not mentioned, is very much related, is it not?. Have you done any analysis on what you think the Ukrainian crisis might do to inflation and interest rates, and what that might therefore do to the OBR's latest forecasts? I think it is assuming a peak inflation of 7.25% in April and the path of interest rates following what the market is assuming. Do you have any comments on that? What do you think the effect of that could be?

Professor Millard: We have done a bit of analysis on that; unfortunately, it is still ongoing, so I do not have the final results. What is fairly clear is that the Ukrainian situation—particularly the sanctions—will lead to a large increase in energy prices. That is for sure, and that will add to inflation. Inflation will peak, I imagine, higher than we were expecting.

Q8 **Chair:** Gut feeling? Any thoughts at this stage?

Professor Millard: I would not want to take a guess at that, but it could be pretty significant.

Chair: Some people have been suggesting 8, 9, 10 or even 11% in the press.

Professor Millard: It is believable. I do not think those are wildly inaccurate forecasts, but I would not like to get drawn on exactly what I think the number is. It will be higher, that is for sure. That will hit households who are already facing a big cost-of-living increase and squeeze. That will not be good. Translating that into interest rates is even harder. The question is the extent to which the uncertainty and the cost-of-living squeeze could lead to a recession. That would leave the Monetary Policy Committee in an extremely difficult position, because it would have to tackle high inflation at exactly the same time as looking at a recession. How it would respond is up to the committee and I cannot speak for it, but personally, if it were me, I would probably allow inflation to go up and hold interest rates lower than otherwise, to deal with the uncertainty and the possible recession. I will say for sure that inflation will rise as a result. Interest rates are less clear.

Chair: Thank you. Do any of our other witnesses have anything on those topics that they wanted to add? It has all been very macro, so very much your area, Stephen. Let's go to Anthony.

Q9 **Anthony Browne:** My questions are about the overall level of taxation in the economy. From 2000 to 2020, tax in the UK was about 32%-33% of GDP, but the latest Treasury forecast is that it will go up to 36% or above in the next couple of years. Is there a risk that that level of taxation will damage the economy? I will ask Stephen Millard first, but then I will seek other opinions—don't worry.

Professor Millard: Yes, there is a definite risk, and particularly the higher a tax is. Taxes are distortionary. They affect people's decisions and lead to lower output. The question is, though, why are taxes so high? At the end of the day, you have to finance Government spending, so maybe the real question is, how large do you want the Government to be as a proportion of the economy? Then the tax question is, how do I most efficiently finance that size of Government in the economy? Seen in that light, I could not comment on whether Government spending is too large a proportion of the economy, and hence taxes, because that is really a political decision. That is for all of you. We elect you; that is your call.

As I said, the important thing from the tax side is to ensure that once you have decided on that level of Government spending, you finance it in a way that is the least distortionary possible. When I am thinking about distortions, I am thinking both of things that cause people to change what they would do today, and of distortions about the future, such as taxes on investment, because they could affect future GDP growth.

It is those sorts of questions: how do you minimise the distortions from the tax system? But the level really depends on how large you want the Government to be as a part of the economy in the first place.

Q10 **Anthony Browne:** Before I come to the other witnesses, may I press you on one point? In a sense, you are saying that there is a trade-off between the risks to economic growth and the amount of money we decide we want to spend on things like social care, health and so on. How would you assess that risk to economic growth? How do you actually know that the level of taxation is damaging? In the 1980s, there was quite a consensus that lower taxes stimulate economic growth, and everybody talked about Hong Kong and so on, but there seems to be a greater plurality of views now.

Professor Millard: Yes, it is really hard to assess—that is the quick answer. To the extent that we know certain things add to growth, you would not want to tax them. A lot of those things are provided publicly in the first place, such as infrastructure, education and training. Investment more generally leads to growth, so investment taxes are probably less growth-enhancing than other taxes might be. It is a difficult question. I read a paper just the other day that said the reverse: that now in a world where a lot of capital is intangible and depends on people themselves, what you want to do is not tax people, but go back to taxing old-fashioned fixed capital. I am not sure that that is necessarily the correct answer, but it makes the same point that you just made that there is a plurality of views now.

Q11 **Anthony Browne:** Stuart, do you think there is a risk that this really high level of taxation—the highest level since just after the second world war—could damage economic growth?

Stuart Adam: First, I pretty much agree with everything that Stephen said. Higher taxes, as a general proposition, do discourage economic activity and economic growth. There are several caveats I would add, though. One is that the UK is on course to have a high tax burden by historical standards, but it is still not particularly high by international standards. There is not much of a correlation across countries that a bigger state equals a worse performing economy, or whatever. One reason is that while higher taxes can inhibit growth, some Government spending can also be good for growth. You think about spending on education, training, infrastructure and all the rest of it, so some of the spending that tax pays for can be growth-enhancing as well.

The most important thing I would say is that I think the level of tax revenue as a share of GDP is probably much less important than how well taxes are designed. Stephen alluded to that as well, but what really matters is not so much what the overall level is, but whether this is done in a way that is particularly damaging to work, investment, innovation and all the rest of it, or in a way that is much less damaging. To some extent there can be a trade-off between those objectives and others. Economic growth is one thing that the Government is interested in, but it is not the only objective, and there are trade-offs between that and some of the other objectives.

Q12 **Anthony Browne:** Rhiannon, same question to you on tax at record levels since the second world war. Is there a danger that that will damage the economy, or can we mitigate it if we make sure they are all really intelligently designed?

Rhiannon Kinghall Were: Obviously, the relationship between the state and the level of taxation that you need is, as Stephen said, a political question, but from my perspective we would want to see how you can raise taxes in a business-friendly way. There will probably be a few components and, building on what Stuart said, the rate is important. The headline rate is a signal, but within the tax system, the reliefs and incentives also play their part in whether the level of taxation is too high.

You then have the certainty point, which Stephen mentioned, around stability. We hear that from businesses time and again, so you want something that is consistent and that businesses have an element of certainty about so that they can make investment decisions. Increasingly we are hearing about administration and the relationship with HMRC, and ensuring that that also works in the same way. So you have all of those components working together to ensure that it is a business-friendly environment, and then you can raise taxes efficiently without distortions and you will get to the right level for the amount that you need to spend.

Anthony Browne: Jon, same question for you. It is difficult coming last because everyone might have already said what you were going to say.

Jon Richardson: I would re-emphasise that it's a package—not only the administration and the actual tax, but also which taxes are within that. There are a couple of data points in our work that we do with the 100 Group around the FTSE 100. We have been doing the total tax contribution for about 17 years, so we have a track record of what that shows. Interestingly, the actual tax burden—the total tax take—has stayed relatively constant across that period. Within that, the switches between corporation tax, employee taxes and other taxes have shifted quite markedly, but overall the burden has been relatively stable.

The other key thing—maybe we will move on to this—is that we are coming up to quite a change from a business taxation perspective when we get to next April with various taxes going up quite significantly. Another survey—another data point—that we do with UK Finance is around the comparison of the UK versus other big financial centres such as Frankfurt and New York. Historically, if you look at total tax rates—total taxes borne by a model bank over total profit minus those taxes—the rate has been relatively similar: towards the top end, but not too far away. If we project to next year, the gap to the next, which is probably Frankfurt, will be about 10 or 11 percentage points different, from about 38 to 48-type levels. There is a danger that once you get to gaps that large, that is when it starts to make a difference.

Q13 **Anthony Browne:** How critical is the level of taxation to the competitiveness of the economy as a whole—or, when your clients are looking where to invest, are they looking at other factors such as infrastructure and so on?

Jon Richardson: Clearly, there are many great reasons why people come to the UK to invest, and tax is a factor. It always gets factored in, but it is not the factor. Some other countries make tax a much bigger thing, but it is a cost of doing business. When companies model investment plans and compare different countries, they will take that into account. I would say that up until now, over the last few years, tax has probably been a neutral consideration. I don't think it's seen as a massive benefit, from a tax perspective, despite us having a relatively low corporate rate; likewise, I don't think it's at a rate that historically has been detrimental. We are probably in the neutral camp to date. However, as I say, things may change come April next year.

Anthony Browne: That's great. I would love to ask you more questions, but I am out of time.

Q14 **Dame Angela Eagle:** Jon, I think you were saying that you are worried about the international competitiveness of the UK because of the tax rises—particularly business tax rises, I presume—that are in the pipeline for this year. Is that correct?

Jon Richardson: Yes. Looking at April next year, the corporation tax rate will go up 6% at the same time as the super deduction that came in for a short window drops off; there are also other taxes rising. At that point, we will start to get to a rate that is definitely a consideration. Next year, we will be in the unusual situation of having a higher corporate tax rate than the US—it is certainly the first time I can remember that happening in my career. That changes the dynamics. Companies are looking at whether they should invest in the US versus the UK or in the UK versus another big trading bloc in Europe. That's the comparison I'm looking at. With those increases next April, we will probably get to a point where the consideration tips into negative, rather than neutral.

Q15 **Dame Angela Eagle:** Those are only marginal calls, though, aren't they? There are other big reasons why companies either invest or don't—for example, a legal system that works, proper protection of property and other rights. How important is tax? It's at the margins, isn't it?

Jon Richardson: You are right; it is marginal. There are clearly some situations—for instance, when a lot of US clients come to Europe, they use the UK as a testbed for launching into Europe—that come back to the fundamentals that we're blessed with in this country. You're right; it's a marginal call. I don't know how you model that. I'm just basing it on what I hear from clients and what they're looking at. In some situations, it will make a difference. In others, it will not.

Q16 **Dame Angela Eagle:** Professor Millard, you spoke about our position in the international league table for tax competitiveness. I have always been rather sceptical about that. You spoke about stability of taxes, but surely we are at the beginning of a major structural change to our tax system, for a whole range of reasons. Demography is going to increase public expenditure, if we're going to have decent social care. We need a green shift. We have the aftermath of the pandemic and the move to online. Tax bases are being eaten away in certain places. We have challenges to our tax take that we did not have a few years ago: a massive increase in profit shifting and huge corporate tax avoidance. How can we end that?

You can't keep a tax base the same forever, especially in the middle, with the maelstrom of all of those structural changes that we have to react to as a society. There is also employment tax—the entire thing. Some employment methods are under-taxed; other employment definitions are over-taxed. None of it is very fair. Isn't it about time that we had a major look at all our tax structures to see whether we can get a tax base that is forward looking and will outlast some of these changes, rather than being eaten away by them?

Professor Millard: It is hard to disagree with that statement. There are major changes coming along: the move towards net zero is one, as well as demographics, as you said; changes in the way we shop and work—all those things. My point about stability was, in a way, completely complementary to that. What we need is a framework for tax that we know will be suitable for the economy as we move forward in time and all those things happen. The point is to get the framework in place. The framework itself should be stable so that people will be able to plan, invest, spend and save, safe in the knowledge that, five years down the track, there is not going to be another major change in the way that taxes are collected in this country.

