



House of Commons
Treasury Committee

Tax after coronavirus

Twelfth Report of Session 2019–21

*Report, together with formal minutes relating
to the report*

*Ordered by the House of Commons
to be printed 24 February 2021*

HC 664

Published on 1 March 2021
by authority of the House of Commons

The Treasury Committee

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Summary

The coronavirus crisis has generated one of the greatest shocks to the UK's economy in the past 300 years. It has accelerated the UK's public debt at the fastest rate ever seen in peacetime. After the crisis has passed, it will have exacerbated the long-term pressures on the public finances that are projected to see revenues and spending diverge indefinitely if no action is taken.

The public finances challenge

Our expert witnesses said that now is not the time for tax rises or fiscal consolidation, which could undermine the economic recovery. However, the public finances are left more exposed to rises in interest rates. Significant fiscal measures, including revenue raising, will probably be needed in future.

In our September 2020 report on Economic Impact of Coronavirus: The Challenges of Recovery, we concluded that the Chancellor should, at the next fiscal event, set out an initial roadmap of how he intends to place Government finances on a sustainable footing. A reassurance that the Government intends to take steps to ensure fiscal sustainability in future will underpin market confidence and reduce uncertainty for households and businesses that may fear immediate tax rises.

The public finances are on an unsustainable long-term trajectory that has been exacerbated by the coronavirus pandemic. Additional tax revenue could make a contribution to addressing this. But the tax measures that are most politically palatable in the short term are often not those that minimise distortions to economic activity in the longer term. This is a large-scale and long-term challenge that requires taking a view of the whole tax system, how it can be reformed, and how it can raise revenue in a way that minimises economic damage as well as effectively supporting public services, which can in turn promote growth.

Windfall and wealth taxes

Some firms and sectors have seen a significant increase in turnover as a result of the pandemic, and some witnesses made arguments in favour of a windfall tax on the profits which have resulted. There are downsides to a windfall tax, including its potentially retrospective nature. There would also be complexities, including the difficulties of identifying sectors to which any such tax should apply, ensuring that such a tax is fairly targeted at firms which have benefited excessively within those sectors, and identifying the element of a firm's profits which could be reasonably attributed to excessive profits generated by the pandemic. For these reasons, introducing such a tax would be problematic, but that is not to say that it would be impossible to introduce a windfall tax in certain circumstances in the future, if that was the political choice made. The Treasury would clearly need to conduct a thorough assessment of its feasibility and of the revenue which it might raise.

We believe that the development and administration of an annual wealth tax would be extremely challenging, and we would not recommend it. It is recognised though that were the wealth to income ratio to increase considerably, the political arguments for some form of wealth tax would become stronger.

Though those who gave evidence were sceptical of an annual wealth tax, there was more support for a one-off wealth tax. It could be used to raise significant revenue. However, amongst witnesses there were significant reservations that a tax imposed once can be imposed again, and that such a tax might be seen as retrospective.

The major contributors to tax revenues

Any increases in the rates of income tax, national insurance or VAT were ruled out in this Parliament by the Government's "tax lock" manifesto commitment. It is clear to the Committee that the manifesto commitment of the Conservative Party will come under pressure under the current circumstances.

Careful consideration would need to be given to any potential increases in income tax, VAT and national insurance contributions, taking into account the degree to which any increases

- result in additional economic distortions,
- make taxes more or less progressive,
- assist or otherwise with the Government's "levelling up" agenda, and
- impact on employment.

Increases in national insurance contributions may be especially difficult given the probable impact on jobs, at a time when increasing employment is likely to remain an economic priority.

While we have not heard enough evidence to recommend a wholesale merger of national insurance contributions and income tax, the Government should consider what can be done to remove the distortions gradually through time.

We do not recommend any significant changes to the scope of VAT.

The Government should, following consultation, set out principles and objectives for the VAT system, now that VAT is free from EU law. The Government should ensure that the principles balance revenue raising, economic growth and other objectives, such as improving the quality of the environment and "levelling up".

Corporation tax

A moderate increase in the corporation tax rate could raise revenue without damaging growth, especially if balanced with fiscally appropriate measures to help business, such as enhanced loss relief and capital allowances. However, it is clear that a very significant increase in the rate would be counterproductive.

Taxes and pensions

Given the regressive nature of the benefits accruing to individuals from the current arrangements on pension tax relief, especially those in the top earnings decile, the Chancellor should urgently reform the entire approach to pension tax relief.

We believe that when reviewing the burdens of taxation for the employed and self-employed and limited companies, the Government should also review the taxation of pensions and the tax relief applicable to pension payments.

Taxation of different forms of work

We strongly believe that a major reform of the tax treatment of the self-employed and employees is long overdue. The current system is confused, unfair and unsustainable. The review should incorporate the benefits which accrue upon payment of NICs and other taxes as well as the level, the incentives and the interaction of such taxes. It should look as far as is possible to eliminate the so-called ‘three person problem’ altogether.

Stamp duty land tax

The Government should treat stamp duty land tax as a priority for reform and should set the tax at a level that optimises revenue while encouraging home ownership. Any review should take into account the impact of any UK changes on equivalent devolved taxes.

Tax strategy

The Government should draw up a draft tax strategy for consultation, setting out what it wants to achieve from the tax system and identifying high level objectives. Any such strategy should include principles for:

- The role of the tax system in meeting fiscal goals
- Securing a neutral tax system which treats similar activities in similar ways, including fair taxation of different structures of work
- Ensuring that taxation is progressive and fair to future generations
- Meeting climate change goals for net zero and other environmental objectives whilst giving consideration to those who are on lower incomes
- Ensuring growth of business and employment, including a new business tax roadmap to provide investment certainty for business and a five to ten-year strategy for corporation tax rates
- Reducing the tax gap
- Indirect taxes such as VAT which were previously covered by EU law which no longer applies
- Reducing compliance costs, especially through appropriate tax simplification.

1 Introduction

1. The coronavirus crisis has generated one of the greatest shocks to the UK's economy in the past 300 years. It has accelerated the UK's public debt at the fastest rate ever seen in peacetime. After the crisis has passed, it will have exacerbated the long-term pressures on the public finances that are projected to see revenues and spending diverge indefinitely if no action is taken.¹

2. In July 2020, we announced an inquiry into Tax After Coronavirus. Our overall aim has been to form a view of how the tax system should respond to ensure long-term fiscal stability. Specifically, we set out to examine, amongst other issues:

- What the major long-term pressures on the UK tax system are and whether such pressures should be addressed through tax reform;
- What overall level of taxation the UK economy might bear;
- Which areas of the tax system are most in need of reform, and which are best left alone; and
- Whether there might be a role for windfall taxes in the post-crisis world.²

3. We have been selective in our approach to these questions. A full and detailed survey of the UK tax system would be beyond the scope of a report such as this: the tax code is complex and runs to thousands of pages. We have chosen to focus on elements of the tax system which are in clear need of reform.

4. Chapter 2 provides an analysis of the scale of the long-term public finance challenge, the extent of the fiscal legacy of the pandemic, and the taxable capacity of the UK economy.

5. In Chapter 3, we make recommendations on immediate action to assist business recovery in the short term. We have considered elsewhere, in a series of reports on the economic impact of coronavirus, other forms of support which could or should be offered to support businesses and employees who have suffered during the crisis.³

6. The majority of this report, however, considers options for change over the medium to long term. Some of these options relate to new taxes: Chapter 4 considers new taxes on wealth and business. Other chapters look at the scope for reform of existing taxes. Chapter 5 assesses options around the three taxes that contribute most revenue: income tax, VAT, and national insurance contributions. Chapter 6 examines a range of other taxes which are widely seen as in need of reform. We include in this chapter the taxation of work, pensions and digital services, capital taxes, and local taxes.

7. The final chapter—Chapter 7—takes a broad overview of the tax system and sets out the case for a new approach to both policymaking and implementation. It considers the merits of a high-level tax strategy and the efforts that have been made for simplification.

8. The virus, along with other factors such as growing demographic pressures, has resulted in an increased requirement to look at taxation to raise revenues. However,

1 See Chapter 2 below

2 Full terms of reference are at <https://committees.parliament.uk/call-for-evidence/206/tax-after-coronavirus/>

3 [Economic Impact of Coronavirus inquiry page](#)

alongside revenue raising there is also a strong case for reform. Taxes can have distortionary and damaging effects including, for example, the way in which the differing tax arrangements for the employed, the self-employed and those working through their own limited company are steadily eroding the tax base.⁴ Other factors that need to be considered include the phasing out of petrol and diesel cars, the decline in the high street and the rise of online shopping, which could in turn result in reduced tax yields.

9. In some ways the pressures on the public finances and on tax yields present the Government with an increased opportunity for substantial and structural reform of the tax system. Making this point, Paul Johnson, Director of the Institute of Fiscal Studies (IFS), told us: “If you are in the business of raising taxes and putting in big reforms in the scale of the tax system, you have an opportunity to make changes to the structure as well”.⁵

10. We hope that this Report can make a useful contribution to the debate on tax reform. It is informed by written submissions from a wide range of individuals, businesses and third sector organisations, most of whom highlighted concerns with the present tax system. 25 witnesses, including the Financial Secretary to the Treasury, gave evidence over the course of seven oral evidence sessions. We thank all the witnesses for their time and expert comment, and we are grateful to everyone who submitted written evidence. Both the oral evidence and the published written evidence is available on the Committee’s webpages.⁶

4 Office for Budget Responsibility, Fiscal Risks Report, [CP131](#), July 2019, p78, para 4.19

5 [Q39](#)

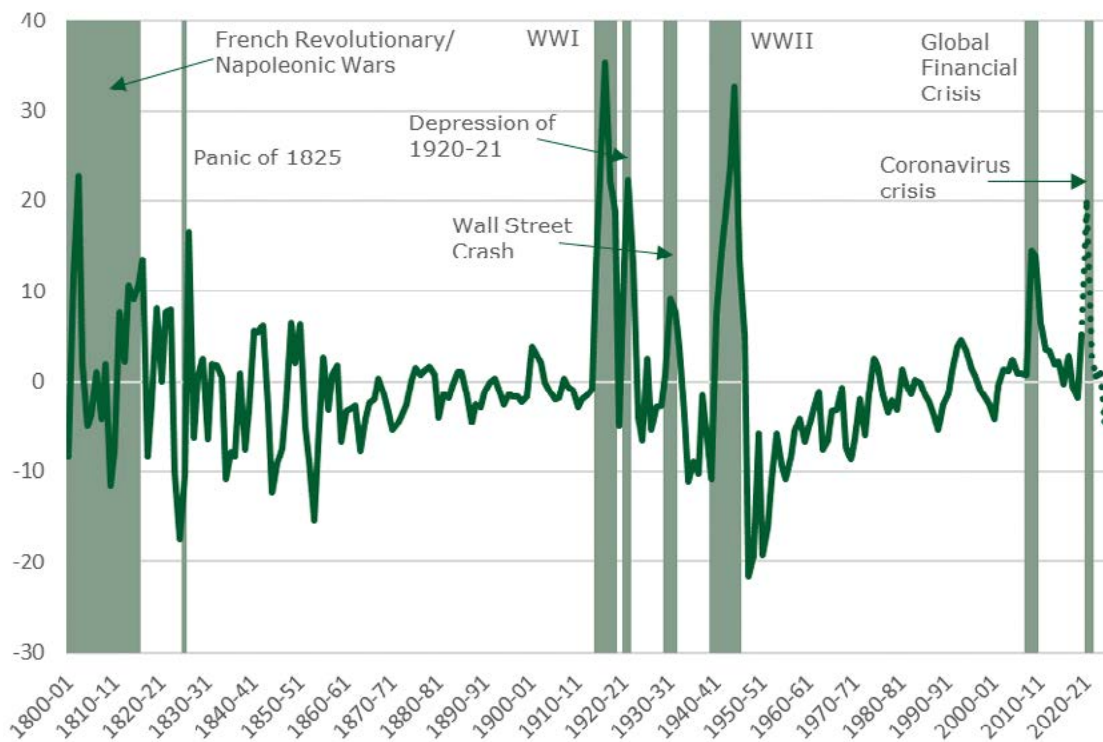
6 <https://committees.parliament.uk/work/465/tax-after-coronavirus/publications/>

2 The scale of the public finances challenge

The fiscal legacy of coronavirus

11. The economic downturn caused by the outbreak of coronavirus, social distancing and lockdowns, together with the Government's series of discretionary fiscal interventions, are having a huge and rapid impact on public borrowing and debt. It is estimated that central Government receipts were down by 14 per cent on a year earlier in the first nine months of the 2020–21 fiscal year, while central Government spending was up 31 per cent.⁷

Figure 1: Annual changes in public sector net debt since 1800 (% of GDP, OBR forecast after 2019–20)



Source: OBR, Economic & Fiscal Outlook November 2020, 25 November 2020, Chart 4.

12. The Office for Budget Responsibility (OBR) has revised its forecast of public sector net borrowing (PSNB) in 2020–21 up by £339 billion since its March 2020 forecast (in its central scenario). The OBR states clearly that a failure to provide support to firms and households would have caused “immense economic damage” and that “[fiscal] sustainability would have been damaged.” Nonetheless, the pandemic is having a major impact on the public finances.⁸

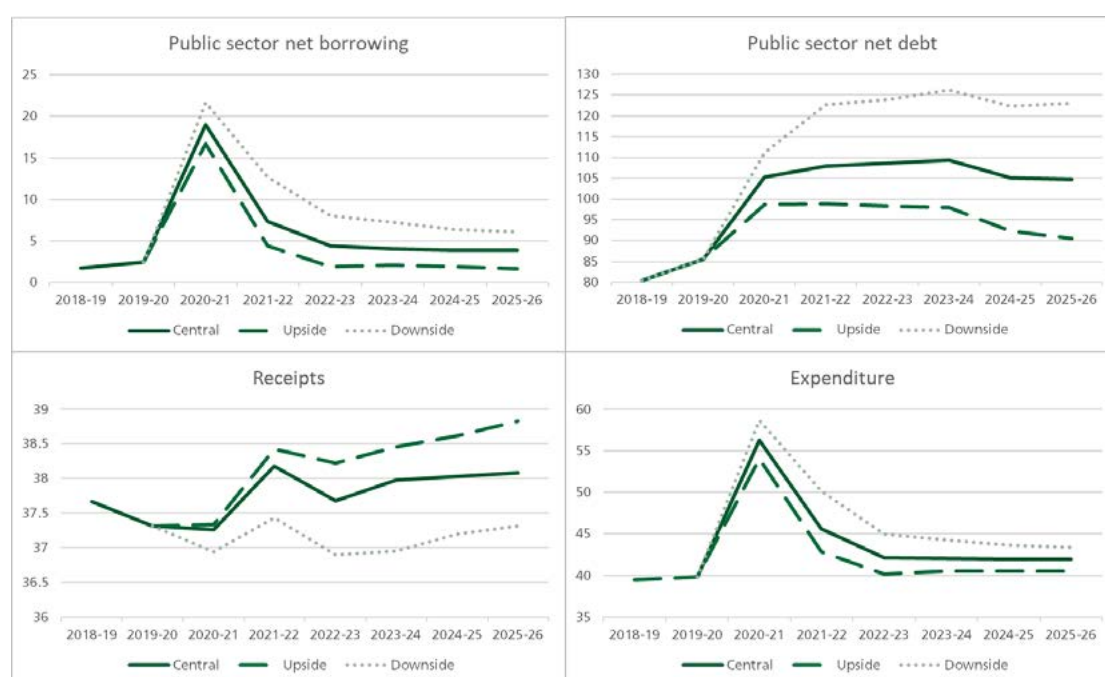
13. The OBR analyses the medium-term impact on the public finances against three scenarios in its November 2020 forecast. In its upside scenario, in which the economy

⁷ Office for Budget Responsibility, [Commentary on the public sector finances—December 2020](#), 22 January 2021

⁸ Office for Budget Responsibility, [Economic and fiscal outlook—November 2020](#), 25 November 2020. A new OBR forecast will be issued alongside the Budget Statement on 3 March 2021.

rebounds by the end of 2021 without any scarring, there is a one-off rise in the level of public sector net debt (PSND), while ongoing borrowing (PSNB) returns to the pre-crisis forecast of 1.7 per cent in 2025–26. PSND stands at 91 per cent of GDP in 2025–26, up from 75 per cent in the March 2020 forecast. In the OBR's central and downside scenarios, in which the economy does not return to peak until the end of 2022 and 2024 respectively and there is long-term scarring of 3 per cent and 6 per cent of the level of GDP respectively, there are larger initial rises in the debt *and* rises in ongoing borrowing. PSNB rises to 3.9 per cent and 6.1 per cent respectively in 2025–26, while PSND stands at 105 and 123 per cent of GDP respectively. These are the highest levels of public debt since the 1960s, albeit still well below the World War II peak of over 200 per cent.⁹

Figure 2: Medium-term public sector net borrowing and public sector net debt, receipts and expenditure (OBR scenarios, % of GDP)



Source: OBR, Economic & Fiscal Outlook November 2020, 25 November 2020, Chart 3.15

14. However, countervailing against the impact of coronavirus support and falling revenues, the interest rates being paid on Government borrowing have fallen further from already historically low levels. The yield on 10-year gilts is under 0.5 per cent at the time of writing, from around 5 per cent at the start of 2007, prior to the Financial Crisis.¹⁰ Paul Johnson, Director of the Institute for Fiscal Studies (IFS), explained to us that on this measure, the public debt was more affordable than it had ever been:

It is astonishing that we have so much debt and that we are spending the lowest fraction of our revenue on debt interest as we have ever done, or at least since 1700 or thereabouts. In the short run, in the arithmetic sense, it is extraordinarily affordable. [...] That feels like a very good time for Government to be borrowing, partly reflecting, of course, international circumstances.¹¹

9 Ibid

10 CNBC Finance, [British 10 Year Gilt](#)

11 Oral evidence: Spending Review 2020; HC 1029; 882, [Q64](#)

15. Richard Hughes, the Chair of the OBR, explained that as a consequence of this, the OBR projects the public debt to be broadly stable as the economy recovers from the pandemic, despite its elevated level:

One of the paradoxes of the consequences of the pandemic for our public finances has been the fact that our debt burden has gone up from around 80% of GDP to already over 100% of GDP, and that it stays there for the five-year forecast period. It has not been at that level since 1960, but [...] the burden of servicing that debt has gone down relative to even what we were forecasting back in March, and has gone down considerably compared to how much having a 100% debt-to-GDP ratio cost us back in 1960.¹²

16. Faced with an extraordinary economic downturn and exceptionally low debt servicing costs, witnesses to this inquiry were unanimous that significant tax rises should not be attempted in the short term. On the timing of any tax rises, Mr Johnson said:

The answer is “not yet”. [We] are not very clear about where the economy is going to go, but we are pretty clear that it is going to be weak for some period. [...] Remember that through the financial crisis we had at least two years—maybe three—of spending increases and tax cuts to support the economy, and at least in the short run, the impact of this crisis has been more substantial than we saw back then. [...] If we do need higher taxes then, we are probably looking at bringing them in from two to three years hence, rather than six months to 18 months hence, when we hope the economy will be firing on all cylinders, or close to it.¹³

17. Professor Sir Charlie Bean, a member of the OBR’s Budget Responsibility Committee leading on economic issues, said that fiscal consolidation should be a long-term matter:

[One] should not think that there is a great urgency in closing the deficit. It is entirely appropriate, given the large and very unusual shock the economy has been subject to, for the Government to run a large deficit so long as the virus emergency persists. That is something pretty much all economists would agree with.

As one goes beyond the emergency, it will be appropriate to stabilise the public finances and potentially start building in fiscal space to recognise that there will be future bad shocks further down the road.¹⁴

18. On the other hand, Richard Hughes warned that the elevated public debt stock does leave the public finances more exposed to rises in interest rates:

We show that [a 1 per cent rise in interest rates] ends up costing you about a third of a percent of GDP within the forecast period, so that is going to be somewhere in the ballpark of £10 billion by the end of the five-year period.¹⁵

12 Oral evidence: Spending Review 2020; HC 1029; 882, [Q29](#)

13 [Q27](#)

14 [Q150](#)

15 [Q148](#). Mr Hughes went on to point out that quantitative easing exposes the public debt to changes in overnight interest rates: “The Bank of England buys up mostly long-dated Government debt and finances that by issuing central-bank reserves, which is also public sector debt but at a very short maturity; it is, basically, overnight debt. [... It] makes the Government more exposed to future rises in interest rates, because those long-term interest rates are not locked in.”

[...]

[...] We are in exceptional times at the moment with very low interest rates for a number of reasons, partly reflecting flight to safety concerns and people wanting to hold on to safe assets and liquid assets. How long that will last is a big question.¹⁶

19. Witnesses also warned that low interest rates reflect low growth expectations, which if fulfilled will have a negative impact on the public finances. Karen Ward, Chief Market Strategist for Europe at JP Morgan Asset Management, told us:

We have to be very careful with this narrative that low interest rates are good news, because we have to think about what is driving low interest rates on both sides of the Chancellor's ledger. [...] Interest rates are this low because expectations of nominal growth are so very low. [Both] our outlook for our spending via interest rates as well as the outlook for our tax receipts via the nominal economy are looking fairly bleak at the moment.¹⁷

20. As well as fiscal consolidation, public debt as a proportion of GDP can be reduced by other alternatives such as growth, inflation or repressed interest rates. Witnesses questioned whether growth could have the same impact now as in earlier periods of high public debt, and warned of the risks of high inflation and repressed interest rates. On growth and inflation, Paul Johnson, Director of the Institute of Fiscal Studies (IFS), told us:

After the second world war we got the overall level of debt down very substantially and really quite fast, because both real growth and inflation were running at much higher levels than we have been used to [...] over the last several decades. [...] Whether we have the magic solution to getting growth at those levels, and whether we would want inflation at those levels, is very much open to question.¹⁸

On inflation, Philip Booth, Professor of Finance, Public Policy and Ethics and St Marys University and Senior Academic Fellow, Institute of Economic Affairs, said:

[We] should not forget the pain of the 1970s, with the industrial strife and so on, and the early 1980s, with the unemployment that arose from trying to squeeze inflation out of the system. [...] We took a long-term, very big hit from allowing inflation to rise. It is not a pain-free way to deal with a debt problem.¹⁹

On repressing interest rates, Karen Ward told us:

[The Bank of England's quantitative easing has] perhaps given us a little bit of a premium between where interest rates should be on the economy and where they actually are [...]

