

UK Taxation – Unfair and Unclear

Taxation

With recent scandals highlighting global, industrial scale tax avoidance, the spotlight has once again fallen on the thorny issue of tax - who pays what, who avoids it altogether, and what level of taxation is 'fair'.

Unfortunately, since the publication of the Panama Papers leak, much of the subsequent debate has been based upon a misleading account of tax and our tax system. For example, income tax is often used to describe overall tax, and to suggest our tax system is progressive. In fact, income tax accounts for just over a quarter of the total tax take, less than the combined tax take of VAT and National Insurance Contributions.

This is compounded by people's understanding of their own tax often being considered only in terms of their marginal tax rate. The result is that there appears to be little public awareness of how much tax is paid by people on different incomes. Polling conducted by the Equality Trust found that nearly seven in ten people (68%) believe that households in the highest 10% income group pay more of their income in tax than those in the lowest 10%. But this is not the case.

Equality Trust analysis of the Office for National Statistics, Effects of Taxes and Benefits on Household Income, publication found that:

- The poorest 10% of households paid on average 46.8% of their income in tax in 2014/15 (the most recent year, with stats released today)
- The richest 10% of households paid on average 34.4% of their income in tax
- Last year (2013/14) this difference was 45% - 35%, and the year before (2012/13) it was 43% - 35%. So while the proportion of income paid in tax has fallen slightly for the richest, it has increased for the poorest.
- An average household pays 33.8% of their income in tax
- Council tax is sharply regressive even after adjusting for rebates and Council Tax Benefit with the poorest 10% paying 7.1% of their income in council tax whilst the richest 10% pay only 1.5% of their income in council tax

Inequality in the UK

In Britain today, the richest 1,000 people own more wealth than 40% of households, or 10.3 million families. In the last year alone their combined wealth increased by £28.508 billion to a staggering £576 billion. At the same time, the average pay of a FTSE 100 CEO has risen to almost £5 million, or around 180 times the average annual income.

This inequality is of huge concern to the British public, with over 80 per cent believing the gap between rich and poor is too great. And this concern is increasingly supported by a wealth of evidence. Numerous studies now show that more unequal societies such as the UK suffer from poorer physical and mental health, lower life expectancy, higher rates of violent crime, poorer educational outcomes, and lower levels of trust. Evidence from the International Monetary Fund, World Bank and OECD suggests our extreme inequality may also damage our economy too.

Inequality and taxation

When used well, tax and transfers are an important tool in reducing the worst excesses of inequality. In Finland and France for example, tax and transfers reduce the income disparity by 51% and 42% respectively.

In the UK, the overall effect of our system of taxes and benefits is similarly progressive reducing the income gap by 45%. However, when looked at separately, our tax system is in fact regressive, hitting the poorest households hardest.