Q17 **Dame Angela Eagle:** I understand that that might be something that we would all want to see. We all rather like stability, don't we, having lived through "the great moderation," as it was called? In 2008 we had a global financial crash, then we had a pandemic and now we are having a war. Rhiannon, against that churning structure of changed reality, can we have an unchanging tax system?

Rhiannon Kinghall Were: When businesses seek certainty, to some extent it is through that framework and understanding the strategy. Quite frequently, the businesses I speak to recall the 2010 corporate tax road map, which set a flavour. It set out the strategy and identified areas of pursuit that the Government were going to look at and explore. Through the consultation, some ideas were discounted but some were built on, and it was the sense of direction that businesses valued most.

At this moment, partly perhaps due to events, we have not had a sense of that. We are on the cusp of some significant international tax reforms that will have a significant impact on—

Q18 **Dame Angela Eagle:** Do you think they will be effective in stopping the erosion of the tax base that we see from profit shifting, where we see big global companies having huge turnovers in sales in this country and paying ridiculously tiny amounts of tax?

Rhiannon Kinghall Were: They will make quite significant changes, in a sense, because you are looking at the effective tax rate. Any company that is not paying an effective tax rate of 15% will have a top-up. There are some quite sophisticated mechanisms to ensure that even in territories that have no interest in implementing these rules, other territories can pay a top-up tax to ensure that that group will be paying an effective minimum tax of at least 15%. There will then be questions as to whether that is the right rate, but I think it is a good starting point and will provide some of the certainty that has pervaded this debate about the incremental changes over the last five or 10 years.

Chair: Sorry to interrupt, but did you want to come in on that point, Kevin?

Kevin Hollinrake: On this section generally.

Chair: We will come to you in a second. My apologies, Dame Angela.

Please carry on.

Q19 **Dame Angela Eagle:** In essence, do you think that if we have a 15% tax rate bedded in, that is the kind of stability you are looking for rather than all the incremental stuff that has to happen, because the base is being eroded the whole time? I speak as a former Exchequer Secretary who had to spend their time trying to collect the taxes that were due, let alone watch the base washed away by offshoring and various other nefarious activities.

Rhiannon Kinghall Were: I think it provides the floor. Obviously, some jurisdictions—the UK is an example—have chosen a rate of 25%. That leaves a little bit of scope for some incentives, perhaps targeting specific activity that, as a country, we have decided that we want to incentivise. But there is a floor of 15% and a debate around whether that is the right level. As I say, I think the floor is a starting point.

Q20 **Dame Angela Eagle:** Quite a modest floor, if you ask me. Professor Millard, did you ever believe that the erosion of the base and so-called tax competition was a good thing, or do you think, with societies getting more complex and with our society aging, that we need to be able to guarantee a tax base so we can look after our people as they get older and pay for that properly?

Professor Millard: I agree with that. The tax competition literature is about more than just taxes. It is about asking what we, as a society, want to be spending public money on versus what we want to leave to the market. That decision leaves me with the follow-up, which is, "Okay, now I need to work out how I am going to finance that. What is the most non-distortionary way of doing that?" Obviously, when you are thinking about that question, you are thinking, "Okay, what is the tax base?"—

Q21 **Dame Angela Eagle:** By "non-distortionary", you mean between sectors and companies rather than countries, though, don't you? Distortions can be different things. What we do not want is a race to the bottom so everybody ends up beggared, if I can put it that way, because they cannot raise the proper amount of tax that they need to look after the basic structures of the state. Tax competition all too often gets us into a situation where there is a race to the bottom, and that is surely wrong, which is why the floor that the OECD is creating is at least a stop.

Professor Millard: Yes, I agree. Again, in order to finance a given level of public spending, you need to ensure that you have the tax base and the tax system in place that will enable that to happen. As to how you actually do that in practice, my colleagues to my left and right are probably in a much better place than I am in terms of the details on that, but certainly I agree with—

Q22 **Dame Angela Eagle:** Perhaps forward signalling is an issue. For example, as petrol and carbon fuels exit, drivers' taxation—taxation of petrol—is clearly going to crash in terms of revenues and will need to be replaced by other things. What you want, ideally, is a Government signalling in advance the areas it is looking at to recoup some of that tax base in the future with new technology, I assume.

Professor Millard: Again, this comes back to the framework. What you need, as you rightly said right at the start of this line of questions, is a clear framework for how the Government is going to collect taxes over the next 50 or 100 years, how the tax base is going to change, and how taxation is going to adapt to the changes that we know are going to happen.

Dame Angela Eagle: I wish I had some insight into what was going to happen over the next 100 days, let alone 100 years. Thank you, Chair.

Q23 **Kevin Hollinrake:** In his lecture last week, the Chancellor talked about the lower levels of business investment in the UK, and puts that down to the tax treatment of capital investment. He says, "It seems likely to me that a priority will be to cut taxes on business investment" in the future. Do you know which ones you would cut to be able to incentivise businesses to invest more freely? Jon?

Jon Richardson: There are two ways of looking at this: you either cut taxes or increase reliefs—basically, two sides of the same coin. Picking up on the last point around stability, one specific thing to look at is the super deduction we currently have, which is innovative, caught the eye, and clearly companies took notice of it.

Kevin Hollinrake: You would keep it, is what you are saying.

Jon Richardson: I am not sure that I would keep it at 130%. Rather than this boom of a massive super deduction and then going right back to where we were with capital allowances or tax depreciation for investment, which was internationally pretty far down the competition stakes, I would move to something in between the two and keep it there for a longer term.

When companies are looking to invest, it is clearly a long-term investment, and you need to plan that ahead. You do not just plan it five minutes ahead: often, these are three-year to five-year plans that are being baked in. You need that lead time to start to factor these things in when you are looking at a three-year to five-year horizon. To take that example, I think that if we signalled now that we were going to move to something less generous than the super deduction, but something that encouraged investment and then growth and jobs, that would give an environment and a platform. Recognising all the changes in this world, nobody can guarantee it, but it gives a platform—

Kevin Hollinrake: A less super super deduction, basically.

***Jon Richardson**:* Yes.

Q24 **Harriett Baldwin:** This Committee has been very concerned about inflationary pressures for some time, and what I wanted to try and draw out of each of the panellists was the link that you see between tax cuts, tax increases, and inflation. We cited in our recent report the Office for

Budget Responsibility, which had said that the forthcoming national insurance rise was likely to be inflationary because of the way in which businesses will be able to pass their costs on in the current environment, so I want you to try to tell me—I am going to go to each panellist in turn—given the current OBR framework, forecast and environment, which taxes you think have the highest impact in terms of inflationary pressures, and secondly which taxes you could change without having any impact on inflation.

I want each panellist to think of their top three examples in each of those categories. I will repeat my question: which taxes have the highest impact, given the current state of the OBR forecasts, and which taxes can you change without any impact on inflation? Stuart, you have not come in for a while, so I am going to ask you first.

Stuart Adam: There are a couple of different things that we need to distinguish here.

Q25 **Harriett Baldwin:** I just need a list. I am trying to get pithy answers out of a panel of economists and tax experts.

Stuart Adam: There are two different things going on here, and I suspect that Stephen may be better placed to comment on this than I am. One is which tax changes will feed most directly through to prices. You would normally say that indirect taxes—VAT, excise duties and so on—would feed through straightforwardly into prices. Something like the health and social care levy, or employers' national insurance more generally, might be partly passed on by employers, raising the price of their products and reducing the wages that they pay their staff. There are those aspects, but there is also the more macroeconomic side of it, which is that a fiscal loosening, whether that is tax cuts or increased spending, helps to stimulate and heat up the economy, and therefore tends to increase inflation.

Q26 **Harriett Baldwin:** Is that regardless of the kind of tax cut? Any kind of tax cut is inflationary—is that what you are saying?

Stuart Adam: Some more than others.

Harriett Baldwin: That is what I was hoping you would answer.

Stuart Adam: I think on something like the national insurance rise—the health and social care levy—I think you have a combination of the two things going on. I am not sure whether I think it will be inflationary or disinflationary. I am not sure whether what you should expect to see is the dampening of the economy as a result of a tax rise helping to dampen inflation or, as employers face higher costs, whether they will partly pass them on by increasing prices.

Q27 **Harriett Baldwin:** Can you name a tax cut that would not have any impact on inflation?

Stuart Adam: No, I do not think that I could. I could possibly have a go at which ones would have less impact, but I do not feel confident enough to want to comment on it.

Q28 **Harriett Baldwin:** Okay. Jon, perhaps bringing a different point of view, which taxes have the highest impact on inflation and which ones could you cut without having an impact on inflation?

Jon Richardson: This is definitely more the economists' end of the questions. I agree with Stuart that clearly VAT, and things like it, feed more obviously and directly into prices. However, fundamentally, from a business point of view, all taxes are a cost and a burden and will be taken into account in the cost base. Companies have to decide where their competitive position is in the market and decide if they can pass that cost on or not pass it on and keep it as profit. It very much depends on the relative dynamics of the market, in terms of whether the key players are able to pass it on as a tax cost or not.

Q29 **Harriett Baldwin:** That is why I framed it as of now, with the OBR's current forecast. In the current situation, which taxes could you cut without having any impact on inflation?

Jon Richardson: I would honestly be guessing off the top of my head. It is not a question I have thought about before. I still think, regardless of the current OBR forecast and the broader economics, it is going to come down to each industry sector, how competitive that market is, and whether companies have a strong enough position that means they can afford not to pass on tax cuts—or not. That is not so much an economics environment; it is actually the specifics of each industry, and some parts of industry are more competitive than others.

Q30 **Harriett Baldwin:** So for you, it is more a sector-by-sector issue then? Okay.

Rhiannon Kinghall Were: My answer is similar; as I am not an economist, it is probably harder to answer. There are some other non-inflationary tax changes that you might consider, in terms of administration and simplification. They would all be valuable, but as Jon says, in terms of actual tax cuts, businesses would need to take those into account and consider how they were going to pass them on or not.

Q31 **Harriett Baldwin:** So you do not have a view on any tax increase that might have the highest impact on inflation.

Rhiannon Kinghall Were: I have not done any modelling on a per-tax basis.

Q32 **Harriett Baldwin:** Do you have a view on whether you could change any taxes downwards without having an impact on inflation?

Rhiannon Kinghall Were: It is the same question. Unless you have done an analysis on looking at those taxes and on looking at their impact through a business on a sector basis, it is hard to answer. At a law firm, that is not our day-to-day work.

Harriett Baldwin: Fair enough. Professor Millard, I hope you have a long answer on this one.

Professor Millard: I agree with pretty much everything Stuart said. I will add that a particular move in tax can have a different effect in the short run versus the long run. The VAT example, and the health and social care levy—these will clearly have an effect on inflation in the short run, as the OBR said. But further out, because they reduce demand, they are more likely to be bearing down on inflation. It is the reverse for a tax cut: if you want to see inflation go down as a result of a tax move tomorrow, you cut VAT. It has an immediate effect in that direction. But of course, it encourages more spending, so over time, inflation will actually be rising with demand.

