

Fairer Taxes

Policies for the Reform of Taxation

Policy Paper 111



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Executive Summary

Liberal Democrats believe that Government has an important duty both to enable people to get on in life, and to ensure that everyone pays their fair share. Our tax system has a crucial part to play in achieving this, and we set out here our proposals for how it should do so.

Cutting tax for people on low and middle incomes

In government we have already taken 2.7 million of the lowest-paid employees out of paying income tax altogether, and delivered a £700 annual tax cut to many millions of other employees.

Liberal Democrats wish to continue to focus assistance on those on the lowest incomes, and therefore we now want to increase the income tax threshold further, to a level equivalent to a full time job on the National Minimum Wage, to take several million more people out of paying income tax altogether, and give a further tax cut to yet more. We then propose to link the personal allowance to the minimum wage, so that in future no-one with a full time job on the minimum wage would pay income tax.

Ensuring the richest pay their fair share

In these tough economic times, it is right that those who are most well off pay a fair share. Liberal Democrats will therefore:

- Introduce a Mansion Tax, applicable at 1% on the value of a residential property in excess of £2 million.
- Cap the lifetime limit for which tax relief is available on pension contributions at £1 million.
- Ensure benefits in kind received in lieu of salary are subject to full national insurance contributions.
- Tighten the rules which allow preferential tax treatment for some non-domiciled individuals who live in the UK, and prevent non-dom tax status from being hereditary.
- Tighten corporate tax rules to prevent large companies reducing their tax bills by paying excessive interest to related parties overseas.

Ensuring that tax isn't optional

A minority of wealthy individuals and companies actively seek to avoid making a fair contribution through hiding money offshore or through artificial schemes designed to avoid tax. To combat this, Liberal Democrats will:

- Introduce a General Anti-Avoidance Rule, supported by a straightforward pre-clearance system, outlawing any move taken simply to try and avoid tax.
- Continue to push for international tax reform, greater banking transparency and greater co-operation between nations to tackle tax evasion and avoidance, within the EU, the G8 and beyond.
- Continue to invest in HMRC, as we have done in government, to enable them to tackle tax evasion and avoidance, which demonstrates a good return on investment.
- Expand HMRC's powers to name and shame taxpayers penalised for tax evasion.
- Push for greater tax transparency from multinational companies, including country-by-country tax reporting, increased disclosure of intercompany transactions, and publication of tax settlements.

A tax system that's simpler for all

A simplified tax system benefits taxpayers and government alike, providing greater certainty and less bureaucracy. Liberal Democrats will therefore:

- Take millions more people out of income tax altogether by increasing the personal allowance to a level equivalent to the full time minimum wage.
- Simplify personal tax returns by pre-completing them with relevant information held by HMRC.
- Strengthen the General Anti-Abuse Rule to a General Anti-Avoidance Rule to minimise the need for detailed specific anti-avoidance legislation.
- Introduce a pre-clearance system alongside the GAAR to give taxpayers certainty over any transactions where they are unsure if the GAAR applies.
- Renew the mandate of the Office of Tax Simplification for a further parliamentary term.
- Replace the complex 'worldwide debt cap' rules which govern interest deductibility for large companies with a much simpler 'earnings stripping' rule.
- Specify time limits for any new tax measures by including 'sunset clauses' within the enacting legislation.

- Provide more flexible options for contacting and interacting with HMRC, including expanded online functionality, email and out-of-hours telephone options.
- Repeal the 'share-for-rights' rules which if left in place will complicate otherwise straightforward employment relationships to the detriment of ordinary employees.

Shifting the burden of taxation from income towards wealth

We believe that in order to make the tax system fairer and encourage employment and economic growth, UK taxation needs to be rebalanced towards increased taxation of wealth and lower taxes on earned income. Therefore Liberal Democrats will:

- Return to a system that taxes capital gains at the same rates as the top slice of an individual's income.
- Extend the time period for which lifetime transfers of wealth are within the scope of Inheritance Tax from 7 years to 15 years.
- Ultimately seek to replace Inheritance Tax with an Accessions Tax, which would tax bequests in the hands of recipients rather than taxing the estate of the deceased.
- Launch a consultation to determine how to implement Land Value Tax.