16 [Q168](#)

17 Oral evidence: Spending Review 2020; HC 1029; 882, [Q66](#)

18 [Q10](#)

19 [Q12](#)

If it is the case that central banks globally can hold down bond yields well into the recovery, it could be very helpful in allowing us to grow into our debt. We saw, for example, in the US, after the Second World War, very high debt levels came down very easily because of that combination of the central bank holding down the interest rate as the economy gathered steam. That could be a very effective strategy but, at the same time, we are not the US; we are the UK, and we are vulnerable to global interest-rate movements.²⁰

21. When the Committee asked the Financial Secretary to the Treasury whether he foresaw a need for tax rises in future, he cited the OBR's upside scenario and Paul Johnson in saying that there may be no need for future consolidation:

[The OBR's] optimistic scenario has us returning to the growth path that they had anticipated in March. It is not absolutely obvious, therefore, that there may be any future need for consolidation [...] I was struck, in looking at some of the testimony you have been given, by the remarks of some of the experts. Paul Johnson said that he was not absolutely sure that taxes need to rise, and that was quite an interesting external expert view.²¹

22. However, while as quoted earlier, Mr Johnson did tell the Committee that tax rises were not recommended in the near term, he also told us that the fallout from the pandemic may require tax rises in the longer term:

I think that is probably true [that taxes will have to rise]. It is worth saying that that is not because of the scale of the deficit this year. I think it is likely to be for two reasons. The first is that the economy, certainly according to most forecasts, will be smaller in four or five years' time than we were expecting, and therefore tax revenue will be less than expected. Secondly [...] the pressure on public services will be greater [...]²²

23. Gemma Tetlow, Chief Economist at the Institute for Government, suggested that the Chancellor could set out some strategies for a medium-term fiscal consolidation at the next Budget:

This year and in the next Budget, the Government need to set out broad fiscal objectives based on the best forecast that the OBR is able to provide to them at that time, showing the "no policy change" forecast for borrowing. The Chancellor could then say, "But actually our objective is over the medium to longer term to reduce borrowing down to some level, or to stabilise debt or reduce debt over some period of time."²³

24. In our September 2020 report on Economic Impact of Coronavirus: The Challenges of Recovery, we concluded that:

The Chancellor should, at the next fiscal event, set out an initial roadmap of how he intends to place Government finances on a sustainable footing. The milestones on that roadmap will need to be flexible—tax increases imposed too early are likely to stifle economic recovery. A reassurance that the

20 Oral evidence: Spending Review 2020; HC 1029; 882, [Q66](#)

21 [Q434](#)

22 [Q2](#)

23 [Q30](#)

Government intends to take steps to ensure fiscal sustainability in future will underpin market confidence and reduce uncertainty for households and businesses that may fear immediate tax rises.²⁴

25. In its response, the Treasury only committed to a revised fiscal framework “in due course.”²⁵ The Financial Secretary told the Committee that “now is not the moment to be bringing in new fiscal rules.”²⁶

26. **The pandemic will leave behind a large increase in the public debt and, possibly, a rise in ongoing borrowing into the medium to longer term. However, low interest rates have helped to open up fiscal space, and our expert witnesses said that now is not the time for tax rises or fiscal consolidation, which could undermine the economic recovery. However, the public finances are left more exposed to rises in interest rates; and witnesses told us that economic growth, inflation and measures to lower interest rates probably could not on their own be relied upon to stabilise or reduce the public debt. Indeed, interest rates increasing from current low levels would put further pressure on the public finances. Significant fiscal measures, including revenue raising, will probably be needed in future.**

27. **The Financial Secretary to the Treasury is right to point to the uncertainties in the economic and fiscal forecasts. However, the Government would be prudent not to focus on the OBR’s upside scenario at the expense of failing to prepare for its central and downside scenarios. We re-iterate our earlier conclusion that “the Chancellor should, at the next fiscal event, set out an initial roadmap of how he intends to place Government finances on a sustainable footing.”**

The long-term fiscal gap

28. Witnesses to the inquiry stressed that projected long-term trends in the demography of the UK, associated public spending commitments and shifts in the tax base likely represent an ultimately greater challenge to the public finances than the pandemic. These trends all pre-date the pandemic. Philip Booth told us:

I would not get too wound up about the increase in debt caused by the Covid crisis; that is not my big concern. One of the reasons why you accumulate Government debt is to deal with one-off emergencies. My big concern is the next 30 or 40 years when, as a result of demographic pressures, the relationship between the tax base and Government spending changes dramatically.²⁷

29. Since 2011, the OBR has published a regular *Fiscal Sustainability Report* (FSR) that makes fifty-year projections of the public finances, based upon currently-stated Government policy and assumptions about how these apply to the demographics and economics of future decades.²⁸ It has been a feature of every FSR that the OBR has

24 [Eighth Report: Economic impact of coronavirus: the challenges of recovery](#)

25 [Fifth Special Report: Economic impact of coronavirus: the challenges of recovery: Government Response to the Committee’s Eighth Report of Session 2019–21](#)

26 [Q445](#)

27 [Q12](#)

28 The report was published annually over 2011–16—although the 2016 report was delayed until January 2017—and since then in even years. In odd years, a *Fiscal Risks Report* is now published instead.

concluded that the public finances are on an unsustainable long-term path, in the sense that “the public sector is on course to absorb an ever-growing share of national income simply to pay the interest on its accumulated debt.”²⁹

30. In the July 2020 FSR, the long-term unsustainability of the public finances is exacerbated by higher starting points for debt and—depending on the scenario—borrowing, due to the coronavirus pandemic. In all scenarios, public debt and borrowing stabilise following the recovery from the pandemic but expand without limit from 2025–26. In 2069–70, public borrowing (PSNB) is projected to reach between 24 and 37 per cent of GDP, while the public debt (PSND) is projected to reach between 320 and 522 per cent of GDP. In the July 2018 FSR, PSNB and PSND were projected to reach 19 and 247 per cent of GDP respectively over the same period.³⁰

Table 2: OBR long-term projections for 2069–70 by scenario (% of GDP unless stated otherwise)

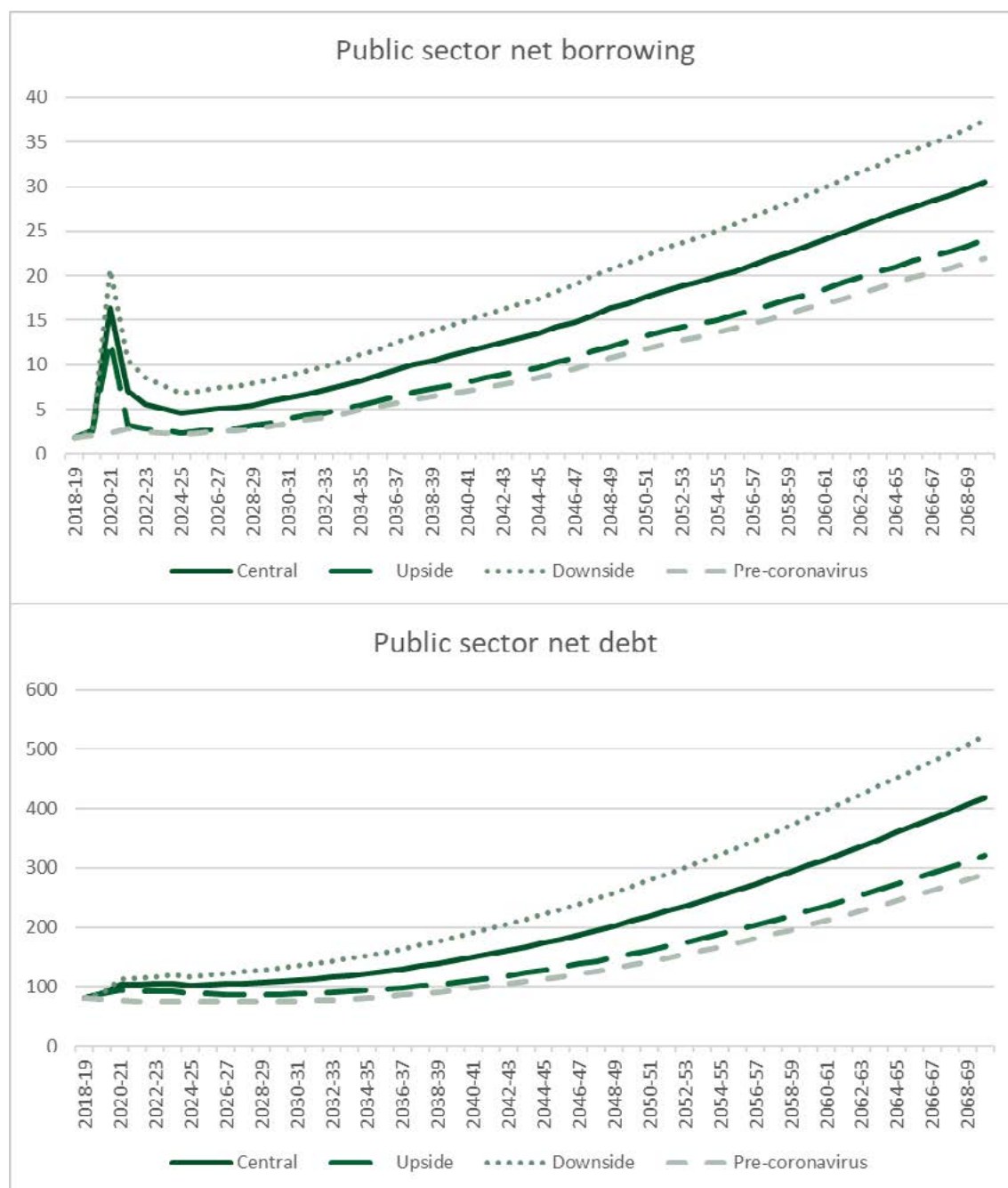
	2019–20	Central	Upside	Downside
Primary receipts	36	36	37	36
Primary spending	37	49	47	51
<i>Health spending</i>	7	15	14	15
<i>Adult social care spending</i>	1	2	2	2
<i>State pensions</i>	4	7	7	7
Primary deficit	1	13	10	15
Gilt rates (%)	0.7	4.1	4.1	4.1
Net interest spending	1	18	14	22
Public spending net borrowing	3	31	24	37
Public sector net debt	88	418	320	522

Source: OBR, July 2020 Fiscal sustainability report—supplementary tables, 14 July 2021

29 OBR, Fiscal Sustainability Report—July 2018, 17 July 2018, pp1 and OBR, Fiscal Sustainability Report—July 2020, 14 July 2020

30 Ibid

Figure 3: Long-term public sector net borrowing and public sector net debt (OBR scenarios, % of GDP)



Source: Office for Budget Responsibility, Fiscal Sustainability Report July 2020, 14 July 2020, Chart 4.5

31. We took evidence from members of the Budget Responsibility Committee on the OBR's 2020 FSR. While in previous Parliaments the Treasury Committee has routinely taken evidence from the OBR on the five-year forecasts in its biannual *Economic & Fiscal Outlook*, it has not before taken evidence on the long-term FSR.

32. Richard Hughes explained to us the main drivers of the OBR's projection of a rising primary deficit:³¹

31 The primary deficit is the difference between public expenditure and receipts excluding the cost of debt servicing.

There is a very modest decline in the tax to GDP ratio over our 50-year forecast horizon driven by an ageing population and the fact that pension incomes are less taxed than those of people of working age, but the vast bulk of that increase [in the projected primary deficit] is driven by age-related spending. It goes up by about 9 per cent of GDP from 15 per cent of GDP in 2024–25 to around 25 per cent of GDP by 2070 [in the central scenario]. About half of that increase is due to increases in the unit cost of healthcare and social care. The cost of providing health services and social care per person is going up for a number of reasons.

Then the other half is driven predominantly by demographic pressures. The population of people who need healthcare and social care is also going up. Of that 9 per cent of GDP increase in primary spending over the next 50 years, the increase in unit cost of healthcare accounts for about 5 per cent of GDP and then demographic pressures and an ageing society add another 4 per cent of GDP to that.³²

Andy King, a member of the OBR's Budget Responsibility Committee leading on fiscal issues, explained further the reasoning behind these judgements:

Innovation in health tends to push up costs, whereas in most businesses it pushes down costs, either because more things can be treated or because they can be treated better but the cost of each treatment is higher. [The remaining spending increase] is demographics: in health, because of the cost of care at the end of lives, and in the pensions system, for obvious reasons.³³

33. The OBR also assumes that interest rates rise from today's historic lows and converge towards the rate of nominal GDP growth, which increases debt servicing costs. Sir Charlie Bean acknowledged that "there is a lot of uncertainty about that [since] there has been downward pressure on long-term interest rates in recent years [that we] do not fully understand."³⁴ However, Mr Hughes stated that low interest rates "is not something that you would want to base Government policy on in the longer term, if you look back at the broad sweep of history."³⁵

34. Long-term shifts in the tax base, related to trends including globalisation, digitisation, ageing demography and a rising wealth-to-income ratio (which in itself puts pressure on inequalities of income), also present a long-term challenge to the public finances. These are explored in the following chapters of this Report.

35. The OBR were not able to tell us at what level the public debt ought to be stabilised, nor at what level, if any, public debt undermines economic growth or Government's ability to borrow. Mr Hughes told us:

On the question of the danger level of debt, many people much smarter than I am have got themselves into trouble by naming particular figures, including Reinhart and Rogoff saying 90% of GDP was the threshold

32 [Q144](#)

33 [Q161](#)

34 [Q147](#)

35 [Q168](#)

beyond which Governments face debt spirals because of rising debt stocks and rising interest rates.³⁶ We clearly have not seen that with the projections in the aftermath of the coronavirus shock. That comes back to the fact that interest rates have been very accommodative, and markets have enabled Governments to finance their debts at historically low interest rates.³⁷

36. Despite these uncertainties, independent witnesses agreed that the public finances were on an unstable trajectory in the long term, and that future Governments faced a dilemma between raising additional revenue, limiting rises in age-related public spending and provision, raising private age-related spending, and/or limiting rises in other public spending. Mike Brewer, Deputy Chief Executive and Chief Economist at the Resolution Foundation, told us:

The OBR report is not a forecast; it is really illustrating that there are long-run pressures in providing the sort of health, social care and pensions that we are used to now to our population over the next few decades. Something's got to give somewhere. We either need substantial tax rises or we need to provide less good health and social care and pensions, or the population have to pay more themselves. That is really what the OBR is telling us.³⁸

Philip Booth described an unavoidable trade-off:

There are no really easy ethical options here, because promises have been made to future generations for which nothing was set aside in order to finance the promises of income, healthcare and all the rest of it [...] So you are in the position of either reneging on those promises, reducing spending in other areas, or taxing the next generation at very high rates [...] taxing the next generation in order to pay for the promises that were made in the past generation.³⁹

37. Dr Gemma Tetlow, Chief Economist at the Institute for Government, warned that limiting rises in non-healthcare public spending had been done in the past but would be more difficult in future:

[The] way we have paid for extra spending on healthcare has typically been to squeeze other areas of public spending. We squeezed defence spending through the 1980s. We have squeezed education spending at some points, police spending at other points. So far, we have just found it elsewhere rather than cutting back the offer on healthcare, but I think it is a political choice for future Governments what we offer.⁴⁰

38. When asked whether he agreed that the Government's current long-term fiscal commitments were unsustainable, the Financial Secretary to the Treasury said:

36 Mr Hughes is referring here to Reinhart, Carmen M., and Kenneth S. Rogoff. 2010. "[Growth in a Time of Debt.](#)" *American Economic Review*, 100 (2): 573–78. The authors found that a public debt level above 90 per cent was associated with a sharp decline in growth in cross-country comparisons. However, other researchers argued that their results were dependent on errors in their calculations, which the authors have acknowledged. See for example, BBC News, '[Reinhart, Rogoff... and Herndon: The student who caught out the pros](#)', 19 April 2013

37 [Q164](#)

38 [Q14](#)

39 [Q17](#)

40 [Q16](#)

We look to the OBR to tell us what the debt position is going to be and, of course, it is reflective of a set of policy assumptions, and those assumptions themselves may change. There is no doubt that the levels of debt and borrowing are sources of continuing concern and importance to Treasury officials, and certainly to Ministers.⁴¹

39. The Financial Secretary also acknowledged the opportunity and challenge in using the FSR as a tool to hold Governments to account:

The joy of having the OBR's forecasts now is that we have a 50-year planning basis on which to make an assessment of these policies and, ultimately, to hold Governments to account.

[...]

You run up against the fundamental problem in our constitution, which is that no Parliament can bind its successors, so the key is to evolve a culture between parties and within our public administration [...] that is frugal in regard to the long-term fiscal effects of policy.

40. The Chancellor's official response to the 2020 *Financial Sustainability Report* was a 300-word statement to the House that promised "further details on its plans to put the public finances back on a sustainable footing over the medium-term at the next Budget."⁴²

41. The public finances are on an unsustainable long-term trajectory. This is due primarily to projections of rising age-related spending based on existing Government commitments. This situation is being exacerbated by the fiscal impact of the coronavirus pandemic. Even in the most optimistic scenario, the current and future UK Governments face a dilemma: if public spending and revenues are not to diverge without limit, either the former must be restrained or the latter must be raised.

42. The Office for Budget Responsibility has been stating that the public finances are on an unsustainable long-term trajectory since 2011, but the Government has not done enough to engage with the issue. The Government should routinely produce a more extensive and considered response to the Fiscal Sustainability Report than the 300-word statement it provided in 2020. Such a response should set out a strategy for how and at what level the public debt could and should be stabilised. To support this process, the Committee intends to carry out full scrutiny of the biennial Fiscal Sustainability Report in future, as it did for the first time in 2020.

Scope for raising additional tax revenue

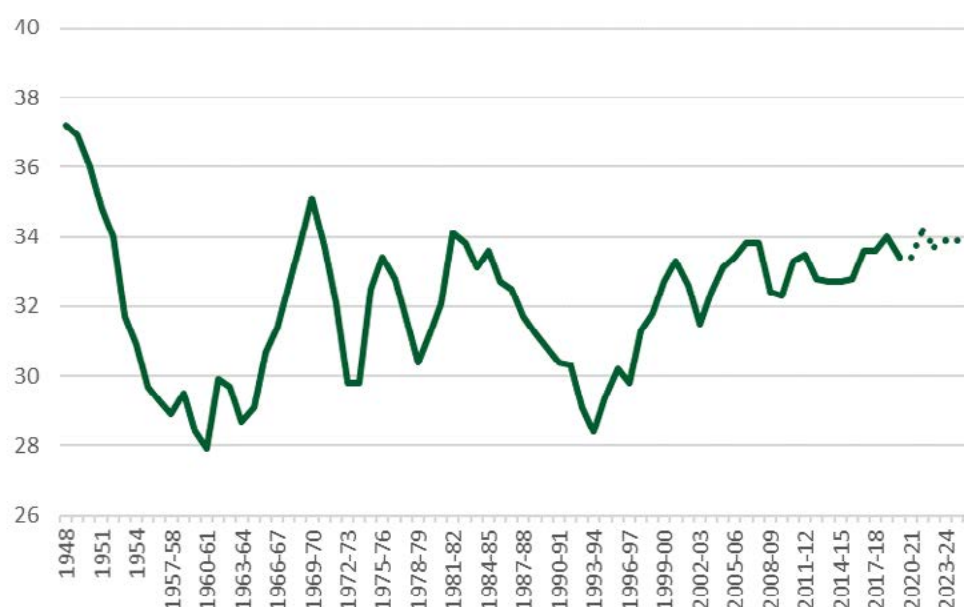
43. Tax revenues as a share of GDP in the UK stood at a little below 34 per cent of GDP prior to the outbreak of coronavirus. This was the highest level since the early 1980s, although not greatly above the average since 2000 of 33 per cent of GDP and the post-war average of 32 per cent. Prior to the outbreak of coronavirus, the OBR forecast that

41 Q441

42 [OBR 2020 Fiscal Sustainability Report and response to the OBR 2019 Fiscal Risks Report, Statement UIN HCWS364, 14 July 2020](#)

the taxation-to-GDP ratio would edge up a little further over the forecast period. The near-term future for public revenues is now far more uncertain, but the OBR projects that taxation will be around 34 per cent of GDP in 2025–26.⁴³

Figure 4: UK aggregate tax revenues (% of GDP, OBR forecast from 2020–21)



Source: OBR, Public Finances Databank—January 2021, 28 January 2021

44. Some evidence submitted to us said that the overall levels of taxation had reached or surpassed the point at which higher rates would reduce economic growth and/or reduce levels of taxation by reducing taxable economic activity—the latter would mean that overall tax rates were past the peak of the theoretical “Laffer curve”.⁴⁴ Philip Booth told us that he thought that the UK was past the point where rises in overall tax rates would reduce growth but not yet past the point where they would reduce tax revenues:

[You] damage the economy with a tax system a long time before you get to the point at which you cannot raise any more taxes. [Some politicians believe that] “If we tax any more, we’ll end up raising less revenue because of the impact on economic growth.” That may not yet be the case where we are currently in terms of tax revenue, but you are doing an awful lot of damage before you get to that point by raising taxes in any case. [...] You could go higher, but only with a much better-designed tax system.⁴⁵

43 OBR, Economic & Fiscal Outlook November 2020, 25 November 2020

44 For example, in written evidence, David B. Smith argued that “the tax burden already appeared to be close to the upper limit of historic sustainability before the current pandemic”, based on the observation that the tax-to-GDP ratio had rarely been above the pre-pandemic level in the past. David Brian Smith (Proprietor at Beacon Economic Forecasting) ([TAC0004](#))

45 [Q22](#)

45. Other witnesses were more optimistic about the UK's ability to raise additional taxation without significantly hampering growth, should the Government want to do so.⁴⁶ Paul Johnson observed that tax levels in the UK were currently below the levels of certain other advanced economies:

[Our] tax take is significantly below that of many other countries [...] in the old European Union [...] So that does indicate that it is possible to run a pretty effective and efficient economy with a higher tax burden than the UK currently has. [...] I wouldn't necessarily agree with the statement that we are at the limit of taxable capacity.

Dr Gemma Tetlow said that it is unclear that a single growth-maximising level of taxation exists:

My reading of the economic literature is that the relationship as between overall tax levels and growth is very murky. There is no clear evidence that there is a growth-maximising level of tax, not least for the reasons we have talked about: it matters how you tax, not just the total level you are taxing at.⁴⁷

46. Beth Russell, Director General of Tax and Welfare at HM Treasury, confirmed to us that the Treasury works on the assumption that the UK is not at or past the point at which tax rate rises (cuts) would lower (raise) revenue:

[It] is for the OBR to certify and agree the costings for any tax cuts or tax rises, but [...] we would not expect that any tax cuts would, in effect, pay for themselves. The OBR would be expecting tax cuts to cost money.⁴⁸

47. Notwithstanding their views on the overall taxable capacity of the UK, witnesses agreed that reform of the tax system was desirable, that the case for it would be greater if taxes were to rise, and that tax rises could be focused on taxes that are less distortionary and less damaging to growth. Mike Brewer, Deputy Chief Executive and Chief Economist at the Resolution Foundation, told us:

[The] large deficit means that you should look really carefully at those parts of the tax system where you are taxing apparently similar things differently, because that is what causes distortions and a reduction in overall economic activity. [...] Ultimately, we have to raise taxes somehow, so it is really a question of finding the ones that do the least damage to the economy, rather than hoping for ones that would actually be good for growth.⁴⁹

Ms Tetlow said that broadening the tax base could be a less distortionary way of raising revenue:

46 In written evidence, Richard Murphy argued that "there is, in fact, strong evidence that the higher the aggregate total tax paid in a country the higher is its GDP per capita. [...] There is, as a result, no clear evidence that there is an obvious overall limit to the level of taxation that the UK economy can bear without undesirable or counterproductive harm to economic growth." Professor Richard Murphy (Director at Tax Research LLP) ([TAC0100](#))

47 [Qq19-21](#)

48 [Q440](#)

49 [Q4](#)

There are current problems with the tax system which create distortions to economic behaviour and therefore may discourage economic growth. Simply increasing the rates of existing taxes runs the risk that you increase those distortions. For that reason, I would [think] about broadening the base of some of these taxes rather than just increasing the rates, which has tended to be what Governments have liked to do in the past.⁵⁰

48. Witnesses also emphasised that any programme of tax rises and/or tax reform in the aftermath of the pandemic would be best announced and planned as part of a long-term strategy. Professor Booth told us:

If you are going to make significant policy changes that put our tax system on a better footing, it is best to at least announce that, if not implement it, sooner rather than later, because there is going to be a very large adjustment in economic activity. [...] You do not necessarily have to implement it immediately, but the thinking and the planning should be done very quickly.⁵¹

Ms Tetlow warned against resorting quickly to the most politically palatable tax measures:

The OBR central scenario for July suggests that Covid may well have knocked a hole of about £60 billion in the finances in the medium term. That is a huge number and trying to announce a package of tax measures to fill it would be significant, and the public has not really been talked through the necessary tax rises. Trying to announce specific measures quickly runs the risk of ending up being backed into a corner of introducing the most politically feasible tax changes, which [...] are often not the most sensible economically in terms of tax changes.⁵²

49. The evidence submitted to this inquiry generally supports the proposition that the UK is able to raise taxation as a share of GDP and raise additional tax revenues. However, there is also a need for reform of the tax system.

50. The public finances are on an unsustainable long-term trajectory that has been exacerbated by the coronavirus pandemic. Additional tax revenue could make a contribution to addressing this. But the tax measures that are most politically palatable in the short term are often not those that minimise distortions to economic activity in the longer term. This is a large-scale and long-term challenge that requires taking a view of the whole tax system, how it can be reformed, and how it can raise revenue in a way that minimises economic damage as well as effectively supporting public services, which can in turn promote growth. As part of its recovery from the coronavirus pandemic, the UK has an opportunity for a comprehensive review and reform of the tax system.