The second point I will note is that temporary tax cuts and permanent tax cuts have very different effects. If I know VAT has been cut now and will be raised again in a year's time, I will spend at the time that the VAT is lower. But what does that mean? It means that there is less spending after the rise. To a degree, people will look through taxes that they know are just cut today and back up again tomorrow, so a temporary tax cut will typically have a much smaller effect than a permanent tax cut.

The final distinction here is between labour taxes and capital taxes. Because they go straight into consumption, tax cuts on labour income tend to have a higher effect on demand than tax cuts on corporate income, so you might expect that a labour income tax cut would have a higher effect on inflation over time. But again, the distinction here is between the short run, where it is those taxes that actually affect prices—the ones that Stuart mentioned, such as VAT, excise duty and national insurance—and the longer run, where it is the demand-versus-supply conditions in the economy that matter. All tax cuts increase demand.

Q33 **Alison Thewliss:** I wanted to ask some questions around Laffer curves and things of that type, and I wonder if I could start with Stuart Adam. The Chancellor said last week that tax cuts do not "pay for themselves". How true do you feel that is?

Stuart Adam: Tax cuts can sometimes pay for themselves. The Laffer curve is a real thing; it exists. The shape of the Laffer curve, and where the peak of the Laffer curve is, will be different for every bit of every tax and in every different circumstance, so you cannot give a general answer on whether tax cuts will pay for themselves. At the moment, I would struggle to pick out tax cuts that I would say, "That's nailed on. That will pay for itself." There are some that I would say might be close or might be there or thereabouts, where changing the tax rate probably would not make too much difference to revenue either way, but there is a lot of uncertainty, even around those. If you ask me where I think we are closest to the top of the Laffer curve, the taxes on the richest and the poorest, as it were, are probably two of them. I think the top rates of stamp duty on £1.5 million-plus properties are probably pretty close to revenue-maximising already. The 45% rate of income tax at the top is probably close to revenue-maximising. At the bottom, tobacco duty is probably pretty much close to revenue-maximising.

Again, I think there is quite a lot of uncertainty around all of those and clearly in all of those cases there are considerations other than revenue-maximising about how high you want to set those tax rates.

Q34 **Alison Thewliss:** Do you feel that the success of a tax should be measured purely on its yield, or are there other issues—such as inequality or perhaps health—that might be taken into account when judging how people should be taxed?

Stuart Adam: There are absolutely other things that should be taken into account; it's not just about revenue. We have talked about economic growth, but, yes, inequality of the income distribution will be relevant; yes, impacts, such as health in the case of tobacco duty, but environmental impacts, too, and so on, all need to be taken into account.

What I spend quite a lot of my time doing is trying to answer the questions about which tax policy is best suited to pursuing different objectives. It is about designing a system so that you have the right measures targeted at the right outcomes.

Q35 **Alison Thewliss:** Okay; thank you very much. I also wanted to ask you about corporation tax, for example. There will be a move to increase that from 19% to 25%. Do you think that will have any impact on those companies, on their activity and how they operate?

Stuart Adam: Yes, undoubtedly; a six-percentage point rise in the corporation tax rate is not to be sniffed at. We know that it will make the UK less internationally competitive; to some extent, it will discourage investment. Having said that, the corporation tax rate at the moment is at an historic low. Raising it now worries me much less than if it were already at 30% and we were talking about raising it by six percentage points.

Also, I will echo what someone mentioned before about the Chancellor's MAIS lecture last week. He was pointing out that actually the most effective thing you can do for investment is not necessarily just about the headline rate; it is also about the treatment of investment. With capital allowance, to come back to what we were saying, I would not support the continuation of above 100% deductions for capital investment.

However, the super deduction aside, we currently have 100% deductions where the annual investment allowance applies, but for investment above that or for investment in assets other than plant and machinery—so, things that are not covered by the annual investment allowance—the UK is very ungenerous internationally. That also affects how competitive the UK is internationally and it can be more effective than reducing the headline rate of corporation tax at stimulating investment.

Q36 **Alison Thewliss:** Thank you; that is helpful. Professor Millard, can I ask you the same sort of questions, I suppose, starting with taxes paying for themselves?

Professor Millard: To be quite frank, this is more Stuart's area of expertise, so I would be inclined to echo everything that Stuart has just said on that.

Q37 **Alison Thewliss:** Okay; that is very straightforward. Picking up on what Jon Richardson said earlier about the clients you are talking to and the factors they take into account when making their decisions, what kind of impact do you think the changes in corporation tax would have, and are those changes among the higher considerations that companies take or are they looking at other things in a more holistic way?

Jon Richardson: The fundamentals need to be there. Thinking about my clients at the moment and significant ones in various important sectors, they are looking to build new facilities. The reality is that there is a shortlist—skilled labour and all those sorts of things are fundamental. Tax will not trump those; you have got to have them.

However, when you then get down to a shortlist of whether it is the US, UK or Australia even, tax will come into that. It comes back to the fact that tax at the margins will make a difference. Looking back five or six years, the Government went out with a very clear message to corporates: "Come to the UK." It was not only about the lower headline rate; it was about tax administration and stability, and the fact that we could provide more certainty on that. That certainly made a difference in attracting corporates into the UK. Now, did it make the difference? It is hard to measure that, but it was definitely an attraction and gave companies confidence that the UK was a good place to invest. I think that that has changed. As I said, I think, at the moment, it is probably fairly neutral. However, I think that could change next year, when the rate goes up, if allowances go back to where they were, as we talked about a minute ago.

We have got R&D incentives as well, which, again, are relatively ungenerous internationally. I think the R&D credit for large businesses is currently about 10.5%. As the corporation tax rate goes up, that will come down, because it gets taxed, so will actually become worth 9.5%. The international average is about 17%. When we surveyed our clients—well, a broad population of corporates—last year, in the R&D review that was going on, most said, "You'd probably need 13% to 15% to make a difference in investment decisions." I think that it does play into it at the margins but, clearly, as a suitable location, the fundamentals must be there.

Q38 **Alison Thewliss:** Okay, but, broadly, you need a tax regime that allows you to have an educated population, a health service, and all the other things that make things work.

Jon Richardson: Yes, and, ideally, a tax system encourages all of that too. In many ways, the Chancellor was right last week on attracting the investment, but you also have got to have the skills, especially if we want to go to an innovative high-tech environment to foster innovation and then develop those skills. It becomes a virtuous circle: if you create those jobs, then more people will get trained up, then you will attract more of that type of innovation.

Q39 **Alison Thewliss:** Thank you. Rhiannon, do you have any particular thoughts on that?

Rhiannon Kinghall Were: When the rate increase to 25% was announced, it certainly raised a few eyebrows, but I think businesses are mostly interested in the effective tax rate. That is obviously when you take into account incentives and reliefs. I think that there is a bit of uncertainty around capital allowances going forward; there have been some changes around R&D. However, I think it is about ensuring that those incentives are targeted to the type of economy that the Government want to deliver and thinking about making those work in tandem to then encourage the high-value jobs associated with that sort of economy.

On the point around whether yield is affected or not, when the rate was cut, I think that corporate tax revenues held, if not increased. However, it is very hard to isolate what was actually driving that. At the time, there was quite a lot of base broadening, so that lower rate was applied to a much higher tax base. You now have a much higher tax rate on that broadened tax base, so I think that that will play into the revenues, but it is difficult to isolate.

Q40 **Alison Thewliss:** That is interesting; thank you. I have one final question for Stuart. When taxes get to that higher end, there are incentives, I suppose, in trying to avoid and evade them. How do you think that can be tightened up to maximise the tax taken and avoid people just trying to shift and hide whatever they can?

Stuart Adam: Well, there are not many easy answers, because successive Governments have spent years and years trying to clamp down on that as far as possible. Let’s not pretend that nothing has been done or is being done. On what has been a little bit more missing, I would come back to what Stephen said earlier about the need for a strategy for the system. I think I would treat avoidance and evasion somewhat differently, but at least on the avoidance side, a lot of the problem is in not setting out clearly what it is that we are trying to tax. Having a clearer view of that makes it easier to reduce those opportunities.

To take a simple example, the opportunities for avoidance would be much reduced if we were taxing income from different sources in the same way. Earlier, Angela Eagle mentioned the idea that if you work in a different legal form, you can pay much less tax—yes, the same with shifting income into capital gains and so on. Taking a view that we might like to try to do all those things equally would massively reduce the scope for avoidance—if income from all sources were taxed at the same overall tax rates.

Doing that in isolation would just involve big increases in tax rates on income from savings and investment, and the problem there is that that discourages saving and investment. Therefore, we need to think of that in concert with what I was saying on what allowances you give for investment and whether a low rate is the best way to encourage that.

Taking a view of what you are trying to do with the system as a whole can allow you to reduce those opportunities for avoidance by not having so many different rates across different things that people can shift across to reduce their tax liability, without some of the side-effects that have stopped us getting to that point so far, such as discouraging saving, investment, entrepreneurship and all the rest of it.

You need to take an holistic view of the tax system in order to get there, although even that will not deal with everything. International corporate profit shifting is not just a question of that, and tax evasion is a different matter—that is not a matter of the tax base; that is a matter of tax enforcement, essentially. The set of tools that you would want to look at there are different.

Alison Thewliss: Thank you.

Q41 **Rushanara Ali:** I have some questions about which taxes incentivise growth, but please don't feel that you need to reiterate stuff you have already covered. To all of you, which taxes or tax rates do you see as the most harmful to businesses? We need to think about that in the context of some of your earlier points about investment in other areas, including education, health and public services. Who would like to kick off?

Jon Richardson: I'll go first. At the risk of repeating a little, if we foster investment, that leads to growth, so the tax regime to enhance investment is definitely an area to focus on. Rather than tax cuts though, I come back to more targeted reliefs to encourage such investment, whether the capital allowances we talked about or R&D incentives.

The other area that we need to factor in, which we have not mentioned yet today, is the move to net zero. Can we use those regimes to target more on the investment that we will need in net zero technologies? That can definitely be used more in the R&D regime and the capital allowances regime to encourage environmentally friendly investment. Those are probably the areas that I would fix on most.

Professor Millard: I agree with all of that, and reiterate an earlier point that it is as much about what you want to invest in as a Government as it is about the tax system. Investment in education and infrastructure and the move towards net zero will be important, and all of that needs to be financed through taxes. Again, maybe the issue is to find the least distortionary way of doing that.

Rhiannon Kinghall Were: I would not underestimate the value of some sort of road map inasmuch as what the rate and the reliefs are. Just setting out the objectives in line with what economy the Government want can be really powerful. As I say, time and again, we still hear references to the 2010 road map. That is a very useful framework to consider.

