Tax in a Corbyn era?

How would a future Labour Party change the tax system? Paul Beausang and Kunal Nathwani discuss some of the likely policies.

The election of Jeremy Corbyn as leader of the Labour Party (and John McDonnell as shadow chancellor of the exchequer) has marked one of the most significant shifts in British politics since the 1940s. The effect of this change has not yet been entirely appreciated given the ubiquitous obsession with all things Brexit. However, the incremental revelation of Labour’s fiscal and tax policies since 2015 shows the prospect of a significant departure from the UK’s tax policy and principles that have formed part of the bedrock of the UK economy and business environment, irrespective of which party has been at the helm of the government – including coalitions.

This article presents an apolitical view of some of these proposed and ‘rumoured’ tax changes; in the UK’s current politically polarised state there will, of course, be contrasting views on the merits of such policies.

Background

Before considering specific tax policies of Corbyn’s Labour, we need first to understand the context in which they have been developed and the objectives sought to be achieved. A tax system is best understood as a cohesive of the entire system and not of the individual taxes in themselves. Typically, as has been well documented previously, there are various factors and combinations of factors that contribute to the general design of a tax system. One of the overarching objectives of Corbyn’s Labour is best illustrated by McDonnell’s own words in an interview with The Observer to deliver an ‘irreversible shift in wealth and power in favour of working people’.

Therefore, when considering the policies and proposals, it must be borne in mind that the underlying motivation behind these changes is to deliver this objective: to facilitate this irreversible transfer of wealth and power.

Personal tax

In its 2017 manifesto (tinyurl.com/y7k6edfo), Labour proposed an increase in income tax rates broadly for the top 3% of earners, but guaranteed no rises in income tax for those earning below £80,000 a year. Specifically, in 2017 before the elections they proposed to introduce a new 45% tax rate for income exceeding £80,000. Further, there would be a return to a 50% tax rate for income above £123,000.

Interestingly, Labour did not propose any changes to the existing provisions dealing with the withdrawal of personal allowances for incomes in excess of £100,000. These already produce an arbitrary result for taxpayers caught within this ‘hidden’ tax band, in which personal allowances are phased out. The effect of this yields a marginal tax rate of 60% for such individuals even though the stated tax rate is 40%.

Persisting with this personal allowance withdrawal for income above £100,000 and introducing a new tax rate of 45% for income over £80,000, increases the marginal rate of tax further to 67.5% for those caught this way (as has previously been noted by the Institute for Fiscal Studies (IFS)).

The pejorative nature of some of Labour’s proposals are clear given the title of another significant proposed measure in its 2017 manifesto – the ‘excessive pay levy’. Broadly, this would require companies to pay an additional levy of 2.5% for individual staff earning in excess of £330,000, increasing to 5% for earnings above £500,000. The objective here is to rein in executive pay. It should be viewed in conjunction with the non-tax policy to restrict public sector bodies – or persons bidding for the estimated £200bn public sector contracts awarded annually – to a 20:1 maximum pay ratio for staff within the business. In short, pay disparity outside this ratio is to be discouraged and taxed.

Key points

- The Labour Party’s motive is to facilitate the irreversible transfer of wealth and power in favour of working people.
- A 50% income tax rate would apply to individuals earning above £123,000.
- No changes proposed to the withdrawal of personal allowances when income exceeds £100,000.
- Labour proposes reintroducing a small companies corporation tax rate and raising the main rate.
- The general anti-abuse rule would be extended to cover avoidance.
- Introduction of a financial transaction tax in the financial services sector.
Another major shift in UK policy, albeit one that has been the subject of much discussion in the recent past, particularly as considered in the Mirrlees Review (tinyurl.com/3skzr54), involves abolishing inheritance tax – this is inferred from McDonnell’s endorsement of the Institute for Public Policy Research (IPPR) report, *Prosperity and Justice: a plan for the new economy* (tinyurl.com/ippr-jrep) which includes this policy. The proposal is that inheritance tax be replaced with a lifetime gifts tax levied on the recipients; this would mark a shift from the current system which is donor-focused to one that is donee focused. There would be a lifetime allowance of £125,000, with any sums above this taxed as income at the marginal rate in the year of receipt.