50 [Q3](#). Additionally, Paul Johnson told us that “ I think we have the capacity overall to raise somewhat more tax than we do at the moment, should we decide to do so; but I think if we go down that route we have to be a lot more careful than we have been in the past about how we raise that tax, and make sure we do it significantly more efficiently and equitably than we have up till now. [\[Q19\]](#)”

51 [Q29](#)

52 [Q30](#)

3 Support for business

51. The coronavirus crisis has had a profound effect on many business sectors. Some have done much better, while some have been required to close by law. The Government has responded by offering various forms of support for business. In some cases that support has been made available through grants and loans; in others it has been offered through the tax system:

- Deferrals of VAT and the July 2020 self-assessment tax payments;
- A temporary reduced rate of VAT for hospitality, holiday accommodation and attractions;
- business rates relief for retail, hospitality and leisure businesses and child nurseries; and
- Additional time to file self-assessment returns.⁵³

52. We consider below two further options which the Government could use to do more now to help the self-employed and limited companies through the tax system.

Increasing the period over which losses can be carried back

53. The tax system already has within it a way to, in part, cushion the impact of losses suffered by firms due to the crisis, known as the “loss carry-back”. This allows a company to offset current losses against previous profits, thereby allowing for repayments of Corporation Tax.⁵⁴ These arrangements also allow for unincorporated businesses to offset losses against profits made in the previous tax year.⁵⁵

54. At previous times of economic crisis, such as in 1991⁵⁶ and 2008,⁵⁷ the Government of the day extended the carry-back period over which present losses could be offset, by introducing a temporary three-year loss carry-back. This was intended to support companies and self-employed people by generating tax repayments to people who were making trading losses during the crisis when previously they had been profitable, by increasing the period of tax years over which losses could be spread.

55. Introducing a similar three-year loss carry back now would allow losses made during the pandemic to be set against up to three previous profitable years, generating a tax refund. Annie Gascoyne, Director of Economic Policy at the CBI, said that such a temporary increase to the period for loss carry-back “would give those firms that have struggled through the crisis from a cashflow perspective, and which are now potentially saddled with higher levels of debt, a vital cash injection to then grow and invest out of this crisis.”⁵⁸ Chris Sanger, Global Government Leader at Ernst and Young, and Chair of the Tax Professionals Forum, said:

53 [Financial support for businesses during coronavirus \(COVID-19\), www.gov.uk](#), accessed 18 February 2021

54 GOV.UK, [Work out and claim relief from Corporation Tax trading losses](#), accessed 13 February 2021

55 HMRC [Help sheet on losses](#), accessed 18 February 2021

56 HC Deb, 13 March 1991 [col 172](#) [Commons Chamber]

57 HC Deb, 24 November 2008, [col 498](#) [Commons Chamber]

58 [Q406](#)

One real benefit of a loss carry-back for those three years is that you are supporting businesses that have made profits here in the UK and, indeed, have paid tax here. It fits with the mantra of supporting those who have contributed to the UK. A three-year loss carry-back seems to be a very sensible approach.⁵⁹

56. We recommend that the Government should do as its predecessors have done during previous crises and support businesses by introducing a temporary three year loss carry-back for trading losses in both incorporated and unincorporated businesses. This would help those businesses which have shown that they are previously profitable recover from losses imposed on them by the impact of the pandemic.

Increased capital allowances

57. During the pandemic business investment has fallen. The Office for Budget Responsibility said in November 2020 that business investment had fallen 27% in the second quarter, and recovered only slightly in the third quarter, with investment still 20% down on its level at the end of 2019. The OBR expected it to fall again in the fourth quarter.⁶⁰

58. Capital allowances are one way to encourage business investment. They provide tax relief for purchases of assets for use in a business⁶¹ but do not normally allow write-off of the entire cost of an asset at the time it is purchased. We were told that the tax system could help investment and growth in businesses by allowing increased capital allowances. Tom Clougherty argued for “full expensing”,⁶² telling us that “letting companies write off their capital expenditure in full and immediately ... would be one of the best ways to boost growth through the tax system.”⁶³ However, he went on to note that “in the short term, it could cost an awful lot of money depending on how exactly you implement it”.⁶⁴

59. At present, the UK tax system has a more targeted measure than the wholesale reform described above. Companies can benefit from an Annual Investment Allowance (AIA) which was first introduced in April 2008,⁶⁵ and which provides tax relief for 100% of the expenditure on most plant and machinery. The relief is subject to an annual limit, which was increased from £200,000 to £1m on 1 January 2019.⁶⁶ When it was first announced, the increase was described as temporary and was due to end on 31 December 2020, but on 12 November 2020 it was announced that the increase would be extended to 31 December 2021.⁶⁷ The Financial Secretary provided the following three reasons for this extension, stating that it would:

- Respond to the needs of business, giving enhanced tax relief on plant and machinery expenditure;

59 [Q406](#)

60 Office for Budget Responsibility, [Economic and Fiscal Outlook, November 2020](#), CP318. Para 2.50

61 [Claim Capital Allowances](#), [www.gov.uk](#), accessed 18 February 2021

62 “Full Expensing” would allow businesses to immediately deduct the full cost of certain capital expenditure.

63 [Q370](#)

64 [Q418](#)

65 [Annual Investment Allowance](#), [www.gov.uk](#), accessed 12 February 2021

66 This change was announced at Budget 2018 on 29 October 2018. HC Deb, 29 October 2018, [col 660](#) [Commons Chamber] and HM Treasury, [Budget Report](#) 29 October 2018, paragraph 3.22 page 44.

67 [Written Statement to House from Financial Secretary Rt Hon Jesse Norman MP, 12 November 2020](#)

- Provide businesses with upfront support during continuing covid-related uncertainty;
- Simplify taxes for the 99% of businesses investing up to £1 million on plant and machinery assets each year.⁶⁸

60. It was suggested to us that the increase in the allowance should be extended. Anita Monteith, Senior Policy Adviser at the Institute of Chartered Accountants in England and Wales (ICAEW), said:

“The annual investment allowance for plant and machinery is currently available on £1 million-worth of investment up until the end of this year, and then it drops back down again. Everybody is asking the Chancellor to keep it at £1 million, possibly even looking for more ways to encourage people who have cash, and there are not many of those at the moment, to spend. We want to grow the economy, rather than tax it to death.”

61. In its written evidence, the Chartered Institute of Taxation made the point that continued uncertainty about the relief is damaging:

“Tinkering constantly with rates and allowances in unexpected ways undermines the principles of stability and certainty that taxpayers need, and reduces the international competitiveness of the UK’s tax system. For example, in just over ten years, the level of Annual Investment Allowance (AIA) has changed five times, to amounts ranging from £25,000 to £500,000. The right level for AIA is a matter of political judgment but it is damaging if it is repeatedly altered, and causes complexity where a business’s accounting period spans changes in the AIA.”⁶⁹

62. *The Annual Investment Allowance is valued by business and it appears well targeted to promote growth in small and medium-sized enterprises. As with all tax reliefs there is likely to be some deadweight cost; but we urge the Government to look favourably on further extension and possibly permanency at the existing level, which would provide welcome certainty to small and medium-sized enterprises.*

68 HC Deb, 12 November 2020, [col 43WS](#) [Commons written ministerial statement]

69 Institute of Chartered Accountants in England and Wales ([TAC0057](#)) paragraph 7.4

4 Windfall and wealth taxes

Introduction

63. In the face of the deterioration of the public finances described in Chapter 2, there have been calls for new taxes to help tackle the increase in public debt stemming from the pandemic. We consider below two such potential additional types of tax:

- taxes on business which have profited or done particularly well during the pandemic (so-called windfall taxes); and
- taxes on personal wealth, whether levied annually or as a one-off.

Windfall taxes on business

64. The consequences of the pandemic have been spread unequally across businesses. While some have seen their business effectively suspended or even terminated by the restrictions put in place to protect public health, others have seen an increase in their profits, for example as competitors closed or demand went online.

65. These rising profits at some firms have led to calls for “windfall” taxes. Oxfam UK noted that “given the context of the pandemic, there is a clear fairness rationale for higher taxes on those that appear to have benefited economically from the crisis whilst most individuals and companies have become poorer.”⁷⁰ The Resolution Foundation argued, in its November 2020 “Unhealthy Finances” report,⁷¹ for two temporary measures to provide additional revenue, drawing on the “principles of solidarity and fair burden-sharing”:

First, we recommend a Pandemic Profit Levy of 10 per cent on windfall profits made by firms during the pandemic, reflecting the fact that such profits in many cases reflect the luck of some firms being presented opportunities by the crisis or not being adversely affected by social distancing restrictions. Second, the self-employed who have seen their incomes actually rise this year while claiming the poorly-targeted Self-Employment Income Support Scheme (SEISS) grants should have their grants partially clawed back. This would narrow the enormous gap in treatment with the self-employed who have seen income falls but been excluded from support, and would raise at least £3 billion.⁷²

66. The Tax Justice Network has called for both windfall taxes and a 100% excess profits tax.⁷³ We asked Alex Cobham, CEO at the Tax Justice Network, about this. He said that

The last year has seen this completely unprecedented state intervention in economies all around the world, including the UK. Some multinational companies in particular, through no virtue of their own, have done exceptionally well from that. They have made vast unearned profits simply because their smaller, local competitors have been locked down for long

70 Oxfam GB ([TAC0014](#)), para 26

71 Resolution Foundation, [Unhealthy Finances](#) (11 November 2020)

72 Resolution Foundation, [Unhealthy Finances](#) (11 November 2020) p10

73 Tax Justice Network, [State of Tax Justice 2020](#), 20 November 2020

periods. The entirety of that profit is an unearned rent captured from these state interventions. Ideally, 100% of that would come back into the public purse to pay for some of the other costs of that intervention.⁷⁴

67. Some large firms seem to have responded to this potential criticism and have paid back business rates and furlough grants given during the pandemic.⁷⁵ Tom Clougherty explained that

[...] part of the reason they returned that money or did not take it in the first place is perhaps that they did not want to be subject to a windfall tax. They did not want to have the argument that they were profiting at the taxpayer's expense aimed at them. [...] It would be wholly unjust to punish basically those businesses that have helped make the last year barely tolerable for all of us, by providing essential goods and services when we could not get them in the way that we did before.⁷⁶

68. Others were similarly cautious about the imposition of such “windfall” taxes and their potential long-term impact. Chris Sanger, Global Government Leader at Ernst and Young and Chair of the Tax Professionals Forum, said that a windfall tax would have a negative impact on inward investment in the future:

If businesses think that, when they make money in the UK, a retrospective tax is going to come and claw back some of those profits, they will embed that into their thinking about what the corporate tax rate is in the UK. It can therefore undermine the investment proposition for the UK as opposed to somewhere else.⁷⁷

69. The Chartered Institute of Taxation was also not convinced that a conclusive case had been made, and it told us that “It is easier to say who has lost out as a result of COVID than who has unexpectedly benefited, and it is difficult to see a convincing tax base being identified which would yield worthwhile revenues”.⁷⁸

70. Some firms and sectors have seen a significant increase in turnover as a result of the pandemic, and some witnesses made arguments in favour of a windfall tax on the profits which have resulted. There are downsides to a windfall tax, including its potentially retrospective nature. There would also be complexities, including the difficulties of identifying sectors to which any such tax should apply, ensuring that such a tax is fairly targeted at firms which have benefited excessively within those sectors, and identifying the element of a firm's profits which could be reasonably attributed to excessive profits generated by the pandemic. For these reasons, introducing such a tax would be problematic, but that is not to say that it would be impossible to introduce a windfall tax in certain circumstances in the future, if that was the political choice made. The Treasury would clearly need to conduct a thorough assessment of its feasibility and of the revenue which it might raise.

74 [Q402](#)

75 For example see: [“Sainsbury joins rush to return business rates relief”](#). The Financial Times, 3 December 2020

76 [Q404](#)

77 [Q405](#)

78 Chartered Institute of Taxation ([TAC0074](#)) paragraph 9.5

Wealth taxes

71. Another additional form of taxation has been suggested to counter the large increase in public debt brought on by the pandemic—wealth taxes. The Committee has taken evidence on two potential forms: an annual wealth tax and a one-off tax.

Growth of wealth

72. The UK has never had a tax based on the net value of a living individual's wealth, but it does tax capital gains, the value of estates at death, and income arising from capital. The UK also taxes the capital value of housing transactions through stamp duty land tax (SDLT),⁷⁹ and council tax is linked to housing values.⁸⁰ We address aspects of these two taxes in Chapter 6.

73. The value of wealth in the UK has grown much more rapidly than incomes in recent decades. The Office for National Statistics' estimate of the UK's net worth—a measure of wealth—has risen from 3.3 times annual GDP in 1995 to 4.5 times in 2019—and this measure is likely to understate the total level of wealth.⁸¹

74. Meanwhile, relative wealth inequality has been broadly stable since the 1980s, having fallen for most of the twentieth century, but on some measures there has been a slight rise in the last decade. Moreover, since households in the bottom half of the UK distribution hold little or no net wealth, they have gained much less in absolute terms from growth in wealth than have families in higher deciles. The growth in wealth relative to income means that it is harder for individual households to rise up the wealth distribution scale by building up savings.⁸²

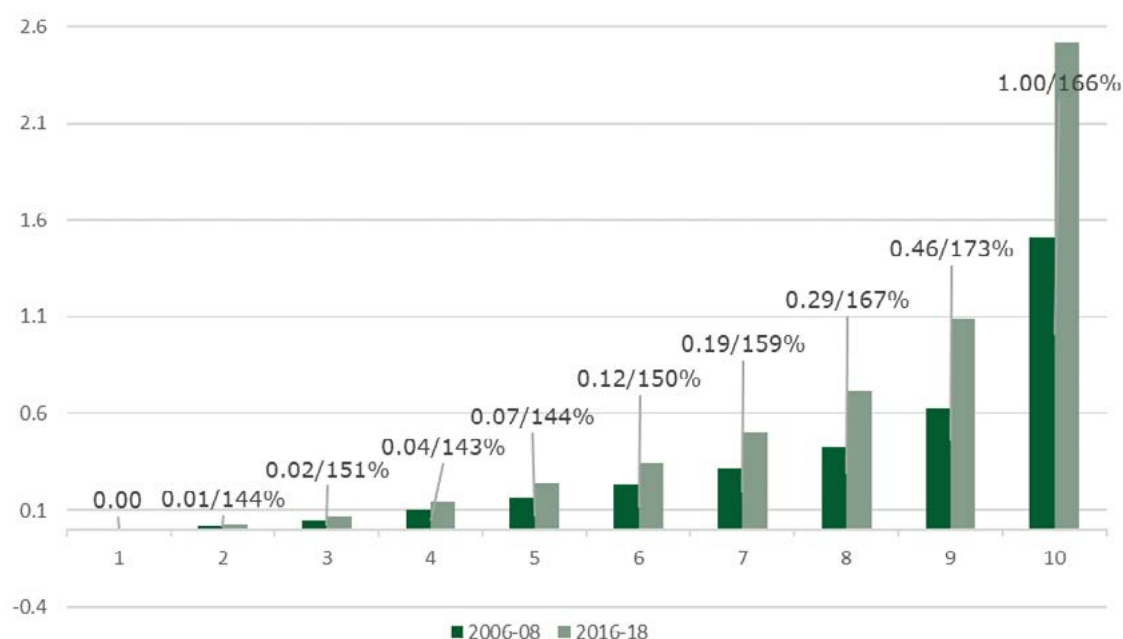
79 Devolved to Scotland which has introduced a similar Land and Buildings Transaction Tax and Wales which has introduced Land Transaction Tax.

80 Council tax is based on 1991 valuations except in Wales where the tax was revalued in 2003 and Northern Ireland which still has domestic rates

81 Staff calculations based on Office for National Statistics (ONS), [National balance sheet estimates for the UK: 2020](#), 1 December 2020. This estimate of wealth is based on the UK national accounts. The ONS's Wealth and Assets Survey returns a higher estimate of net wealth, at over 6x GDP (Office for National Statistics, [Total wealth in Great Britain: April 2016 to March 2018](#), 5 December 2019). However, the national accounts-based measure is used here because it has a longer historical time series.

82 Wealth Tax Commission, [Evidence Paper 1: The UK's wealth distribution and characteristics of high-wealth households](#), 30 October 2020

Figure 5: Mean household wealth by decile in Great Britain, 2006–08 and 2016–18 (£ million) [labels show absolute/proportion changes in wealth]



Source: ONS, Total wealth in Great Britain: April 2016 to March 2018, 5 December 2019 (Wealth and Assets Survey)

75. Meanwhile, the existing wealth and capital taxes make a significant and growing contribution to the public purse but a much smaller one than taxes on income and expenditure: they accounted for 9 per cent of tax revenues in 2019–20, up from 6 per cent in 1999–2000.⁸³

An annual wealth tax

76. An annual wealth tax could be based on total net wealth of individuals. Some other European countries have taxes on that basis, including Switzerland, Norway and Spain.⁸⁴

77. The case for a wealth tax was made by Robert Palmer, Executive Director, Tax Justice UK:

“There are two arguments in favour of a wealth tax: the first is to raise revenue, and the second is to tackle inequality. In the long term, as we build back from coronavirus, it looks as though we will have to raise more in tax. That leads to big questions about who should pay. As we all know, coronavirus has not hit equally. The poorest have seen their incomes disappear and end up relying on food banks, while wealthier people with salaries have ended up saving more than they would do usually. If we are thinking about how we raise taxes, taxing those who have wealth and assets is a good starting point.”⁸⁵

83 Staff calculations based on [Office for Budget Responsibility, Public Finances Databank, January 2020](#). These figures include Stamp Duty Land Tax, Inheritance Tax, Capital Gains Tax and Council Tax, but not do include the Income Tax derived from capital arising from income.

84 Emma Chamberlain, [“Wealth taxes in foreign countries”](#).

85 [Q276](#)

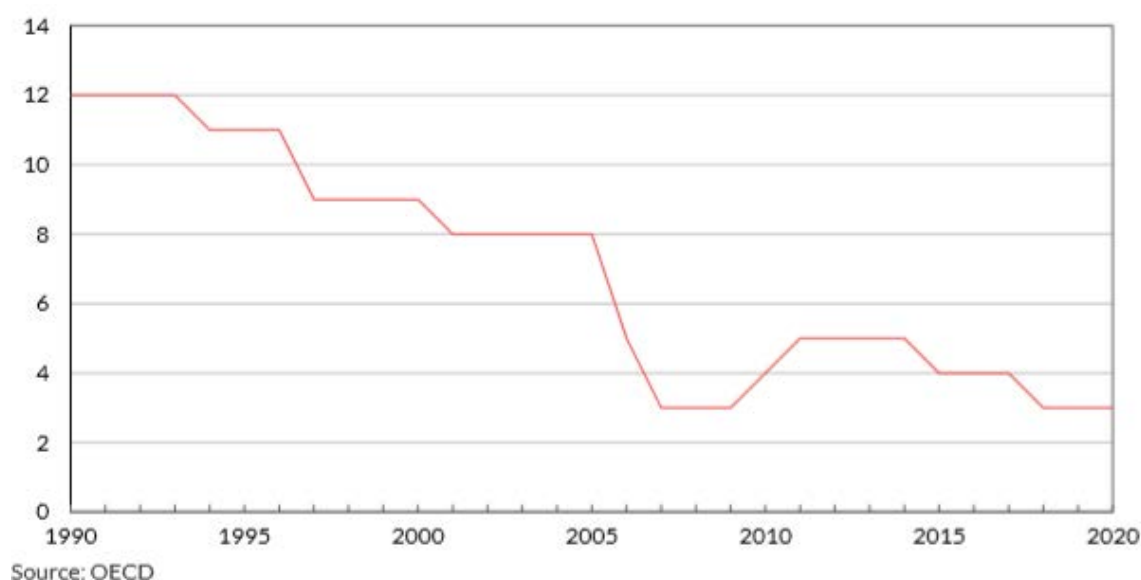
78. On the other hand we were made aware of practical difficulties. Emma Chamberlain OBE, barrister at Pump Court Chambers and a member of an academic project known as the Wealth Tax Commission, which had examined the case for a wealth tax,⁸⁶ told us that “it is important to distinguish between quite a lot of complexity and administrative problems with an annual wealth tax. I have been persuaded that that is really quite difficult to deliver. In practice, I am doubtful ... about whether you could improve inequality or deliver revenue.”⁸⁷

79. Tim Worstall, Fellow of the Adam Smith Institute, was concerned about the nature of a wealth tax, in that it would tax wealth accumulated in the past. He told us:

A retroactive tax is an appalling idea. It is akin to theft. Roy Jenkins did this in the 1960s. He retroactively imposed a 130% tax at the top end of capital incomes on the previous tax year that was already closed. That is just appalling behaviour. However much Government need the money, that is just not what we should be doing. Tax, just like any other form of law, should be: “It starts today. If you do not agree with it, you can change your behaviour in the future to avoid it and not do the activity [...]”⁸⁸

80. Many countries that have introduced wealth taxes have subsequently abandoned them, and so the number of countries with wealth taxes has been falling steadily in recent years, as the following chart shows.

Figure 6: Number of OECD countries levying individual wealth taxes over time



Source: Wealth Tax Commission⁸⁹

When asked why other countries had abandoned wealth taxes, Emma Chamberlain told us:

⁸⁶ [Wealth Tax Commission](#). Sponsored by LSE, Warwick University, CAGE research centre and IFS

⁸⁷ [Q286](#)

⁸⁸ [Q290](#)

⁸⁹ Wealth Tax Commission, [Why did other wealth taxes fail and is it different this time?](#), p5

“It is all because of the administrative difficulties of an annual wealth tax. In Germany, it was abandoned in 1996–97 because it was found to be unconstitutional because land was very favourably taxed and businesses were not. It was essentially quite discriminatory. France abandoned it, although reintroduction is still very popular, because the revenue it raised was not worth the hassle and, in fact, richer people did not pay it because they had a cap that was prone to avoidance.”⁹⁰

81. She contrasted the UK with Switzerland, which has an annual wealth tax:

“We are different from Switzerland. First of all, Switzerland does not have inheritance tax to any significant degree and it does not really have a capital gains tax. Wealth tax there is sort of substituting for capital gains tax. We have to be very careful comparing ourselves with Switzerland, but it does raise over 3% of tax revenues on an annual wealth tax. It is a low base and a very low threshold, under £500,000, with low rates. The maximum rate is 1% in Geneva and it is cantonally based.”⁹¹

82. Sir Edward Troup, former Chief Executive and Permanent Secretary of HMRC, summarised the cases for and against a wealth tax:

A lot has been said about this and I know there are some extreme views at either end. That is not suggesting that Robert and Tim’s views are extreme but there are a lot of views on this. You asked the question about complexity. Of course it is complex, but any act of taxation is intrinsically complex because it needs to deal with the millions of citizens out there. The question is not so much whether it is complex but whether its complexity and inefficiency—because all taxes impose some burden on the economy—are made up for or compensated for by the revenue raised or the other objectives that the tax might fulfil?

Robert has put forward some challenging suggestions about the amount of revenue that might be raised. If that were possible, in a sense the complexity and inefficiency could well be justified. I have to say I am sceptical. Spain raises about €1 billion a year with its wealth tax. The case and the justification for the wealth tax and the complexity it would introduce is not justified on revenue-raising grounds. Taxes can and should be introduced on other grounds, either to maintain overall support for the tax system, and the integrity and perceived fairness of the tax system, or to pursue other societal or economic objectives. Very often, taxes that are introduced on that basis are complex. That complexity is the cost you pay.

83. A fundamental concern about wealth taxes is that they do not take into account the ability to pay as they are a tax on assets rather than income. There are many who have seen an appreciation of asset values but have little income.

90 [Q291](#)

91 [Q291](#)

84. We believe that the development and administration of an annual wealth tax would be extremely challenging, and we note that other countries have abolished such a tax in recent years. We would not recommend an annual wealth tax. It is recognised though that were the wealth to income ratio to increase considerably, the political arguments for some form of wealth tax would become stronger.

