Liberal Democrats Policy Consultation

Taxation

Consultation Paper 107

Background

This consultation paper is presented as the first stage in the development of new Party policy in relation to taxation. It does not represent agreed Party policy. It is designed to stimulate debate and discussion within the Party and outside; based on the response generated and on the deliberations of the working group a full taxation policy paper will be drawn up and presented to Conference for debate.

The paper has been drawn up by a working group appointed by the Federal Policy Committee and chaired by Jeremy Hargreaves. Members of the group are prepared to speak on the paper to outside bodies and to discussion meetings organised within the Party.

Comments on the paper, and requests for speakers, should be addressed to: Kevin Norton, Taxation Working Group, Policy Unit, Liberal Democrats, 8-10 Great George Street, London, SW1P 3AE. Email: kevin.norton@libdems.org.uk

Comments should reach us as soon as possible and no later than 31st October 2012.

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Introduction

1.1 Government raises taxes in order to fund everything it does. What it taxes to raise that money, and how it taxes it, has a huge impact on the lives of us all. At election times, one of the things that citizens and companies are most interested in is how much tax the different parties propose different groups will pay. Where we think the tax burden should and should not fall is an important statement about us as a party.

1.2 More broadly, any tax system encourages and discourages certain types of behaviour. Liberal Democrats are clear about many of the things we want to encourage or discourage and the tax system should play its part in helping to achieve those aims. We want to foster a strong and sustainable economy that encourages wealth creation, develops and uses the skills of the people and works to the benefit of all, with a just distribution of the rewards of success.

1.3 To this end, we believe that a Liberal Democrat taxation system should be progressive and proportionate and should seek to both to reduce inequality and to fund public services and national infrastructure.

1.4 Liberal Democrats in government are now having a positive impact on Britain's tax system. The Federal Policy Committee has set up this working group to conduct a thorough review of the tax system and how it should develop further to meet Liberal Democrat aims.

1.5 This consultation paper seeks views widely, from both within the party and outside, to help develop this thinking, to inform proposals that will come to party conference in autumn 2013. Responses and policy suggestions are invited on all aspects of taxation, both those specifically set out in this paper and more broadly.

1.6 The proposals that this working group makes will be 'revenue neutral'. There is an important much wider debate about just how much tax the state should raise; our remit is to look rather at how the tax system should raise it.

1.7 We believe some fundamental challenges are:

- **How do we create a tax system that is fair?** What should we do to achieve a tax system that is progressive in relation to income and wealth, that ensures those earning the lowest wages are not disadvantaged by working, and in which wealthy individuals and businesses make their fair contribution and those who seek to avoid paying tax are prevented from doing so?