This change would introduce a tax akin to the Irish capital acquisitions tax and, in effect, reintroduce a gift tax. Conducting an adequate analysis of this area would require complicated policy discussion; this is not considered further, however, because it has been a highly fraught area of tax.

**Corporation tax**

The proposals here are straightforward at least – an increase in the rate of tax from 17% to 26%, with a re-introduction of a small companies rate of 21%. When considering the measures in recent years to stabilise and grow the corporation tax base – such as the corporate interest restriction, hybrid rules, further reductions to capital allowances rates – it is unsurprising that this rate change is calculated to deliver a significant tax yield. The IFS estimates it as £19bn, but it notes this does not take into account any resulting profit shifting and reduced investment in the UK.

Again, the objective is to rebalance the tax burden and is a part of what is intended to be an ‘irreversible shift’. An accepted tenet in tax policy is that the eventual burden of the tax is not borne by the corporation itself (which is a legal fiction), but is instead ultimately borne by shareholders, employees or consumers, although economists differ on which stakeholder really bears the burden of such a tax.

A point to note in relation to the small companies rate is that, depending on the structure, there may be World Trade Organisation (WTO) compatibility issues – as were previously raised by academics in relation to the small companies rate that has since been abolished. Given the landscape with Brexit and the potential relative increase in importance of the UK’s WTO membership, this may become a potential problem.

The IPPR report includes a proposal to phase out and eventually abolish research and development tax credits and the patent box. The intention is to route the money saved to specific bodies to provide direct funding for investment.

**Transparency and avoidance**

As noted above, Labour’s objective is to achieve a transfer of both wealth and power. To achieve the latter, selective transparency in respect of tax affairs is seen as key. For these reasons, Labour has proposed that all large companies’ tax returns and related documentation, including DOTAS disclosures, will be publicly accessible through Companies House. The intention appears to be, as noted in Labour’s *Transparency and Enforcement Programme* (tinyurl.com/ labhtep) to ‘empower parliamentary committees to ask searching questions’.

The proposal suggests an increase in parliamentary scrutiny in large companies’ tax affairs. It will be interesting to see whether this creates any constitutional issues in relation to the separation of powers, since traditionally the method to deal with such disputes would be the judiciary.

The public availability of tax returns will also be extended to the those of ‘wealthy individuals’, or taxpayers earning more than £1m. Applying this rule only to a select group of people based on income appears arbitrary, but is consistent with a philosophy motivated to deliver a shift in power between ‘wealthy individuals’ and the ‘working people’.

Labour also favours a significant reworking of the existing general anti-abuse rule (GAAR); specifically, it wishes to adopt a general anti-avoidance rule. The GAAR has limited scope in that it targets abusive arrangements and operates to tackle avoidance alongside common law principles developed since Ramsay.

The Labour anti-avoidance proposals suggest that any transaction that lacks economic substance will be regarded ‘as a sham’ and ignored for tax purposes. Coupling what amounts to a significant extension in the intended scope of the GAAR, Labour also envisages changes in the working of any GAAR panel; its future role is unclear, but it will have a broader representation.

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As well as the 20:1 maximum pay ratio, Labour proposes that businesses bidding for public contracts must be transparent and will have to disclose UK profits and corporation tax paid in the previous five years. In addition, any bidders must not have been involved in ‘tax avoidance’ nor structure their bidding proposal through any jurisdiction designated a tax haven.

By way of comparison, the restriction on being awarded public contracts is a possible consequence for bodies convicted of the corporate criminal offences for failure to prevent the facilitation of tax evasion under the Criminal Finances Act 2017. Extending this proposal to tax avoidance blurs the distinction between evasion and avoidance by imposing an equivalent sanction for each. From a broader economic perspective, Labour’s published proposals do not address any increased public contract procurement costs arising from a self-selected narrowing of the field of available bidders.