The one-off wealth tax

85. We also heard evidence on the related case for a one-off wealth tax to reduce the public debt after the pandemic. We took evidence from Dr Arun Advani, Assistant Professor at the Department of Economics at the University of Warwick, who had led the Wealth Tax Commission, which had examined the case for a wealth tax.⁹² Its final report, published in December 2020, argued against an annual wealth tax but was favourable to the idea of a one-off wealth tax.⁹³ The Commission maintained that it would be difficult to avoid, would work in practice with small administrative costs relative to yield, and would be “fairer and more economically efficient than alternative tax rises”. Calculating the yield and taking account of behavioural effects, it argued that a one-off tax could raise £260bn if based on a rate of 5% on net wealth over £500,000 per individual or £80bn if at a rate of 5% over £2m per individual, payable over 5 years.⁹⁴

86. Emma Chamberlain thought that this idea was preferable to an annual tax. She said: “I think it could raise a large amount of revenue much more efficiently than many other tax rises, and it could be targeted.”⁹⁵

87. Tim Worstall was, however, concerned about retrospection and precedent setting. He told us:

The other thing that has just struck me is that people are talking about retrospective one-off wealth taxes. One-off wealth taxes are not all that good an idea simply because, once it has happened once, absolutely nobody is ever going to believe that it will not be done again.⁹⁶

88. Though those who gave evidence were sceptical of an annual wealth tax, there was more support for a one-off wealth tax. It could be used to raise significant revenue. However, amongst witnesses there were significant reservations that a tax imposed once can be imposed again, and that such a tax might be seen as retrospective.

92 [Wealth Tax Commission](#). Sponsored by LSE, Warwick University, CAGE research centre and IFS

93 Arun Advani, Emma Chamberlain and Andy Summers, “[A wealth tax for the UK](#)”, final report of Wealth Tax Commission 9 December 2020, paragraph 6.1 page 106.

94 Arun Advani, Emma Chamberlain and Andy Summers, “[A wealth tax for the UK](#)”, final report of Wealth Tax Commission 9 December 2020, page 106.

95 [Q286](#)

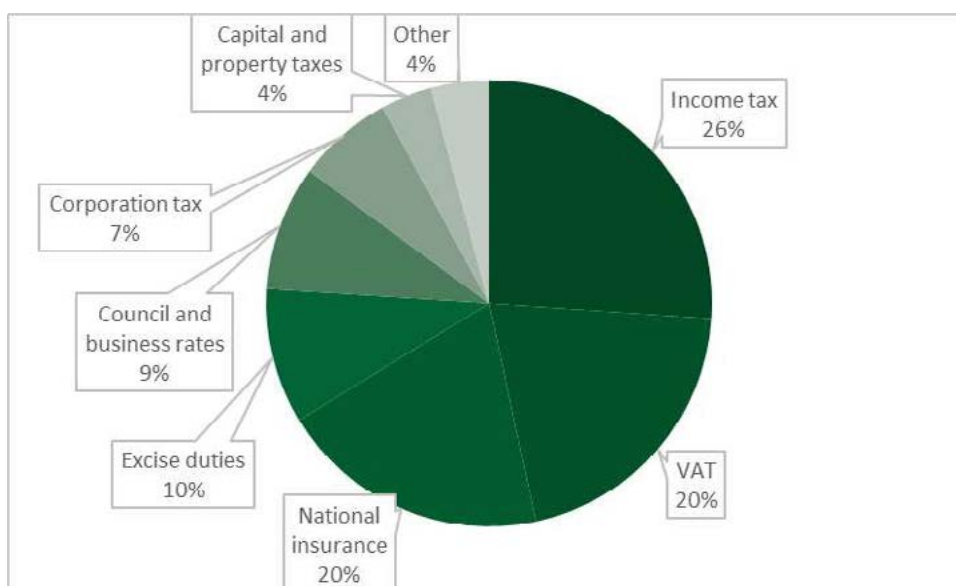
96 [Q290](#)

5 The major contributors to tax revenues

The importance of income tax, National Insurance and VAT to tax yield

89. The tax system raised over £740bn in 2019–20.⁹⁷

Figure 7: Contributions to tax receipts in 2019–20



Source: Extracted from data in OBR, Economic and Fiscal Outlook November 2020⁹⁸

The three taxes which contributed most to this total were income tax, VAT and national insurance contributions. Together these three taxes raised £472.4bn, 63.7% of the total.⁹⁹ They are therefore leading candidates for raising additional revenue to plug the widening gap between public spending and revenue identified in the OBR's *Fiscal Sustainability Report*. Sir Edward Troup, a former First Permanent Secretary at HMRC, noted that "If you want big money, you have to go for the big taxes ... Therefore, VAT, income tax and NICs will have to be in the mix."¹⁰⁰

90. HMRC provides an illustrative guide to the direct impact of tax changes on revenues, which shows that:

- a 1p increase in the basic rate of income tax would raise £5.5bn in 2022/23 (0.2% of GDP), and a 1p increase in the higher rate would raise £1.3bn in 2022/23 (0.1% of GDP);

97 Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, [Cp318](#) page 88 table 3.3. This provides the figures for 2019–20 and future tax years. It also lists the yields from all the major taxes.

98 Total tax is 742.1bn. Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, [Cp318](#) page 88 table 3.3

99 Staff calculation based on Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, [Cp318](#) page 88 table 3.3

100 [Q287](#)

- A 10% cut in the income tax personal allowance would raise £8.8bn in 2022/23 (0.4% of GDP);
- A 1% increase in Class 1 national insurance contributions would raise £4.3bn in 2022/23 (0.2% of GDP); and
- A 1p increase in the rate of VAT would raise £6.7bn in 2022–3 (0.3% of GDP).¹⁰¹

91. Paul Johnson, Director of the Institute for Fiscal Studies (IFS), told us that, given the proportion of tax revenues that come from national insurance, income tax and VAT, he would expect in the medium run at least some increases in those taxes simply because that is where a significant amount of income comes from.¹⁰²

92. The Conservative Party manifesto at the 2019 election said: “We promise not to raise the rates of income tax, National Insurance or VAT.” The manifesto did not specifically address the thresholds for these taxes.¹⁰³ The policy is widely referred to as the “triple tax lock”.¹⁰⁴ In evidence given to the Liaison Committee in May 2020, responding to a question from the Chair of this Committee, the Prime Minister said: “We are going to meet all our manifesto commitments. Unless I specifically tell you otherwise”.¹⁰⁵

93. The evidence submitted to this inquiry indicates that raising tax revenue quickly and at a large scale is likely to require higher contributions from one or more of income tax, national insurance and VAT, as they currently yield over two-thirds of the total tax take. Any increases in the rates of these taxes were ruled out in this Parliament by the Government’s “tax lock” manifesto commitment. It is clear to the Committee that the manifesto commitment of the Conservative Party will come under pressure under the current circumstances.

Income tax

94. Income tax is paid on all forms of income received by individuals, including wages and salaries, profits from trades or professions, pensions, interest, dividends and rents received. Income tax yield in 2019–20 was £193.6bn, of which £165.2bn was collected through the PAYE system.¹⁰⁶

95. As income tax rates and thresholds on non-savings and non-dividend employment income (unlike national insurance contributions and VAT) have been devolved to Scotland, any change to rates of non-savings and non-dividend income tax would only directly affect England, Wales and Northern Ireland, although there would be an indirect effect on Scotland through block grant adjustments.¹⁰⁷

101 [Direct effects of illustrative tax changes](#), HMRC January 2021. The GDP ratios are calculated using the nominal GDP forecast in OBR, Economic and Fiscal Outlook, November 2020.

102 [Q2](#)

103 [The Conservative and Unionist Party Manifesto 2019](#), 24 November 2019

104 For example: Sky News, [General election: Johnson’s manifesto pledges ‘triple tax lock’ and Brexit vote in weeks](#), 24 November 2019

105 Oral evidence taken before the Liaison Committee on 27 May 2020, HC (2019–21) 322 [Q83](#) The Prime Minister Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, Cp318 page 88 table 3.3.

107 <https://www.gov.scot/publications/scottish-income-tax-2021-2022>. See also paper by David Eiser, Adviser to the Finance and Constitution Committee, Scottish Parliament, [Essentials of the fiscal framework](#),

96. Increases in income tax rates and changes to thresholds could make a significant contribution to yields. We heard evidence that increases in income tax would raise revenue with little economic damage. Paul Johnson told us:

If you were not politically constrained and you wanted to raise significant amounts of money quickly, you would probably want to simply raise the basic or the main rates of income tax by a few pence. That raises you a lot of money very quickly and easily. Certainly increasing the basic rate of 20% by 2% or 3% will not do any significant economic damage.¹⁰⁸

97. **Based on the evidence we heard and received, we conclude that income tax is more efficient than some other taxes and we do not see a pressing need for reform at this time. The Government's manifesto commitment not to increase the rate of income tax does not preclude it from adjusting income tax thresholds. We note that the Government could raise revenue simply by freezing income tax thresholds, and that such a change would cause minimum economic distortion.**

The standard rate of VAT

98. £133.8bn was raised from VAT in 2019–20.¹⁰⁹ It would be open to the Government to amend the standard rate of VAT, which applies to most goods and services in the UK, and which currently stands at 20%. Structural changes to the VAT regime, going beyond a straight change to the standard rate, are discussed in Chapter 6 of this Report.

99. VAT has been one of the taxes used in the past when the fiscal position has required additional tax yield. Its present rate stems from two such rises: in 1991 it was increased to 17.5% from 15%, and (following a short period where it was again 15% between 1 December 2008 and 31 December 2009) it was further increased to 20% in 2010, following the financial crisis.¹¹⁰

100. Stuart Adam, senior research economist at IFS, summarised for us some of the advantages and disadvantages of increasing the standard rate of VAT:

Thinking [...] just about increasing the rate, rather than broadening the base, which is perhaps where I would be more inclined to look, it is not as progressive as increasing income tax, national insurance or most other taxes. Contrary to popular perception, it is not regressive, but it is much less progressive. It has an effect on discouraging consumption and therefore work, but it probably has less effect on that than income tax and national insurance does, and therefore somewhat less effect on growth.¹¹¹

101. However, the 20% VAT rate is not uniformly applied across products—some, such as food, newspapers and children's clothes, are zero-rated or have a reduced rate. Stuart Adam argued that a VAT rate rise could exacerbate the problems these differentials cause. He told us:

108 Q2

109 Office for Budget Responsibility, *Economic and Fiscal Outlook* November 2020, [Cp318](#) page 88 table 3.3

110 Institute for Fiscal Studies, *Fiscal Facts: tax and benefits VAT*, accessed 18 February 2021

111 [Q183](#)

One disadvantage of using it is that, because we have a lot of zero and reduced rates and exemptions, you will be increasing the bias between those things that are subject to VAT and those that are not. On the other hand, it does not have some of the disadvantages that other taxes have. It does not discourage saving. It does not encourage people to convert income into capital gains, to set up a business to avoid tax and all those kinds of things.¹¹²

102. Alan McIntock, Chair of the Indirect Taxes Committee at the Chartered Institute of Taxation, commented on international comparators:

“The median VAT rate in at least the European Union is 21%, with about half the member states being at 20%, 21% and 22%. At 20%, we are slightly below the median rate, so we think there is room to move up a little without being outside the pack. Germany is at 19%, so there would be a bit of a difference there. Moving our rate up and down is probably less open to challenge than dealing with the exemptions.”¹¹³

103. However, while increasing taxes is rarely popular, Charles Seaford, senior fellow at Demos, who has researched public opinions of tax rises,¹¹⁴ noted that increasing VAT may be particularly unpopular. He told us:

Raising VAT by a penny in the pound was the second most unpopular tax change that we polled out of 16. The most unpopular was a social care tax. It got a net positive rating of only 3%—that is to say the total of those who supported it minus the total of those who opposed it. It was still a net positive, but compared with changes to income tax it was much more unpopular. A proposal to raise income tax by 2p in the pound while raising the personal allowance by £1,000 to £13,500, which would mean that those earning less than £20,000 paid no more tax, got a net positive of 41%. There is far more appetite in the country for raising more money from income tax than from VAT.¹¹⁵

Rates and thresholds of national insurance contributions

104. Another way to raise revenue would be to change the rates and/or thresholds for national insurance contributions (NICs). It is estimated that in 2019–20 NICs raised £145bn, which is equivalent to 6.5% of GDP.¹¹⁶

105. We have not, however, looked in detail at this stage of the Report at the case for changes to national insurance contribution rates, because of the evidence which we have received on the increased distortions which would result. This is a structural problem which needs structural reform, and we address it in Chapter 6.

112 [Q183](#)

113 [Q183](#)

114 Charles Seaford co-authored a DEMOS report, [“A Peoples Budget”](#) into public attitudes to tax rises which was published on 24 September 2020.

115 [Q184](#)

116 Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, [Cp318](#) page 88 table 3.3, and page 84 table 3.2

Overall recommendation on income tax, VAT and NICs

106. Careful consideration would need to be given to any potential increases in income tax, VAT and national insurance contributions, taking into account the degree to which any increases

- result in additional economic distortions,
- make taxes more or less progressive,
- assist or otherwise with the Government’s “levelling up” agenda, and
- impact on employment.

Increases in national insurance contributions may be especially difficult given the probable impact on jobs, at a time when increasing employment is likely to remain an economic priority.

Rate of corporation tax

107. After income tax, national insurance and VAT, corporation tax is the next largest source of revenue from taxation. It is not covered by the so-called “triple tax lock”. The Office for Budget Responsibility estimates that the corporation tax yield for 2019–20 was £48.0bn, equivalent to 2.1% of GDP.¹¹⁷ HMRC estimates that an increase in corporation tax by 1 percentage point would yield £2bn in 2021–22, £3bn in 2022–23, and £3.4bn in 2023–24.¹¹⁸

108. The rate of corporation tax is currently 19%, which is the lowest it has ever been in the UK and is one of the lowest in the G20. The average corporation tax rate for European OECD countries in 2020 was 21.9% and the world average in 2019 (measured for 176 jurisdictions) was 24.2%.¹¹⁹

109. Corporation tax rates in the UK have steadily fallen since the 1990s, and since 2010 they have reduced from 28% to 19%.¹²⁰ The Government had intended to reduce the rate to 17%,¹²¹ but that was paused in 2018. Despite the overall decline in the corporation tax rate since 2010, the yield has risen from £36.5bn in 2009–10¹²² to £48bn in 2019–20.¹²³

110. Chris Sanger, Global Government Leader at Ernst and Young and Chair of the Tax Professionals Forum, told us that

117 Office for Budget Responsibility, Economic and Fiscal Outlook November 2020, [Cp318](#) page 88 table 3.3, and page 84 table 3.2

118 HMRC, [Direct effects of illustrative tax changes](#), 22 January 2021

119 Tax foundation [Corporate income Tax Rates in Europe](#) 16 April 2020

120 Until 2016 small companies benefited from a 20% small companies rate. An 8 % surcharge applies to banks, see HMRC [Banking Manual](#). Oil and gas companies pay a supplementary charge of 10%. See HMRC, [Oil and gas: supplementary charge](#), accessed 18 February 2021.

121 See [Corporation Tax](#) on [www.gov.uk](#). The reduction to 17% was announced at Budget 2016 but in 2020 it was confirmed it would remain at 19%

122 See OBR [Economic and Fiscal Outlook November 2010](#) table 4.6 on page 91

123 See OBR [Economic and Fiscal Outlook November 2020](#) table 3.3 on page 88

[...] the statutory corporate tax rate [...] is the shop window for a company looking at where to make investments. [...] We have seen a considerable reduction [...] That has had a big impact on making the UK an attractive place to invest into and to invest in for companies that are here today. ¹²⁴

When asked about what the impacts of increasing the rate from 19% would be, Mr Sanger said

“In my view, anything that goes higher than the other lowest of the G20, the 20%, would send all the wrong signals about the direction for tax policy making in the UK if you want to encourage international investment.”¹²⁵

111. On the other hand, John Cullinane, Tax Policy Director at the Chartered Institute of Taxation, said

“I do not think that multinational companies try to fine-tune shavings on the rates exactly like that. There is a lot of evidence that most of their investment planning is pre-tax in most cases, with specific exceptions, and then they look to make sure there is not a fundamental tax problem. Then, okay, they do their tax planning on the back of their commercial investments”.¹²⁶

112. On the related question of whether increasing the corporation tax rate would raise money or whether Laffer curve¹²⁷ effects would reduce the yield from an increase in rates, Tom Clougherty, Head of Tax at the Centre for Policy Studies, told us that

you probably can squeeze a bit more money out of the corporate sector with a slightly higher corporation tax rate before any sort of significant Laffer disincentive effects set in. I would question whether that would be the right thing to do, especially at a time like this when you really want to send a pro-business, pro-investment message as we come out of the pandemic.¹²⁸

113. We were given an opposing view from Alex Cobham, Chief Executive of the Tax Justice Network:

The UK rate is inappropriately low in the international context. As Chris has said, it is well below most major economies, which means we are losing revenues because multinationals are coming here for the market size anyway. It is also far above the effective rates in profit-shifting hubs like the Netherlands or Ireland, so we are not competing with them, even if we wanted to compete in the dirty game of profit shifting. You would be looking at something like the Biden-Harris proposals, raising the rate to something in the order of 28%, which would bring in, depending on the size of the behavioural effects, perhaps £20 billion to £25 billion.¹²⁹

124 [Q355](#)

125 [Q357](#)

126 [Q135](#)

127 The Laffer curve is named after economist Arthur Laffer, who described an economic phenomenon whereby increasing tax rates beyond a certain point would reduce the overall tax yield

128 [Q359](#)

129 [Q361](#)

114. Another consideration which must be taken into account regarding changes to the corporation tax rate is the effect it has on decisions by small businesses to incorporate. We asked witnesses about how the corporation tax rate affects the attractiveness of using limited company structures rather than employment which is taxed under PAYE (see Chapter 6 below). Chris Sanger told us that:

“One or two percentage points is not going to overcome the lack of paying national insurance that comes as a benefit of paying out dividends through a personal service company. You would need to go up quite a few percentage points to address that. Arguably, it may be better to look at the employment/self-employment divide that I know you have considered before, because that would then be taken into account into the IR35 calculation. On the question of raising it for small businesses, if you were going to go down that route, you would really have to distinguish between the avoidance you are trying to deal with rather than penalising smaller businesses because of the third-person problem.”¹³⁰

115. Recent press reports have suggested that the Government is considering increasing the corporation tax rate.¹³¹ We note that the policy of the Biden administration in the US is to increase corporation tax rates.¹³²

116. The UK has a lower corporation tax rate than other major economies, and we believe that a moderate increase in rate could raise revenue without damaging growth, especially if balanced with fiscally appropriate measures to help business, such as enhanced loss relief and capital allowances. However, it is clear that a very significant increase in the rate would be counterproductive.

Tax relief on pension contributions

117. Pension tax relief is the second most costly tax relief and is estimated to have cost £20.4bn in 2018–19.¹³³ Reducing the cost of this income tax relief could make a significant contribution to public finances.

118. Pension tax relief for employees enables them to benefit at their highest rate of income tax for pension contributions both for deductions from salary and for contributions paid by the employer on their behalf. The size of any relief is limited by a lifetime allowance, which limits the value of payouts from pension schemes by providing for a tax charge when the allowance is exceeded, and an annual allowance which limits the total amount of employee and employer combined contributions in any one year.¹³⁴ When pensions are paid on retirement, any lump sum provided by the pension scheme is free of income tax, and the annual pension is subject to income tax but not national insurance contributions.¹³⁵

130 [Q372](#)

131 For example: [“Rishi Sunak risks clash with business over proposed corporation tax rise”](#), Financial Times, 18 January 2021

132 [“The economic challenge facing Joe Biden”](#), BBC News, 20 January 2020.

133 National Audit Office, report by the Comptroller and Auditor General, [The Management of Tax Expenditures](#) HC 46 (2019–21) 14 February 2020, figure 3 page 18.

134 HMRC, [Pension Scheme Rates](#), accessed 18 February 2021

135 GOV.UK, [Tax when you get a pension](#), accessed 18 February 2021

119. At the July 2015 Budget,¹³⁶ the Government announced a consultation on pension tax relief which raised the possibility of reducing the amount of tax relief for employee pension payments.¹³⁷ It also suggested moving to a system which is “taxed-exempt-exempt”,¹³⁸ in which pension contributions would be made out of taxed income, but then the income accruing from such savings within the fund, and the pension income derived from it, would be tax-free. However, the Chancellor announced no fundamental change to the tax treatment of pension contributions in the 2016 Budget Statement.

120. Changes made to restrict pension tax relief have caused problems.¹³⁹ For example they have had an impact on doctors and consultants, as the limits to, and tapering of, the annual allowance and the lifetime allowance caught many higher-paid public sector workers.¹⁴⁰ Some NHS consultants ended up with effective marginal tax rates of over 100% on any additional earnings, meaning that working extra hours would actually make them worse off. The Government sought to address these problems at Budget 2020.¹⁴¹

121. There was a range of views in evidence on pension tax relief: some were supportive¹⁴² while others called for it to be restricted.¹⁴³ The Chartered Institute of Taxation was cautiously positive about the idea of reform:

These are politically and economically sensitive matters in which it will be difficult to achieve consensus and in which technical issues of various disciplines interact with political choices. People have expectations developed over many years and it is clearly undesirable to ‘chop and change’ too often. However comprehensive, public, consultative review seems overdue ...

And it went on to say:

This does seem worth revisiting in current circumstances. It may also offer a way of addressing the absolute tax breaks inherent in the current system, without needing to ‘attack’ one or more of them on an isolated basis. No doubt there were good reasons for the thumbs-down given to the earlier consultation but since then we have had the COVID crisis and the partial retreat in the 2020 Budget from the piecemeal complex measures taken over the last 12 years to reduce the weighting of benefits in the system toward the higher paid.

122. A previous Treasury Committee also considered this relief, and recommended that:

There is widespread acknowledgement that tax relief is not an effective or well-targeted way of incentivising saving into pensions. Ultimately, the Government may want to return to the question of whether there should be fundamental reform. However, the existing state of affairs could be improved

136 HM Treasury, [Summer Budget 2015](#) 8 July 2015, HC 264

137 HM Treasury, [Strengthening the incentive to save: consultation on pensions tax relief](#) 8 July 2015. See also House of Commons Library, *Reform of pension tax relief*. Briefing paper, [CBP-7505](#), 7 February 2020

138 HM Treasury, [Strengthening the incentive to save: consultation on pensions tax relief](#) 8 July 2015, para 3.12

139 *Reform of pension tax relief*, Briefing paper, [CBP-7505](#), 7 February 2020

140 *Pension tax rules—impact on NHS consultants and GPs*, Briefing Paper. [CBP-8626](#) 20 March 2020

141 HM Treasury, *Budget 2020*, [HC 121](#). 11 March 2020 paragraph 2.183–5 page 89

142 See Association of British Insurers ([TAC0090](#)), Pensions and Lifetime Savings Association ([TAC0093](#))

143 See for example Natixis Investment Managers ([TAC0028](#)), Professor Richard Murphy (Director at Tax Research LLP) ([TAC0100](#))

through further, incremental changes. In particular, the Government should give serious consideration to replacing the lifetime allowance with a lower annual allowance, introducing a flat rate of relief, and promoting understanding of tax relief as a bonus or additional contribution.¹⁴⁴

123. Given the regressive nature of the benefits accruing to individuals from the current arrangements on pension tax relief, especially those in the top earnings decile, the Chancellor should urgently reform the entire approach to pension tax relief.

¹⁴⁴ Treasury Committee, [Household finances: income, saving and debt](#), Nineteenth Report of Session 2017–19, para 117

6 Priorities for tax reform

124. In Chapter 2 of this Report we presented an analysis of the widening long-term gap in the public finances between public spending commitments and current plans for taxation. The evidence submitted to this inquiry generally supports the proposition that the UK would be able to raise additional taxation to help fill this gap, should current and future Governments choose to do so. However, in addition to its function of raising revenue, there is a pressing case for reform of the tax system, in order to ensure that taxes are less distortionary and less damaging to growth.

125. The UK's tax system encompasses a vast range of different taxes, reliefs and regulations. It is hugely complex: the reform of its every aspect would be beyond the scope of a select committee inquiry. In this Chapter, we have been selective and have drawn together the evidence we have received on what seem to be some of the most pressing areas in need of reform.