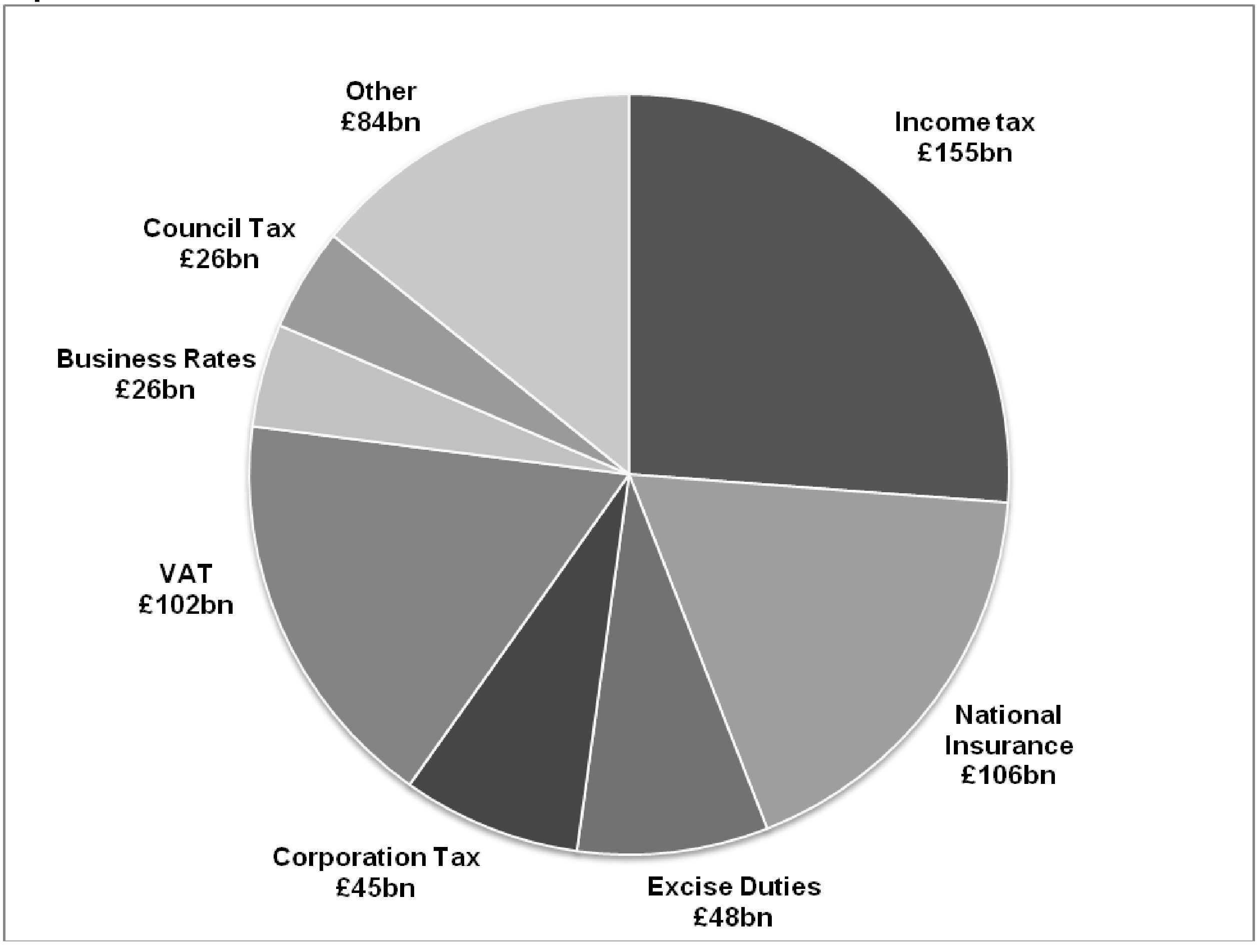
- **How do we create a tax system that is simpler, easier to understand and more predictable?** One with less complicated rates and reliefs - especially for pensioners and small businesses – and which is characterised by well publicised overarching roadmaps for strategic reform.

- **How do we create a tax system that is greener?** One that taxes environmental pollution and resource depletion and gives bigger incentives to sustainability and the responsible use of resources.

- **How do we create a tax system that is more decentralised?** So that there is a clearer link between local services and local accountability and greater freedom for democratic local government to raise, and spend, revenue.

- **How do we create a tax system that is more efficient?** Recognising the importance of incentives to work and save; and growing global competition.

Expected Government income from taxation in 2012/13[1]:



Questions

1. *Are these the most important objectives for the tax system? Are there other important priorities that we should be asking the tax system to help us achieve?*

2. *Are there other significant areas of taxation not covered in this paper that we should be thinking about?*

[1] http://cdn.hm-treasury.gov.uk/budget2012_complete.pdf

Corporation Tax

2.1 Corporation Tax is the tax paid by companies on their income profits and capital gains. The main rate of Corporation Tax is gradually being reduced from 28% in 2010 to 22% by 2014. A small profits rate of 20% broadly applies to companies with annual profits of less than £300,000 (over 90% of companies), however the large majority of Corporation Tax receipts are derived from large companies and large taxpayers.

2.2 The Corporation Tax system is currently based on a low tax rate with significant reliefs targeted at specific business sectors. The aim is to encourage multinational companies to invest in the UK and to grow the UK private sector. However targeted reliefs have been criticised for increasing the overall complexity of what is already one of the longest tax codes in the world.

2.3 Broadly speaking, a company can deduct from its turnover all the costs it incurs for the sole purpose of earning business profits. It cannot deduct costs that are incurred for a non-business purpose, and it cannot deduct capital costs.

2.4 Government also incentivises a number of things through the corporation tax system, by creating:

- Specific allowable tax rates of depreciation for assets, rather than the commercial accounting depreciation.
- 100% deductions available for expenditure on energy and water saving equipment (technically 'capital' expenditure in nature).
- Enhanced deductions for certain revenue expenditure such as research and development (R&D), expenditure on qualifying films (and this is due to be extended to animation), video gaming and other creative industries.

2.5 Certain profits are not taxed – for instance dividend income, profits arising from certain overseas branches and sales of qualifying holdings in trading companies.

