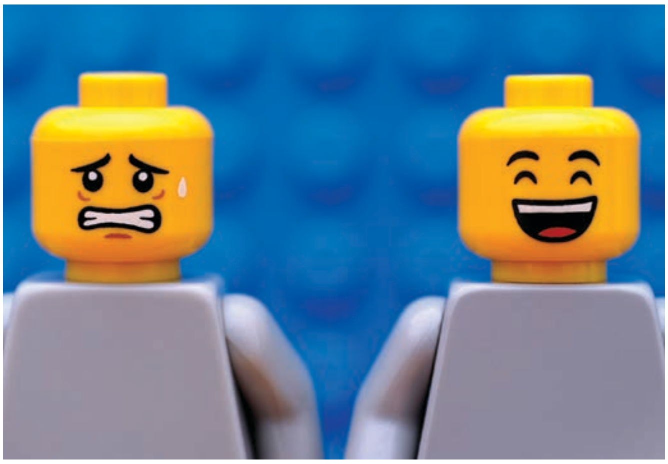
Boris's tax policies: DUDE or DUD?

Paul Beausang and Kunal Nathwani consider the implications of the tax policies proposed by the UK's new prime minister.



The recent Conservative party leadership contest was born out of Brexit. The battleground between the contenders has been backlit against the backdrop of Brexit. Tory party members voted to deliver the leader they thought best placed to negotiate Brexit. Boris Johnson has been emphatically elected to deliver Brexit. Predictably, his legacy will be dictated by Brexit.

However, despite this overhanging cloud of all things Brexit, some of the most significant policy announcements drip fed over the course of this contest have been in the realm of tax – direct and indirect. Michael Gove's announcement of replacing VAT with a simple sales tax, Boris Johnson's proposal to raise the income tax higher rate threshold significantly and Jeremy Hunt's proposal to cut corporation tax to 12.5% are perhaps the most striking.

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For tax policy enthusiasts (with the writers being a case in point), perhaps the most compelling was Rory Stewart's proposal in a *Financial Times* editorial for the simplification and modernisation of the UK tax system, drawing heavily from principles in the seminal *Mirrlees Review*. While the credibility and practicality of several of the tax proposals suggested during the contest can be questioned, it is now clear that tax matters occupy the centre stage in public and political discourse. We observed a similar trend with Labour (see our article 'Tax in a Corbyn era', *Taxation*, 30 May 2019, page 8).

At the time of writing this article, various MPs were making their way to and from Number 10, and little was known about the tax policies Boris Johnson would propose or endorse as prime minister, however, a certain amount can be gleaned from his announcements and drip fed statements.

This is the context within which we explore Johnson's possible tax policies. The objective of the article is to present an apolitical view of some of these proposed or speculated tax policies. Predictably, there will be considerable divergence in views on their merits.

We acknowledge that Brexit and the form it takes will have a fundamental impact on tax policy and systems. The potential consequences – in particular a hard Brexit, which may be likely – have been extensively documented previously and therefore, we do not discuss them further here.

Key points

- Brexit will have a fundamental impact on tax policy and systems.
- Effect of increasing the higher rate threshold on National Insurance.
- Balancing the economic efficiency against the extent to which wealth distribution is required.
- Radical overhaul of stamp duty land tax would abolish and reduce rates.
- The effect of sin taxes should be considered along with the extent they change behaviour.

Personal tax

There are two major personal tax proposals that we understand Johnson is likely to support: an increase in the income tax higher rate threshold and an increase in the National Insurance contribution threshold. A key point in relation to both is that they are not revenue-neutral proposals for the exchequer.

Income tax

Johnson's income tax proposal is to increase the income higher rate threshold from £50,000 to £80,000. There is little further information that has been released in relation to this proposal.

The current income tax bands provide that the basic rate of 20% is levied on taxable income above £12,500 and below £50,000, the higher rate of 40% is charged on taxable income above £50,000 and below £150,000, and the additional rate of 45% on income above £150,000. Therefore, raising the higher rate threshold to £80,000 will result in taxpayers earning between £50,000 and £80,000 becoming basic rate taxpayers and subject to income tax at a 20% rate with the benefit of the personal allowance.