Taxing income from work

Inconsistencies between tax contributions under different forms of work

126. When launching the Self-Employed Income Support Scheme (SEISS) on 26 March 2020, in response to the coronavirus crisis,¹⁴⁵ the Chancellor of the Exchequer (the Rt Hon. Rishi Sunak MP) said that "... in devising this scheme—in response to many calls for support—it is now much harder to justify the inconsistent contributions between people of different employment statuses. If we all want to benefit equally from state support, we must all pay in equally in future."¹⁴⁶

127. Although the Chancellor was referring specifically to the self-employed and their lower rates of taxation relative to those who are employed directly and taxed entirely under PAYE, he might also be taken to be implying that the relative lack of support for those taking salary as dividends is due to the tax advantages that many of them are receiving. The different burden of taxation between the self-employed and employees is largely due to differing levels of national insurance contributions.

The long-term shift in burden of taxation from income tax to NIC

128. Over the past 40 years there has been a steady reduction in the basic rate of income tax but an increase in rates of national insurance contributions (NICs), which has reduced the benefits of income tax cuts. For example, in 1980–81 the basic rate of tax was 30%, the employee Class 1 NICs contribution was 6.75% and the employer NICs 10.2%. In 2020–21 the basic rate of tax is 10% lower than it was in 1980–81, at 20%, but the benefit of the reduction to employees is partially offset because the employee Class 1 contribution is now 12% and the employer contribution 13.8%.¹⁴⁷ This shift towards NICs and away from income tax has occurred incrementally over many years. Coupled with reductions in the corporation tax rate, it has made alternative work structures to PAYE employment more

145 HM Treasury, [Chancellor's statement on coronavirus \(COVID-19\)](#): 26 March 2020, accessed 18 February 2021

146 HM Treasury, [Chancellor's statement on coronavirus \(COVID-19\)](#), accessed 18 February 2021

147 HMRC, [Rates and thresholds for employers 2020 to 2021](#), Institute for Fiscal Studies, [historical tax information](#), accessed 18 February 2021

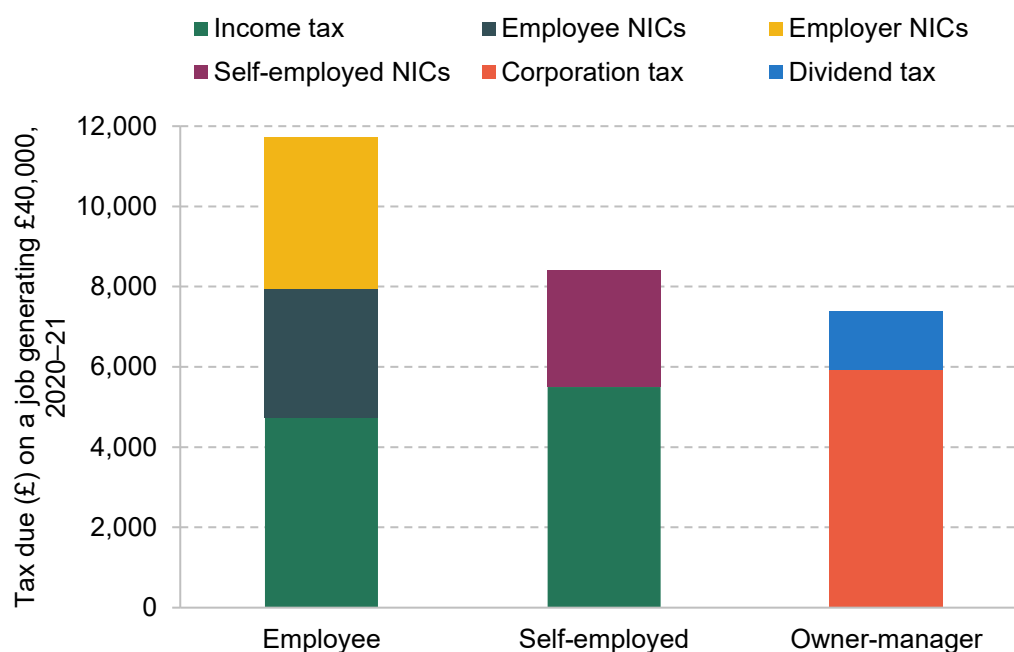
attractive from a tax perspective and has contributed to more workers and employers seeking to avoid PAYE costs by working as self-employed or contracting through a limited company.

129. The self-employed pay Class 2 NICs at a flat £3.05 per week and Class 4 NICs of 9% (2% on profits over £50,000).¹⁴⁸ In 2017 an increase in the self-employed Class 4 NICs by 1% was announced in the Budget but was abandoned.¹⁴⁹ When announcing it, the then Chancellor of the Exchequer (the Rt Hon. Philip Hammond MP) said that “This change reduces the unfairness in the national insurance contributions system and reflects more accurately the current differences in benefits available from the state.”¹⁵⁰

Differences in taxation between different legal forms of work

130. The Institute for Fiscal Studies has set out in graphic form the differences in taxation between different legal forms of work:

Figure 8: Tax in different legal forms



Note: Income tax is slightly higher for the self-employed than for employees because the latter are charged income tax on income net of employer NICs. Excludes trading allowance and employment allowance where applicable.

Source: Institute for Fiscal Studies, Taxing work and investment across legal forms¹⁵¹

148 HMRC [Self-employed National Insurance rates](#) GOV.UK

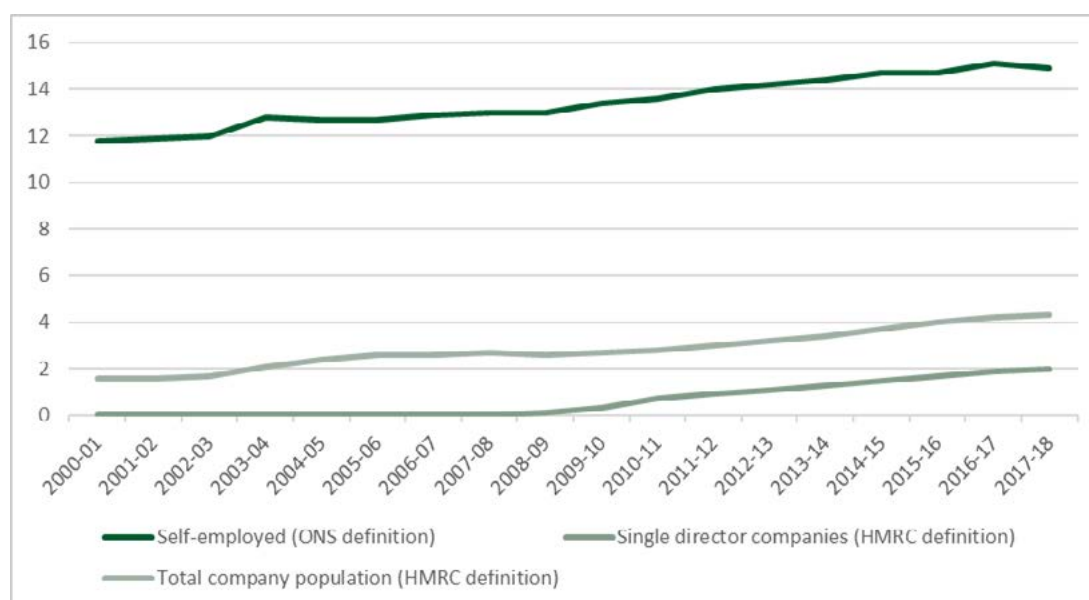
149 See [Spring Budget report](#), page 2 for the original announcement. The Chancellor announced the change in policy (and the reasons for it) in the House of Commons on 15 March 2017. See HC Deb 15 March 2017, [col 623](#), [Commons Chamber]

150 [Budget statement, Hansard 8 March 2017](#). Col 814

151 Helen Miller and Stuart Adam, Institute for Fiscal Studies, [Taxing work and investment across legal forms: pathways to well designed taxes](#), 26 January 2021. See page 8

131. The growth in self-employment and incorporation is one of the “Fiscal risks” that the Office of Budget Responsibility set out in its Fiscal risks report in 2019.¹⁵² The OBR takes the view that the increase in these forms of work is likely to be the result of differences in tax treatment.

Figure 9: Trends in self-employment and incorporation (% of the workforce)



Source: OBR, Fiscal Risks Report 2019, chart 4.7¹⁵³

Should the income of the self-employed be taxed at the same rate as employees?

132. We have received differing evidence on whether the self-employed should be taxed at the same rates as employees. Professor Judith Freedman, Professor of Taxation Law and Policy at the Faculty of Law at Oxford University, told us:

I do not think there is any principle at all on which the self-employed should be taxed at a lower rate than employees. There is some small difference in rights to benefits, which accounts for about a 1% difference, around parental leave and jobseeker’s allowance. Beyond that, there is no good rationale. The rationale usually used is to encourage entrepreneurship and so on, all of which is very important. We are going to need to encourage entrepreneurship after this pandemic. However, doing that through a blanket relief to all self-employed, some of whom are not particularly entrepreneurial, does not seem to be a good way of using scarce resources.¹⁵⁴

On the economic benefits of tax neutrality, she said:

As far as the tax system is concerned, the ideal is to be as neutral as possible between different legal forms of working, because that would then not

¹⁵² Office for Budget Responsibility, Fiscal Risks, [CP131](#), July 2019, p78, para 4.19

¹⁵³ See paragraph 4.17 on page 78 of [Fiscal Risks report](#) 2019.

¹⁵⁴ [Q222](#)

distort the market. Both the engagers and the engaged would decide how best to organise their businesses without having to take tax into account. That would be far better commercially and would be good for the economy.¹⁵⁵

133. We asked Charlotte Barbour, Director of Taxation at the Institute of Chartered Accountants of Scotland (ICAS), whether reduced taxation of the self-employed was justified. She said:

“It is very difficult to justify different tax rates for what people call the three-person problem. If you have similar work, whether you are employed, self-employed or through a company, there does not seem to be a logical reason in terms of fairness as to why those different people should pay different amounts of tax.”¹⁵⁶

However, she went on to recognise that the self-employed face more risk, saying that “the self-employed do face more risk so maybe, arguably, they have to pay less”.¹⁵⁷

134. On the question of whether the additional risks taken on by the self-employed justify less taxation, Professor Freedman said:

“The tax system is a very poor vehicle for reflecting that risk, because some self-employed take on risk, but some take on very little or no risk. Therefore, if you use the risk argument, it does not work well. Some employees are in very risky and precarious employment. Risk is not related to the amount of tax being paid under the current system. It would be impossible to devise a system that would properly reflect risk within the tax system. There are other ways of assisting people to take risks. Tax is a pretty crude instrument for doing that.”¹⁵⁸

135. Derek Cribb, Interim CEO at the Association of Independent Professionals and the Self-Employed, (IPSE) disagreed:

“Unsurprisingly, I am going to disagree with Judith on a few of these points. Tax is a very blunt system and blunt implement for differentiating between types of risk, in terms of your business. Sadly, it is the only one we have. Yes, there is a differential that needs to be there. We do need to encourage the entrepreneurialism. There is also a premise here that the self-employed want the same support and safety nets as employed people have. I am not sure that is always the case. A large number of the self-employed are more independently-minded, risk-taking and entrepreneurial. That does not mean they never need support. Coming back to the coronavirus and support packages, we need to look outside the normal economic 10-year cycle, or whatever it might be, where I do not think most of the self-employed would look for support from the Government. Coronavirus is more of a one-in-100-year event, and with that everybody needs a bit of extra support. [...]”¹⁵⁹

155 [Q222](#)

156 [Q88](#)

157 [Q90](#)

158 [Q223](#)

159 [Q224](#)

136. John Cullinane, Tax Policy Director of the Chartered Institute of Taxation, recognised the principle that the self-employed should be taxed the same as employees but also saw difficulties with removing the differences. He said:

“it is very hard to justify these differences. If you had a blank sheet of paper, you would probably design something where either they were somehow paying the same tax or, even if there were different taxes for different legal situations, the overall balance was better. The big problem with saying that [...] is that the differences are so huge that to adjust them would be massively painful for self-employed people.

People often talk about the few-percent differences on employees’ national insurance, or not having national insurance on dividends, as being what it is all about, but the elephant in the room is the employer’s national insurance of 13.8%, which is being taken out of the system by having somebody move off payroll, whether they are incorporated or not. The amount of money that self-employed people are able to charge in the market no doubt reflects the fact that they are less heavily taxed than if everything was run through an employed basis.

[...] The politics are much more difficult here, frankly, than with VAT on food or some other things we have been talking about, and for good reason. It would be a massive shock to people. [...]”¹⁶⁰

137. Bill Dodwell, Tax Director at the Office of Tax Simplification, said:

“ [...] A self-employed person pays self-employed national insurance, albeit at a lower rate, and income tax. Of course, a great many freelancers provide their services via a company. Work from the Institute for Fiscal Studies and others has demonstrated that people in that category can use the flexibility of a company to smooth out their tax rates and, over time, end up with substantially lower rates than everyone else through all that.”¹⁶¹

There is definitely a case for looking at evening up that burden of taxation, and you will have to find different ways of doing it. [...]”¹⁶²

138. Andrew Titchener, Head of Tax Policy at the Confederation of British Industry, suggested that tax was not the only reason why employers engage people as contractors instead of employees:

“ [...] the differential in cost is taken into account when employers are making decisions, but there are a huge range of reasons why an employer would engage with someone as a contractor or as an employee, around the type of work you are doing, the sector you are in and the sort of project you are doing.

One of the other things is certainty. If employers are trying to decide what they need for their workforce, whether someone permanent or a contractor, the way that employment status is currently quite difficult to manage and

160 [Q91](#)

161 [Q227](#)

162 [Q227](#)

come to a conclusion on is probably as big a thing, if not bigger, than the tax. There is a risk to the employer, in that they cannot be sure in certain cases whether they have got the status right for the person they are engaging with. The fact that they have to pay people to help them decide that adds to the overall cost of engaging somebody.¹⁶³

Mr Titchener also made a point about clarity of employment status:

[Employers] would welcome clarity ... We mentioned earlier the certainty piece for employers ... we have three different statuses for employment law and two for tax, each of which requires an independent determination. For every worker, you effectively need an employment, a tax lawyer and an HR professional to decide their status, which adds a lot of cost to the engagement¹⁶⁴

139. We strongly believe that a major reform of the tax treatment of the self-employed and employees is long overdue. The current system is confused, unfair and unsustainable. The review should incorporate the benefits which accrue upon payment of NICs and other taxes as well as the level, the incentives and the interaction of such taxes. It should look as far as is possible to eliminate the so-called ‘three person problem’ altogether.

Limited companies

140. Limited companies pay corporation tax at 19%. Profits distributed as dividends to shareholders are taxed at the dividend rates, which are 7.5% for basic rate taxpayers, 32.5% for higher rate and 38.1% for additional rate.¹⁶⁵ As the chart in paragraph 130 above shows, owner-managers are taxed less overall than those in employment or self-employment.

141. The incentives to set up as a limited company are currently even stronger in Scotland, where income tax on employment is devolved but national insurance contributions, corporation tax and income tax on savings (including dividend taxation) are not. John Cullinane, Tax Policy Director at the Chartered Institute of Taxation, told us:

For an unincorporated business in Scotland, the business owner will be paying income tax under rates set entirely in Scotland but national insurance will be set in the UK. If they incorporate that business, you are thinking about corporation tax and income tax on dividends, all of which are at the UK level. You can have a mess entirely within the tax system.¹⁶⁶

142. We believe that if the tax advantages of self-employment were to be reduced, then the tax advantages of running a limited company should be considered for reduction relative to the taxation of employees under PAYE.

163 [Q226](#)

164 [Q243](#)

165 [Tax on dividends](#)

166 [Q78](#)

Merger of NICs and income tax

143. The differences in design and scope between tax and NICs have impacts beyond the taxation of employees, the self-employed and contractors discussed above. For example, NICs—unlike income tax—are not payable by employees or the self-employed when they are above the state retirement age;¹⁶⁷ nor are they payable on pensions or investment income. Another difference is that NICs rates and thresholds are calculated on the amount of earnings received each month (or week for weekly-paid staff) and not, as in income tax, for the full year; so NICs are not cumulative in the same way.¹⁶⁸

144. These differences have led to calls for a merger of the two taxes. We heard evidence in support of this from Judith Freedman, Professor of Taxation Law and Policy at the Faculty of Law at the University of Oxford, although she also recognised the practical difficulties:

“I am on record as having proposed a merger. [...] but one has to recognise the practicalities. That would be an immediate jump of the headline rate of income tax, which politicians would find hard to deal with. We may have to take steps towards that, but eventually that should be the aim. I do not feel that the current national insurance system is any longer what it was intended to be. It is not a contributory system any more. We could move towards merger, in my view, and remove a lot of the structural problems that we are talking about.”¹⁶⁹

145. Bill Dodwell, Tax Director at the Office of Tax Simplification (OTS), told us that the OTS had looked at the idea of merger in 2016.¹⁷⁰ He said:

“The Office of Tax Simplification did some work in 2016, looking at merging the base for national insurance and income tax in relation to employment income only. That is important, because national insurance does not apply to pension income or investment income. Moving to extend it to that would mean a substantially higher burden for pensioners. There are about 12 million pensioners in the UK. About 6 million of them actually pay income tax, a little bit. It is a group that has benefited over the decades from the increase in national insurance, borne by them when they were employed, but not borne by them as pensioners. Simply looking at merging the base for the two of them, the Office of Tax Simplification, working with HMRC’s economics unit, estimated that there would be about 7 million winners and about 7 million losers from that merger”.¹⁷¹

146. *Evidence to this inquiry is clear that differences between income tax and national insurance contributions create distortions and unfairness. While we have not heard enough evidence to recommend a wholesale merger of national insurance contributions and income tax, the Government should consider what can be done to remove the distortions gradually through time.*

167 HMRC, [National Insurance and tax after State Pension Age](https://www.gov.uk), www.gov.uk

168 Office of Tax Simplification [Closer alignment of income tax and national insurance contributions](#). 7 March 2016. This report discussed the issues in detail and made recommendations for change.

169 [Q247](#)

170 Office of Tax Simplification [Closer alignment of income tax and NICs](#), first report (7 March 2016) and [further report](#) (14 November 2016)

171 [Q251](#)

Taxation of pensions

147. Paul Johnson, Director of the IFS, commented on the effects of taxation of pensions in payment¹⁷² resulting from the long term increases in national insurance contributions and reductions in income tax discussed at paragraph 128 above:

“There has, of course, been no increase in the tax on pensions in payment. In that sense, as in many other senses, those who have already reached pension age have been protected from tax rises, so there is a case for at least a modest increase in tax on occupational pensions in payment, given that they will have not have had national insurance paid at any point in the past and have been extremely well tax relieved.”

However, he noted that “this is not something that would raise you very large amounts of money.”¹⁷³

148. We believe that when reviewing the burdens of taxation for the employed and self-employed and limited companies, the Government should also review the taxation of pensions and the tax relief applicable to pension payments.

Digital services tax

149. The OECD’s Base Erosion and Profit Shifting (BEPS) project aims to reach international agreement to put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules to avoid paying tax.¹⁷⁴ These gaps and mismatches have been used by multinational enterprises—including large multinational digital companies—to move profits to low or no-tax jurisdictions.¹⁷⁵ The UK has played a leading role in the development and implementation of BEPS.

150. The UK is also one of a number of countries which have introduced unilateral taxes on digital services aimed at capturing more of the profit made in their territories by large overseas digital concerns such as Google, Amazon and Facebook. The digital services tax was announced by then Chancellor of the Exchequer, the Rt Hon. Philip Hammond MP, in the 2018 Budget statement.¹⁷⁶ It is charged at 2% on the revenues of certain digital businesses. The tax came into force on 1 April 2020.¹⁷⁷ The UK Government has said it will abolish the tax when international agreement is reached to share the profits of the companies more fairly across the territories in which they operate.¹⁷⁸

151. When introducing the tax, Mr Hammond said:

We will continue to work at the OECD and G20 to seek a globally agreed solution, and if one emerges, we will consider adopting it in place of the UK

172 Term used to describe a pension payment received by a pensioner

173 [Q2](#)

174 OECD, [Inclusive framework on Base Erosion and Profit shifting](#)

175 BEPS Action 1 is “Tax Challenges Arising from Digitalisation”

176 HC Deb, 29 October 2018, [col 662](#) [Commons Chamber]. HM Treasury [Budget Report](#), HC 1629, 29 October 2018, paragraph 3.4 page 41

177 HMRC, [“Work out your digital services tax”](#) guidance

178 HC 121, March 2020 [para 2.205](#). see also, PQ61662, 24 June 2020; HC Deb 15 September 2020 [cc179–180](#); [PQ96879](#), 7 October 2020

digital services tax, but this step shows that we are serious about this reform, because it is only right that these global giants with profitable businesses in the UK pay their fair share towards supporting our public services.”¹⁷⁹

152. The current Chancellor of the Exchequer, the Rt. Hon Rishi Sunak MP, signed a joint letter from finance ministers of the UK, Spain, Italy and France to US Treasury Secretary Mnuchin in June 2020, restating the governments’ commitment to the principle of a digital services tax. The letter stated that

Digital giants, no matter where they are headquartered, will emerge from the current crisis more powerful and more profitable. These companies benefit from free access to the European market. It is fair and legitimate to expect that they pay their fair share of tax within countries where they create value and profit.¹⁸⁰

153. Whilst recognising that the digital services tax is well designed and is expected to raise about £400m per year,¹⁸¹ Chris Sanger, Global Government Leader at Ernst and Young and Chair of the Tax Professionals Forum, said:

It will increase the price, effectively, of those businesses acting here in the UK. That then will determine whether that is a price that they can either bear themselves and therefore it will not affect the consumer or whether they pass it on. At the margin, it will deter investment.¹⁸²

154. Tom Clougherty also thought that the tax had faults:

“The fact that it is levied on turnover is a problem. The fact that we are just targeting a specific industry and specific businesses within a specific industry is a problem. It sets a bad precedent for good tax policy in general. The real danger is not so much with the UK levying a relatively marginal minor tax unilaterally. The problem would come if lots of other countries follow in our footsteps and if the US continues to put in place retaliatory tariffs because it sees this as a move against American business interests.”¹⁸³

155. We recognise that the digital services tax is a useful step towards capturing some of the profits made in the UK by digital companies. We strongly approve of the Government’s approach in seeking international agreement on taxation of companies providing digital services and, where international agreement is reached, maintaining its commitment to abolishing the digital services tax in favour of any such agreement.

156. We recommend that the Government provide this Committee with an annual report on progress towards reaching international agreement on the taxation of digital services, the yield of the digital services tax and the effects of the tax on digital companies and the wider economy.

179 HC Deb 29 October 2018 [col 662](#) [Commons Chamber]

180 HM Treasury, [Letter 17 June 2020](#).

181 [Q373](#) Also this as the estimate of yield at Budget 2018, see HM Treasury [Budget report](#), 29 October 2018, HC 1629 table 2.1 line 53 page 38

182 [Q374](#)

183 [Q377](#)

Capital gains tax and inheritance tax

157. The Government has recognised that there are problems with two of the main capital taxes, inheritance tax (IHT) and capital gains tax (CGT). Capital gains tax is paid on gains made on the disposal of capital assets. Inheritance tax is payable on the value of the estate of a deceased person. Both taxes are subject to extensive reliefs and exemptions.¹⁸⁴

158. The Government commissioned the Office of Tax Simplification (OTS) to examine both taxes and to make proposals for reform.¹⁸⁵ The OTS published reports on inheritance tax on 5 July 2019 and on capital gains tax on 11 November 2020. On inheritance tax, its recommendations included simplifying the lifetime gifts allowance, shortening from seven years to five years the period before death during which lifetime gifts are chargeable,¹⁸⁶ and restrictions to the capital gains uplift on death.¹⁸⁷ The capital gains tax report recommendations included a closer alignment between capital gains tax rates and income tax rates, and it also called for restrictions to the capital gains uplift on death.¹⁸⁸ The Government has yet to respond to either report.