Stuart Adam: First, I say again that we all know that growth is not the only objective, so thinking about what the best tools are to meet multiple objectives at once has to be part of it. Just thinking about tax and growth, a starting point is that the things I mentioned—top rates of income tax, stamp duty and so on—are close to the top of the Laffer curve at the moment. I note again that if you reduced those, basically it would be tax cuts for the rich. You have to think about what the best way of doing that is and what your other objectives are. Beyond that, what we have talked about—

Q42 **Rushanara Ali:** So you are saying that tax cuts for the rich would be good for the economy. Could you clarify this point?

Stuart Adam: Well, tax cuts in general would reduce the disincentives that taxation creates and would therefore help to boost the economy, subject to what I was saying earlier—that the less public spending that that finances would not help. There is a broad trade-off between incentives and redistribution. Broadly speaking, taxing the rich less will probably be a more effective way of stimulating the economy—sorry, not stimulating the economy, but incentivising activity—than taxing the poor less. But—

Q43 **Rushanara Ali:** Isn't it more complex than that?

Stuart Adam: It is much more complex than that.

Q44 **Rushanara Ali:** If the rich only save the money they have received, how does that stimulate the economy or growth?

Stuart Adam: It is certainly all much more complicated than I am saying; I am doing the broad-brush headlines here.

One distinction that I think is worth making is between the supply side and the demand side effects. There is a thing on the demand side that is the flip side of what we were talking about in relation to inflation earlier. If you cut taxes, people spend some of that money; you get a multiplier effect across the economy and that can have a stimulating effect. That is essentially a short-run effect: it can stimulate the economy and grow it in the short run, but it can't grow it in the long run, really.

For the long run, what matters is the supply side of the economy and the incentives the tax system creates for behaviour. That is about doing less to discourage work, less to discourage investment, and so on. In broad terms—again, this is very, very broad brush—cutting taxes at the top will tend to have stronger incentive effects than cutting tax rates at the bottom. Again, there are caveats to that. For one thing, it depends on how high the tax rate is to start with. That is one of the reasons I am saying it, because stamp duty rates and income tax rates at the top are higher than they are lower down, but we also have very high effective tax rates from benefit withdrawal at the bottom, and reducing that could be very effective as well.

Q45 **Rushanara Ali:** Can I move all of you on to the question about smaller businesses versus larger businesses? Would it be better to focus tax cuts aiming to promote economic growth on small business growth as opposed to bigger businesses? Apologies, but we are short of time, so can I have brief answers?

Rhiannon Kinghall Were: You need a balance; I don't think you can choose one over the other. On the small business side, convoluting the system with too many incentives and reliefs can be difficult in terms of accessing and understanding them. Also, there are complexities with the change in the main rate of corporation tax; there is also a lower rate, and that creates more complexity for those businesses. Simplification at that end would be my answer.

Jon Richardson: I certainly agree about simplification. It is a fact that at the moment, the obligations on businesses with a turnover of over €750 million globally are increasing quite considerably in terms of compliance, because generally they can cope with it better than small businesses can. Regarding small businesses, obviously start-ups and everything else need all the help they can get, so there is some sense in having some incentive to help them to get going and get off the ground.

Stuart Adam: My starting point would be to keep things simple and have the same regime across the board. There are things that small business in particular might need, perhaps more so than new businesses, such as getting started and raising finances early on; they might need special arrangements. There is also a case, for competition reasons, for not wanting to have a very small number of firms dominating in any particular market. Whether tax is the right instrument to do that, I am not sure. My prime aim generally would be to keep things simple and just have the same regime across the board.

Q46 **Rushanara Ali:** Professor Millard, I put the same question to you, and a supplementary one about an earlier answer you gave to Angela Eagle about Ukraine and energy prices, with the tension between cost of living pressures and trying to avert a recession, and interest rates. You said that inflation could be way higher than 7.5%, given the crisis, so do you think that there is a case for doing much more to offset the impact on households? Otherwise, understandably, there will be more pressure for increased wages. Picking up on the Governor's justification about upward pressure on wages, who can blame people for wanting higher wages to offset the increases in fuel prices? What do you think is the answer? What would you advise them to do?

Professor Millard: I don't think I would ever deign to advise the MPC. Certainly I see a case for support for struggling households at the minute. The cost of living squeeze is very significant. I quite understand why people will push for high wage claims, given what is happening. Is there an obvious and easy way out of the conundrum? I think the answer is no.

Q47 **Rushanara Ali:** But the answer has to come from the Government rather than the MPC if we are to address increases in the price of fuel and inflation and we do not want to go down the interest rate route, given that there is some evidence to suggest that that will not work either, especially not in the short term.

Professor Millard: The MPC is charged with dealing with inflation—that is its target and its priority. It will do what it sees to be the best thing to deal with that. Dealing with the cost of living squeeze and its effects on the poorest families in the land is one for the Government, I absolutely agree.

Q48 **Rushanara Ali:** Thank you. Do you want to add anything to the earlier questions that the other panellists addressed?

Professor Millard: No, I think I agree with everything the other panellists said.

Rushanara Ali: Thank you.

Chair: That brings us to the end of our time for this panel. Thank you very much, especially you, Stuart, for joining us remotely while battling through the covid. I thank all four of you for an informative, insightful and helpful session covering all sorts of aspects of tax. We can all agree that there is huge uncertainty out there now, which of course makes everything that we have discussed extremely difficult and much more complicated. For those viewing live, we will reconvene in five or 10 minutes for another witness panel on the same topic.

Examination of witnesses

Witnesses: John O'Connell, Suren Thiru and Alfie Stirling.

Q49 **Chair:** Good afternoon and welcome to the Treasury Select Committee's second session today on the UK's tax burden. We are pleased to be joined by three witnesses, whom I ask to introduce themselves briefly to the Committee.

Suren Thiru: I am Suren Thiru, head of economics at the British Chambers of Commerce, a network of 53 accredited chambers across the UK that covers businesses of all shapes and sizes, but mainly in the SME space.

Chair: Thank you very much, and welcome.

John O'Connell: I am John O'Connell, the chief executive of the TaxPayers Alliance.

Chair: Thank you, John.

Alfie Stirling: I am Alfie Stirling, director of research and chief economist at the New Economics Foundation think-tank.

Q50 **Chair:** Welcome to you all. We want to look at tax, and in this session we are going to go a bit more micro and look at businesses. Will each one of you tell us a little about what sort of taxes businesses, particularly small businesses, generally want to see reduced? Perhaps you could kick off, Suren.

Suren Thiru: The biggest issue that a lot of our members talk about when they talk about tax is up-front taxes—those taxes that you pay no matter how well your business is doing or how well the wider economy is doing. One example is business rates, which is the big challenge that a lot of businesses are facing. It is a key challenge for them, so they would like to see action there. We saw some action in the autumn Budget, which went some of the way, but businesses are looking for more fundamental reform in their rates bill and the creation of a fairer system.

Another area of up-front costs is national insurance. There is clearly concern about the impact of the national insurance increase that is coming in April. Businesses often talk about the cumulative burden of all these costs together impacting their businesses at a time when they also face higher raw material costs, higher energy bills and upward pressure on wage costs. They talk about that overall burden impacting their businesses quite a lot. Any measures that help to ease the up-front burden on business will be gratefully received.

Q51 **Chair:** With the national insurance increases, are employers perhaps more concerned about the employer increase than about the employee increase? How do they view the two of them?

Suren Thiru: There is concern about both, but particularly about the employer contribution. One thing they often say about national insurance is that it is very much a tax on jobs, and not necessarily only in respect of recruiting and hiring people. If businesses have to pay extra to retain or recruit someone, that may have an impact on the amount they have to spend on training, for example, which has a knock-on impact on things such as productivity and the wider operation of the business.

Q52 **Chair:** Thank you. John, what taxes would small businesses like to be reduced? What do you think matters in the small business space?

John O'Connell: It is probably a similar picture for most businesses, small or large. You are definitely looking at employers' national insurance, and business rates are a huge concern for lots of small businesses up and down the country. If you are looking at the bigger picture for things that could help to improve growth and productivity, you could look at things like getting rid of the so-called factory tax—that is, an allowance for investment in plant and machinery. Other ideas that have been thrown around include taking buildings and machinery completely out of business rates. Those kinds of tax changes, which would really incentivise growth and productivity, are probably similar for small businesses and for big.

Alfie Stirling: I have little significant to add. Business rates come up in a lot of the conversations I have, but it is often not about the tax per se; rather, it is about particular elements of that tax base that are important for a business of any kind. It is hard to pick out a particular tax. If you take business rates, for example, the fact that land and capital are collapsed into a single multiplier is of particular importance. If you can separate some of those things out, you can vary the marginal rate of investment versus other things. That is something that we might come on to, but yes, business rates have come up a lot.

Q53 **Chair:** It has been around a long time as an issue, hasn't it?

In a moment, my colleague is going to get into the detail of perhaps having an online sales tax, but what are the alternatives to business rates? What would it look like? It raises around £25 billion, it is easy to collect and it is an important amount of money. What do you do as an alternative?

John O'Connell: If only we knew the answer to that question. It has been the one sort of tax on which I feel there has been a real lack of decent proposals for reform, which is probably why it has been untouched for so long. It raises a big amount of revenue as it stands, so there is no real incentive to make too many changes to it.

It is very difficult. You could look instead at taxes on consumption—for instance, VAT—and trying to simplify things. Other things that have come up as a replacement for business rates include land value taxes, which our organisation has explored in a little detail. The lack of a killer proposal on business rates is part of the problem—part of the thorny issue with them.

Suren Thiru: In our view, that is absolutely right. There are a lot of limitations. Some of the alternatives are still open questions. We would not necessarily call for an alternative system to business rates; rather, we would want fundamental reform of business rates—for example, lowering the overall burden, making it a simpler, much more light-touch system with more frequent revaluations, removing plant and machinery from business rate valuations to incentivise investment; and looking at some of the myriad reliefs in the system and simplifying it, particularly at the lower end. That would be an easier system for businesses to manage and make it much more light touch. There will always be winners and losers from any sort of reform or any alternative tax base. From our point of view, the need is to make the system much fairer, easier to understand and more aligned to what is happening in the wider economy.

Alfie Stirling: We actually have a proposal for quite wholesale reform of business rates. When thinking about this tax, you cannot attack it from the point of view of businesses alone; you have to step back a bit and think about all the key stakeholders in this policy area. There are three big obstacles to reform. The first is devolution, and the fact that trying to do anything on business rates brings you up against the fact that local authorities and mayors will want greater devolution of tax powers than they have now; that becomes an important factor. Then you have the business perspective, involving both the overall tax burden and the point about tax efficiency—capital being overtaxed versus other elements of their activities. Then there is the local government funding gap as well, both aggregate and across local authorities, where business rates are a really important element of individual local authorities meeting local need.