2.6 A special 10% rate of tax is due to be introduced on profits from qualifying patent income.

2.7 Companies are subject to UK tax on certain of their overseas subsidiaries' profits (under the Controlled Foreign Companies or 'CFC' regime) where UK profits have been artificially diverted to low tax territories. This regime has recently been updated.

2.8 Profits arising from oil and gas extraction are taxed at significantly higher rates (60-80%), but with specific reliefs available for expenditure on decommissioning oil platforms.

2.9 There have also been a number of changes to Corporation Tax, especially for small businesses, which had not been well thought through – some of which have ended up being partially reversed. Administering both tax collection and the tax credit system is a significant burden on small businesses in particular.

Questions

3. *Should the Corporation Tax system be used to encourage particular types of activity?*

4. *If so, what types of business or business activity should be prioritised in the tax system?*

5. *Are there other types of business, other than oil and gas extraction, that should be taxed at higher, or lower, rates?*

6. *How can the Corporation Tax system be improved for smaller businesses?*

7. *Should any other reliefs be introduced? Should any existing reliefs be removed?*

8. *Do we accept a 'race to the bottom' with regards to our Corporation Tax rate, or is there scope for international agreement to prevent this?*

Income Tax and National Insurance

3.1 Income Tax is levied on almost all individual incomes (with exceptions for some benefits) and capital gains receipts. There is an Income Tax-free personal allowance that Liberal Democrats are committed to raising to £10,000 during this Parliament – a policy that we are proud of, which will lift millions out of paying Income Tax altogether and give a flat-rate tax reduction to almost every other taxpayer.

3.2 The calculation of income tax is complicated: dividend income has a different set of rates (currently 10%, 32.5% & 42.5%) from other types of income (currently 20%, 40% & 50%); and tax treated as deducted at source from dividends (confusingly called 'tax credit') is not repayable if no tax is due, unlike tax deducted from earnings and interest.

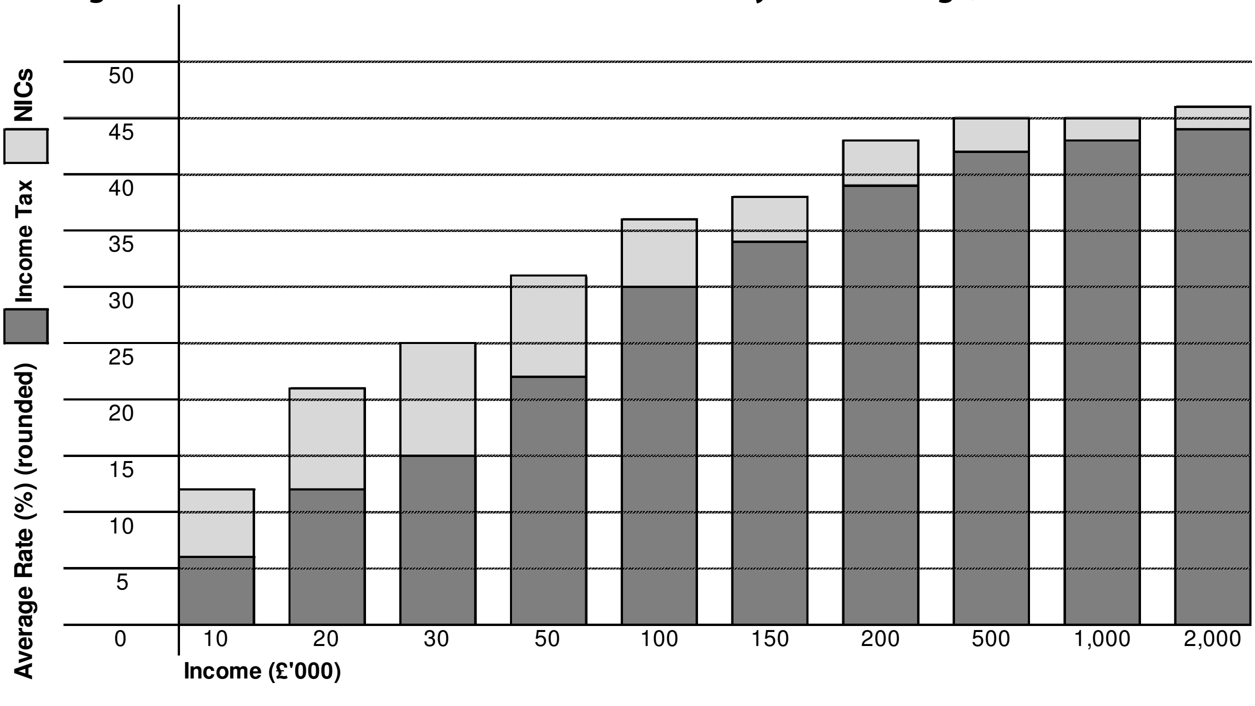
3.3 The basic rate of Income Tax, paid by 26.6 million people, has been at the historically low level of 20% since 2008/9. The level at which the higher rate of Income Tax (currently 40%) applies has fallen from £37,400 in 2009/10 to £34,371 in 2012/13. The proportion of people paying this rate has risen from 10.4% in 2009/10 to a projected figure of 13.8% in 2012/13.[2]

