

FAIRER, SIMPLER, GREENER

Liberal Democrat Policy Paper 75 (Taxation)

Executive Summary

We aim to **reform the tax system** to make it:

- **Fairer:** progressive in relation to income and wealth
- **Simpler:** for individuals and companies: fewer rates and reliefs, more transparent
- **Greener:** taxing environmental pollution and resource depletion and giving bigger incentives to sustainability
- **More Local:** greater freedom for democratic local government to raise (and spend) revenue
- **More Efficient:** recognising the importance of incentives to work and save; and growing global competition

Our package of reforms is **tax neutral overall** - that is it does not alter the total amount of taxation raised, but raises it in different ways. This does not pre-judge decisions which need to be made in future Alternative Budgets and General Election Manifestos on whether we should increase or reduce the total burden of taxation. The thresholds and other figures used below and in the supplement reflect what this package would mean if we were introducing it in 2006/7 values.

This short policy paper cannot cover all aspects of tax policy and there are many issues - such as those surrounding the taxation of land, international tax competition and tax avoidance - which need fuller examination. Nor have we dealt with the overlapping issues of tax credits and benefits, which are to be covered by a forthcoming working group on Tackling Inequality and Poverty.

The proposals sketch out what a Liberal Democrat government would aim to achieve in the early stages of the next Parliament but also indicate a longer-term direction of travel. The Labour Government is, additionally, reviewing the system of local government finance (through the Lyons Review) and, pending its conclusions, we re-affirm our commitment to replacing Council Tax with a tax based on ability to pay - Local Income Tax - and our support for returning business rates to local control.

The specific proposals for the national budget in a new Parliament would be to:

- Abolish the existing 10p starting rate of income tax - taking more than two million people out of tax altogether and removing one rate of tax.
- Raise the employee NICs threshold so that NICs begin to be paid at the same level of income as income tax, simplifying the system, and to seek to make employee NICs payable on annual rather than a weekly earnings.
- Raise the starting threshold for the 40% upper rate of taxation to £50,000 pa - taking 1.3 million people out of paying upper rate tax (while raising the upper threshold for the higher rate of National Insurance Contributions to £50,000 pa.)
- Cut the basic rate of national income tax by 2p.

To help fund these changes and make the tax system fairer we will:

- Reform and simplify Capital Gains Tax, in particular by removing taper relief.
- Provide pension contribution tax relief at the basic rate of income tax only.

In the supplement we set out how these changes taken together will affect particular groups of taxpayers and, separately, how these impacts would be changed on the assumption that local income tax were to replace council tax on a tax neutral basis.

To tax environmental pollution and resource usage, and help fund our other reforms, we will make a 'green tax switch' by:

- Replacing the existing Airport Passenger Duty with an Aircraft Tax based on the emissions of each aircraft.
- More steeply graduating vehicle excise duty for new vehicles based on carbon emissions, with a higher level for the highest emissions band.
- Reforming the existing climate change levy, indexing it annually and eventually changing it into a simpler carbon tax.
- Indexing fuel duty to inflation except in periods of oil price spikes.
- Phasing in reform of the basis on which business rates are charged in England to Site Value Rating.

To simplify the tax system for businesses we will:

- Create a simpler Corporation Tax structure, removing complex reliefs and cutting the main rate.
- Repeal most anti-avoidance legislation and use a General Anti-Avoidance Rule to simplify the tax code.
- Give an option for small businesses to be taxed on net cashflow not profit.
- Introduce a small business rates relief as an interim measure before major reforms to the business rate can be implemented.

In the longer term we aim to achieve much more radical change:

- Raise the income tax threshold further - an intermediate objective would be to raise the threshold to around £10,000, the approximate annual equivalent of the National Minimum Wage.
- Enlarge the tax base by developing policies on land taxation.
- Merge the system of employee and employer National Insurance Contributions as the contributory principle becomes obsolete.
- Overhaul the system of taxing transport and congestion to reflect the potential of road user pricing.
- Reform the taxation of assets, notably Inheritance Tax by changing the basis on which IHT is charged so that it falls on accessions, including lifetime gifts in the taxable sum, and raising thresholds and cutting rates.
- Reform Stamp Duty Land Tax into a progressive tax that only charges higher rates of duty on the proportion of the property value above a threshold.