How taxes can redistribute upwards
Notes of the [Low Incomes Tax Reform Group] roundtable
29 November 2017
Artillery House

Present: Anne Fairpo (chairperson LITRG), John Cullinane (tax policy director CIOT), Robin Williamson (technical director LITRG), Victoria Todd (senior technical manager LITRG), Matthew Brown (technical officer CIOT), Diane Maddison (HMRC secondee LITRG), Gillian Wrigley (technical officer LITRG), Paddy Millard (Tax Help for Older People), George Crozier (media relations CIOT), Stephen Herring (IoD), Nicola Mandale (national tax Grant Thornton), Justine Rousseau (Grant Thornton), Jane Vass (head public policy Age UK)

Discussion led by Adrian Sinfield
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AF opened the meeting and welcomed everyone.

AS: Our tax and related systems can redistribute upwards as well as downwards, working to protect and privilege the better-off through 'fiscal welfare'. This refers to the benefits from tax and related reliefs when the government runs social spending through the tax system rather than through public spending.

The term was introduced by Richard Titmuss, the first professor of social policy in the UK, in an essay on 'the social division of welfare' (1958). He was concerned to show that the welfare state was not the only way that government redistributes income and wealth.

This type of welfare might be regarded as a form of 'pre-distribution' because the revenue is reduced by the reliefs before the public spending rounds and so cannot be redistributed there.

This predistribution is not included in public spending and we do not know the full scale or cost through the reliefs in the tax system. The Office of Tax Simplification (OTS, 2015) has counted 1156 tax reliefs while HMRC only lists 400, and only around 200 of these are costed. The National Audit Office (NAO) and the Public Accounts Committee have been very critical (NAO, 2014 and 2016; PAC, 2015 and Hodge, 2016).

Even so the published scale of tax expenditure is massive – around £30 bn per year in income tax reliefs alone, excluding the basic personal allowances (HMRC, 2016). This is equivalent to 1/6th of the annual income tax take. Three-quarters of this can be accounted for by the main social welfare reliefs. There are also, for example, £27 bn CGT reliefs on selling one's only or main residence and some £16 bn NI relief on non-state pensions.

The reliefs to non-state pensions are among the commonest and most expensive forms of fiscal welfare in many countries. Here they are particularly costly, doing much to maintain and promote inequality.

On non-state pensions the estimated reliefs are £40.5 bn for 2015-16 (HMRC 2017a, but no data on capital gains taxes). This is more than six times the cost of Pension Credit, the means-tested support for those older people with the least resources, and equivalent to 45% of the spending on contributory state pensions.

Income tax reliefs come to £24.8 bn after deducting the tax collected on pensions in payment. Another £15.7 bn results from the exemption of NICs on employers' contributions at 13.8% and on employees not being charged NICs at 12% on that employer contribution (2% for the higher-paid). Salary sacrifice appears to be widely used, also reducing NICs, but HMRC does not have an estimate of its extent. Most of the 'old' (pre-1992) universities, for example, automatically apply salary sacrifice whereas the newer ones are unable to.

The total published NI relief is substantial but does not appear in the NI Fund annual accounts (HMRC, 2017b). I wrote to the HMRC Accounting Officer responsible for signing off the NI Fund accounts to ask why and was referred to a report that makes no mention of NIC reliefs.

There are many other NI exemptions, but very little evidence on most. Relief from NICs if people over pension age continue to work is estimated by HMRC at £1.1bn. Requiring the full, instead of a lower, NIC rate on earnings over £45,000 might generate £8bn according to IFS in 2003, although there is no HMRC estimate. I was surprised to learn that, while termination payments over £30,000 had long been taxed, no NICs at all were levied on the whole amount until April 2018 – and there are no estimates of that cost.

How the pensions tax relief is distributed is only occasionally reported, but it is the only relief with any distributional analysis now. There are none for NICs. In 2014-15 some three-fifths of the costs of the income tax relief on contributions went to those paying higher rates, or who would be but for the reliefs (Hansard, 2014). The proportions going to both the highest and lowest income groups have fallen in recent years. Although there is no gender analysis, the great majority of higher-paid benefiting are men.

No 'value for money' analysis has been carried out by government, but NAO does not believe that providing relief on pension contributions has incentivised pensions savings in the population. Given that most of the tax and NI relief will go to higher earners, the reliefs are 'means-enhancing' rather than 'means-testing'. In other words, they are giving more benefit to those who are already better-off rather than restricting it to those with the smallest incomes.