3.4 The additional rate of 50% tax on income over £150,000 was introduced in 2010/11, and will fall to 45% in 2013.

3.5 National Insurance is levied on both the employer and employee, but only on income earned from employment or self-employment. There is also a tax-free allowance for National Insurance.

3.6 All full-time employees and most part-time employees pay Income Tax and National Insurance. This is in stark contrast to the position 50 or 100 years ago, when Income Tax was very much a tax on the affluent. Taken together, income tax and employees' National Insurance is strongly progressive. The top quintile of households, by income, pays sixteen times as much as the bottom quintile, by income. The equivalent figure for indirect taxes is just two to one.

Average rate of Income Tax and National Insurance by income range, 2012-13[3]



[2] http://www.hmrc.gov.uk/stats/income_tax/liabilities-april2012.pdf
[3] Liberal Democrat research

3.7 The Income Tax and National Insurance system in particular can be used to influence people's behaviour. At a general level, there is debate among economists as to whether higher taxes yield higher revenues for government (the so-called 'Laffer Curve'[4]) and whether any shortfalls in expected revenue come about because people actually work less, or whether they come about because of increasing avoidance or evasion.

3.8 There is good evidence that average tax rates can affect the 'participation decision' (that is, the decision whether to work or not), particularly for second earners in households with children and people at or around the retirement age.

3.9 Various specific taxes can also act as incentives to promote certain behaviour. These include tax privileges for pensions, savings held in the form of an ISA, charitable giving, employee share schemes and venture capital, as well as more esoteric schemes such as those involving forestry and film production.

Questions

9. *Should the Liberal Democrats argue that the Income Tax allowance should be raised further than £10,000, perhaps to be equal to the minimum wage for a full-time employee? On the one hand this would be broadly progressive, but on the other it would be expensive, and would offer nothing to people whose incomes were lower than £10,000 a year.*

10. *Should Liberal Democrats support the integration of Income Tax and National Insurance? If so, does this imply that pensions and savings income should be subject to National Insurance?*

11. *Paying National Insurance entitles you to particular benefits, although this link has got steadily weaker over the years. Is it time to give up the notion of a 'National Insurance fund'?*

12. *Employers' National Insurance is often seen as a 'tax on jobs', since it is an additional tax that employers have to pay when they employ someone. Should Liberal Democrats argue for the abolition of employers' National Insurance in order to incentivise employment? If so, should this be for all employees, or only for employees whose characteristics are correlated with high rates of unemployment, such as the low skilled?*

13. *Should Liberal Democrats argue for a reduced or increased basic rate of Income Tax?*

14. *Should Liberal Democrats argue for a reduced or increased higher rate of Income Tax (currently 40%), and should it apply at a different income level than at present (currently £35,000)?*

15. *Should the additional rate of Income Tax of 50% over £150,000 per year (45% from 2013) apply at a different rate or at a different income level?*

16. *Should tax breaks for 'good behaviour' continue to exist? How do we stop them going overwhelmingly to the most affluent, as evidence suggests they often do?*

17. *Should the tax treatment of dividend income be simplified?*

18. *Should some current specific tax breaks, such as ISAs and pension relief, be capped for the wealthiest?*

19. *Should the UK tax its citizens who live abroad (as in the USA)?*

[4] http://www.heritage.org/research/reports/2004/06/the-laffer-curve-past-present-and-future

Wealth Taxes

4.1 The most significant 'wealth tax' (wealth being defined as the money or assets which someone holds over time, as distinct from their income) in the UK is Inheritance Tax (IHT) – a tax on a person's estate over the value of £325,000 and on gifts made within the seven years prior to death.

4.2 In 2009 IHT raised £3.2bn, which for comparison is a little over a third of the tax raised from alcohol sales and is under 3% of the tax raised from income tax.