For us, a solution that ticks a lot of those boxes and can advance on all those fronts is one in which you split business rates into two taxes, or at least you keep the tax base but have two different rates, one for land and one for commercial property. That would allow you the flexibility to do quite a lot of different things. For example, you could levy the tax on commercial property on a very similar basis to council tax, which would involve considerable devolution to local authorities compared with the current system, and allow local authorities to lower that tax rate if they wanted to, which would lower the marginal tax on business.

Q54 **Chair:** It sounds more complicated than what we have now.

Alfie Stirling: Actually, it is significantly simpler. At the moment, you don't have just the business rates system; there is the business rates retention system, with 75% or 50% retention, and the formula that lies behind that. If you take those two together, there is a highly complex system to prop up a seemingly simple tax rate. We propose going to a two tax rate system and disposing of the whole business rates retention system, because the tax levied on land would be allocated to local authorities according to need, on a funding settlement basis, and the commercial bit would be funded just like council tax. The whole thing would be much simpler, albeit you would be going from one rate to two.

Q55 **Kevin Hollinrake:** My first question is a bit left field. If you introduce an online sales tax, that is an increase in taxes that raises £1 billion to £2 billion, according to the Government's consultation. If you simultaneously reduced business rates, the multiplier or something on retail premises, would that be net neutral from the consumer point of view? Retailers might pass on an online sales tax. If you combined the two, do you think that in a competitive market, you would see net neutrality in terms of the impact on prices? Say you take £1 billion or £2 billion off business rates and increase the online sales tax. Would overall prices go up, or would it just blend itself away?

John O'Connell: It is really hard to say. Prices would go up with an online sales tax. Some work we have done shows that an online sales tax of 2% could increase costs for the average consumer by about £50 or so a year, which is a decent amount of money for a lot of families. Similarly, the proposed tax on online deliveries would make things more expensive. Trying to offset that against business rates seems to me to demonstrate a bit of a problem—it is taking with one hand, giving with the other. A big consumer shift is happening; lots of people are buying goods online. That is not necessarily a bad thing. It serves consumer preferences and we should not necessarily be looking to tax that success. If there is a problem with business rates, we ought to sort that out rather than clobber people elsewhere.

Q56 **Kevin Hollinrake:** Does anyone like the idea of an online sales tax? Suren, do you like the idea of it?

Suren Thiru: We like the idea of it. I think our members are open to some sort of rebalancing in the tax system, in which bricks-and-mortar firms are taxed more heavily than online firms. We have seen this historically. There could be some rebalancing there, but we have to be quite careful how it looks in practice, particularly for smaller businesses. A lot of start-ups are online only, so we do not want to choke them off. Also, the feedback we have had from our members is that if, for example, a small business has an online presence and a bricks-and mortar presence and there were to be an online sales tax, it may well accelerate their move to being online only. They will face all these other costs from running a shop and having business rates and other overheads. We are looking at the overall cumulative burden of a property-based tax on running a shop, with all its overheads, and the online sales tax, which may accelerate the move away from having a high street shop to online. That needs to be worked out quite carefully.

Q57 **Kevin Hollinrake:** Alfie, what do you think? Are you okay with the different solution? Looking at the solution itself, isn't it just going to make the whole thing more complicated? Isn't this another bureaucratic burden for businesses?

Alfie Stirling: I think we have to go back to what question we are trying to answer and what problem we are trying to solve. There are two possibilities. One is to reduce business rates, as you talked about. If that is the objective, an online sales tax is problematic because it is complicated and it does not raise a huge amount. If you talk about £2 billion, that is less than a percentage point on corporation tax, so you are putting in quite a lot of effort to raise a fairly marginal sum of money.

The quantum is the important thing, because you are talking about lowering business rates. If the objective is to rebalance the tax burden on different types of activity in the economy, I would just observe that businesses that have bricks and mortar and trade on the high street have a higher or disproportionate tax burden relative to those that trade online. I am much more sympathetic to that objective in trying to solve the problem.

Again, I think the devil will be in the detail and the design. I am not convinced. I am very sympathetic to trying to see whether an online sales tax can help to answer the problem, and I think what we have seen in other countries may help to bring in more information, but in the end it may come down to taxing profits more effectively from different types of sectors and different companies, and some companies are more mobile and able to move those profits, including those that trade online sometimes. That may, in the end, be the path of least resistance to tackling that problem.

Q58 **Kevin Hollinrake:** The trouble with that is that some firms are very good at hiding their profits or putting them into different jurisdictions.

Alfie Stirling: To be honest, this is the reason for taxing businesses at all. In the end, the incidence of tax falls on individuals. It is either going to fall on consumers through prices, on workers through their lower pay or on shareholders. In the end, it all disperses. The reason why we tax businesses is because it is sometimes hard to get at some of those groups, particularly shareholders, in many instances. From that point of view, in respect of business rates and corporation tax, and if we start talking about an online sales tax, if you are thinking about widening the net to make sure we have an effective tax rate on the right types of end incidence, I think there is a good case for exploring these sorts of proposals.

Q59 **Kevin Hollinrake:** John, we already have a sales tax in the UK: it is called VAT. You said nobody has come up with a compelling way to reform business rates. I have spoken a number of times about this. What if we just scrap business rates completely, stick 4p or 5p on VAT, and that would be job done? You would have a hugely competitive, simple system. Tens of thousands of people who do rating will suddenly be released into the productive economy. It is a simplification, which the TaxPayers Alliance are dead in favour of.

John O'Connell: Yes, it is appealing for two reasons, one being simplification. A lot of the problems with the tax system are not always about the tax rates; it is more about the complexity. That boils down to everything from whether businesses can operate efficiently and the competitive advantage that a big business might have over a small business—in that it can manage the complexity of the tax system much more effectively—right down to people's trust in the tax system, because the more complex it is, the less people trust it. That is not a good thing for ensuring that everybody is happy and that everyone is paying their way.

The second reason it is appealing is that it eliminates the need for an online sales tax. Online sales are subject to VAT, so you take away that distinction between high street and online. The obvious downsides are that VAT is a regressive tax, so it could impact those on lower incomes more harshly, and that we already have a pretty high tax burden that we should be looking to lower. I think any tax reforms ought to look at lowering the tax burden; we should not be so obsessed with revenue-neutral tax reforms.

Q60 **Kevin Hollinrake:** It does not increase the tax burden or cost; it just shifts it?

John O'Connell: Yes.

Q61 **Kevin Hollinrake:** Suren, what do you think?

Suren Thiru: It is not something we have tested with our members. I think they are very open to alternatives. There are issues, as has been mentioned, around VAT. From a business perspective, particularly at the smaller end, they do understand the need for a properly based tax system, because it is there and you can see it. I think there is recognition that some sort of tax—be it a reform of business rates or some alternative—is needed in the tax system. I think there is openness to some sort of reform in that space rather than simply scrapping it altogether.

Q62 **Kevin Hollinrake:** Alfie, what do you think? A land value tax has been mooted but, as the Chair says, that seems pretty complicated—there is a lot of bureaucracy around it. Will that make the situation worse or better?

Alfie Stirling: As I mentioned, the proposal we would push for is a split rate, with one of the rates on the value of land. This goes back to your question about whether we should get rid of that tax altogether, and the answer is no, partly because, in the end, you cannot just consider taxes on their own; you have to think about what the revenue is used for—£25 billion is a huge amount of money and will have huge benefits, whether in economic growth or distributional and social outcomes. Taking that away at the same time as the tax clearly tips getting rid of the tax towards being a bad idea.

Also, on economic efficiency grounds, a big part of that tax base is land, which is an economic rent—it is an unearned benefit to the occupier—so if you do not tax it, that is a distortion in the system. Taxing it in a more effective and targeted way, through a land value tax or a split rate tax, is better than getting rid of the tax altogether.

Q63 **Kevin Hollinrake:** Back to you, John. If you had an online sales tax, it would apply across the board for certain types of retailers, but lots of retailers have different profit margins. The tax would not have an input and output element, so would it not be unfair on some businesses compared with others?

John O'Connell: I would imagine so, yes. It would also be unfair on particular types of consumers who have found online sales and online shopping to be a new lease of life for them, whether because they cannot get to the shops for physical reasons or whatever else—online sales have been fantastic for them. It would probably discriminate against some types of businesses, but also against certain types of consumers.

Q64 **Kevin Hollinrake:** I know the digital services tax was added to prices by Amazon. If that is the case, is it being passed straight on to the consumer?

John O'Connell: As was mentioned earlier, the incidence of tax is higher prices and lower wages or lower returns to investors. Companies do not pay taxes; they cannot pay taxes—they are a bundle of contracts. People end up paying taxes—that is how the incidence falls.

Q65 **Anthony Browne:** I have one quick follow-up question. A proposal for an alternative or an addition to business rates is to have a logistics warehouse tax. There are lots of problems with taxing online sales, as you have been talking about. All the major online sales have to go through logistics warehouses: the big Amazon warehouses, the Ocado warehouses—all the big online retailers have to have specialist warehouses. They are easy to identify. That would implicitly rebalance things, as the money from that could be used to reduce tax on normal retail shops with physical properties. What are your thoughts about that? I do not know whether you have come across that idea, which has been considered by the Treasury.

John O'Connell: I would be wary of specifically designing tax to go after one particular type of sector—I would be worried about that.

Q66 **Anthony Browne:** It is a sort of proxy for going after online sales because major online sales have to go through logistics warehouses.

John O'Connell: I would still be wary of it. What is happening is probably quite a significant shift in how consumers behave, and that relates to how they spend time socially. They may not view shopping as a pastime, as people might have done in the recent past. I do not think we should necessarily fight those changes using the tax system; I think we should look at the ways that people are changing their consumer behaviours and look into the future of how that might work, rather than trying to preserve in aspic the idea that the high street is a nice row of shops that you go down every Saturday afternoon. People's preferences are changing, and I don't think we should be using the tax system to fight that.

Q67 **Anthony Browne:** Suren, do you have any views on that? Do you think your members would have any views on that?

Suren Thiru: From our members' perspective, the concern is: at what point will it hit the business? If it is the up-front immediate costs that these businesses will be facing, I think there will be a great deal of concern about how that impacts their business. If it's at the front end, that may be a bit easier, but that would be the main concern for our members: that it will just add another cost on top of all the other costs they are facing.

Q68 **Anthony Browne:** The idea would be to make it revenue neutral, I guess. Any comment on that?

Alfie Stirling: I have nothing to add.

Q69 **Julie Marson:** I have some questions about the relative advantages and disadvantages of pursuing tax changes that would benefit businesses, compared with individuals. I will ask everyone, but let me start with you, Alfie. Would you rather see tax reductions focused on individuals or businesses?

Alfie Stirling: I am not trying to be difficult, but it is very hard to answer that question without knowing what the objective of that tax reduction is. Of course, a different objective would lead to a different policy design. Do you have a particular objective?

Q70 **Julie Marson:** No. There are obviously different implications for the two. However, if the Treasury is making choices in terms of the effect on workers, compared to businesses, what, philosophically, are the most sensible choices to make? What are the implications of those choices?