It is unclear whether any other changes will be introduced to income tax. Points to watch include whether there will be a recalibration of tax bands above £80,000 and whether the personal allowance withdrawal will persist.

The proposal may also have a consequent impact on National Insurance. In its paper, *Boris Johnson's tax policies: what would they cost and who would benefit* (tinyurl.com/ifsbjtpjun), the Institute for Fiscal Studies (IFS) notes that because the upper earnings limit for National Insurance is aligned to the higher rate threshold, when the higher rate threshold increases, the upper earning limit would usually be expected to increase to £80,000.

The consequence of this would be that taxpayers below the revised upper earnings limit who currently pay 2% employee National Insurance would, post-change, be required to pay contributions at 12% for employees and 9% for the self-employed.

The IFS estimates that this measure would cost the exchequer about £8bn a year in terms of reduced tax revenue. It will be interesting to see how the exchequer proposes to make up this tax revenue decrease. However, it is unclear whether the proposal would involve an immediate full increase in the threshold in the next Budget or whether this would be phased in over the course of Johnson's term as prime minister.

The importance of this point should not be understated. The IFS states that if this policy were implemented incrementally, for example, with the threshold reaching £80,000 in 2023-24 (which seems to be based on an assumption by the IFS that there could be a general election this year, which the Conservatives would win), on the basis that inflation would continue to rise in line with the Office of Budget Responsibility's predictions, the cost to the exchequer would be £1bn a year lower.

An essential point not considered is the economic efficiency of the policy, for example its impact on incentives, and how this objective can be balanced against the extent to which redistribution of wealth is required. The IFS states that 97% of the benefit in this measure would go to the richest 30% of households. An economic analysis therefore becomes critical if Johnson is to provide sound reasoning for the implementation of this policy, in particular in light of the potential revenue loss at stake.

In stark contrast, the Jeremy Corbyn-led Labour party has taken the opposite stance and, before the 2017 election (and repeated since), proposed to introduce a new rate band of 45% on income exceeding £80,000; although in its 2017 manifesto it also guaranteed no rises in income tax for those earning below £80,000 (as we discuss in our aforementioned article on Corbyn's policies).

National Insurance

Johnson has also suggested that there may be an increase in the threshold at which National Insurance contributions must be paid – currently the annual figure is £8,632. No information is available on how much this would be increased by, whether the change would be to the employee and self-employed thresholds only or also the employer thresholds (as also noted by the IFS), whether it would be phased in over time or whether it would be immediate.

However, like the income tax policy, addressing issues in relation to the economic efficiency, redistribution of wealth and their trade-off becomes critical. Does an increase in the threshold discourage people from earning more so as to remain below the threshold to ensure no National Insurance contributions are payable? Does the policy benefit those in the lower income brackets? The IFS suggests that, in reality, it does not despite the appearance that such a tax policy is targeted at those in lower income households.

How does this policy affect redistribution of wealth when looked at in the context of the tax system as a whole? Is the objective of this government to maximise economic efficiency, redistribution of wealth or an intermediate stance, and if so, where will the balance be? These are only some of the questions that Boris Johnson and Sajid Javed, chancellor of the exchequer, will have to tackle.

Stamp duty land tax

Another announcement that is short on detail involves Johnson's suggestion that residential stamp duty land tax is absurdly high and should be radically overhauled. The *Reforming Stamp Duty* paper published by Onward on 22 July (tinyurl.com/rsdreformjul) proposes the abolition of charges for residential properties worth less than £500,000, with current rates for consideration in excess of this threshold to be halved.