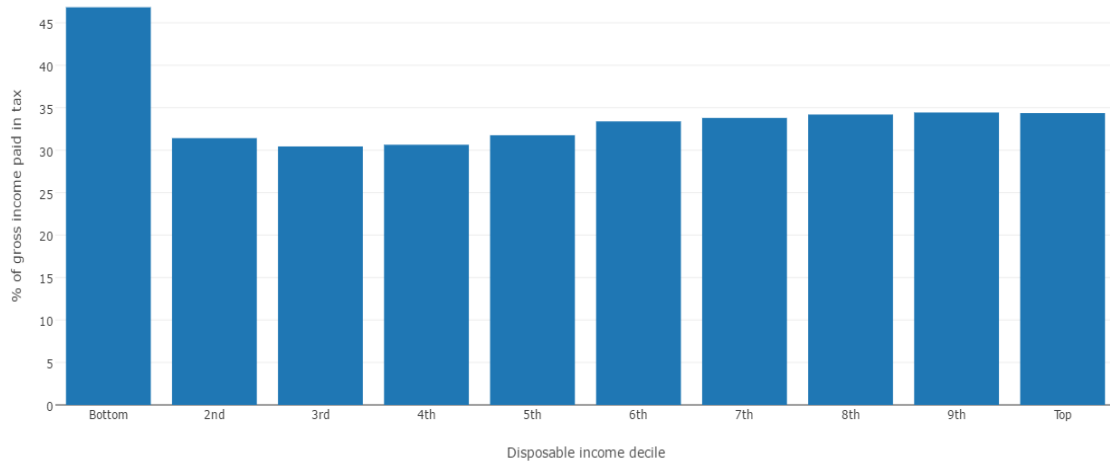
There are good reasons to focus on the tax system in isolation from the benefit system. The public believe that the tax system by itself reduces inequality and it is often spoken of by politicians as if that is the case. In reality the main inequality reducing element of the tax and benefit system is the benefit system. The benefit system as a whole decreases the Gini coefficient by 14 percentage points. Direct taxes (Income Tax, National Insurance, and Council Tax) decrease the Gini coefficient by 3 percentage points whilst indirect taxes (Value Added Tax, other consumption taxes and business taxes) increase it by 4 percentage points. Understanding why the tax system does not by itself reduce inequality is important for both thinking about how tax revenues could be more effectively raised, and for understanding the importance of the benefit system in narrowing the gap between the richest and the poorest.¹

¹ Source for all numbers is:

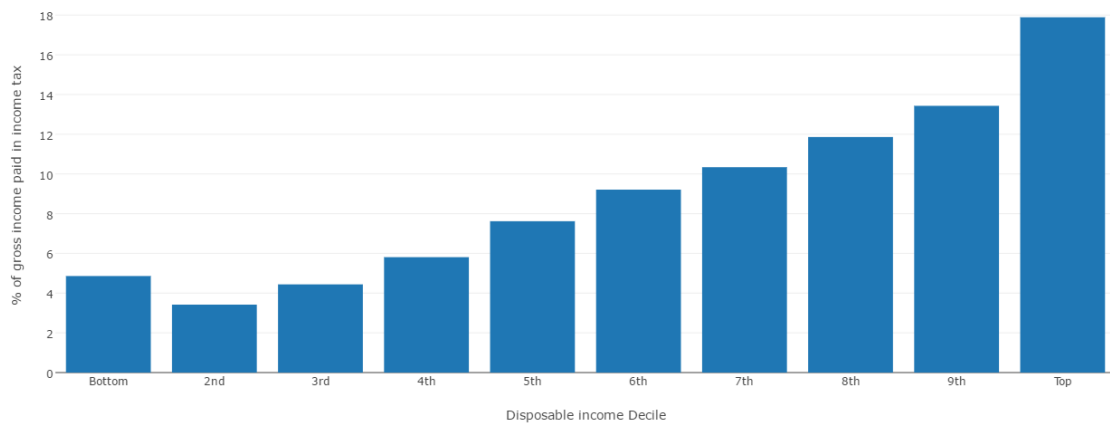
<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/theeffectsoftaxesandbenefitsonincomeinequality/1977tofinancialyearending2015>