Alfie Stirling: In terms of tax burden, it is about thinking through the different types of individuals who sit behind those businesses. As I said, you have workers, consumers and shareholders. It is interesting to try to compare some of those constituents on a like-for-like basis—if you take shareholders versus workers, for example, and think about the income they receive through their economic activity. At the moment, we have a much higher tax burden on workers—those who take earnings from work as their main source of income—than on those who take earnings through dividends or capital gains. On the previous panel, Stuart mentioned that you can move income into capital gains. There is both a moral, normative point and a tax-efficiency point. First, that leads to adverse distributional outcomes, with those who have large stocks of wealth and rely on them for their income having a lower tax burden than those whose income comes from a different source; and secondly, from a tax-efficiency point of view, that means you are treating different types of income in the economy very differently, which will lead to behavioural effects that may not be desirable.

Q71 **Julie Marson:** We touched on VAT, for instance. Is VAT a handy hit to, say, cut taxes for individuals and businesses at the same time? Is that useful?

Alfie Stirling: It can be. As tax cuts go, VAT will reach a broader base of people. If you are trying to do something about the cost of living, for example, a big problem with tax cuts is that they often will not reach the people you most want to reach. Things like income tax and national insurance—the other big-ticket items alongside VAT—often will not reach the very poorest, or at least not to a high degree, whereas VAT might. The other benefit of VAT is that it is quite easy to predict what the short-run effect on prices will be. It is a kind of one-for-one transmission, usually. In the long run, it becomes more complicated.

The problem with VAT is that, from an income point of view, it can be a bit regressive. It all comes down to whether or not you are thinking about people moving income across years et cetera—it gets quite complicated. It is certainly regressive in respect of a snapshot against income; across expenditure it is a bit less so. You have to look at the shape of the society that sits behind that. If you are trying to raise revenue or address costs in a society that is very equal—I am thinking about the Nordic countries—VAT is a very powerful and effective lever. Sweden has much higher rates of VAT than the UK. However, if you are in a highly unequal society—perhaps more like the UK or the US—those sorts of taxes become more problematic, because a more neutral lever reflects the shape of the society that you are leveraging that tax on.

Q72 **Julie Marson:** Thank you very much. Let me ask you the same sort of question, John. What are the advantages and disadvantages of pursuing tax on individuals versus businesses?

John O'Connell: An important thing to remember is that the true basic rate of income tax is 40.2%, once both strands of national insurance are factored in. That is going to go up further still in April. With student loan repayments and benefit withdrawal rates, the real rate is even higher for lots of people. It is too high and it ought to come down in April, not go up. Choosing one or the other is difficult, again, in that there is an objective. Is it a growth-maximising strategy or a welfare-maximising strategy? Again, some of the key tax changes on growth could be changes that encourage investment, such as changes to things like the factory tax and stamp duty on shares, even. My personal preference is that, with a 40.2% basic income tax rate, there ought to be a lesser burden there.

Q73 **Julie Marson:** Thank you very much. Suren, you have got a particular interest in the SME space. What is your view from an SME perspective on that kind of balance or choices?

Suren Thiru: It is a very difficult balancing act. There are knock-on effects of taxes on businesses, and indeed on individuals. From a business perspective, with all the other costs that they are facing, we are seeing a pass-through effect in terms of high prices, but also a limit to the extent to which businesses can provide training to employees. There is a limit to the extent to which they can pay higher wages because they are facing all those other costs. There is a knock-on impact of higher costs and higher taxes that does feed through.

In terms of VAT, the rate is not something that businesses necessarily talk about; they talk more about the complexity or the myriad different rates that are out there. Where we do get some interest is particularly around VAT for hospitality and tourism, where there is a disparity between the normal UK rate and the rate of some of our European competitors. Having a permanently lower rate of VAT for hospitality and tourism is something that our members would welcome. In terms of energy costs, a temporary cut in VAT to help both consumers and businesses would certainly help, but it is not something that we hear a lot about; it is not one of the No. 1 issues that businesses are facing.

Q74 **Julie Marson:** One of the first taxes that you mentioned, in answer to the Chair, was business rates. From a SME perspective, would SMEs be focused on something directly affecting them, such as business rates, or would it be equally acceptable or welcome to reduce taxes on individuals, creating a huge boost in consumption and demand?

Suren Thiru: I would say both if I am being honest. As always, it is about where the balance lies between the two. Certainly, they would look closely at the impact on both consumers and employees. A balance between individual consumers and businesses helps consumer demand, but also helps businesses to support employees and the wider economy by, for example, trying to keep prices under control.

Q75 **Julie Marson:** Thank you. Going back to Alfie, when we look at those choices, and impacts on individuals, higher taxes on businesses can create an incentive to move operations elsewhere—overseas and so on. Obviously, that has an impact on UK workers. Would it be better for UK workers if the tax system incentivised businesses to stay in the UK or relocate here, even though another impact of that might be higher taxes on those workers and individuals?

Alfie Stirling: Again, it depends on what the objective is. Workers are also people who use public services; if you are cutting taxes then you may well end up with poorer quality—or less access to—public services. I am not that sympathetic to the view that tax rates are hugely important for the mobility of companies, and where they take up residence and put activities. It is part of the calculations they make, but as was discussed on the last panel, it is comparatively marginal compared to other factors, such as the domestic workforce, the regulatory environment beyond taxes, law and order, and so on.

Julie Marson: Thank you. John, the same question on that type of judgment call.

John O'Connell: I think we ought to be making our own system as competitive as possible. A large part of that is not about the tax rates, but about how simple and clear the rules are. If you were starting with a blank sheet of paper, you would design an entirely different tax system; it would be a lot simpler and it would be more transparent. There would not be endless rules and carve-outs; it would be very easy for people to see who was paying what.

In an ideal world, that would be the direction I would like to see us go in—reforming and simplifying—and that would give us the best system. In the 21st century, in the global economy, of course companies could still move money, even in that scenario, to different jurisdictions and all those kinds of things. I think the best thing that we can do is to give ourselves the best chance to be as competitive as possible, which would definitely involve a big simplification of taxes.

Q76 **Julie Marson:** Would you agree with the simplification element in addition to the balance—the choices made?

Suren Thiru: Absolutely. We have polled our members on this previously, and over three quarters of members said that tax administration and tax compliance are quite huge issues for businesses, particularly at the smaller end, where they do not necessarily have the support in place from HMRC. But there is also the cost involved. It is obviously an indirect cost of tax administration alongside the actual cost of the taxes themselves.

Q77 **Emma Hardy:** Good afternoon, everyone. I have to say that I find the TaxPayers Alliance a really interesting organisation, so I was quite fascinated that you were coming to give evidence today, John. How do you prioritise which campaigns you get involved with?

John O'Connell: We have internal discussions and, in a similar way to other businesses and campaigns, we have meetings internally and decide what we ought to focus on.

Q78 **Emma Hardy:** I was just curious, because I was looking at your website, as I have looked at all the websites of all the organisations and witnesses here, and looking at things that you prioritise. I think the last one that you had listed as a success was getting Southampton Council to cut a clean air duty. I wondered where your priorities were in terms of campaigns at the moment. Is it more local councils, or is it national?

John O'Connell: No, we aim to have a mix; I think that is important, because politics matters to people on a local level. We have a campaign going on in the London Borough of Havering at the moment, because the council is talking about increasing council tax in its upcoming budget, so we have done some campaigning work there.

Q79 **Emma Hardy:** Okay, and are they all internal decisions? Is that just with a board? I don't know how it works.

John O'Connell: Internal decisions, but based on lots of interaction with supporters. People write in to us and say, "This is happening in our area", or we might talk about it in that way with them.

Q80 **Emma Hardy:** And because we are talking about taxes and obviously about businesses versus individuals, as with the evidence you have just given, where does your funding come from?

John O'Connell: We have several thousand donors who support us every year. They are private individuals.

Q81 **Emma Hardy:** Okay. Are they linked in any way to business, or to any of the questions or evidence that we have had so far on this panel?

John O'Connell: No.

Q82 **Emma Hardy:** When we were looking at financial transparency, I just noticed that the TaxPayers Alliance had the lowest possible grade for financial transparency. Obviously, when giving evidence to a Committee and influencing the Committee, do you not think that greater financial transparency is something that you should maybe have a look at?

John O'Connell: Well, we respect the privacy of our individual donors.

Q83 **Emma Hardy:** Okay, but you are giving evidence to a Committee, and it is very difficult when listening to your evidence to know how much of it is influenced by your private donors, because obviously—unlike football players—nobody has their sponsor written on their T-shirt. I just wonder whether you are able at least to inform us, when giving this evidence, whether your private donors are involved in big businesses or small businesses? We know, clearly, that the chambers of commerce are SMEs. We know that Alfie's organisation is a charity and how that is funded. I just think that if you are giving evidence to a Committee, it is a fair question to ask how you are funded.

John O'Connell: We have supporters who are involved in big business and small business; people who are retired; and some younger supporters, as well. It is across the board.

I think that our campaigns and research work are all relatively consistent on what they are about. We are a campaign group for lower taxes and responsible Government spending. I think that is fairly clear and demonstrable in our work.

Q84 **Emma Hardy:** Okay. I just think, Chair, that if people are giving evidence that we need that greater transparency, just to understand. You know, when the TUC comes in, we know where their funding comes from and the angle they will take. I think that it is important if someone is giving evidence. It is important for our democracy to have that transparency as to who is funding you and what their priority is.

Having said that, Chair, I will move on to ask you all: which taxes do you think it would be best to cut in order to increase labour participation—to get more people back into the labour market? Shall we start with you, Alfie?

Alfie Stirling: There are two things to think about. It is a bit of a dry, technical point of view, but there are marginal tax rates—so, for an additional £1 of earnings for someone in work, what is the rate of tax that they will pay on that? That is really important for higher pay progression, arguably more than things like productivity. There are also participation rates: what is the tax burden of someone moving into work? I think your question is about the first, but they are both relevant.

In the end, I think it all comes down to the withdrawal rate of work-related benefits. If you look at the system at the moment and where marginal tax rates are highest, they are far, far higher at the point at which people are on universal credit or working tax credits and are moving into work, having their welfare income reduced for every £1 of earning.

Before the October Budget, you had effective tax rates of about 75%—far, far higher than at the top end of the schedule. With the taper rate cut and the work allowance lifted a little bit, that has now gone down to about 70%. Of course, the Chancellor made the point of saying, "This is a tax rate"—that is, the withdrawal of benefits out of earnings when people enter work is the same in economic terms. He is absolutely right about that. But having had those reforms, we still have eye-watering tax rates at points.

For me, it is about two things: bringing the universal credit taper rate down further; and the work allowance—the amount that someone can earn before the taper rate kicks in—which you can think about as a targeted personal allowance for income tax. Everyone has a personal allowance of income tax, but for many people that will not affect their incentives at all. It is effectively just cash that they will get because they were going to be in work either way. If you actually moved to a system where you might have a lower personal allowance of income tax, but a higher work allowance, that would target that tax cut where it is most needed: on those who are making the decision about moving back into work.