4.3 There are numerous ways that people avoid Inheritance Tax, for example through trusts or gifts made at least seven years before death. There are also various reliefs that can be exploited, such as those on agricultural land and property.

4.4 Where estates are primarily made up of property that has gained in value, IHT could be compared with Capital Gains Tax; where estates are primarily cash savings made from earned income, IHT acts as a double tax – taxing funds on which Income Tax has already been paid.

4.5 Possible alternatives to IHT include:

- An Accessions Tax, where the tax liability would fall on the person receiving the income rather than the estate of the deceased. This would simplify the settling of the estate, making inheritance income more like employment and investment income.

- The replacement of IHT with location value taxes, thus resolving the double taxation issue. For example a 'Mansion Tax' that would be less avoidable - collected via extra council tax bands.

4.6 A handful of countries levy annual net asset taxes, which raise similar amounts of revenue as IHT raises in the UK.

4.7 Wealth is currently taxed much less than income. Liberal Democrats have taken the view that the burden of tax should shift to some extent away from taxing income, which can reflect productive economic activity, and onto held wealth, which can be very considerable.

Questions

20. *How much should we be aiming to shift the burden of tax from income to wealth?*

21. *Should methods of taxation not only take into account the degree of wealth, but also the way in which it was acquired (for example - earned vs. unearned wealth, income vs. capital etc)?*

22. *If so, how should different forms of wealth be taxed and why?*

23. *Do wealth taxes distort the UK economy in undesirable ways?*

24. *How can we best mitigate the avoidance of wealth taxes?*

25. *In what ways might existing taxes be unfair, and how could we improve them?*

26. *Should we offer people the ability to opt-out of inheritance tax at death by paying higher rates of other taxes before death (such as higher council tax on their house)?*

Financial Services

5.1 Excluding the £2.5bn financial services levy, the financial sector provided £63bn or approximately 12% of the total UK tax take in 2010/11. This was made up of employment taxes, corporation tax payments and irrecoverable VAT[5].

5.2 The sector paid £7.2bn in Corporation Tax in 2011. On average, the Total Tax Contribution was equivalent in size to 18.9% of revenues in 2011.

5.3 British business as a whole was estimated to contribute 29% of total Government tax receipts in 2011 including £41.2bn of corporation tax.[6] The one hundred largest corporate groups in the UK made a Total Tax Contribution equivalent in size to 12% of revenues in 2011.[7]

5.4 A Financial Transactions Tax ('FTT') is frequently proposed as both a way to raise additional tax revenues from this sector and to reduce risk-taking behaviours by incentivising longer-term investments. There is broad agreement that to be effective, it needs to be imposed universally (i.e. at global or possibly European level). The party has previously committed to support a FTT at the global level.

5.5 Many argue, however, that an FTT is not a tax on financial institutions but rather on the underlying users of financial transactions (e.g. pension funds, made up of the pensions of the public as a whole) and that it would be more appropriate to tax the profits of financial institutions and the remuneration of bankers.

5.6 Others argue in favour of a Financial Activities Tax (FAT), which might operate in a way that is more akin to VAT.

Questions

27. *Does the UK financial services industry broadly pay the right level of tax?*

28. *Should the party support an FTT at European level?*

29. *If so, how should we look to implement it?*

30. *Should the Liberal Democrats pursue a multilateral Financial Transactions Tax through the EU, G20 and OECD?*

31. *Should the bank levy be extended to other types of financial institution?*

5 http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/The-Total-Tax-Contribution-of-UK-Financial-Services---Fourth-Edition.aspx
6 http://www.cbi.org.uk/media/1456721/tax_and_british_business_making_the_case.pdf
7 http://www.pwc.co.uk/tax/issues/total-tax-contribution-2011-report.jhtml

Land and Property Taxation

6.1 The UK currently has two recurring (i.e. annual) property taxes: Council Tax (for residential property) and Business Rates (for commercial property). There are also non-recurring property taxes, payable on purchase (Stamp Duty Land Tax or 'SDLT'), sale (Capital Gains Tax), and award of planning permission ('Section 106' payments or Developers Obligations, to be largely replaced from 2014 by Community Infrastructure Levy).

6.2 Land and property taxes are a form of wealth tax and Liberal Democrats have supported a shift in taxation away from income and towards property. Landed property is always local and needs to be serviced, so property taxes are commonly used to pay for local services, especially those 'place-based' services such as waste collection, roads & transport and housing.

