

Income Tax

The Policy in Brief

Liberal Democrats propose to cut income tax by 4p in the £1 financed by green taxes and by taxes on the wealthy.

Why is it Necessary

The current tax system is unfair, does not do enough to create incentives to work and save and is overcomplicated. The proposals build on the proposals of the 2006 Liberal Democrat Tax Commission and in particular respond to the changes made in Gordon Brown's final Budget as Chancellor.

Policy Detail:

These are radical tax plans that will take the basic rate of income tax to its lowest level since 1916 and will go to Liberal Democrat Autumn Conference.

The unacceptable reality is that in Britain today the poorest pay a higher proportion of their income in tax than the super-rich. Low and middle income earners in this country shoulder too heavy a tax burden. Our new proposals put fairness at the heart of the tax system.

Cutting the basic rate by four pence in the pound will reduce the basic rate of income tax to 16p, benefiting millions of people on low and middle incomes. The plans form part of the party's proposals to lift the tax burden on low and middle income earners whilst making the rich and people with environmentally damaging lifestyles pay a fairer share.

The national tax cuts will be paid for by raising taxes on polluters, abolishing the capital gains tax break, which allows the very rich to pay a lower tax rate than the person who cleans their office, and only providing tax relief for pensions at the standard rate. Under our proposals tax cuts for the majority will be paid for by the wealthy minority, as well as those with environmentally damaging lifestyles.

In his last Budget as Chancellor GB abolished the 10p starting rate of income tax and so was able to cut the basic rate of income tax. Liberal Democrats have no plans to reinstate it.

The revised proposals are tax neutral and have been independently evaluated by the IFS.

The table below shows some examples of possible winners and losers:

ESTIMATED EXAMPLES OF IMPACTS ON DIFFERENT FAMILY TYPES AND "BREAK-EVEN" POINTS

Impact of changes on households	Council Tax Band	Council Tax Bill	Income Tax changes	LIT Change	*Overall Gain/Loss
Pensioner Couple, income £15,000	F	£1,908	£182	(£171)	£1,993
Teacher, £25,000, (single person household)	C	£891	£791	(£742)	£940
Median Household income, (double earner) £29,000	D	£1,321	£702	(£659)	£1,008
Nurse, £20,000, and Police officer, £25,000	D	£1,321	£1,382	(£1,298)	£1,051
Cabinet Minister, £135,000	H	£2,842	£1,811	(£4,879)	(£4,708)
City banker £250,000, (single earner household)	H	£2,842	£1,811	(£8,179)	(£611,800)
Young professionals, (double income-£38k & £25k)	E	£1,815	£2,102	(£1,871)	£972
Young professionals (double income-£25k each)	D	£2,302	£3,022	(£3,388)	(£1,669)
4 Nurses earning £25,000 each	F	£1,908	£2,384	(£2,218)	£1,699

*Includes environmental, pension tax relief and capital gains tax changes
Pension tax relief lost based on 9% income
CGT figures based on 98:20 split
Assume Environmental taxes affect all households equally- average is £289 per annum

The "break-even point" for households will obviously depend on a number of factors, including but not only, council tax currently paid, household behaviour with respect to the environment, level of pension contributions, capital gains realised in a particular year and of course the number of earners in a household. On the assumption of a single earner household, currently paying average Band D council tax, and incorporating the assumptions on CGT, environmental taxes and pensions above the cut off point would be around £46,000. For a double earner household the cut off point is around £69,000. Given the assumptions there are likely to be both households above these figures who will gain and households below these figures who will lose- these figures represent some kind of average.