Emma Hardy: Thank you very much. The point about the taper rate was raised by the TUC as well. John?

John O'Connell: I agree with a large part of what was just said, but I think that, most directly, employers' national insurance would obviously free up some money for companies to hire more. There are different elements to this. One would be how we could best look at encouraging promotion within work. Freezing the thresholds at which people move up into tax brackets might have an impact, in the sense that people may not feel incentivised to push harder for that promotion if they are going to move up into a higher tax bracket. Those are the two key points that I would pick out.

Suren Thiru: I echo the calls around national insurance. One of the issues around labour participation from a business perspective is access to training. We are seeing it in the aftermath of the pandemic, with rising economic inactivity, particularly among older workers, so there needs to be better access to training. We have talked about maybe providing a tax credit for skills training to help businesses deal with that, alongside looking at improvements with funding access to rapid, bitesize training, for example, to get all the workers back into the workforce. That is where we would focus, as well as the bottom-line costs around national insurance.

Q85 **Emma Hardy:** That is interesting. How have you found SMEs dealing with the apprenticeship levy, which is in effect a taxation for training?

Suren Thiru: They have found it quite a challenge and quite complex, and that it does not necessarily have the flexibility that they need to help their own business needs. Each individual business has different needs, including which training providers they need, and what training and development each individual needs within the business. They have found the apprenticeship levy a little bit cumbersome in that respect, so there could be greater flexibility there, but also greater flexibility around how they can use some of their funding to help support retraining, people coming into their workforce, moving towards new technology, digital skills and those sorts of things.

Q86 **Emma Hardy:** Brilliant, thank you. I am looking at the time—one last question. Alfie, are initiatives such as tax-free childcare better at increasing participation than changes to the direct taxation system? I was reading an article that said that the tax-free childcare offer is not really picked up by many people at all, but should have the incentive of bringing more people into the workforce. Do you think that tax-free childcare is better than changes to the direct taxation system, as a way of bringing in more people?

Alfie Stirling: In general, tax cuts are not very well targeted for almost any social outcome that you seek. That is why my answer to your question was, strictly speaking, not a tax rate cut, but changing the withdrawal rate of benefits—changing the taper of the public spending. Taxes carry a huge amount of dead weight loss because they are very broad brush and will affect huge swathes of people, but are not very well targeted at the margin.

The short answer is yes; childcare, when it is attached to a particular ticket of spending, will be better than most other areas of tax cut, but it is still working through the tax system. The amount of relief you can get will be the inverse of how much tax you pay and how much income you have, so there are challenges there.

In the end, if you want to improve childcare from the point of view of work incentives—of course, there are two main reasons you might want to invest in childcare. One is attainment and development for children and the other is work incentives, and incidentally the UK performs very badly across both, almost uniquely across advanced economies. If you want to invest in childcare, it is probably more efficient to do so through the supply side—thinking about how a childcare provider is funded, and about direct grants as opposed to through the tax system—but compared to taxes, it is probably quite good.

John O'Connell: We ought to bear in mind fiscal churn—giving with one hand and taking with the other. Reducing the tax burden would obviously leave more money in people’s pockets for them to better afford childcare themselves. With childcare, there are some other issues on the supply side and on regulations. I know there have been issues with the number of children that each individual childminder can look after compared to other European peers. I think some of that is being looked at. While it is not the definitive answer, I do think we need to bear in mind that element of fiscal churn—that is, having quite high tax rates and then having to give the money back because people do not have enough money to afford important things, such as childcare.

Emma Hardy: I am not sure if it is relevant, but you are welcome to come in, Suren.

Suren Thiru: It can play a role, but our focus is again similar to what Alfie mentioned around the funding side. That is probably more where we would sit. It is about simplifying childcare funding. For example, each family would have a childcare budget that they can again use for their own needs to have this flexibility that meets their individual family work practices. That is something that some members would enjoy, and I think it would help to improve participation.

Q87 **Gareth Davies:** I would like to talk about how the tax system can help tackle negative externalities, such as pollution and other factors. Let me start with you, Suren, if I can. What is better as a tool to tackle negative externalities: taxes or regulation?

Suren Thiru: From our experience, it is tax. One example of this is some sort of carbon tax, which has been suggested at certain points in time, to support the transition to net zero. That needs to be backed up by greater support for businesses, so it is essentially revenue neutral. If you are trying to correct a negative externality on one side by raising a tax, the revenue from that tax should be used to help small businesses in particular to make that journey. Our members tell us that one of the big barriers, particularly around the transition to net zero, are upfront costs, and one of the things they often say will be helpful is allowances, support and grant support. For example, if you had some sort of carbon tax to address pollution, that money should almost be used to provide grants to help businesses, particularly small businesses, make that journey to adapt.

Q88 **Gareth Davies:** Do you think that from a business community perspective, hypothecation of our tax system is a better or easier way of getting support from those who are being taxed?

Suren Thiru: It can play a role, but a lot of what our members talk about when they talk about taxes is how that tax revenue is being used. Is there a virtuous circle between being taxed and the support at the other end? That is something that, again, comes through quite strongly from our membership.

Gareth Davies: That is kind of what I was getting at. John, have you got a perspective on tax versus regulation?

John O'Connell: Not that I come down on one side or the other, but we often need to think about the fact that taxes on externalities can actually create their own externalities. A good example is the landfill levy. On the positive side, it disincentivises people from using landfill and encourages people to use recycling plants and all that kind of thing. On the downside, it encourages fly-tipping and makes that more attractive, as well as unofficial incineration and things like that. We need to be wary of trade-offs when we are using the tax system to tax externalities. That is not to say it is necessarily a bad thing; it is just about being aware of those trade-offs.

In areas such as harm reduction, again it is about being aware of the trade-offs. Does it actually reduce the harm it is intended to reduce? If somebody likes eating sugary food, will they just switch from one product to another—from fizzy drinks to something else entirely? Tax can be an instrument in those objectives—I am not denying that for a second—but I would say that we need to be aware of the trade-offs and unintended consequences of introducing them in the first place.

Q89 **Gareth Davies:** Yes, I get that. Looking at regulation or tax, what do you think is met with the greatest resistance from a business cost standpoint?

John O'Connell: That is a really good question. From my experience of talking to people in business, they talk about regulation just as much as they talk about tax. Again, a lot of it is about complexity, time, having to learn what new regulations mean for their business and that kind of thing. That is similar to the tax system in a way: there is not that sense of, "I know how I am going to be running my business in five or 10 years' time," because things are constantly in flux. That is sometimes for good reason—don't get me wrong—but people do talk as much about regs as about tax.

Q90 **Gareth Davies:** To tackle negative externalities such as pollution, for example, is it better to reduce tax on the goods and services that reduce or mitigate those negative externalities, or to increase taxes on those who cause them, as a general principle?

John O'Connell: That is not something I have thought too deeply about, but I do not know the answer offhand.

Q91 **Gareth Davies:** You are the TaxPayers Alliance. Come on—you must have a perspective. Is it better to incentivise better behaviour or to punish bad behaviour?

John O'Connell: The thing about taxes is that they do not incentivise; they are disincentives. You are removing or adding a disincentive. It is a complicated question on which I do not have a clear answer, I am afraid.

Gareth Davies: Suren, do you have a perspective?

Suren Thiru: From our members' perspective, it would be more around incentives. We polled our members on this, in particular around net zero, in the survey we did a couple of months ago, and what came up quite strongly was ways of incentivising people. Allowances, for example, came up as one of the top three areas for supporting businesses in becoming more sustainable.

Q92 **Gareth Davies:** An oil company would presumably welcome incentivisation through the tax system to focus more on renewables, for example, but there could also be higher taxes on its oil exploration or whatever. Presumably it would welcome the incentivisation, but which do you think is most effective at getting them to change?

Suren Thiru: That is not really something that we have tested with our members.

Q93 **Gareth Davies:** Alfie, let me ask you about this, because you produced a report in November on this very area, particularly on the environment. We have already heard about the landfill tax, but there are a number of different measures and levies, or whatever you want to call them: the aggregates levy, the climate change levy, the landfill tax. What is your assessment of the current tax regime in tackling negative externalities for the environment?

Alfie Stirling: It is inadequate because, in the end, the other parameter you have to consider is where you have to get to by x time point. If you have a target of net zero by 2050, or whatever it might be, you have to then calibrate your policy stance with that objective. I think it is quite clear that we are not taxing negative externalities or regulating against them to a sufficient degree to remain within carbon budgets.

In terms of the relative merits of regulation and tax, it is very much a case-by-case basis. There are things you need to consider. What are you trying to prioritise? In the end, both of them will have welfare effects and both of them could have price effects. If you reduce the supply of something because you have regulated it, but demand remains constant, the price will go up. If you increase the tax, you get the same. They will both have the same price effects.

One area that we looked into in quite a lot of detail was the aviation industry and flights. We know that air passenger duty is not high enough for the sector to remain within its carbon budget as set out by the CCC, so what do you do? You could restrict airport expansion—that is a regulatory option, if you like. You could also tax it higher—perhaps a higher APD. Both of those lead to quite regressive outcomes, pricing out from flying people on low incomes, so we pushed for a tax option in this scenario: a frequent flyer levy, where you have a schedule of tax that rises for every subsequent flight that you take. You have to look at each area on its merits and think about the external parameters, where you are trying to get to and how fast, and the distributional outcomes.

Q94 **Gareth Davies:** So you would focus on punishing through the tax system, rather than incentivising improvement and reform to become more sustainable.

Alfie Stirling: No, not necessarily. That was thinking about regulation versus tax. If you are thinking about tax incentives versus higher taxes, tax incentives are not the full suite of subsidies or incentives. You can have grants and so on. The tax system is a system for increasing the burden on something. It is much better to use taxes for what they are supposed to be for, which is to increase the price or the cost of certain activities. If you want to incentivise something, it is much more efficient to do it through grants or targeted spending in some form, rather than through the tax system. That is not to say that it is more stick than carrot. It is just that you use the stick for the stick and the carrot for the carrot.

Q95 **Gareth Davies:** I hear what you are saying. You would rather have grants than reduce taxes. Of the current regime of incentivisation, what is your assessment of the current set-up that the Government have?

Alfie Stirling: Similar to the tax burden, they are not using the carrot sufficiently, so we do not have sufficient incentives.

Gareth Davies: At least you are consistent.

Chair: Finally, Siobhain.

Q96 **Siobhain McDonagh:** Thank you very much, Chair. I want to look at the question of whether or how the tax system could be changed to reduce inequality. My first question is to you, Alfie. Which tax changes would be most effective in reducing income or wealth inequality?

Alfie Stirling: This is the really big one. If you are talking about the stock of wealth, you can go down the route of a windfall tax. If you are looking at excess profits in a sector or at a vast stock of wealth—perhaps land, or perhaps another form of asset—windfall taxes are very useful, but in the end it is income that causes a lot of the problems.