Specific taxes

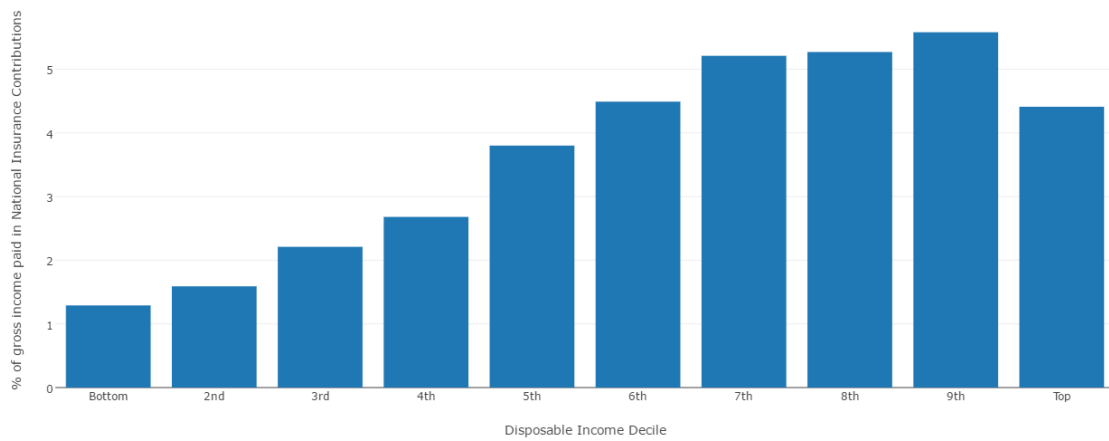
The tax system as a whole



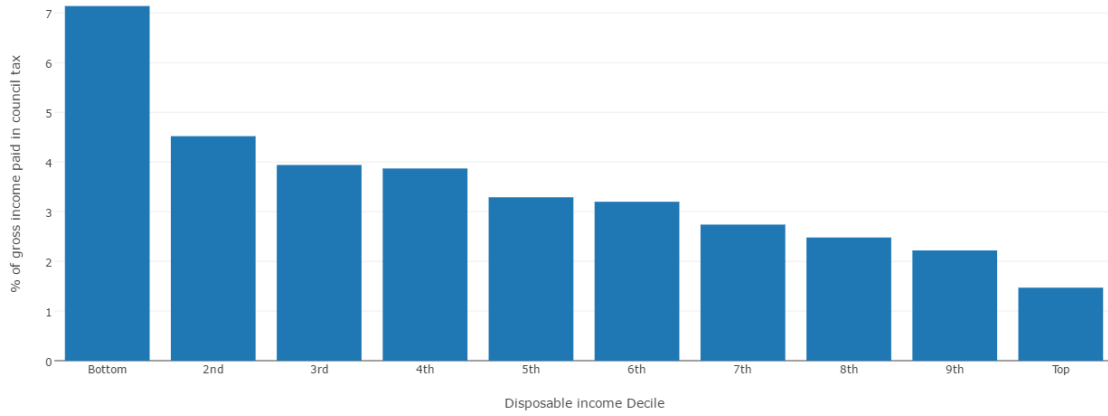
Income Tax



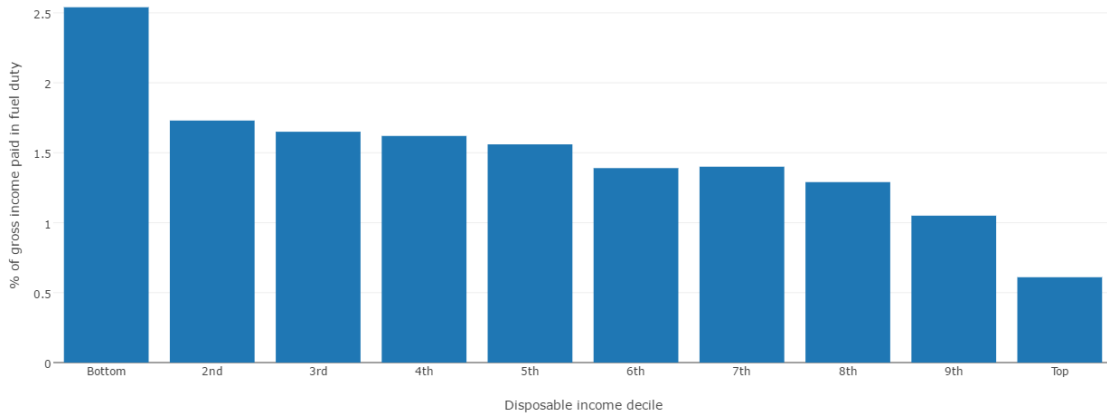
National Insurance Insurance Contributions



Council Tax



Fuel Duty



Value Added Tax

