

# Nefarious politicking

Is tax becoming too politically motivated, ask **LESLEY STALKER** and **PAUL WEBB**.

**T**axes are necessary to finance the running of the country, and we all recognise that they affect its long-term health. However, more and more we are seeing tax increases, decreases and new incentives, which appear to be purely political and hastily implemented to the detriment of the public who are faced with increasingly complex legislation and uncertainty as to how certain taxes operate. Even those who find politically motivated taxes acceptable may agree that their introduction often needs to be better considered.

## Recent history

Immediately after World War II, the UK fell into decline. The job of both the main political parties at that time (Labour and Conservative) was to manage the decline to ensure it was not too disruptive. This involved, for example, accepting demands from unions that were far above those justified by productivity.

Furthermore, there was a desire for stability and security. This led to the establishment of a far-reaching welfare state that included the nationalisation of much of Britain's industry. Taxes were raised to confiscatory levels, and sterling was devalued to pay for all the benefits.

To keep this system operating required huge government subsidies, which were paid for with budget deficits monetised by the Bank of England.

Among other things, this led to high wage inflation, pushing huge numbers of taxpayers into tax brackets once reserved for the wealthy. In 1979, the basic tax rate was 33% and the top rate went as high as 98%: 83% on wages and a further 15% surcharge on unearned income (i.e. interest and dividends).

In 1975, Margaret Thatcher was the elected leader of the Conservative party, which was then in opposition. She argued

### KEY POINTS

- Tax rates soared in the 1970s.
- Effect of the 1988 MIRAS change on the property market.
- Abolition of tax credits on dividends for pension funds.
- The 10% tax rate hiatus.
- Independent tax policy committee is needed.



that the UK's decline was not inevitable and the right policies could tame inflation and restore prosperity. These policies included tight control of the monetary supply, tax cuts, privatisation of British industry, deregulation and tougher policies on unions.

Just one month after Mrs Thatcher was elected prime minister, the basic rate of income tax was cut from 33% to 30%, and the top rate went down from 83% to 60%. In 1988/89, the basic rate was reduced to 25% and the top rate lowered to 40%.

## Low tax politics

Establishing the Conservative party as a low-tax party was something that saw the Tories win a record term in office, and seeds were sown so that taxes could be a very effective mechanism for securing and retaining power.

Since that time, we have seen the increasing manipulation of taxes for political ends. We have watched the evolution of 'headline taxes': tax reductions that hit the front pages of the national newspapers and are aimed at the core voters of the government.

Perhaps more worryingly, we have seen the development of tax increases that are largely hidden from the general public. They are not made obvious in Budget speeches, but are included in the detail of the subsequent press releases.

Against this background, and yet more recently, we have come to see legislation that appears to have been implemented on the hoof, largely in response to statements and policy announcements made by opposing parties, but also as a result of a party's standing in the polls.

Examples of each of the above can be found without too much difficulty. In this article, we have examined some of the more

obvious examples and tried to ascertain the motivating factor behind their implementation.

## Higher tax rates

In the 2008 pre-Budget report, Alistair Darling announced his intention to introduce a new 45% tax rate for high-earners.

In January 2009, a story in the *Daily Mail* outlined the findings of a poll conducted by YouGov and a series of focus groups, which found that 70% of UK voters believed 'those at the top are failing to pay their fair share towards investment in public services'.

At the same time, research carried out by the centre-left think-tank the Fabian Society suggested more than three-quarters (76%) backed moves to impose a 45% rate on taxpayers earning more than £150,000. But there was also a clear majority in favour of going further, with 69% believing a 50% rate for those on salaries of £250,000 and above would also be fair.

At the same time, the *Mail* reported a senior Conservative frontbencher as saying that higher taxes on top earners, which the party has not pledged to reverse, would cause long-term damage to the economy. He did not openly demand that the party should promise to axe the rise, but said, 'I can't predict where we're going to be when we get into office, and we're going to have to live with some of the consequences of what the Government does, but raising taxes on higher earners does seem to me, from the historical evidence, damaging in the medium to long term in terms of the amount you then get out of the economy.'

Former cabinet minister John Redwood, who heads the Tories' economic competitiveness commission, did call for the 'extremely unhelpful move' to be ditched if the party wins the next general election.

'It is a huge self-inflicted wound. It will backfire. I hope we will say we will not do it. It is not something an incoming Conservative government should be doing', he told the *Mail*.

It could be argued that with backing from Labour rank and file, and with the issue causing a division within the Conservative party, the Chancellor saw this as an opportunity to create further political capital.

In fact, three months later, in the 2009 Budget, he announced that the new tax rate would be 50%, formally breaching the commitment not to increase income tax rates that Labour made in 1997, 2001 and 2005.

## MIRAS

Mortgage interest relief at source (MIRAS) was introduced in 1969 by the then Labour Chancellor of the Exchequer, Roy Jenkins. It was widely understood that this measure was to encourage home ownership, to reduce the ever increasing burden on the state.

In 1983, Conservative Geoffrey Howe increased to £30,000 the allowance on which relief could be claimed and also allowed couples with joint mortgages to pool their allowances.

In the 1988 Budget, Nigel Lawson abolished the pooling option but, in what he later regarded as his biggest political error,

he delayed the implementation of this change until August of that year. The effect was to cause a surge in demand for properties over a five-month period, causing an inevitable price spike. Interest rates spiralled from 8.5% in March 1988 to 13% in November 1988 and, less than a year after the MIRAS change, the property market collapsed, leaving thousands of people with substantial negative equity.

Although it did not appear to be politically motivated, this is a prime example of where ill thought-out policy changes can have a significant and wider impact than perhaps first imagined.