159. Speaking in favour of reform of CGT and IHT, and against the idea of a wealth tax, Sir Edward Troup, Former First Permanent Secretary at HMRC, told us:

There is real risk that we are looking at putting something new, difficult and probably pretty inefficient on top of some already non-working taxes. We should actually go back and look at inheritance tax and capital gains tax. If this commission and your Committee's work do one thing, I would like it to expose some of the defects of the existing capital taxes while expressing some view on what you think about this as an additional capital tax."¹⁸⁹

160. It was also suggested to us that there would need to be an indexation allowance to avoid taxing inflationary gains.¹⁹⁰ Emma Chamberlain, barrister at Pump Court Chambers and visiting Professor at Oxford University, cautioned against alignment, based on her professional experience:

“I am old enough to have been in practice in 1998, when Labour reduced the rates. They had a differential rate between long-term and short-term gains, which is what some other countries, like France and the USA, do. I remember that people just stopped going abroad, doing avoidance schemes like selling their shares and taking loan notes. The rate is absolutely critical to behaviour. If you raise CGT rates, I am sceptical about whether you will get more revenue. If you are going to align the rates, you are probably going to need an exit tax, because otherwise before people sell their business they will go abroad, stay abroad for six years, sell while they are abroad, and then you will not get anything”¹⁹¹

184 HMRC guidance [Capital Gains Tax](#), GOV.UK and HMRC [Inheritance Tax](#) GOV.UK

185 [Government letter to OTS about Capital Gains tax, 14 July 2020](#), [Government letter to OTS about Inheritance Tax](#), 29 January 2018.

186 Office of Tax Simplification, *Inheritance tax Review—second report: Simplifying the design of Inheritance Tax*, July 2019, p7

187 Office of Tax Simplification, *Inheritance tax Review—second report: Simplifying the design of Inheritance Tax*, July 2019, p10

188 Office Of Tax Simplification, [Capital Gains tax stage 1 report](#), November 2020, p18–19

189 [Q314](#)

190 For example see Dr Arun Advani [Q343](#)

191 [Q343](#)

161. Sir Edward Troup was also cautious about alignment, saying:

“Capital gains tax is a bit like Churchill’s description of democracy. It is the worst way of taxing capital gains except every other one that has been tried. It is very much a minority sport. We did not have it until 1965. It is only really here to protect the bigger base of income tax, to try to stop people turning income into capital gains. There is no right way to do it. You can actually say that what was done in 1965 was not a bad way, just taxing gains at about half the rate of income tax and be done with it, because some gains represent income that is already taxed—your shares in a company, which has already paid the full amount of tax, for instance—and some represent gains that are completely untaxed, like your holding of gold bullion or whatever else”.¹⁹²

162. But in contrast to other witnesses he thought there was a case against indexation:

“It is extraordinary that the Office of Tax Simplification should be advocating inflation relief in capital gains tax, when if I go out and buy a Government gilt, in normal days when there is normal interest rates and normal inflation, I get no relief against income tax for the inflationary element of my interest. They are now suggesting that we have all the complexity of inflation relief on capital gains.”¹⁹³

163. There are problems with the existing capital taxes, and we await with interest the Government response to the OTS reports on inheritance tax and capital gains tax.

164. Based on evidence to the Committee, we believe that there is a compelling case for the reform of capital taxes.

Retail sales tax as an alternative to VAT

165. VAT was introduced in the UK when it joined the European Economic Community in 1973 and was one of the requirements of joining. The overall structure of the tax, including what could and could not be charged to VAT, was set in an EU VAT Directive.¹⁹⁴ Now that the UK is no longer a member of the EU, this Directive does not apply. The UK Government now has more scope to tailor the VAT system to suit the UK economy or to go further and replace VAT with a retail sales tax.

166. A sales tax is incurred by the buyer at the point of sale of goods, and the retailer accounts to the tax authority. VAT, by contrast, is incurred by all buyers in the production chain. VAT allows businesses to recover the VAT they pay (their “input tax”) by setting it against the VAT they receive (“output tax”). It is not necessary to define the final retail purchaser: that will be anyone who cannot recover the VAT. Businesses only account to HMRC for the difference between output and input and can claim a refund from HMRC. VAT is favoured by economists because, by accounting for inputs and outputs, it distorts transactions less than a retail sales tax does, and because it applies only to the “Value Added” at each stage of production.¹⁹⁵

192 [Q344](#)

193 [Q344](#)

194 [Council directive 2006/112/EC](#) which updated previous directives on turnover taxes

195 For a detailed discussion of the economics see Mirrlees report, Dimensions of Tax Design, chapter 4 “[Value Added Tax and Excise](#)”

167. We took evidence on whether a sales tax should replace VAT.¹⁹⁶ Stuart Adam told us that:

If you were starting from scratch, either [VAT or a sales tax] would be potentially a reasonable option, thinking specifically about a retail sales tax, not a turnover tax. Either would in principle be reasonable. I would probably still lean towards VAT, but, given that we have a VAT system up and running, I would not go near the upheaval of scrapping one and introducing the other with a bargepole.”¹⁹⁷

168. Alan McLintock, Chair of the Indirect Taxes Committee at the Chartered Institute of Taxation, agreed. He said: “If you look over the last 20 to 25 years, almost every country in the world has implemented a VAT system. None of them is implementing sales at purchase tax systems. The US is pretty much a standalone. I would not look at that as a model of good tax.”¹⁹⁸

169. We did not hear or receive any evidence in favour of replacing VAT with a retail sales tax. Any contemplation of such a change must be accompanied by more evidence as to the effects it would have, not least on our trade with the EU, which would continue to levy VAT.

Changes to the scope of VAT including reduced and zero rates

170. The VAT rate of 20% applies to most goods and services, but there are a number of zero rates, including food, children’s clothes and books. In addition, there are reduced rates on domestic energy, energy saving materials and protective and safety equipment such as children’s car seats. There are also a number of exemptions from VAT. A seller can recover input VAT where goods or services are zero-rated but cannot where the goods are exempt. The Government also introduced reduced rates for hospitality and certain attractions on 15 July 2020, as a measure to help businesses affected by the pandemic.¹⁹⁹

171. We asked witnesses about the impact of the UK’s departure from the EU and the freedom to change the scope of VAT. Stuart Adam, Senior Research Economist at the Institute for Fiscal Studies, said:

“The obvious danger is [...] it opens up scope for every sector of the economy to lobby for preferential VAT treatment. So far, the Government have been able to say, “The EU ties our hands”. If they cannot say that, lobbying pressure may grow. That is particularly in the context of a weak economy. Lots of sectors can make reasonable arguments for saying, “Look, we are struggling. We need support”. Every sector can make a good case for why it is particularly deserving. I am not convinced that preferential VAT treatments are a good way to support particular industries.”²⁰⁰

172. We received evidence putting the case for new zero rates.

196 [Qq189–190](#)

197 [Q189](#)

198 [Q190](#)

199 [HMRC Guidance on the temporary reduced rate of VAT for hospitality, holiday accommodation and attractions](#), 9 July 2020

200 [Q195](#)

Some witnesses spoke about the desirability of zero rates. Paul Johnson, Director of the Institute for Fiscal Studies, suggested extension of the VAT base as a revenue raiser after the pandemic. He said: “Politically difficult, but good for the efficiency of the tax system, would be to extend the VAT base somewhat—not necessarily by charging 20% on everything that is currently charged at zero per cent ... “.²⁰¹

173. Dr Gemma Tetlow, Chief Economist, Institute for Government, agreed. She said:

“I would support Paul’s call for thinking about broadening the base of some of these taxes rather than just increasing the rates, which has tended to be what Governments have liked to do in the past. I agree with Paul’s statement that it is hard to do politically but, for example, things like charging VAT on all goods rather than having many products zero rated would be one way of doing that. It would stop the current behaviour, which is that the producers of goods try to ensure that their goods get classified as being zero rated and not 20% rated.”²⁰²

174. Philip Booth, Professor of Finance, Public Policy and Ethics and St Marys University and Senior Academic Fellow at the Institute of Economic Affairs, was opposed to tax increases, but he pointed out that other countries have a broader VAT base and suggested that expanding the VAT base would be a way of raising additional tax without damaging growth:

“if you are looking for the least anti-growth taxes, one thing you could do is look at tax systems in other northern European countries where they raise a somewhat higher proportion of national income through tax. [...] they [have] a much broader VAT base, for example by charging VAT on domestic fuel and transport and very often food as well. They [have] [...] people starting to pay tax at lower levels of income and higher rates of tax come lower down the scale. [...]. Broadening the VAT base and potentially some kind of tax on user services and cost of housing—a complex issue that we might come back to and that I know the IFS has written about—would be another non-anti-growth way of raising taxes significantly.”²⁰³

He also said “ ... I would extend the VAT base to at least include domestic fuel and transport.”²⁰⁴

175. We asked Alan McLintock about changing the VAT base. He said:

“The VAT exemptions and zero rating are very significant. Food is about £19 billion. Construction and sale of new dwellings is about £15 billion. Domestic passenger transport is about £5.5 billion. There are obviously large amounts of tax being relieved there so you could look at increasing the tax base and taxing these. As we have just seen with the retail export scheme, there are lots of people and businesses that would be negatively impacted and would be lobbying hard against such a move. Extending the tax base

201 [Q2](#)
 202 [Q3](#)
 203 [Q5](#)
 204 [Q59](#)

or increasing the tax rate is probably where your choices are. For things like healthcare and particularly financial services, it feels far more difficult technically to apply a rate of VAT. It would get very complex. You would probably have to do very narrow things, such as applying VAT to motor or contents insurance, rather than taxing it as a generality. Technically, food and passenger transport are the easy ones because you just apply VAT rate.”²⁰⁵

176. Our witnesses mentioned the political difficulties in changing the scope of VAT. Dr Gemma Tetlow, Chief Economist, Institute for Government, reminded us of the difficulty that the Government encountered in its attempt to charge VAT on “pasties” in 2012 when she said “... if you look back to the attempt in 2012 to charge VAT on a slightly broader range of products, including pasties, that obviously created serious difficulties.”²⁰⁶

177. Another example of difficulty was the attempt by the Chancellor of the Exchequer in 1993 (the Rt Hon. Norman Lamont MP) to remove the zero rate on domestic gas and electricity that had been in place since 1973 and charge the full rate of VAT, partly to raise revenue but also to encourage energy efficiency. The new policy was announced in the Budget in March 1993, but the Government was defeated on a Budget resolution in December 1994 and the reduced VAT rate applied instead of the full rate.²⁰⁷

178. We asked Charles Seaford what his research of public opinion on VAT showed about attitude to changing the VAT base.²⁰⁸ He told us:

“If we turn to exemptions, the ones like food are the easy ones technically, but they are the most difficult in terms of politics and what people think. In the groups, we got very strong objections to increasing on what are perceived to be essentials and eliminating exemptions on essentials.

We got some support for extending the tax base to what people thought of as luxuries or those goods and services that are bought by people who are thought to be able to afford it. In the poll, we got strong support for levying VAT on private school fees—not nurseries but private schools. We got a net positive of 49%, which is one of the most popular proposals we put forward. That would raise about £2.5 billion. We got a net positive of 57% for applying VAT to gambling stakes. We got a net positive of 26% for applying VAT to private medical fees. All those were strong net positives, but there was a total opposition to extending it to food or those things that people thought of as essential.”

179. There was also agreement amongst tax professionals that the VAT regime is complicated, and that reliefs and exemptions need reform. John Cullinane said that “... the whole area of exemptions, zero ratings and reduced ratings costs a great deal of money and, at the same time, is a source of complexity, compliance issues in the system and ongoing disputes.”²⁰⁹ Anita Monteith, representing the Institute of Chartered Accountants of England and Wales (ICAEW), said about VAT: “We need simplification, but I would go further and suggest that we examine the whole principle of exemption.”²¹⁰

205 [Q183](#)

206 [Q6](#)

207 See [House of Commons library research briefing about VAT on fuel and power](#)

208 [Q184](#)

209 [Q72](#)

210 [Q73](#)

180. We welcome the increased flexibility that the UK Government has to set VAT rates—for example we welcome the abolition of the “tampon tax”. We recognise that the VAT system is complicated and that the zero and reduced rates, together with the exemptions, create economic distortions. We also recognise, however, that in political terms simplification through removing exemptions and zero rates is likely to be very hard to deliver. We do not recommend any significant changes to the scope of VAT.

181. *The Government should, following consultation, set out principles and objectives for the VAT system now that VAT is free from EU law. This should include a framework within which new reliefs can be assessed or existing ones withdrawn. The Government should ensure that the principles balance revenue raising, economic growth and other objectives, such as improving the quality of the environment and “levelling up”.*

The role of taxes in greening the economy

182. Parliament legislated in 2019 for a reduction in the target for net greenhouse gas emissions to zero (or negative) by 2050, measured against the 1990 baseline.²¹¹ The UK will host the COP26 summit in Glasgow in November 2021, and the Government recognises that it will be expected to take a clear lead in addressing climate change. It also recognises that the environment will play a key part in the UK domestic economy’s recovery from the effects of the pandemic. In his Summer Statement on 8 July 2020, the Chancellor of the Exchequer said: “This is going to be a green recovery with concern for our environment at its heart.”²¹²

183. Green taxes currently raise around 4½ per cent of the tax yield. These and new green taxes may need to play a greater role in the short to medium term as part of incentivising the transition to net zero, while in the long term, a successful transition to net zero seems likely to result in a loss of environmental tax revenue.

184. An Institute for Government report published in September 2020 concluded that after more than a year the UK was still off track to meet not only net zero by 2050 but also its previous less ambitious target, which was to reduce emissions by 80% from the 1990 levels by 2050. It called for the Treasury, in co-operation with a new unit in the Cabinet Office leading on net zero, to “produce a tax strategy to support the move to net zero, which will need to address the substantial loss of revenue from fuel duty as the vehicle fleet is electrified.”²¹³

185. During our Decarbonisation and Green Finance inquiry we asked about the role of the Treasury in decarbonisation.²¹⁴ Baroness Worthington, an environmental campaigner, told us that “the Treasury is central to all of this and we are delighted that it has now set up a dedicated team to look at net zero and make recommendations on how we get there.”²¹⁵ Lord Turner of Ecchinswell, Chairman of the Energy Transitions Council and the founding Chairman of the Committee on Climate Change, agreed. He told us:

It is obvious what the core role of Treasury is in this. Treasury is in charge of taxes and Treasury is in charge of public expenditure. Although there are

211 HC Deb 24 June 2019, [col 506](#) [Commons Chamber]; HL Deb 26 June 2019, [col 1083](#) [Lords Chamber]

212 HC Deb 8 July 2020, [col 976](#) [Commons Chamber]

213 Institute for Government, [Net zero How government can meet its climate change target](#), 7 September 2020. p8

214 Treasury Committee, [Decarbonisation and Green Finance](#)

215 Oral Evidence taken on 10 March 2020 [HC 147 \(2019–21\)](#) Q2 [Chair]

many other tools of policy required to build a zero-carbon economy, what the tax regime is and what the public expenditure regime is are crucially important, so that needs to be integrated with the overall strategy [...]

Expanding the point about tax, Lord Turner said:

[You] have to use the power of the price mechanism to incentivise companies to search for the cost-efficient solution [to decarbonisation], and that means a tax regime. The Treasury is in charge of taxes in other sectors of the economy, some of which we are not currently differentiating by high carbon or low carbon. We already have a non-trivial tax on air traffic ... but at the moment there is no differentiation in that levy according to whether the airline is using a zero-carbon fuel or a high carbon fuel. There are major opportunities to introduce a differentiation, which would create incentives to develop low-carbon fuels.²¹⁶

186. In this inquiry we asked about the challenges of green taxes. Alex Cobham, CEO at the Tax Justice Network, pointed out that they are not always progressive. He said:

[...] A lot of these taxes on consumption or emission end up being passed through in pretty regressive ways. That not only worsens the inequalities in our societies, but it imperils the political support, as we see with things like the gilets jaunes movement in France. [...]²¹⁷

187. He suggested that this difficulty might be overcome with a hypothecated payment to households:

One idea that is worth looking at is the carbon dividend, where you would say, “We will capture the revenue that comes in from taxes on carbon and pass that back out to people”. Even if you are paying a bit more for your petrol, say, because you as a poor household do not have a choice about using the car, you will get more than that back in the dividend ... You get both elements of addressing inequality and reducing carbon emissions.²¹⁸

188. Annie Gascoyne, Director of Economic Policy at the Confederation of British Industry, was concerned about complexity that could arise from multiple carbon taxes:

One thing that probably needs to be done first on carbon taxes is to decide exactly what kind of tax we want and where we are going to tax it because, at the moment, there is a risk of lots of taxes trying to price carbon in different ways. There is a simplification thing that we can do there.²¹⁹

189. Tom Clougherty, Head of Tax at the Centre for Policy Studies, agreed with the need for simplification:

There is scope for huge simplification because we have lots of different taxes on environmental ills at the moment. Replacing them with a comprehensive carbon tax would be a great move.²²⁰

216 Oral Evidence taken on 10 March 2020 [HC 147 \(2019–21\)](#) Q3 [Chair]

217 [Q423](#)

218 [Q423](#)

219 [Q420](#)

220 [Q422](#)

Mr Clougherty also emphasised that carbon taxes could not be regarded as a lasting source of public revenue by their very design, since “if you change behaviour, you get less revenue in the long run.”²²¹

190. We recognise the challenge of net zero and agree with witnesses to our Decarbonisation and Green Finance inquiry that tax has a part to play in achieving this goal. However, carbon taxes are unlikely to form a major part of the long-term tax base or stabilisation of the public finances, as they are designed to complete the transition to net zero.

191. *The Government should develop a tax strategy to meet net zero. This should include tax measures to incentivise the behavioural changes needed to achieve net zero while at the same time providing short term support in the tax system for pump-priming green innovation and balancing the need to protect those on low incomes.*

Stamp duty land tax

192. Stamp duty land tax is a tax on property transactions. It was introduced in 2003 as an administrative modernisation of stamp duty which removed the need to physically stamp documents. The OBR estimates the total yield for property transaction taxes for 2019–20 to be £12.5 billion.²²² The tax has been devolved in Scotland and Wales.

193. In 2014 the structure of the tax was reformed so that instead of tax being payable at one rate on the entire value of the property, tax is calculated by applying different rates to different bands of the total value. For 98% of home buyers this led to a cut in liability.²²³ One consequence of this reform was that the marginal rate of tax on the most expensive home purchases rose considerably, and the top rate which applies in all four nations of the UK is now 12%.²²⁴ There is also a second home surcharge of 3%.²²⁵

194. Many economists have argued that stamp duty is a poorly designed tax as it increases the cost of transactions and can be avoided simply by not moving home. The Mirrlees review, published in 2011 and before the 2014 reform, stated that “there is no sound case for maintaining stamp duty and we believe that it should be abolished”. However, recognising the difficulty of abolition, it said:

Simply removing it would create windfall gains for existing owners, as it will largely have been capitalized into property values; so a reasonable quid pro quo for its abolition is that a similar level of revenue should be raised from other, more sensible, property taxes.²²⁶

195. House price inflation and increased stamp duty rates have increased the revenues from stamp duty over the last 25 years, as this chart shows:²²⁷

221 Q422

222 Office for Budget Responsibility, [Economic and Fiscal Outlook, November 2020, CP318](#), page 88, table 3.3.

223 HMRC, [Stamp Duty Land tax—reform of structure, rates and threshold](#), 3 December 2014

224 Rates and Bands [England](#) and [Scotland](#) and [Wales](#). Northern Ireland has SDLT.

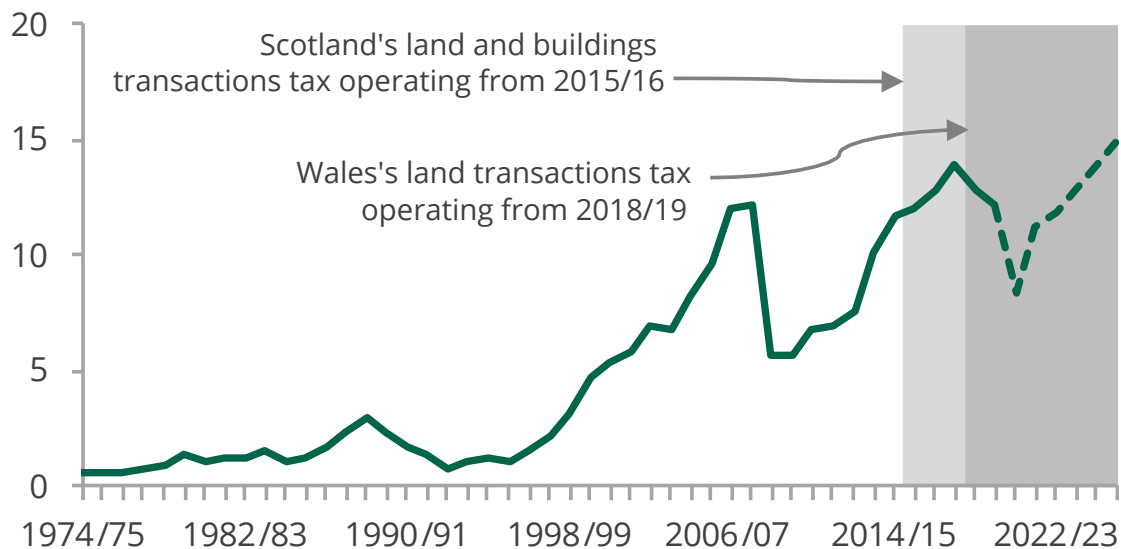
225 HMRC [Stamp Duty Land Tax](#)

226 Institute for Fiscal studies, [Tax By Design](#), p404

227 Stamp duty land tax on residential property, Standard Note [SN7050](#), 29 January 2021. p94

Figure 10: UK Property transactions, tax receipts

£ billion, real (2019/20) prices. Forecasts from 2020/21



196. Research by the London School of Economics for the Family Building Society, published in 2017, examined the impacts of stamp duty land tax (SDLT) on the housing market. In its conclusion it said:

SDLT contributes to reduced household mobility. Having bought a home, people are unwilling to move again soon and 'waste money' by paying SDLT twice over. This is costly for individual households as they are less likely to take up new job opportunities (or, if they do, may need to commute long distances); it is costly for the economy because it inhibits the efficient allocation of labour, and both consumer expenditure and housing investment are lower than they otherwise would be.²²⁸

197. In his summer Statement on 8 July 2020, the Chancellor announced a temporary cut in stamp duty, under which house transactions where the agreed purchase price was under £500,000 would be exempt from the tax. The exemption is due to end on 31 March 2021.²²⁹ Announcing the cut in the House, he said:

One of the most important sectors for job creation is housing. The construction sector adds £39 billion a year to the UK economy. House building alone supports nearly three quarters of a million jobs, with millions more relying on the availability of housing to find work. But property transactions fell by 50% in May. House prices have fallen for the first time in eight years and uncertainty abounds in the market—a market we need to be thriving. We need people feeling confident—confident to buy, sell, renovate, move and improve. That will drive growth. That will create jobs. So to catalyse the housing market and boost confidence, I have decided today to cut stamp duty.²³⁰

228 London School of Economics, [A taxing question: Is Stamp Duty Land tax suffocating the English housing market](#), November 2017, p31–32

229 HMRC [Stamp Duty Land Tax](#)

230 HC Deb 8 July 2020 [col 977](#) [Commons Chamber]

198. During our inquiry, witnesses commented on the inefficiency of stamp duty. Paul Johnson said that:

“The current structure of stamp duty for housing is extraordinarily damaging to the housing market and the economy more generally, and that reflects the very high tax rate. There are bits of the tax system where we need to reduce taxes, but if you are going to cut stamp duty on more expensive properties, there will potentially be an opportunity to increase council tax on more expensive properties, which we know is an extremely inefficient and inequitable part of the system.”²³¹

199. Others were similarly critical,²³² and Dr Arun Advani, Assistant Professor at the Department of Economics at the University of Warwick, said “I agree with what has been said by essentially everybody at this point, which is that stamp duty does not really make any sense as a transactions tax.”²³³

200. *There was widespread agreement among witnesses that stamp duty land tax is economically inefficient, causing damage to the economy by affecting when and how often people buy homes. This in turn has implications for the flexibility of labour markets and for economic activity: a reduction in the volume of house transactions leads to a corresponding reduction in associated economic activity, such as home renovation and refurbishment. The Government should treat stamp duty land tax as a priority for reform and should set the tax at a level that optimises revenue while encouraging home ownership. Any review should take into account the impact of any UK changes on equivalent devolved taxes.*

Council tax

201. There have been recent reports that the Government is considering reform of council tax.²³⁴ The current council tax system is based on the same 1991 valuations that were used when the tax was introduced in 1992. A revaluation in Wales in 2003 led to many properties moving up council tax bands and was unpopular. A planned revaluation in England was cancelled in 2005, and governments since then have not revalued. In Scotland the system was reformed in 2017, following recommendations by the Scottish Government Commission on Local Tax Reform,²³⁵ but there has been no revaluation.