**Financial sector tax proposals**

The most significant Labour proposal in this area relates to the well-publicised ‘Robin Hood’ tax, or financial transaction tax (FTT). Broadly, the proposal is to enlarge radically the scope of the UK’s existing FTT (stamp duty), both in terms of the persons liable and the transactions to be subject to the tax. The changes would include market-makers as well as eventual purchasers, derivatives, options, bonds, debt and equivalent instruments in addition to shares.
According to Labour, this is predicted to raise up to £5.6bn in tax revenues by 2021-22, although there is no analysis as to the efficiency of such a tax and the likely impact on London in terms of transaction volume and, ultimately, financial sector relocation. This would again mark a major shift in policy, since the UK has long been opposed to such proposals as witnessed in its vehement refusal to partake in the EU FTT proposals.

Labour has also made clear its dislike of advanced thin capitalisation agreements (ACTAs) introduced in 2007. These were introduced to give large groups with multiple constituting companies certainty in relation to their future tax liabilities by providing clarity on the amount of expected scale of losses that can be claimed for the relevant cost of capital within the group.

In its Transparency and Enforcement Programme, Labour proposes to introduce a forward-looking ‘general presumption against offering such deals’, but also plans to investigate current ACTAs in an attempt to scale back the losses being claimed by companies. Labour suggests this will result in the paring back of ‘significant and unwarranted losses’. However, the wider effect on certainty does not appear to have been considered and it is unclear on whether and how within the current legal frameworks the ACTAs could be reviewed.

The trend continues with the approach to carried interest taxation. Much like the proposals on inheritance tax, the concept is to re-characterise the nature of the receipt as income chargeable at the marginal rate.

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Another area that should be monitored is the proposal for eurobonds. The Transparency and Enforcement Programme refers to it as the ‘eurobond loophole’, and notes that by listing debt instruments on the Channel Islands exchange, interest payments enjoy a withholding tax exemption. It also states that the recipient usually escapes tax on the receipt. It refers to an article in The Independent from 2013 which analysed corporate groups’ use of a captive eurobond issuance; this would seem consistent with the projected tax raise of only £500m annually. If, however, the suggestion was that the eurobond exemption be repealed entirely, the impact on the financial markets and any debt raising would be severe. In particular, any investment grade residential mortgage backed securitisation is generally reliant on the eurobond exemption to ensure no UK withholding tax and to provide liquidity.

In theory, many of the institutional holders of these instruments may be able to claim double tax relief or approved pension scheme exemption from such withholding tax. In practice, however, any amendment affecting these instruments could have catastrophic consequences for this market and wider UK listed debt markets generally because such a change of law may entitle holders to redeem the bonds immediately.

Real estate tax

Many of the far-reaching proposals for real estate are either already captured through increases in tax rates or do not concern tax directly. Labour’s shadow housing minister, John Healey, made a proposal that would enable councils and others to acquire land compulsorily for social housing development, at current use rather than current market value. This would affect any land bank holders significantly.

On specific measures, Labour has mooted a land value tax to replace business rates. The concept would be to tax the inherent value of the land based on the optimum use under current planning constraints. Coupled with the risk of compulsory acquisition, the challenges facing investors in undeveloped land would be considerable and may well achieve the desired result of freeing land for investment, given the likely hefty tax costs of holding and the risk of being required to sell at less than market value.

Conclusion

These tax proposals represent only part of a much larger framework which, taken as a whole, could transform UK politics and society in general. Whether the political calculus enables many or all of them to be introduced by a Labour government if elected is another matter, but is one that bears a much closer degree of attention than it has received to date. In any event, this does not appear to be the end; businesses, practitioners and policymakers should monitor developments in this area because the proposals would affect most elements in UK society.

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Finding out more

● Tax agendas of the main political parties: tinyurl.com/yyvt64fj
● On your marks – fair tax mark: tinyurl.com/y5usszw
● A general anti-abuse rule that applies to HMRC as well as to taxpayers: tinyurl.com/y3wai223

Planning point

Even though at this stage, it is unknown for certain when the next general election will be, it may be worth keeping an eye on the political parties’ differing plans for tax in case clients want to discuss them.