6.3 The OECD has identified recurring (i.e. annual) property taxes as associated with strong economic performance, compared with income and sales taxes that appear to harm growth. Non-recurring property taxes tend to deter transactions in land, because they add to the cost of development or sale.

6.4 Tax on property and land can influence behaviour as well as raise revenue and pay for services. For instance, a Land Value Tax (LVT) or Site Value Rating (SVR), which is a form of recurring property tax based on the rental value of undeveloped land sites, could potentially stabilise property prices, encourage the most efficient use of land and stimulate sustainable economic growth.

6.5 Current Liberal Democrat policy in England would see Council Tax replaced by Local Income Tax (LIT), with the 2010 Manifesto committed to allowing councils to pilot LIT.

Questions

32. *Should we move towards a system based around a recurring domestic property tax? If so, how?*

33. *Should we consider treating the rent from property as income - thus merging property tax into the income and corporation tax systems?*

34. *If we have a tax-free allowance on earned income, should we also have a tax-free allowance on any recurring property tax: a 'Homestead Allowance' (HA)? If so, should it be linked to local property prices?*

35. *Should these two tax-free allowances be transferable, i.e. someone income-poor could use HA to offset their LVT? (NB. A merger of Income Tax and property tax systems would make this easier).*

36. *Should we focus on developing Land Value Tax as a source of revenue for central government?*

37. *If so, would local and devolved government get a share? Or should we instead retain the policy of a recurring national tax on high-value properties (over £2m): the Mansion Tax? (This could be considered as a crude form of LVT, with high tax-free allowance).*

38. *Should Stamp Duty Land Tax be scrapped?*

39. *If so, should it be done now or in the longer term? How would we make up for lost revenue?*

Local and Devolved Taxation

7.1 Local and devolved government in Britain, which accounts for about a quarter of all public expenditure, is largely financed by national taxation.

7.2 We have one of the most centralised tax systems in the world. Council Tax constitutes less than 20% of the total revenue of Councils in the poorest areas, no more than 80% of the richest: on average around a third.

7.3 Most of the rest comes from Business Rates which are set by the governments in Whitehall, Cardiff and Edinburgh and collected by councils: they currently pass all the revenue to their national government, which then uses a formula to calculate the redistribution according to need (the annual 'Formula Grant' process).

7.4 Both Council Tax and Business Rates are forms of property tax. Council Tax is based on valuations – so-called Bands - of sale price of homes at a fixed date in the past (1991 for England & Scotland and 2003 for Wales). It is unique world-wide and highly regressive as people living in low-value homes pay many times more, as a proportion of property value, than those in 'mansions'.

7.5 Six million people claim Council Tax Benefit as partial compensation for this regressivity: until now, this has been fully reimbursed by government to the councils who pay claimants.

7.6 Council Tax is widely regarded as overdue for reform (and at the very least re-banding) but successive governments have found this politically impossible to achieve.

7.7 District, city and borough councils do all Council Tax billing and collection. In multi-tier local government areas, county, parish, town and community councils add a 'precept' upon the Council Tax, setting their own rate. Police & Fire Authorities and the London Mayor are also funded through a Council Tax precept.

7.8 The Coalition Government currently has no plans to change Council Tax but is reforming the way Business Rates are managed: from 1 April 2013 half of what every council 'earns' within its boundaries will be retained, with a new formula grant system redistributing the rest. This will give councils an incentive to go for growth, encouraging enterprise and job creation.

7.9 Current Liberal Democrat policy in England would see Council Tax replaced by Local Income Tax (LIT), with the 2010 Manifesto committed to allowing councils to pilot LIT.

7.10 The Manifesto in 2010 also proposed that Business Rates be reformed onto a site value basis and paid by owners, not occupiers.

Questions

40. *How much of their income should local authorities raise locally (always allowing for some equalisation mechanism between areas)?*

41. *Local taxation within Wales and Scotland is a devolved matter. What further tax powers could be devolved to Scotland or Wales at the Assembly/Parliament level?*

42. *Should Council Tax be scrapped? If not, should we reform it, and how?*

43. *Does introducing a Local Income Tax remain the best way of providing substantial local funding to councils?*

44. *What other forms of local taxation and funding should councils be able to make use of?*

45. *What tax-raising limits should central government be allowed to set on local or devolved government, in order to control overall public expenditure?*

46. *Should councils be allowed to abolish or vary the Single Persons Discount, which is a vestige of the Poll Tax?*

47. *Should councils be given more freedom to borrow against future property tax revenue, to finance infrastructure projects that will produce this extra revenue (so-called Tax Increment Financing)?*