202. Council tax is devolved to Scotland and Wales and has never been introduced in Northern Ireland, where domestic rates still apply. Any reform of council tax by the Westminster Government would only apply to England.

203. Written evidence to the inquiry from the Local Government Association set out the problems with council tax:

In England, council tax is based on 1991 property values and has not been revalued since. The only circumstance in which a property is revalued is if it is improved and subsequently sold, in which case it may be re-banded

231 [Q39](#)

232 Qq [Q33](#) [Professor Philip Booth], [Q350](#) [Robert Palmer],

233 [Q353](#)

234 “[Rishi Sunak eyes tax rises in March budget](#)”, The Sunday Times, 17 January 2021

235 Scottish Government, [Council Tax](#), accessed 18 February 2021

if the new valuation (still based on 1991 property values) would place the property in a different band. Any change in relative values otherwise, between properties or between areas, will not be reflected.

The banding structure is regressive. The eight-band structure has a spread of 1 to 3 (where Band H pays three times as much as a Band A). It is flat at the top of the range, in other words a property worth £320,001 in 1991 will pay the same as one worth much more at that date. The band structure is fixed nationally so there is no ability to vary locally, for example by adding more bands or by changing the relativities within bands.²³⁶

204. We asked Robert Palmer, Executive Director at Tax Justice UK, whether there should be a revaluation of council tax in England. He said:

“It is almost universally agreed that our current property taxes in England, Scotland and Wales do not work. We have a regressive system where poorer people proportionately pay more of their income and more of the value of their property in tax than richer people, and there are also geographic variations. People in the north of England and the midlands are paying higher rates of council tax than people in London. There is quite a lot of consensus that we should think about revaluation.”²³⁷

He went on to say:

“I would argue that we should scrap stamp duty and council tax, and bring in a property tax based on the value of the property. If you cannot do those big changes, there are things such as revaluation, which I think would be important. You could do things like adding bands, which has been done elsewhere.”²³⁸

205. Paul Johnson, Director of the Institute for Fiscal Studies, told us that “council tax [...] is absurdly generous to people towards the top.”²³⁹ We asked Mr Johnson about the merits of the idea of replacing stamp duty and council tax with an annual housing levy. He said:

Yes, it would be a much better situation from an economic and an equity point of view. From an economic point of view, it would get rid of what has become a really significant housing market problem. It is just very expensive to move house. There has been a downward trend in the number of people moving and people, frankly, are stuck in places they would be better off swapping with their neighbours, because it is just an expensive thing to do. It also has potentially negative effects on labour market flexibility, though it is hard to determine how big that is. Of course, at the moment council tax is extraordinarily out of date and regressive.

236 Local Government Association ([TAC0017](#))

237 [Q349](#)

238 [Q350](#)

239 [Q49](#)

Recognising the political difficulties with reform, Mr Johnson said:

“I am not expecting it to happen any time soon. To make that move would create some very big losers, and those losers will not all have the ready cash to make the additional payments, even if they have very valuable properties”²⁴⁰

206. Other witnesses also found fault with council tax. Dr Advani, Assistant Professor, Department of Economics, University of Warwick, said that “we would much rather have something that is a property tax. Council tax looks a bit like that but is fairly ineffective at this point.”²⁴¹ Philip Booth, Professor of Finance, Public Policy and Ethics and St Marys University and Senior Academic Fellow, Institute of Economic Affairs, said that he “would replace all existing property taxes with a tax on user services on owner-occupied and other property and rents, or a tax on imputed income as it is sometimes known.”²⁴²

207. A recent report by the Housing, Communities and Local Government Committee on Local government finance and the 2019 Spending Review concluded that council tax was a regressive tax which had become disconnected from property values. It recommended a review of council tax to include new bands at the top and bottom of the scale²⁴³ and a review of how a revaluation could be implemented.²⁴⁴

208. We have heard strong arguments in favour of reform of council tax. We encourage the Government to consider how best to reform local taxation, taking account of recommendations from the Housing, Communities and Local Government Committee and we draw the Government’s attention to evidence submitted to this inquiry.

Business rates

209. Our predecessor committee held an inquiry in 2019 into business rates,²⁴⁵ and a review of business rates²⁴⁶ was announced in the Government’s response to our inquiry.²⁴⁷ The review issued a call for evidence in 2020, and further details are expected at Budget 2021. Since 2019 the pandemic has highlighted problems with business rates, as retailers and hospitality businesses have been unable to trade for long periods due to coronavirus restrictions. The Government has provided relief from business rates for businesses forced to close, but businesses may struggle to pay business rates based on historic valuations if the relief is lifted.

210. Business rates remain problematic for many businesses. Annie Gascoyne, Director of Economic Policy, Confederation of British Industry told us: “[...] when we talk about a sustainable tax base, business rates is evidently not one.”²⁴⁸ Commenting on the need

240 [Q58](#), Treasury Committee pre-Budget evidence 3 February 2021

241 [Q353](#)

242 [Q59](#)

243 Housing Communities and Local Government Committee, Eighteenth Report of Session 2017–19, [Local government finance and the 2019 spending review](#), recommendations 74

244 Housing Communities and Local Government Committee, Eighteenth Report of Session 2017–19, [Local government finance and the 2019 spending review](#), recommendation 75

245 [Impact of business rates on business](#), report of treasury committee 31 October 2019

246 [Business rates review](#)

247 [Government response](#)

248 [Q407](#)

for reform, Tom Clougherty said that “it would be a mistake, or at least a big missed opportunity, to simply cut business rates without reforming the way tax works in an underlying fashion.”²⁴⁹

211. As the previous Treasury Committee concluded in 2019, we believe that the business rates system needs reform. We welcome the current Government review and encourage it to make significant reforms to improve the overall functioning of the business rates system for the long term.

7 Tax strategy and simplification

Tax strategy

212. In April 2020, the Institute for Government published a report titled *Overcoming the Barriers to Tax Reform*, in which it proposed that the Government should set clear objectives for the tax system as whole. The Institute suggested five advantages which a tax strategy with objectives would offer,²⁵⁰ which may be summarised as follows:

- Clear objectives would allow the Government to better explain tax reform to the public;
- Objectives would allow Government to plan effectively over longer periods;
- Declared objectives should enable other departments to engage better with the Treasury to help ensure consistency between policies;
- Objectives would allow Members of Parliament to better hold the Government to account on whether tax announcements had met their stated goals; and
- Clear objectives could help build cross-party consensus.

213. The concept of a strategic approach to tax policymaking over a period of years is not new. In June 2010, the then Coalition Government published “Tax policy making: a new approach”, a discussion document which set out principles explicitly aiming to achieve greater predictability, stability and simplicity.²⁵¹ That was followed by the Corporate Tax Road Map, published in November 2010, which set out how the Government intended to approach reform of the corporate tax system over the next five years.²⁵² At Budget 2016, the Government introduced a new plan for business taxes, the “Business tax road map”, which sought to provide similar certainty for business for the period through “to 2020 and beyond”.²⁵³

214. In 2010, the Government recognised the benefits of setting out its strategy in terms of certainty for businesses and creating the conditions for growth.²⁵⁴ This extract from the introduction to the Corporate Tax Road Map is still relevant today:

The quality of tax policymaking and the frequency and predictability of changes is a key concern of business and has the potential to undermine perceptions of stability, which can make businesses less likely to invest in the UK. In recent years the way that changes have been made to the tax system has damaged business confidence. Particular concerns have been raised about a lack of clear direction, the frequency of change and, on some occasions, the lack of attention paid to the real impacts on business.”²⁵⁵

250 Institute for Government, [Overcoming Barriers to Tax Reform](#) page 39

251 HM Treasury, [Tax Policy Making: A New Approach](#) June 2010

252 HM Treasury, [Corporate Tax Road Map](#), 29 November 2010

253 HM Treasury, [Business tax road map](#), 16 March 2016, Foreword

254 See paragraphs 1.1 to 1.3 of the [New approach to Tax Policy Making](#)

255 HM Treasury, [Corporate Tax Road Map](#), 29 November 2010, page 10

215. Witnesses spoke favourably of the Corporate Tax Road Map. Annie Gascoyne, Director of Economic Policy at the CBI, told us that

[...] certainty is a really important part of a competitive tax system, not only for attracting international investment but for business planning and thinking about investment decisions. You have to think about the way companies operate. For their five-year strategy and their investment decisions going forward, they think about what the central scenario is. When we have a tax roadmap, it is really useful. It needs to be both specific and realistic for firms to be able to buy into it and plan that into their investment decisions.²⁵⁶

216. Chris Sanger, Global Government Leader at Ernst and Young, and Chair of the Tax Professionals Forum, agreed:

I really would like to see a corporate tax roadmap. That was very successful in the 2010 era because we were partway through a longer-term transition to being a truly territorial regime and one that had a competitive tax rate.²⁵⁷

217. He set out what he saw as the purpose of a road map:

It is not right to ask the Chancellor to set something in stone, but set a sense of direction. A stability of direction is what is needed by companies when they are looking to invest and that is something that can be included in a roadmap. Indeed, one that applies to the end of the Parliament is good but one that also sets the aspirations ready to be included in manifestos post one Parliament is also very helpful.

Contrasting the 2016 Business tax road map with the 2010 Corporate Tax Road Map, he said:

I would contrast the corporate tax roadmap with the one that came after it, which was a business tax road map. That sought to get close to what Annie is mentioning there. To my mind, that was much more of a travel journal, if you like, about what had happened in the past rather than a road map for the future.

218. Dr Gemma Tetlow, Chief Economist, Institute for Government, cited the Corporate Tax Road Map as a welcome example of strategy:

“I think there are rare areas where there has been strategy: the corporate tax road map in 2010, which set out a plan to lower the rate but broaden the base of corporate tax was an area where there did seem to be a clear strategy that was followed through”²⁵⁸

256 [Q413](#)

257 [Q416](#)

258 [Q33](#)

219. John Cullinane, Tax Policy Director, Chartered Institute of Taxation, said that the Government

“... should set out broad objectives in advance. More than that, they should be prepared to float options publicly on much more of a blue skies basis, so that public opinion could have time to assimilate what problems they are trying to deal with and what the possible options are”²⁵⁹

220. Paul Johnson, Director of the IFS, told us that

It is hard to discern a set of principles underlying tax policy over the past decade ... In every other bit of Government you have Green Papers, White Papers and strategies coming out of your ears—probably far too many of them, because they change very regularly. We have literally never had such a thing for tax policy, and I think we are desperately in need of it.²⁶⁰

221. *We believe that a tax strategy setting out what the Government wants to achieve from the tax system and identifying high level objectives would have much merit. We recommend that the Government should draw up a draft tax strategy for consultation. We propose that any such strategy should include principles for:*

- *The role of the tax system in meeting fiscal goals*
- *Securing a neutral tax system which treats similar activities in similar ways, including fair taxation of different structures of work*
- *Ensuring that taxation is progressive and fair to future generations*
- *Meeting climate change goals for net zero and other environmental objectives whilst giving consideration to those who are on lower incomes*
- *Ensuring growth of business and employment, including a new business tax roadmap to provide investment certainty for business and a five to ten-year strategy for corporation tax rates*
- *Reducing the tax gap*
- *Indirect taxes such as VAT which were previously covered by EU law which no longer applies*
- *Reducing compliance costs, especially through appropriate tax simplification.*

Tax policy making process

222. In the Foreword to the 2010 discussion paper Tax Policy Making: A new Approach, the then Financial Secretary, the Rt Hon. David Gauke MP, set out reasons why the Government wanted to improve the process:

I am frequently told by businesses and the tax profession about the importance of predictability, stability and simplicity in the tax system. Business and tax professionals have previously criticised the tax policy

259 [Q103](#)

260 [Q33](#)

making process as piecemeal and reactive, pointing to the wide range of policy announcements in recent years that have been unexpected and insufficiently thought through.

I want a new approach to tax policy making; a more considered approach. Consultation on policy design and scrutiny of draft legislative proposals should be the cornerstones of this approach. The Government will always need to maintain flexibility to make changes to the tax system. But in doing so, it should be transparent about its objectives, and open to scrutiny on its proposals.”²⁶¹

223. The reforms initiated in 2010 included:

- Creation of the OBR and setting their responsibilities
- Creation of the Office of Tax Simplification
- Publication of more information on costings
- Improvements to impact analysis and implementation of new Tax Information and Impact Notes
- Evaluations of tax policy
- A better framework for tax reliefs

224. The reforms also initiated a new tax consultation framework,²⁶² which established five stages of tax policy making:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.²⁶³

225. The Government reaffirmed its commitment to the tax policy making process on 6 December 2017, following the switch of the Budget from spring to autumn, and the creation of a single annual fiscal event.²⁶⁴

226. There has been some concern that the Government does not always stick to its own tax policy-making process. To take one recent example, a consultation on the potential approach to duty- and tax-free goods arising from the UK’s new relationship with the EU²⁶⁵ was quite open in setting out a range of options; but abolition was not trailed as a leading

261 HM Treasury, [Tax Policy Making: A New Approach](#) June 2010.

262 HMRC, [Tax consultation framework](#), 1 March 2011

263 HMRC, [Tax consultation framework](#), 1 March 2011, p2

264 HM Treasury, [The new Budget timetable and the tax policy making process](#) 6 December 2017

265 HM Treasury, [Consultation on the potential approach to duty- and tax-free goods arising from the UK’s new relationship with the EU](#), March 2020

option, and the decision at the end of the consultation to end both the VAT Retail Export Scheme and the Airside VAT concession was contrary to the thrust of submissions to the consultation from retailers and airport operators, who were taken by surprise.

227. Another example is the Government (HMRC-led) consultation on Notification of uncertain tax treatment by large businesses,²⁶⁶ launched on 19 March 2020. This policy has been widely criticised by tax professional bodies in their responses to HMRC, including the Law Society²⁶⁷ and the Chartered Institute of Taxation.²⁶⁸ The Institute of Chartered Accountants of Scotland (ICAS) was also critical:

Unfortunately, this consultation began at stage 2 of the process. It would have been preferable to have started at stage 1, with a clear explanation of what HMRC wants to achieve and the problem it is seeking to address. This would have provided an opportunity to identify options that do not impose unnecessary burdens on all large companies and partnerships—unlike the current proposals”²⁶⁹

228. Witnesses to our inquiry also commented on the Government’s approach to the consultation framework. John Cullinane, Tax Policy Director of the Chartered Institute of Taxation, told us:

At the moment, everything pretty much comes as a surprise on Budget day. The consultation is at a later stage on the details when most of the people who take part feel, “We would not have started from here.”²⁷⁰

229. Charlotte Barbour, Director of Taxation, Institute of Chartered Accountants of Scotland agreed:

we could follow the 2011 tax consultation framework better. It has five stages, but quite often we come in beyond stage 1 or stage 2. The policy position has been set and all we are asked for is how to make whatever has been decided work ... it is just a case of making it work better.”²⁷¹

230. The tax policy making process instituted in 2010 (and reaffirmed in 2017) appears to be sensibly designed; but concerns have been expressed to the Committee that the Government does not always adhere to it and so risks losing the confidence of stakeholders. If the process cannot be followed, for example because there is not enough time to cover all the stages before a change needs to be implemented, the Government should be open about it and should set out its reasons for doing so.

The case for tax simplification

231. A simple tax system is something to which all governments, economists, tax professionals and taxpayers aspire; yet, through time, the tax system has become more

266 HMRC, [Notification of uncertain tax treatment by large businesses](#), 19 March 2020

267 The Law Society, [Notification of uncertain tax treatment by large business consultation—Law Society response](#), 28 August 2020

268 Chartered Institute of Taxation, [Notification of uncertain tax treatment by large businesses](#), 26 August 2020

269 Institute of Chartered Accountants Of Scotland, [Proposed requirement to notify HMRC of uncertain tax treatments](#), accessed 18 February 2021

270 [Q103](#)

271 [Q106](#)

and more complicated with a strong growth in the volume of tax legislation. But simpler can also mean cruder and less able to deal with specific exceptions or needs. Therefore some complication is unavoidable in a society which is itself complex.

232. Witnesses pointed out that complexity was sometimes a reflection of complicated economic activity and a result of trying to meet policy objectives. Mike Brewer, Deputy Chief Executive and Chief Economist at the Resolution Foundation, said:

Obviously, we all want less complexity rather than more complexity, but the question is what do we lose if we have a simpler tax system? As previous speakers have suggested, we have complexity sometimes to police boundaries between different forms of activity which treat tax differently. Sometimes we have complexity to achieve the social or economic objectives
...²⁷²

233. We asked Professor Philip Booth, Professor of Finance, Public Policy and Ethics and St Marys University and Senior Academic Fellow, Institute of Economic Affairs, whether tax complexity matters for the economy and individual taxpayers, He told us:

It matters for the economy as a whole for at least two reasons. One is that if you have distorting taxes, they lead people to pursue one type of economic activity rather than another type of economic activity purely on the basis of the taxation position of those different activities. It can also lead people to structure corporations and other entities in such a way that they minimise tax rather than maximise the accountability of corporations to shareholders or whatever other objectives a corporation might have.

Complexity also has significant costs, in that the electorate does not necessarily properly understand the tax system, which I think is important.²⁷³

He also said:

If we look at stamp duty, for example, there are something like 16 different rates of stamp duty now, applying to five or six different situations, all of which have to be defined and have large numbers of pages of regulation to try to decide whether one particular property goes into one category or another. We used to just have one rate of stamp duty that applied to all properties across the board.²⁷⁴

234. Anita Monteith, Senior Policy Adviser at the Institute of Chartered Accountants in England and Wales (ICAEW), cited the high-income child benefit charge as a specific example of the conflict between simplicity and fairness. It had both tried to preserve the principle that the main carer for a child, usually the mother, should receive the child benefit payment, while imposing means testing and the charge on the highest earner in the household, regardless of caring duties.²⁷⁵

272 [Q37](#)

273 [Q36](#)

274 [Q33](#)

275 [Q79](#)

235. Paul Johnson, Director of the Institute for Fiscal Studies (IFS), told us that tax policy ought to aim for simplicity by default:

“Simplicity is a difficult one. We live in a very complex world and a very complex economy. I think the underlying point is associated with neutrality. We will not get a simple system while we have a system that treats similar forms of income or similar activity differently, so a lot of the complexity that we get is created by the fact that we treat capital income, earned income, self-employment income, employee income, and different forms of assets and profits differently. The core of a set of principles ought to be one in which we look to treat similar economic activities in similar ways for tax purposes unless there is a very good reason not to.”²⁷⁶

236. The current Chair of the Committee recalls having said, following his time as Financial Secretary to the Treasury: “When I was responsible for tax, as a Minister at the Treasury, colleagues would often say this to me in the House of Commons: “It is far too complicated.” Equally, they would then say something like, “When it comes to this particular tax, could you possibly exempt this group within my constituency who I think are rather unique? They are having a really hard time and you should make some changes,” which of course drives complexity in itself. Perhaps we are all guilty of pushing complexity as well as striving for simplicity.”²⁷⁷

The Office of Tax Simplification

237. The Office of Tax Simplification was established on 20 July 2010. It became an independent office of HM Treasury on 21 July 2015 and gained a permanent basis under statute in the Finance Act 2016. It currently has a headcount of eleven staff, or eight full-time equivalents.²⁷⁸

238. The Government said in 2010 that the responsibilities of the OTS would be “... to identify areas where complexities in the tax system for both businesses and individual taxpayers can be reduced and to publish their findings for the Chancellor to consider ahead of his Budget”.²⁷⁹ Since its creation, the OTS has published 66 policy papers and consultations.²⁸⁰

239. We note that since 2010, far from becoming simpler, the tax system has become more complex than ever. We therefore asked the Financial Secretary what difference the OTS had made. He said that the OTS had been “a very helpful and useful institution” but he appeared to be concerned about its role:

“It is important to be clear about what its role has been. It is not an invigilator of tax policy, and it is not clear that there should be such an institution. After all, Parliament should be the institution that holds Government to account for tax policy, and that is a function that Parliament has historically jealously guarded to itself.”²⁸¹

276 [Q32](#). Also see written evidence from Professor Philip Booth (Professor of Finance, Public Policy and Ethics and St Marys University and Senior Academic Fellow, Institute of Economic Affairs) ([TAC0009](#))

277 [Q142](#)

278 [PQ 131452](#) [on Treasury Staff], 13 January 2021

279 Office of Tax Simplification, [Press release](#), 20 July 2010

280 GOV.UK, [list of OTS documents](#), accessed 10 February 2021

281 [Q481](#)

240. We asked the Minister what he thought could be done to make the OTS more effective. He said:

“The OTS has a five-year review cycle, which we are just coming up to, so we are thinking at the moment about whether the OTS could be made more effective and, if so, how.”²⁸²

He went on to say:

I do not want to anticipate what the review will say, but the pattern of its work over the last few years gives you a sense of areas in which it has been effective and helpful. It has certainly established itself as an independent expert voice.²⁸³

241. We believe that the Office of Tax Simplification (OTS) has an important role to play in identifying how the tax system might be simplified. It is right that the effectiveness of the OTS and its ability to carry out its functions are now reviewed, and we await with interest the outcome of the review.

HMRC and tax administration

242. Her Majesty’s Revenue and Customs (HMRC) is at the centre of the tax system, and any reforms to the tax system need to be deliverable by HMRC. HMRC announced on 21 July 2020 a vision for the future of tax administration: “Building a trusted, modern tax administration system”.²⁸⁴ It set out a ten-year strategy for better use of real time and third party information, completing the Making Tax Digital programme, improving the experience of tax for taxpayers and businesses, reducing the tax gap, and improving resilience. It also proposed reform of the tax administration framework.

243. In its written evidence, the Institute for Chartered Accountants of Scotland (ICAS) made the case for administrative reform.²⁸⁵ Charlotte Barbour, speaking on behalf of ICAS, told us why she thought such reform was necessary:

There are a number of reasons for that. First and foremost is trust. If you want trust in the system—going back to the last question, people behaving well—you need to understand the system. [...] We are working with the Taxes Management Act from 1970. [...] An awful lot of material in taxes management has been introduced since then, [...].

It would be really helpful if we reformed everything, had a look at it, put it all in one place and wrote it in user-friendly language, tax law rewrite kind of language, so that people could clearly see what is expected of them. To my way of thinking, that would bring some trust back into the system and make voluntary compliance a lot easier.²⁸⁶

282 [Q485](#)

283 [Q486](#)

284 HMRC, [Building a Trusted, modern tax administration system](#)

285 Institute of Chartered Accountants of Scotland (ICAS) ([TAC0060](#))

286 [Q117](#)

244. We asked Charlotte Barbour about the scale of this task and she said:

It is probably depressingly big. In fairness to HMRC, it put out its paper in July, about building a trusted modern tax administration system. I think HMRC appreciates that that is something it would like to do, too. We would all like this. Maybe part of the plea here is that we have enough funding put into it so it could be done as a big project, perhaps over 10 years and perhaps with one of these roadmaps or a picture of where exactly you want to get to and what you want to achieve, with full governance around it and a complete articulation of the strategy. ...