One thing I would look at is the use of reliefs in the tax system. It is a huge amount of shadow spending. For example—we talked about it earlier—the incomes tax personal allowance is about £140 billion of forgone tax revenue. The National Audit Office classifies it as a tax relief in order to improve the progressivity of the tax system or to reduce inequality, but it actually does the opposite. It is almost perfectly regressive in terms of who benefits across society. So that is £140 billion in the tax system. It is not a baseline relief. The National Audit Office says it has a social purpose, which is to increase progressivity, but it is doing the opposite. So that would be a place to start. We talked earlier about more targeted forms of personal allowance, perhaps through work allowances and universal credit.

Perhaps this is a bit more left field, or a way of moving the system to something a bit more innovative or radical. If you look at the German system of income tax, a really interesting feature is the formula-based tax schedule, which means that there is no tax band—one tax rate that you move between, whether it is 20%, 40% or so on. Rather, your tax rate changes as your income goes up, so your tax rate changes as a function of your income. That allows you to have a lot more precision across the income distribution. You can have a wide tax base, so everyone contributes something, but you can have very low rates at the bottom, rather than jumping from zero to 20%, as in the UK system.

I appreciate the point that was made earlier—that once you are paying income tax at 20% you are paying lots of other things as well, so it is effectively more than 40%—but to look just at income tax, rather than jumping from zero to 20%, you could have a gradual taper up to that. It would make the system much more progressive overall.

Q97 **Siobhain McDonagh:** I go out and knock on doors every Sunday, and I am really fearful of life in the spring for lots of my constituents who are already terribly worried about gas and electricity prices and the VAT increase. What do you think it would be best to do? Would it be a good idea to reduce tax on consumption, VAT, income or council tax?

Alfie Stirling: If you want to prioritise getting money quickly to those who most need it, the tax system is not the best system to deliver that. It is quite striking that a lot of the packages of proposals put out in the last few months about tackling the cost of living, and energy prices in particular, all tried to think of almost off-the-hoof or fasts ways—sticking plasters—for getting round the problem of getting money to people quickly, when there was already a system sitting there, which is means-tested benefits. You could increase those rates of payments and get money to those people quickly.

Also, these are not marginal constituencies in society: it is 9 million families. If you go across pension credit, jobseeker's allowance and universal credit, it is huge swathes of society, and you could support people in proportion to the income they already have. That is the first thing: I would not do that sort of support through the tax system.

We have talked about some of the options. Council tax is poorly targeted from the point of view of the families that live in a particular property: property values from 1991 are not a good proxy for today's energy consumption or income need. With VAT, again, if you want to have some sort of universal response and you are softening that blow for everyone, fine, but it is very expensive and it will mean that those who have got a very big hit do not get much support, and some people who do not need support will get something they might not have needed.

Q98 **Siobhain McDonagh:** Thank you. John, the upcoming tax increases are going to place the greatest burden on working people who are least able to pay and are having their living standards squeezed. Would it be fairer to look at some of the staggering increases in wealth we have seen over the last 20 years? You could suggest that house price growth has delivered an unearned, unequal and untaxed £3-trillion capital gains windfall, with the least wealthy gaining less than £1,000 per adult, compared to the average gain of £174,000 for the wealthiest 10%.

John O'Connell: The problem with wealth taxes is—

Siobhain McDonagh: Have we got to a stage where you can no longer make yourself rich by going to work?

John O'Connell: That is a really interesting question. The problem with wealth taxes is that they do not work. Countries are dropping wealth taxes rather than adopting them: we are down to about four countries in the OECD that now have a wealth tax, and I think that number was over a dozen not too long ago. Even the Labour Chancellor Denis Healey famously could not make one work. The reason is that wealth is just inherently more mobile. What I would genuinely like to see is much more action on those who are on low and middle incomes. It is usually taxes that stop them progressing to a better standard of life—most fundamentally income tax and national insurance.

Q99 **Siobhain McDonagh:** What if a windfall tax on wealth—on houses, on property prices—can bring you in much more money than really putting pressure on people who are going out to work every day to earn not very much?

John O'Connell: Again, the problem is that there are probably quite a lot of people who are asset rich and cash poor. They might have bought a house many decades ago that now, just by luck, is worth quite a lot of money, and they may not have good incomes at all. You would be asking them to pay a huge amount of money that they simply do not have.

Q100 **Siobhain McDonagh:** Okay. To anybody who wants to answer, there have been criticisms that the Government's national insurance proposals represent a transfer of wealth from the young, who have to pay the national insurance, to the old, who do not and will benefit from the new levy regardless. Do you agree, and is there a more intergenerationally fair way of finding the funding?

Alfie Stirling: Broadly speaking, that is an accurate description. There have also been changes to the student loan system, which have a similar effect—this is part of a basket of measures, of course. Pensioners, I think, were included in the social care levy in that their rate went up, but their rate is still far lower than what is now paid by workers, 13.25%, so there is still that big inequity.

I just want to go back to the wealth tax point, though. Although it is true that it is very hard to tax the stock of wealth—you know, everyone's wealth—account for it and tax it year on year, and it is true that countries have reduced that over time, there are other ways you can get at taxing wealth. The most effective is to tax income from wealth, whether that is capital gains or dividends, and also particular areas where we know—

Q101 **Siobhain McDonagh:** What about the start that George Osborne made on taxing residential landlords, or reducing tax breaks for those landlords?

Alfie Stirling: Exactly—you could start with a lot of the reliefs that are already doing the opposite. There are also some taxes that are very effective at taxing wealth that we do not often think about, such as stamp duty reserve tax, which is a tax on the owners of shares. It is very effective, because people have to register their ownership of a share in order to legally own it: they have to declare, and at that point, we tax a very low rate compared to what we did about 10 or 15 years ago. Other countries tax much more, and that reliably brings in a lot more income.

Q102 **Siobhain McDonagh:** John, do you have any comments on intergenerational unfairness?

John O'Connell: I think it is hard to escape the fact that younger, working-age people will feel a little bit done over by the tax changes—absolutely. That is why I thought national insurance was a particularly badly targeted way to raise the extra money. Again, it is something that stops people on low and middle incomes progressing and having more prosperity and a better standard of living, so I thought it was a particularly bad way to try to raise the £12 billion.

Siobhain McDonagh: Suren, would you like to comment?

Suren Thiru: I would echo the comments made earlier; I think that is absolutely right.

Q103 **Chair:** I have two questions, the first directly leading on from that. The Chancellor's argument was that he had to go for the broad-based taxes in order to raise that kind of amount; £12 billion-plus is a lot of money. You have income tax or VAT as an alternative. Where would you have gone for that £12 billion—assuming that going for a tax rise in the first place is the right thing to do? We will start with you, John.

John O'Connell: I start from the position that actually we would much rather see some tax reforms to bring in more money to pay for the public services that we all value. Absolutely, that would be my starting position, but to address the question much more directly, if you want broad-based, then VAT, for instance, is—

Chair: That is regressive, isn't it?

John O'Connell: It is regressive, but it is particularly broad-based.

Siobhain McDonagh: It hits the same people as national insurance.

John O'Connell: I couldn't agree more, which is why I would go for a different strategy altogether.

Q104 **Chair:** Does anyone else want to suggest an alternative to NI?

Alfie Stirling: You could raise £12 billion from just closing the gap in terms of the tax burden on earnings from work versus income from wealth. You could get rid of, perhaps, allowances in capital gains tax. You could reform inheritance tax to be a gift tax. You could equalise dividend income tax with income tax on earnings. There is a number of routes whereby you could do this.

Q105 **Chair:** We have some of the numbers. Inheritance taxes raise £5 billion a year or something. If we are looking for £12 billion, we are not going to get it from that.

Alfie Stirling: The Resolution Foundation put out some work that showed different options that would raise £2 billion, £3 billion or £4 billion from inheritance tax; that is one particular one I mentioned. If you want to do it all through one tax, then if you were to try to equalise the rate within capital gains tax and dividend income tax with the effective tax on earnings from work, you could raise £12 billion or £15 billion a year. That is based on modelling by the Resolution Foundation, the University of Warwick and the IPPR. That is one route I would go down. It isn't a left versus right point. It would be economically more efficient, because those sources of income are already undertaxed versus earnings from work, so it would remove that distortion in the tax system while raising the revenues.

If you want to do this just with national insurance, I don't think these proposals were the best set of proposals. You could have raised another £1.5 billion by making sure that pensioners paid the same rate as everyone else, but you could have raised £11 billion or £12 billion by ensuring that those with earnings above the upper earnings limit, above about £50,000, who currently pay national insurance at 2%—it's the opposite of income tax; your rate goes down. If you lifted that rate up to the same as for everyone else—13.25% if it's the current system, or 12% under the last system—that would raise about £12 billion as well and would be much more progressive.

Q106 **Chair:** There was a dividends tax increase at the same time, wasn't there, which was fairly progressive?

My second question is specifically to you, Alfie, and is a very specific question. I think you said that the personal allowance was regressive—was intended not to be but was regressive. I was tantalised by that, so can you tell us a bit about why you feel that and what the arguments are around that?

Alfie Stirling: Well, it's not so much a feeling; it's just what the data shows in terms of measuring the distributional benefit of that tax allowance across families. The reason is that those who don't earn anything from work at all don't benefit from it at all; the tax allowance only reaches people who earn over a certain threshold—and proportionately more the more you earn. It also benefits families who have two people in work doubly, because each individual gets that allowance, versus a single-earner household, which would only get that benefit once. Invariably, single-earner households are poorer than wealthier households. There is also a problem in the system where the higher-rate threshold in the tax system is specified as a particular amount above the personal allowance, so for every pound you raise the personal allowance or move it in any direction, the higher-rate threshold moves one for one with that, which means, if you are on the 40p rate, you are doubling the benefit, compared with someone who is on basic rate income tax. Those are three mechanical explanations, but what I was talking about was just in the data. This is regressive, up until you get to the very, very richest 1% or 2%, when it begins to get progressive again, because they don't get a personal allowance, because they might earn more—

Q107 **Chair:** It's gone away; over £100,000, it gets removed, doesn't it?

Alfie Stirling: It gets tapered and disappears entirely—

Q108 **Chair:** Another complication. I think you get a marginal rate of 62% or something as it gets removed.

Alfie Stirling: Incidentally, that is still lower than the 70% rate of tax that someone having their benefits withdrawn pays.

Chair: It would be quite interesting if there was some research on this. If an analysis has been done, I would be very interested if you could drop a line to the Committee. We would be interested to look at it. Thank you very much.

That brings us to the end, so thank you all very much indeed for giving us your time this afternoon and this evening—it's afternoon still. It feels like it has been quite a long day, with all the things that are going on around us at the moment and in the Chamber. Thank you very much indeed; we appreciate your time. That concludes this session.