48. *Are there other taxes that councils should be allowed to raise? Should their 'power of general competence' under the Localism Act extend to the power to choose what taxes to use?*

49. *Should councils charge more than 100% Council Tax on empty and/or second homes? Should there be a vacant land tax?*

50. *Should rural land not actually used for agriculture be included in Council Tax or Business Rates?*

Tax Avoidance and Evasion

8.1 Tax avoidance is the legal exercise of structuring your affairs with the specific intention that you pay less tax. Liberal Democrats have argued for the introduction of a General Anti-Avoidance Rule to combat situations where such tax avoidance is designed to conflict with or defeat the evident intent of Parliament, which we believe is clearly unfair. We have already led the introduction within the Coalition Government of a General Anti-Abuse Rule to prevent the most abusive cases of this happening, which will come into force in 2013.

8.2 Tax evasion is the illegal exercise of hiding information in order to avoid paying tax that is due. An example would be the use of an offshore bank account to hide income from HMRC or the use of a cash payment to evade paying VAT.

8.3 The Government has recently entered into information sharing agreements with most offshore tax havens to enable them to obtain information about UK taxpayers who might be evading tax. Specific agreements have recently been reached with Switzerland regarding deduction of tax by Swiss banks.

Questions

51. *How can the Government improve its attempts to mitigate tax avoidance?*

52. *Should Liberal Democrats argue for a 'tycoon tax', setting a minimum tax level for the very wealthy which would essentially place a cap on the amount that the very richest were able to shelter from tax, whether by placing money into a pension, giving to charity, and so on. If so, how should this work?*

53. *Should we push for a broader ranging General Anti Avoidance Rule, possibly with a pre-clearance system, rather than the narrow Anti-Abuse Rule that is currently proposed?*

54. *What more should the Government do to prevent tax evasion?*

55. *What more should the Government do to crack down on tax havens that allow individuals and corporations to avoid paying taxes to developing countries?*

56. *Tax avoidance in developing countries deprives governments of the vital income needed to build and maintain their public services. How do we ensure that UK-headquartered multinationals pay their fair share of tax in developing countries?*

Non-Doms

9.1 Individuals who are resident and domiciled in the UK are taxable on their worldwide income and capital gains.

9.2 Individuals who are resident in the UK but domiciled outside the UK are only taxable on their UK income and capital gains plus any overseas income and capital gains which are remitted to the UK (the remittance basis). There is an exemption for remitted funds that are used to invest in UK trading companies.

9.3 Domicile is a legal concept. It is something that everyone is born with and it is difficult to change. Domicile is usually determined at birth and inherited from the father. It might not be the country in which an individual was born, but rather, the country that one's father considered his permanent home.

9.4 Residence, on the other hand, is broadly determined by the amount of time an individual spends in the UK in any given tax year: an individual who spends more than 183 days in the UK in a tax year is UK resident for tax purposes.

9.5 After an individual has been resident in the UK for seven years, they are required to pay a £30,000 charge to benefit from the remittance basis in each year. Individuals who are taxable on the remittance basis are liable to UK tax in the normal way on their UK source income and gains, but they are only liable to UK tax on any amounts of foreign income and gains that they remit to the UK. This annual charge will increase to £50,000 if they have been resident in the UK for the past 12 years. The purpose of the regime is to encourage individuals to relocate to the UK, but the benefits can be retained after they have put down roots in the UK, had families, and spent many years in the UK.

Questions

57. *What is the principle that we wish to establish in terms of the taxation of non-domiciled individuals – i.e. do we think that everyone who is a UK resident should pay the full rate of tax? Or that people who have made substantial use of the UK's infrastructure over a period of time should contribute to it alongside those permanently settled here?*

58. *Should the non-domiciled tax benefits be removed altogether?*

59. *If so, after what period of time, or under what conditions, should the benefits be removed?*

60. *Alternatively, should the concept of 'deemed domicile' be extended from inheritance tax to other taxes? (The concept of 'deemed domicile' means that even if you are not domiciled in the UK under general law, you will be treated as domiciled in the UK if you were resident in the UK within the last three years, or you were resident in the UK in at least 17 of the last 20 income tax years).*

61. *Should the annual charge be increased?*

Value Added Tax

10.1 Value Added Tax (VAT) is a consumption tax. It is charged on most goods and services that VAT-registered businesses provide in the UK. It is also charged on goods and some services that are imported from countries outside the European Union (EU), and brought into the UK from other EU countries.