Other proposals launched in the document *"Reducing the Burden: Policies for tax reform"* include:

- Reaffirming the commitment to abolishing Council Tax, replacing it with a tax based on ability to pay
- Removing Capital Gains tax taper relief
- Introducing a single rate of pension contribution relief
- Removing tax loop-holes exploited by the super-rich
- Radically simplifying the tax code, removing over 500 pages of unnecessary regulations
- Reforming stamp duty to reduce the amount of tax paid on properties worth less than £500,000
- Reforming Inheritance Tax, with the aim of raising the starting threshold to £500,000

Costs/Savings:

£21.4bn funded through higher environmental taxes, changes to capital taxes and a single rate of tax relief on pension contributions.

	Gross (m)
Cut Basic Rate by 4%	£17,800
Additional tax cuts	£3,600
TOTAL COST OF PACKAGE	£21,400
	Gross (m)
Capital Gains Tax -Scrap taper relief	£4,000
Single rate of pension contribution relief	£7,500
Additional Environmental Taxes	£8,400
Non Dom tax reforms	£1,500
TOTAL REVENUE OF PACKAGE	£21,400
CONTIGENCY	£3,600

** These figures are taken as a snapshot and so are likely to change with future announcements in budgets

Labour:

In his last Budget as Chancellor, Gordon Brown pledged to reduce the basic rate of income tax from 22% to 20% in April 2008. He was able to fund this by doubling the starting rate of income tax. As a result those on low incomes will actually pay more in income tax from April 2008. No major changes likely in near future as Brown has set out stall in his final Budget. There is a manifesto commitment to "continue to make targeted tax cuts for families and to support work".

Conservatives:

The Forsyth commission set up by Shadow Chancellor George Osborne (October 2006) proposed some income tax cuts (specifically changes to the thresholds for the personal allowance and for upper rate tax) but did not say how they would be funded. Officially the Conservatives have not set out any detailed tax plans but Osborne has hinted at transferable income tax allowances for couples. Nothing is concrete.

Key Statistics

- After 10 years of the current Labour Government the tax system remains unfair, with the bottom 20% of households paying a higher proportion of their income in taxes than the top 20% (36.4% v. 35.5%: Source: page 8 http://www.statistics.gov.uk/downloads/theme_social/Taxes_Benefits_2005-2006/Taxes_Benefits_2005_06.pdf)
- Wealth inequality has been worse under Tony Blair and Gordon Brown than under Margaret Thatcher. (The Gini coefficient, a statistical measure of inequality, averaged 65 under Thatcher and 69 under Tony Blair & Gordon Brown). The Government now will not publish wealth inequality statistics for 2004. The latest year that statistics are available is 2003. The Government is no longer publishing data on wealth inequality.
- Green taxes have fallen to their lowest level since Mrs Thatcher was Prime Minister, they have fallen from 3.6 per cent of GDP in 2000 to just 2.7 per cent of GDP today.
- The tax system has become much more complex under Labour, with the tax code doubling in length from 4,555 pages in 1997 to 9,841 pages in 2006 (Source: Tolley's Tax Guide).
- On 19th June the Liberal Democrats launched a set of proposals aimed to make the rich pay their fair share of taxes. Copies of the paper are available on the extranet.
- The government should learn from the Liberal Democrats and look at more ways to tax Britain's top earners, Treasury Minister Angela Eagle says. She spoke out during a fringe meeting at Labour's conference in Bournemouth, which was joined by senior Lib Dems Vince Cable and David Laws. Lib Dem leader Sir Menzies Campbell wants to tax the super-rich to fund tax cuts for the rest of the population. Sir Menzies has argued that the wealthy have done "too well" under Labour. He used last week's Lib Dem conference to unveil tax policies that he claimed would help 90% of the population. These included lowering the basic rate of income tax by 4p in the pound to 16p, calling for the abolition of council tax and voting to increase "green" taxes, including replacing air passenger tax with a tax on flights. At a CentreForum and Fabian Society fringe event at Labour's conference, Ms Eagle was asked if her party faced a "challenge" from its opponents when it came to talking about the top end of the tax scale. She replied: "Yes. And I for one hope we're going to do a bit of talking about that." (BBC Sept 27th 2007)