The level of MIRAS relief was progressively reduced during the 1990s, and MIRAS was abolished by Gordon Brown in 2000 when he argued it had become a 'middle class perk'.

The reality was that this removed the tax advantages of interest-only mortgages. In addition, a few commentators argue that the move brought about some of the problems that have recently been associated with endowment mortgages, which were introduced in the 1970s and remained popular while MIRAS relief was in existence.

## Repayable tax credits

In his first Budget, Gordon Brown introduced what was arguably his most controversial and potentially short-sighted policy.

The abolition of tax credits on dividends for pension providers and companies has been described by many as a pensions stealth tax. Originally presented as a way of encouraging retention of profits by companies – a traditional policy of the Labour party – the reality of this policy was more far reaching.

Estimates suggest that between £100 billion and £150 billion has been wiped off pension funds. At a time when the country is faced with an increasingly elderly population, it seems sensible for the government of the day, Labour or Conservative, to be doing all it can to support private provision of pensions rather than increasing the inevitable reliance on state benefits for many more future pensioners.

To consolidate this position, there have been yet more recent negative changes to pension legislation, including the abolition of higher-rate tax relief and the introduction of the anti-forestalling measures, which can only reinforce what must be considered short termism from the Government.

These alterations to pensions do not always make the headlines of the general press, unless it is intended for them to do so. The abolition of higher rate tax relief is an example of the latter and is considered a positive move by a particular demographic of voters. It is typical that the changes do not reach the consciousness of most voters. They can therefore be manipulated to raise taxes either with or without mainstream media attention.

## Abolition of the 10% tax rate

In his 2007 Budget speech, Gordon Brown concluded with the following.

'And I have one further announcement. With the other decisions I have made today we are able to hold to

our pledge made at the election not to raise the basic rate of income tax. Indeed, to reward work, to ensure working families are better off and to make the tax system fairer, I will from next April cut the basic rate of income tax from 22p down to 20p. The lowest basic rate for 75 years.'

What he failed to add was that the 10% tax rate for lower earners was being abolished, forcing more than five million workers up into the 20% tax bracket.

This was a measure that, perhaps unexpectedly, caused uproar among opposition parties, campaign groups and Labour backbenchers alike.

It was estimated that around 5.3 million households – roughly one in five – would be left worse off by the changes, mostly in the poorer half of the population. This could have been an intended outcome of this legislation, and it led to accusations of legislation made on the hoof.

The winners, most noticeably, were people earning between £19,355 and around £40,000.

Government figures show that, far from this being a tax cut, the impact of the changes was estimated to leave the Treasury with a £3.7 billion net gain.

**“It became apparent that not only was the original legislation badly thought through, so also were the amendments.”**

The Government had to pacify its backbenchers, and changes were made to the basic personal allowance, with a corresponding reduction in the higher-rate threshold. It was clear that these were quick fixes; people on middle incomes actually benefitted further from the changes alongside people on low incomes. However, those on very low incomes, e.g. £8,000, would still be £50 worse off under the revised proposals.

It became apparent that not only was the original legislation badly thought through, so also were the amendments.

## Political manoeuvring

In Alistair Darling's pre-Budget speech in 2007, he apparently stole three of the Conservative's big ideas on tax policy.

The policies in question were the expansion of the inheritance tax lifetime allowances to allow married couples and those in civil partnerships to combine their individual allowances, the closure of loopholes for non-UK domiciled individuals, and the switching of air passenger duty from passengers to flights.

However, the Chancellor attempted to bring a socialist spin to the policies by limiting the inheritance tax thresholds to £700,000 (the Tories had proposed £1 million) and increasing the annual non-domiciled tax charge to £30,000. (The Tories

had mooted £25,000.) With Labour trailing in the polls, it could be argued that these moves were an attempt to gain the higher ground and restore some political initiative.

Finally, this article would be incomplete if we did not consider taxes designed to affect consumer behaviour. Do we believe taxes can do this? Is it the place of taxes to do so? Chancellors of recent years appear to have believed so and sought to influence spending habits by making certain items cheaper through the use of tax policy to provide incentives.

A recent example of this is the development of green taxes encouraging businesses to provide certain types of car to their employees. The 2009 pre-Budget report saw the introduction of first-year allowances for electric vans and reduced benefit in kind charges for electric cars. The aim was that the changes would affect businesses that decided to increase expenditure on such types of vehicle. It may also encourage individuals to view this type of vehicle as more attractive. Time will tell whether this is successful, but it is arguable that consumer behaviour is better influenced by social factors.

## Suggestion

We believe taxes should not be used to influence power. Rather, they should be deployed on improving the country's economy.

One way to establish this would be the appointment of an independent tax policy committee, perhaps along the lines of the Monetary Policy Committee set up by Gordon Brown in 1997. This is, broadly speaking, a committee made up of the governor of the Bank of England, other senior banking officials and external members appointed by the Chancellor. Crucially, it is independent of the Government and sets interest rate policy to meet the country's inflation policy. Regarded as a success, the Monetary Policy Committee has opened the window for us to consider a similar body to regulate taxes.

A fiscal policy committee or similar would enable the government of the day to stipulate its economic aims, including expenditure and taxation policies, and ensure that a well-researched and well-implemented tax policy is put forward to meet these aims.

In addition, why not harness the power of technology and ask the voters directly? It seems the Conservative party is investigating this idea, with its recent launch of a £1 million competition to find a developer able to create a crowdsourcing platform.

Whether or not this will work remains to be seen, but assuming it does, a future tax policy committee could have access to the system to ensure the UK stays away from quick vote-winning tax schemes and introduces policies that work for the greater good. ■

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