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The proposal is not all good news for the industry as a whole. This largesse would be funded by significant increases in residential stamp duty land tax rates for investors, as well as huge increases in high value commercial real estate transactions, with a proposed marginal rate of 8% for consideration in excess of £1m. It will be interesting to note how Tory members react to a significant charge on investment property which is not dissimilar to the Labour proposals set out in its *Land for the Many* paper published in June (https://landforthemany.uk) in its proposals for residential investment property and further taxes on commercial occupiers or users of land.

Sin taxes and the soft drinks industry levy

Johnson has also suggested that the government should consider how effective ‘sin taxes’ are and whether they change behaviour. In the context of the extension of the soft drinks industry levy to milkshakes he suggested it would affect most those who were least able to afford the drinks, implying that he would not introduce any new sin taxes until a review on their effectiveness is complete.

The soft drinks industry levy is a regressive tax – as is frequently the case with sin taxes – in that people with lower incomes tend to spend higher percentages of their income on soft drinks than those in a higher income bracket. However, the impact on soft drink sales generally is unproven and specifically the risk that consumers then opt for more affordable, but still unhealthy, substitutes. There is limited data available on this in the UK and even extrapolating from equivalent measures evaluated in various jurisdictions, the evidence does not paint a consistent picture.

More importantly, the soft drinks industry levy was introduced with a specific purpose to reduce obesity and to encourage producers to reformulate their products with lower sugar. Therefore, an evidence-based approach, as Johnson has suggested he would adopt, would require asking about the extent to which this objective has or can be achieved by such a tax. If he favours a progressive tax policy income tax and National Insurance are likely to be better tools because they would have a bigger impact on the overall redistribution of wealth.

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Future developments here will be worth watching – not just for sin tax aficionados, but more generally as an indication of the consistency and coherency of the incoming government’s approach on tax matters. On 22 July (the day before Johnson’s election as Conservative leader was announced), a green paper, *Advancing our health: prevention in the 2020s* (tinyurl.com/govhealthjul) was published by Cabinet Office and the Department of Health and Social Care. It states:

> ‘If the evidence shows that industry has not made enough progress on reducing sugar, we may extend the SDIL [soft drinks industry levy] to sugary milk drinks [which are currently not subject to the levy].’

On smoking it suggests adopting a ‘“polluter pays” approach requiring tobacco companies to pay towards the cost of tobacco control’ to support smokers in quitting smoking. It will be interesting to see whether this position changes given that Matthew Hancock MP retained his role as health secretary in the recent cabinet reshuffle.

Planning point

It is not clear whether Boris Johnson’s policies would go ahead but it will be a good idea to have a broad understanding of what they are in case clients wish to discuss them.

Scotland

Nicola Sturgeon recently referred to a comment that Johnson allegedly made after the 2015 general election suggesting that full fiscal autonomy for Scotland might be an attractive proposal for the Scottish National Party if he were to become prime minister. This implies, in effect, giving the Scottish government in effect full taxing powers.

It is not entirely clear whether, were this to happen, it would require a fundamental re-examination of the Barnett formula. However, given the lack of detail and certainty, we have limited our discussion of this further.

We hope we will not often have to limit our analysis for similar reasons, and that fundamental proposals affecting the integrity and operation of the tax system are accorded due weight and consideration before policy announcements are made.

Other policy measures

It is understood that Johnson may also consider increasing the annual investment allowance available on expenditure on plant and machinery in a bid to promote business. It is currently £1m. Interestingly, point six of Jeremy Hunt’s ten-point plan had also proposed to increase the allowance to £5m.

Johnson has also mooted that he may create free ports and tax free zones. Various countries across the world have established the latter. However, despite this, and depending on the form the free ports and tax free zones would take, they may not be immune from a challenge under World Trade Organisation rules and would likely represent state aid under EU law, if that remains relevant.

Conclusion

With a Budget rumoured for September, it is likely that we will receive greater clarity on these proposals – and it is hoped but not certain on Brexit as well. The political variables in the next three months are complex and far-reaching and introduction of any of these measures would need to account for these possibilities.

However, only time will tell whether Boris’s tax policies are adequate to ‘Energise’ the UK economy and whether the acronym should read DUDE or DUD.

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