10.2 VAT is charged when a VAT-registered business sells to either another business or to a non-business customer.

10.3 When VAT-registered businesses buy goods or services they can generally reclaim the VAT they've paid.

10.4 There are three rates of VAT: standard - 20 %, reduced - 5 % and zero – 0%. There are also some goods and services that are exempt from VAT or outside the UK VAT system altogether.

10.5 In favour of VAT is that it is a politically tolerated tax that has been varied both downwards and upwards (downwards as a stimulus and upwards to help cut the deficit) with little resistance.

10.6 While levied on all consumers, VAT is generally incident on the wealthy and on monopoly businesses.

10.7 While raising significant revenue, VAT is not without its faults. It causes government to become involved in private exchange of services (also true of employment taxes), and also causes a considerable burden on small businesses. VAT has a magnifying effect in areas where prices can be volatile, such as transport fuels and domestic energy. VAT varies in rate between new build and renovation. It is also generally regressive, in that the least well off pay a much higher proportion of their income than do the most well off.

10.8 On the other hand, Liberal Democrats and others have often argued that it can be more appropriate for consumption to be taxed more, and income taxed less.

Questions

62. *Should the VAT base be widened, and the overall rate reduced?*

63. *Should the VAT threshold for businesses be raised substantially (e.g. to £250k or more) to reduce the disproportionate administrative burden on professional trades people and small businesses?*

64. *Should a rise in the VAT threshold be prioritised over decreases in corporation tax or reducing the rate of VAT?*

65. *Should VAT be removed from energy efficiency and renovation work to remove the distortion in favour of 'demolish and rebuild', rather than renovation?*

66. *Should VAT be charged where other taxes are already charged, such as on road fuel? An alternative to consider would be to replace it with a carbon tax (aligning it with proposed electricity market reforms) and adjust the fuel duty element to eliminate an immediate change. Future oil price changes would then not be magnified by 20%.*

Environmental Taxation

11.1 Taxation has an important role to play in protecting the environment by helping to incorporate the costs of environmental damage into the price of the goods, services or activities which give rise to it.

11.2 As Liberal Democrats, we believe that environmental taxes should aim to make individuals and companies take account of the environmental effects of their economic activities, wherever private or corporate action affects the common good.

11.3 The Coalition Government is committed to increasing the proportion of tax revenue accounted for by environmental taxes. The UK Environmental Accounts indicate that environmental taxation, as a proportion of all taxation and of Gross Domestic Product, peaked at 9.7% and 3.4% respectively in 1999. Then, until 2009, the proportions generally fell, reflecting the increasing tax revenue from income and profits before the global recession.

11.4 A shift to environmental taxation – i.e. reducing taxes on the things that are valued by society (jobs, incomes and profits) and funding the lost revenue by taxes on things that damage society (pollution and environmental damage) - could help the UK to meet its 2020 climate change targets with minimal impact on the economy overall. There are, however, 'political' obstacles to such a significant change, such as the perceived effect on the international competitiveness of some vulnerable business sectors (energy intensive industries) and on poorer households who pay proportionally the greatest percentage of their income on energy.

11.5 There are different approaches that can be taken to pricing carbon. The main examples are carbon taxes and 'cap and trade' schemes in which overall emission levels of a pollutant are fixed and then progressively reduced, with individual companies allowed to buy and sell permits within the overall cap. Environmental taxes can also be seen as a way of pricing carbon.

Questions

67. *How can we use the tax system to encourage individual and corporate choices to always favour the environmentally least damaging option?*

68. *How can we utilise the tax system to better reflect the externality of environmental impact?*

69. *How can we shift towards environmental taxation in an atmosphere where political obstacles to such a shift are so significant?*

70. *A 'successful' environmental tax may hold down demand for the polluting activity and as a result, revenues raised from such a tax will shrink over time. Should our aim be to steer emissions to sustainable levels through tax incentives, or to eliminate the behaviour altogether?*

71. *What is the best approach to pricing carbon through the taxation system?*

72. *As carbon-pricing measures are developed, should a proportion of revenues raised be used to support energy-intensive industries to take steps to reduce their carbon footprint, whilst being competitive? If so, how much?*

73. *What carbon taxes or cap-and-trade schemes should apply to non-energy intensive companies?*

74. *What other forms of environmental taxation should we be considering (for instance taxes on transport such as fuel duty and air passenger duty, the auctioning of rights for resource usage, tradable personal carbon allowances etc)?*