Tax By Design: The Mirrlees Review

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The review

• Built on a large body of economic theory and evidence
• Inspired by the Meade Review
• Aimed to:
  – Identify features of good tax system for open developed economies
  – Assess the extent to which the UK system conforms
  – Propose reforms
• Two volumes
  – Dimensions of tax design
  – Tax by design
• A distinguished set of authors:
  – Sir James Mirrlees, Stuart Adam (IFS), Tim Besley (LSE), Steve Bond (Oxford), Richard Blundell (IFS and UCL), Robert Chote (IFS), Malcolm Gammie QC, Gareth Myles (IFS and Exeter), Jim Poterba (MIT and NBER)
Assessing tax policy

- Baseline is a progressive neutral system which:
  - Works as a system
  - Doesn’t discriminate between similar activities
    - Except under very limited conditions
    - Balances economic and practical considerations
  - Achieves progressivity as efficiently as possible
What we have

• Does not work as a system
  – Lack of joining up between income tax and NI
  – Personal and corporate taxes
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  – Corporate tax system that favours debt over equity
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  – A mass of different tax rates on carbon
  – Failure to price congestion properly
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• Does not achieve progressivity efficiently
  – VAT zero rating a poor way to redistribute
  – Taxes and benefits damage work incentives more than necessary
Our proposals

• Treat the system as a whole
  – Integrating NI and income tax
  – Aligning tax rates across employment, self employment and profits
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- Move towards neutrality
  - Widening the VAT base
  - Not taxing the normal return to capital
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• Whilst proposing sensible deviations from neutrality
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  – Imposing zero rate of VAT on childcare
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• Achieve progressivity through the direct tax and benefit system
  – Recognising constraints imposed by responses to incentives
  – Taking account of lifetime welfare
Today

- Richard will run through our analysis and proposals on earnings taxation
- Jim will look at capital and corporate taxes
- I’ll pick up some other bits and pieces, specifically
  - Indirect taxes and assessments of equity
  - Environmental taxes
  - Property taxation
We arrive at two guidelines for indirect taxation

1. Tax final consumption only
   • VAT generally achieves this
   • Transaction taxes, business property taxes and VAT exemptions do not

2. Tax goods at the same rate
   • Complexity creates strong presumption against differentiation
   • There are sound economic efficiency arguments for differentiation
   • But case sufficiently strong in only a few cases
     ➢ Alcohol, tobacco, environmentally damaging products
     ➢ Childcare
   • Distributional arguments for differentiation are weaker

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Evaluating VAT in the UK

- UK zero-rates most food, water, books, children’s clothes,…
  - Clearly for distributional, not efficiency, reasons ➔ should be ended
  - Other countries show that it is not inevitable
- Reduced rate on domestic fuel looks particularly bad given environmental concerns
- Exemptions violate both of our principles
- We look at imposing a single rate on almost all consumption
  - Most work suggests this can be done with compensation on average for poorer groups
  - But taking account of work incentive effects is important.
- And equity is not a straightforward concept
VAT reform: effects by income

- % rise in non-housing expenditure
- % rise in income
- cash gain/loss (£/week, RH axis)

Income Decile Group

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VAT reform: incentive to work at all
Participation tax rates

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VAT reform: incentive to increase earnings

Effective marginal tax rates

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Taxation of land and property

- Conceptually, must distinguish:
  - Business land
  - Business property
  - Domestic land
  - Domestic property

- And the fact that housing represents both an asset and a consumption good

William Vickrey:

_The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements… and one of the best taxes – the tax on land or site value_
## Land and property taxation: a summary

### Current, ideal and proposed treatments

<table>
<thead>
<tr>
<th>Category</th>
<th>Current Treatment</th>
<th>Ideal Treatment</th>
<th>Proposed Treatment</th>
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Current, ideal and proposed treatments

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Greenhouse gases and road transport

- For GHG emissions a consistent price is the key – from taxes or trading
  - EU ETS is context for UK policy
- We are a long, long way from this ideal
Implicit carbon taxes in the UK, 2009-10
Excluding VAT subsidy of domestic energy

- Coal-generated electricity, business
- Gas-generated electricity, business
- Gas for heating, business
- Coal-generated electricity, domestic
- Gas-generated electricity, domestic
- Gas for heating, domestic

£/tonne CO₂

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Greenhouse gases and road transport

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- We are a long, long way from this ideal
- High taxes on driving in the UK are probably close on average to the externalities created
  - But very poorly targeted on much the biggest externality: congestion
- Road fuel taxes are important to the exchequer and to taxing the externality
  - Also unpopular, declining, and disappear if GHG targets are to be met
- Big benefits to national road pricing