245. Other aspects of administrative reform were highlighted by Anita Monteith, Senior Policy Adviser at the Institute of Chartered Accountants in England and Wales:

“The biggest problem for a business doing it on its own is knowing what they are liable to pay and what reports they have to make. A company, of course, has Companies House requirements as well as tax requirements. I would like to see a more joined-up process. We were drifting in that direction about seven or eight years ago, where Companies House worked closely with HMRC. That made the obligations that a small company had much more transparent.”²⁸⁷

She was critical of HMRC’s business tax account, which is part of the Making Tax Digital programme and which was introduced in 2015.²⁸⁸ She told us that “the business tax account needs a lot of work doing on it to make it achieve the promises we were first given”.²⁸⁹

246. Improvements to tax administration are likely to have wider benefits. We were told during our inquiry into the Economic Impact of Coronavirus that the ability to tailor support schemes was limited by the ability to extract data.²⁹⁰ HMRC’s digital strategy should—in time—enable it to collect more timely and more accurate data about personal circumstances of taxpayers and businesses.

247. We support the plans announced by HMRC in July 2020 to digitise and improve tax administration. If tax reform is to be successful, it is important that HMRC has the capacity and funding to carry out reform and is not hindered by out of date systems.

The case for a tax commission

248. One way of handling tax reform would be to set up an independent commission to review it. This approach has been taken in the UK in the past, after both world wars: the Royal Commission on Income Tax in 1919–20, and the Royal Commission on Taxation of Profits and Income in 1951–55. There has also been the Meade Review of direct taxation (which reported in 1978)²⁹¹ and more recently the Mirrlees Review (which reported in 2010 and 2011).²⁹² Both of these reviews were managed by the Institute of Fiscal Studies and were not connected to or commissioned by the Government.

287 Q140

288 HMRC [Making Tax Easier: The end of the tax return](#) 16 March 2015

289 Q140

290 Treasury Committee, Eleventh Report of session 2019–21, [Economic impact of coronavirus: gaps in support and economic analysis](#), HC 882, para 59

291 [The structure and reform of direct taxation](#), Professor J.E Meade, 1 January 1978

292 Mirrlees reported in two volumes, [Dimensions of Tax Design](#) (13 September 2010) and [Tax by Design](#) 13 September 2011

249. In other countries “tax commissions” have more recently been used to try to drive reform. These include the Irish Commission on Taxation (2008–9), the Henry Review in Australia, (2008–10) and New Zealand Tax Working Groups (2009–10 and 2017–19).²⁹³

250. In its report, *Overcoming the Barriers to Tax Reform*,²⁹⁴ published on 14 April 2020, the Institute for Government argued that the Government should set up a tax commission. It said that “this could be an effective way of improving public debate and making space for reform”.²⁹⁵ The Institute’s report set out what could be learned from UK and international experience, and it made recommendations about how to maximise the effectiveness of a tax commission.²⁹⁶

251. We asked our witnesses about the merits of a tax commission. John Cullinane, Tax Policy Director, Chartered Institute of Taxation, told us: “I am not exactly sure what a tax commission would do. It may or may not be a good idea, depending on that. Government could make a good start just by consulting at an earlier stage and more generally in accordance with their published framework”.²⁹⁷ Charlotte Barbour, Director of Taxation, Institute of Chartered Accountants of Scotland, could see the case for “a short, sharp tax commission” to look at tax reliefs.²⁹⁸ John Cullinane agreed with that idea and said that the aim of any such commission should be “to try to work out the best way of getting value for money”. He added that “it should be very evidence-based. A commission to look at those areas would make a lot of sense.”²⁹⁹ Anita Monteith, Senior Policy Adviser, Institute of Chartered Accountants in England and Wales, was concerned about administrative complexity for small business and said that “maybe we need a tax commission for small business.”³⁰⁰

252. Tax commissions may play a role in helping reform particular areas, for example tax reliefs. However, the Government already has an effective tax policy making framework, and an overarching tax reform commission is unlikely to be able to achieve anything that the Government could not do anyway by setting out its tax strategy and by following its tax policymaking process. We do not believe that there is currently a need for a tax commission.

293 These are described in Appendix 2 of [Overcoming the Barriers to Tax Reform](#)

294 [Overcoming the Barriers to Tax Reform](#). Institute for Government, 14 April 2020

295 [Overcoming the Barriers to Tax Reform](#) page 77

296 [Overcoming the Barriers to Tax Reform](#), see Chapter 6

297 [Q106](#)

298 [Q127](#)

299 [Q127](#)

300 [Q140](#)

Conclusions and recommendations

The scale of the public finances challenge

1. The pandemic will leave behind a large increase in the public debt and, possibly, a rise in ongoing borrowing into the medium to longer term. However, low interest rates have helped to open up fiscal space, and our expert witnesses said that now is not the time for tax rises or fiscal consolidation, which could undermine the economic recovery. However, the public finances are left more exposed to rises in interest rates; and witnesses told us that economic growth, inflation and measures to lower interest rates probably could not on their own be relied upon to stabilise or reduce the public debt. Indeed, interest rates increasing from current low levels would put further pressure on the public finances. Significant fiscal measures, including revenue raising, will probably be needed in future. (Paragraph 26)
2. The Financial Secretary to the Treasury is right to point to the uncertainties in the economic and fiscal forecasts. However, the Government would be prudent not to focus on the OBR's upside scenario at the expense of failing to prepare for its central and downside scenarios. We re-iterate our earlier conclusion that "the Chancellor should, at the next fiscal event, set out an initial roadmap of how he intends to place Government finances on a sustainable footing." (Paragraph 27)
3. The public finances are on an unsustainable long-term trajectory. This is due primarily to projections of rising age-related spending based on existing Government commitments. This situation is being exacerbated by the fiscal impact of the coronavirus pandemic. Even in the most optimistic scenario, the current and future UK Governments face a dilemma: if public spending and revenues are not to diverge without limit, either the former must be restrained or the latter must be raised. (Paragraph 41)
4. The Office for Budget Responsibility has been stating that the public finances are on an unsustainable long-term trajectory since 2011, but the Government has not done enough to engage with the issue. The Government should routinely produce a more extensive and considered response to the Fiscal Sustainability Report than the 300-word statement it provided in 2020. Such a response should set out a strategy for how and at what level the public debt could and should be stabilised. To support this process, the Committee intends to carry out full scrutiny of the biennial Fiscal Sustainability Report in future, as it did for the first time in 2020. (Paragraph 42)
5. The evidence submitted to this inquiry generally supports the proposition that the UK is able to raise taxation as a share of GDP and raise additional tax revenues. However, there is also a need for reform of the tax system. (Paragraph 49)
6. The public finances are on an unsustainable long-term trajectory that has been exacerbated by the coronavirus pandemic. Additional tax revenue could make a contribution to addressing this. But the tax measures that are most politically palatable in the short term are often not those that minimise distortions to economic activity in the longer term. This is a large-scale and long-term challenge that requires taking a view of the whole tax system, how it can be reformed, and how it can raise

revenue in a way that minimises economic damage as well as effectively supporting public services, which can in turn promote growth. As part of its recovery from the coronavirus pandemic, the UK has an opportunity for a comprehensive review and reform of the tax system. (Paragraph 50)

Support for business

7. *We recommend that the Government should do as its predecessors have done during previous crises and support businesses by introducing a temporary three year loss carry-back for trading losses in both incorporated and unincorporated businesses. This would help those businesses which have shown that they are previously profitable recover from losses imposed on them by the impact of the pandemic.* (Paragraph 56)
8. *The Annual Investment Allowance is valued by business and it appears well targeted to promote growth in small and medium-sized enterprises. As with all tax reliefs there is likely to be some deadweight cost; but we urge the Government to look favourably on further extension and possibly permanency at the existing level, which would provide welcome certainty to small and medium-sized enterprises.* (Paragraph 62)

Windfall and wealth taxes

9. Some firms and sectors have seen a significant increase in turnover as a result of the pandemic, and some witnesses made arguments in favour of a windfall tax on the profits which have resulted. There are downsides to a windfall tax, including its potentially retrospective nature. There would also be complexities, including the difficulties of identifying sectors to which any such tax should apply, ensuring that such a tax is fairly targeted at firms which have benefited excessively within those sectors, and identifying the element of a firm's profits which could be reasonably attributed to excessive profits generated by the pandemic. For these reasons, introducing such a tax would be problematic, but that is not to say that it would be impossible to introduce a windfall tax in certain circumstances in the future, if that was the political choice made. The Treasury would clearly need to conduct a thorough assessment of its feasibility and of the revenue which it might raise. (Paragraph 70)
10. We believe that the development and administration of an annual wealth tax would be extremely challenging, and we note that other countries have abolished such a tax in recent years. We would not recommend an annual wealth tax. It is recognised though that were the wealth to income ratio to increase considerably, the political arguments for some form of wealth tax would become stronger. (Paragraph 84)
11. Though those who gave evidence were sceptical of an annual wealth tax, there was more support for a one-off wealth tax. It could be used to raise significant revenue. However, amongst witnesses there were significant reservations that a tax imposed once can be imposed again, and that such a tax might be seen as retrospective. (Paragraph 88)

The major contributors to tax revenues

12. The evidence submitted to this inquiry indicates that raising tax revenue quickly and at a large scale is likely to require higher contributions from one or more of income tax, national insurance and VAT, as they currently yield over two-thirds of the total tax take. Any increases in the rates of these taxes were ruled out in this Parliament by the Government's "tax lock" manifesto commitment. It is clear to the Committee that the manifesto commitment of the Conservative Party will come under pressure under the current circumstances. (Paragraph 93)
13. Based on the evidence we heard and received, we conclude that income tax is more efficient than some other taxes and we do not see a pressing need for reform at this time. The Government's manifesto commitment not to increase the rate of income tax does not preclude it from adjusting income tax thresholds. We note that the Government could raise revenue simply by freezing income tax thresholds, and that such a change would cause minimum economic distortion. (Paragraph 97)
14. Careful consideration would need to be given to any potential increases in income tax, VAT and national insurance contributions, taking into account the degree to which any increases
 - result in additional economic distortions,
 - make taxes more or less progressive,
 - assist or otherwise with the Government's "levelling up" agenda, and
 - impact on employment.

Increases in national insurance contributions may be especially difficult given the probable impact on jobs, at a time when increasing employment is likely to remain an economic priority. (Paragraph 106)

15. The UK has a lower corporation tax rate than other major economies, and we believe that a moderate increase in rate could raise revenue without damaging growth, especially if balanced with fiscally appropriate measures to help business, such as enhanced loss relief and capital allowances. However, it is clear that a very significant increase in the rate would be counterproductive. (Paragraph 116)
16. *Given the regressive nature of the benefits accruing to individuals from the current arrangements on pension tax relief, especially those in the top earnings decile, the Chancellor should urgently reform the entire approach to pension tax relief.* (Paragraph 123)

Priorities for tax reform

17. We strongly believe that a major reform of the tax treatment of the self-employed and employees is long overdue. The current system is confused, unfair and unsustainable. The review should incorporate the benefits which accrue upon payment of NICs and other taxes as well as the level, the incentives and the interaction of such taxes. It should look as far as is possible to eliminate the so-called 'three person problem' altogether. (Paragraph 139)

18. We believe that if the tax advantages of self-employment were to be reduced, then the tax advantages of running a limited company should be considered for reduction relative to the taxation of employees under PAYE. (Paragraph 142)
19. *Evidence to this inquiry is clear that differences between income tax and national insurance contributions create distortions and unfairness. While we have not heard enough evidence to recommend a wholesale merger of national insurance contributions and income tax, the Government should consider what can be done to remove the distortions gradually through time.* (Paragraph 146)
20. We believe that when reviewing the burdens of taxation for the employed and self-employed and limited companies, the Government should also review the taxation of pensions and the tax relief applicable to pension payments. (Paragraph 148)
21. We recognise that the digital services tax is a useful step towards capturing some of the profits made in the UK by digital companies. We strongly approve of the Government's approach in seeking international agreement on taxation of companies providing digital services and, where international agreement is reached, maintaining its commitment to abolishing the digital services tax in favour of any such agreement. (Paragraph 155)
22. *We recommend that the Government provide this Committee with an annual report on progress towards reaching international agreement on the taxation of digital services, the yield of the digital services tax and the effects of the tax on digital companies and the wider economy.* (Paragraph 156)
23. Based on evidence to the Committee, we believe that there is a compelling case for the reform of capital taxes. (Paragraph 164)
24. We did not hear or receive any evidence in favour of replacing VAT with a retail sales tax. Any contemplation of such a change must be accompanied by more evidence as to the effects it would have, not least on our trade with the EU, which would continue to levy VAT. (Paragraph 169)
25. We welcome the increased flexibility that the UK Government has to set VAT rates—for example we welcome the abolition of the “tampon tax”. We recognise that the VAT system is complicated and that the zero and reduced rates, together with the exemptions, create economic distortions. We also recognise, however, that in political terms simplification through removing exemptions and zero rates is likely to be very hard to deliver. We do not recommend any significant changes to the scope of VAT. (Paragraph 180)
26. *The Government should, following consultation, set out principles and objectives for the VAT system now that VAT is free from EU law. This should include a framework within which new reliefs can be assessed or existing ones withdrawn. The Government should ensure that the principles balance revenue raising, economic growth and other objectives, such as improving the quality of the environment and “levelling up”.* (Paragraph 181)

27. We recognise the challenge of net zero and agree with witnesses to our Decarbonisation and Green Finance inquiry that tax has a part to play in achieving this goal. However, carbon taxes are unlikely to form a major part of the long-term tax base or stabilisation of the public finances, as they are designed to complete the transition to net zero. (Paragraph 190)
28. *The Government should develop a tax strategy to meet net zero. This should include tax measures to incentivise the behavioural changes needed to achieve net zero while at the same time providing short term support in the tax system for pump-priming green innovation and balancing the need to protect those on low incomes.* (Paragraph 191)
29. *There was widespread agreement among witnesses that stamp duty land tax is economically inefficient, causing damage to the economy by affecting when and how often people buy homes. This in turn has implications for the flexibility of labour markets and for economic activity: a reduction in the volume of house transactions leads to a corresponding reduction in associated economic activity, such as home renovation and refurbishment. The Government should treat stamp duty land tax as a priority for reform and should set the tax at a level that optimises revenue while encouraging home ownership. Any review should take into account the impact of any UK changes on equivalent devolved taxes.* (Paragraph 200)
30. We have heard strong arguments in favour of reform of council tax. We encourage the Government to consider how best to reform local taxation, taking account of recommendations from the Housing, Communities and Local Government Committee and we draw the Government's attention to evidence submitted to this inquiry. (Paragraph 208)
31. As the previous Treasury Committee concluded in 2019, we believe that the business rates system needs reform. We welcome the current Government review and encourage it to make significant reforms to improve the overall functioning of the business rates system for the long term. (Paragraph 211)

Tax strategy and simplification

32. *We believe that a tax strategy setting out what the Government wants to achieve from the tax system and identifying high level objectives would have much merit. We recommend that the Government should draw up a draft tax strategy for consultation. We propose that any such strategy should include principles for:*
 - *The role of the tax system in meeting fiscal goals*
 - *Securing a neutral tax system which treats similar activities in similar ways, including fair taxation of different structures of work*
 - *Ensuring that taxation is progressive and fair to future generations*
 - *Meeting climate change goals for net zero and other environmental objectives whilst giving consideration to those who are on lower incomes*
 - *Ensuring growth of business and employment, including a new business tax roadmap to provide investment certainty for business and a five to ten-year strategy for corporation tax rates*

- *Reducing the tax gap*
 - *Indirect taxes such as VAT which were previously covered by EU law which no longer applies*
 - *Reducing compliance costs, especially through appropriate tax simplification.* (Paragraph 221)
33. The tax policy making process instituted in 2010 (and reaffirmed in 2017) appears to be sensibly designed; but concerns have been expressed to the Committee that the Government does not always adhere to it and so risks losing the confidence of stakeholders. If the process cannot be followed, for example because there is not enough time to cover all the stages before a change needs to be implemented, the Government should be open about it and should set out its reasons for doing so. (Paragraph 230)
 34. We believe that the Office of Tax Simplification (OTS) has an important role to play in identifying how the tax system might be simplified. It is right that the effectiveness of the OTS and its ability to carry out its functions are now reviewed, and we await with interest the outcome of the review. (Paragraph 241)
 35. We support the plans announced by HMRC in July 2020 to digitise and improve tax administration. If tax reform is to be successful, it is important that HMRC has the capacity and funding to carry out reform and is not hindered by out of date systems. (Paragraph 247)
 36. Tax commissions may play a role in helping reform particular areas, for example tax reliefs. However, the Government already has an effective tax policy making framework, and an overarching tax reform commission is unlikely to be able to achieve anything that the Government could not do anyway by setting out its tax strategy and by following its tax policymaking process. We do not believe that there is currently a need for a tax commission. (Paragraph 252)

Formal minutes

Wednesday 24 February 2021

Members present:

Mel Stride, in the Chair

Rushanara Ali	Angela Eagle
Mr Steve Baker	Mike Hill
Harriett Baldwin	Julie Marson
Anthony Browne	Siobhain McDonagh
Felicity Buchan	Alison Thewliss

Draft Report (*Tax after coronavirus*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 252 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Twelfth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available (Standing Order No. 134).

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

Tuesday 1 September 2020

Paul Johnson, Director, Institute for Fiscal Studies; **Dr Gemma Tetlow**, Chief Economist, Institute for Government; **Mike Brewer**, Deputy Chief Executive and Chief Economist, Resolution Foundation; **Professor Philip Booth**, Senior Academic Fellow, Institute of Economic Affairs

[Q1–70](#)

[There are no questions 60 to 70. Questions at the next session in this inquiry, on 15 September 2020, begin with Q 71.]

Tuesday 15 September 2020

John Cullinane, Tax Policy Director, Chartered Institute of Taxation; **Charlotte Barbour**, Director of Taxation, Institute of Chartered Accountants of Scotland; **Anita Monteith**, Senior Policy Advisor, Institute of Chartered Accountants in England and Wales

[Q71–142](#)

Wednesday 7 October 2020

Richard Hughes, Chair, Office for Budget Responsibility; **Andy King**, Member, Budget Responsibility Committee; **Professor Sir Charles Bean**, Member, Budget Responsibility Committee, Office for Budget Responsibility

[Q143–168](#)

Stuart Adam, Senior Research Economist, Institute for Fiscal Studies; **Alan McIntock**, Chair, Indirect Taxes Committee, Chartered Institute of Taxation; **Charles Seaford**, Senior Fellow, Demos

[Q169–204](#)

Tuesday 20 October 2020

Professor Judith Freedman CBE, Professor of Taxation Law and Policy, Faculty of Law, University of Oxford; **Bill Dodwell**, Tax Director, Office of Tax Simplification; **Derek Cribb**, Interim CEO, Association of Independent Professionals & the Self-Employed (IPSE); **Andrew Titchener**, Head of Tax Policy, Confederation of British Industry (CBI)

[Q205–274](#)

Wednesday 18 November 2020

Arun Advani, Assistant Professor, Department of Economics, University of Warwick; **Emma Chamberlain OBE**, Barrister, Pump Court Tax Chambers; **Robert Palmer**, Executive Director, Tax Justice UK; **Tim Worstall**, Senior Fellow, Adam Smith Institute; **Sir Edward Troup**, Former First Permanent Secretary, HM Revenue and Customs

[Q275–353](#)

Wednesday 16 December 2020

Chris Sanger, Global Government leader and Chair of the Tax Professionals Forum, Ernst and Young; **Alex Cobham**, CEO, Tax Justice Network; **Tom Clougherty**, Head of Tax, Centre for Policy Studies; **Annie Gascoyne**, Director of Economic Policy, Confederation of British Industry (CBI)

[Q354–431](#)

Monday 18 January 2021

Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, HM Treasury;
Beth Russell, Director General, Tax and Welfare, HM Treasury; **Mike Williams**,
Director Business and International Tax, HM Treasury

[Q432–520](#)

Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee's website.

TAC numbers are generated by the evidence processing system and so may not be complete.

- 1 AJ Bell ([TAC0071](#))
- 2 Aberdeenshire Council ([TAC0034](#))
- 3 Action on Smoking and Health ([TAC0087](#))
- 4 Adam Smith Institute ([TAC0058](#))
- 5 Airlines UK ([TAC0125](#))
- 6 Alcohol Health Alliance UK; and Institute of Alcohol Studies ([TAC0099](#))
- 7 Anchor Hanover ([TAC0121](#))
- 8 Anonymous ([TAC0102](#))
- 9 Anonymous ([TAC0043](#))
- 10 Association of Accounting Technicians (AAT) ([TAC0097](#))
- 11 Association of British Insurers ([TAC0090](#))
- 12 Association of Consulting Actuaries ([TAC0044](#))
- 13 Association of Convenience Stores ([TAC0092](#))
- 14 Association of Taxation Technicians (ATT) ([TAC0047](#))
- 15 AudioUK ([TAC0032](#))
- 16 BFI ([TAC0054](#))
- 17 BIRA (British Independent Retail Association) ([TAC0117](#))
- 18 Baldwin, Mr. Richard (Consultant, RK Baldwin Consultant) ([TAC0025](#))
- 19 Barlow, Mr Stuart ([TAC0001](#))
- 20 Barneby, Nicky (Managing Director, Barneby Ltd) ([TAC0063](#))
- 21 Booth, Professor Philip (Senior Academic Fellow, Institute of Economic Affairs) ([TAC0009](#))
- 22 Borg, Professor Emma (Professor of Philosophy & Director of the Reading Centre for Cognition Research, University of Reading); and Professor Bradford Hooker (Emeritus Professor, University of Reading) ([TAC0101](#))
- 23 British Association for Counselling and Psychotherapy (BACP); British Psychoanalytic Council (BPC); and United Kingdom Council for Psychotherapy ([TAC0059](#))
- 24 British Beer and Pub Association ([TAC0012](#))
- 25 British Insurance Brokers' Association (BIBA) ([TAC0040](#))
- 26 Campaign for Better Transport ([TAC0037](#))
- 27 Campbell, Mary ([TAC0053](#))
- 28 Cardiff Interdisciplinary Taxation Research Group (CITRG), Cardiff Business School ([TAC0072](#))
- 29 Charities Aid Foundation ([TAC0049](#))
- 30 Charity Tax Group ([TAC0124](#))

- 31 Charity Tax Group (CTG); Charity Finance Group (CFG); National Council for Voluntary Organisations (NCVO); and Chartered Institute of Fundraising (IoF) ([TAC0079](#))
- 32 Chartered Institute of Taxation ([TAC0074](#))
- 33 Chartered Institute of Taxation - Scottish and Welsh Technical Committees ([TAC0075](#))
- 34 Christian Action Research & Education ([TAC0123](#))
- 35 Church Action for Tax Justice ([TAC0008](#))
- 36 Confederation of British Industry ([TAC0068](#))
- 37 Creative Industries Federation ([TAC0055](#))
- 38 Crowe UK LLP ([TAC0027](#))
- 39 Deloitte LLP ([TAC0076](#))
- 40 Directors UK ([TAC0018](#))
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- 42 Dixon, Andrew (Founder, Fairer Share); Matthew Lesh (Head of Research, Adam Smith Institute); Torrin Wilkins (Director, Centre Think Tank); Tom Burgess (Chair, Coalition for Economic Justice); Robin McAlpine (Director, Common Weal); Kevin Hollinrake (Conservative MP for Thirsk & Malton, Member of Parliament); Polly Mackenzie (Chief Executive, Demos); Dr Wanda Wyporska (Executive Director, The Equality Trust); Dan Wilson Craw (Director, Generation Rent); and Liz Emerson (Co-founder, Intergenerational Foundation) ([TAC0046](#))
- 43 Equity ([TAC0041](#))
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- 45 Evans, Rebecca (Minister for Finance and Trefnydd, Welsh Government); Kate Forbes (Cabinet Secretary for Finance, Scottish Government); and Conor Murphy (Minister of Finance, Northern Ireland Executive) ([TAC0094](#))
- 46 Fair Tax Mark ([TAC0039](#))
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- 60 Kirk, Mr David (Director, David Kirk & Co. Ltd) ([TAC0003](#))
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- 67 Murphy, Professor Richard (Director, Tax Research LLP) ([TAC0100](#))
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- 87 Smith, David Brian (Proprietor, Beacon Economic Forecasting) ([TAC0004](#))
- 88 Smith, David Brian (Proprietor, Beacon Economic Forecasting) ([TAC0098](#))
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- 90 Summers, Andy (Associate Professor of Law , London School of Economics); and Arun Advani (Assistant Professor of Economics , University of Warwick) ([TAC0024](#))
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