How far tax and NI reliefs contribute to the fact that 7.6% of households own 47% of pension wealth (ONS, 2015) deserves much further analysis. There are important issues about who gets what – how much of a subsidy to the employee, the employer and/or the pension funds? How much support to private pensions in the market at the expense of welfare state pensions or other social spending?

In the run-up to the recent changes to welfare benefits introducing universal credit, it was claimed that the reforms would increase 'fairness between benefit recipients and taxpayers'. This wording is far from appropriate since taxpayers are also receiving reliefs and recipients of state benefits are also paying taxes.

Despite the widespread belief in a progressive tax system, official figures show a roughly proportional incidence of total taxation across UK households with an average of 33.4% in 2015-16 (ONS, 2017). Indeed the lowest quintile have long paid a slightly higher proportion of their income in tax – 35% compared with only 34.1% for the richest quintile. This is due to the regressive impact of VAT and council taxes as well as the inability to save and take advantage of the reliefs of fiscal welfare.

The same ONS study reports that half the population receive more from the government in benefits than they pay in taxes. If unequal fiscal welfare benefits were included, the analysis would look very different and could lead to different political debates and decisions.

Failing to publish the extent and distribution of fiscal welfare, just as is done with public spending, helps to continue and enhance social inequality and privilege without most realising it. At the same time it allows the view that there are no resources available to significantly reduce marginalisation and poverty to carry on flourishing justifying 'austerity' cuts. There urgently needs to be more transparency and accountability for fiscal welfare set alongside the regular analyses for public spending. This could help to shift the view of where the total burden of welfare, public and fiscal, actually lies.

International agencies such as OECD (Brys, 2016) are at last taking a greater interest in this area, arguing that the tax base should be broadened by first tackling the reliefs benefiting those with higher incomes. Wilkinson and Pickett's *The Spirit Level* provide considerable evidence that virtually all do better in more equal societies. It is more difficult, if not impossible, to reduce inequality and promote the common wealth if redistribution upwards through means-enhancing benefits remains hidden.

Slides for the presentation based on a chapter in the forthcoming *Social Policy Review* are available from adrian.sinfield@ed.ac.uk

References

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Titmuss, R.M. (1958) *Essays on 'The Welfare State'*, London: Allen & Unwin, chapter 2. Also in Alcock, P. et al (eds) (2001) *Welfare and Wellbeing: Richard Titmuss's contribution to social policy*, Bristol: The Policy Press, part 2:2.

AS threw the debate open. The following observations were made by attendees.

- The paper was interesting and there may be two distinct areas: whether tax reliefs were an efficient and/or sensible way to use tax expenditure; and is there any other form of redistribution that might be more appropriate? He suggested changing thresholds and redistributing the balance. He referred to a paper by Lord Jacobs with the suggestion that higher rate pension tax relief could be abolished and used to cut the higher income tax rates.

- It is difficult to make any suggestions when we do not know the costs.

- We need to be clear what definitions are. CIOT has been calling on government to be more open in its Budget process. In particular, all spending budgets are scrutinised by parliament whereas tax raising or relieving powers have little scrutiny.

- But the powers of the relevant accounting officers may be limited in this area.

- As VAT strongly skews the figures, maybe this is something the UK might be able to act upon after Brexit. But it will be difficult to target something at the low income group.

- We need info to know just what effect different tax reliefs might have and on which section of taxpayers.

- Tax reliefs can end up making progressive tax rates regressive. If you increase the Personal Allowance, the lower paid do not benefit.

- And any changes have to be seen in terms of the global marketplace as the UK needs employers to stay in the UK. If you ramp up tax and NICs you could destroy employment opportunities. Other EU countries have reduced social security costs.

- Effective rates of state pension (now there is no enhancement) may be lower in the future than now. So what are any changes to pensions relief to achieve?

- Should NICs payments be considered on other sources of income, for example, dividend income, given that NI is really just another tax?

- And what would the money that would be raised be used for? Would it be a "general" source or would it be used for State pensions? Clarity of aim is required. This point goes back to the earlier point made about scrutiny and what the purpose of a tax is.

- As far as tax relief for charities is concerned *the level going to charities* has remained fairly constant while relief for donors has nearly doubled. The group accepted that perception was important: a donor might feel they had more control over their donation to a charity than a charge made by government.

- The question is what does society want the government to fund? There is an increase in the use of crowd-funding where people take control of what the money is spent on and this could be a reaction to lack of government funds but only helps in areas where people can afford to do it.

AS asked for more help *and any suggestions for reading*.

AF thanked all for their contributions.