Either Option A:

- Maintaining the existing rates of income tax, including the additional rate of 45% for income over £150,000 per year.

Or Option B:

- Maintaining the existing rates of income tax, apart from the additional rate for income over £150,000, which should rise to 50%, subject to an independent review concluding that the additional income from this change would exceed the costs of introducing it.

A strong platform for business, and encouraging small business

Helping business to set-up, prosper and grow in the UK is a key part of driving our economy forwards. Liberal Democrats would:

- Maintain the stable and competitive corporate tax regime developed by the Coalition to continue to attract inward investment and give business the certainty it needs to make long-term decisions.
- Introduce a range of measures designed to make dealing with HMRC easier for small businesses, including greater online capabilities and harmonisation of tax payment requirements for different taxes.
- Provide further tax-incentivised investment opportunities for investors in start-up technology and green businesses.
- Expand the £2,000 Employment Allowance to provide further assistance to small businesses taking on new employees.
- Re-design cider duty to apply differentiated rates based on fruit content, to support and encourage manufacturers of high-quality British ciders.

Devolving control of taxation to nations

Liberal Democrat aim to give the Scottish Parliament and the Welsh Assembly more control over, and accountability for, how revenue should be raised and spent in their area. We would:

- Devolve power over a range of taxes to the Welsh Assembly, in line with the recommendations made by the Silk Commission.
- Support a move towards fiscal federalism for Scotland, including further transfer of tax powers as set out in the Scottish Liberal Democrats' policy paper *Federalism: the best future for Scotland*.

Using the tax system to achieve environmental goals

The tax system is a valuable tool which can be used to incentivise environmentally beneficial activities and penalise polluting activities. Liberal Democrats would:

- Push for central reform of the EU Emissions Trading System in order to ensure it truly drives behavioural change amongst large greenhouse gas emitters.
- Link Vehicle Excise Duty bandings to EU emissions targets to ensure it remains a relevant influence in vehicle purchase decisions.
- Continue to push for reform of taxation of international aviation to change Air Passenger Duty to a Per-Plane Duty.

- Lower the rate of VAT on home renovations to the reduced rate in instances where the work improves the Energy Performance Certificate rating of the home.
- Provide ISA allowances for investments into enterprises with environmental and/or technological benefits.
- Introduce a 5p per bag carrier bag levy for England, similar to the measures already in place in Wales and Northern Ireland.

Principles

1.0.1 Taxation is fundamental to the operation of government. The tax system is ultimately the means by which government raises the revenue to fund the rest of its activities. Which taxes are used to raise that revenue, and how those taxes are applied, have a huge impact on our lives. One of the things that citizens and businesses are most interested in is how much and what kind of tax the different parties propose different groups will pay. Where we think the tax burden should and should not fall is therefore an important statement about us as a party.

1.0.2 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 we seek to ensure the tax system plays its part in helping to achieve those aims.

1.0.3 We want to foster a strong and sustainable economy that encourages wealth creation and growth, develops and uses people's skills, protects the environment, and works to the benefit of all, with a fair distribution of the rewards of success. To this end, we believe that a Liberal Democrat taxation system should be progressive and proportionate, and should seek to reduce inequality as well as fund public services and national infrastructure.

1.0.4 Liberal Democrats in government are now having a positive impact on Britain's tax system, and we outline a number of specific ways in which we are doing so throughout this paper, as well as our proposals for how the tax system should change further to meet the above aims.

1.0.5 The foremost principles which underpin the proposals we set out in this paper are:

- **Fairness** - We wish to achieve a tax system that is progressive in relation to income and wealth, that reduces inequality, ensures those earning the lowest wages are not disadvantaged by working, in which wealthy individuals and businesses make their fair contribution, and where those who seek to avoid paying tax are prevented from doing so.
- **Prosperity** - A tax system which raises sufficient revenue without disproportionately reducing incentives to individuals to work and save, keeps the cost of collection to a minimum, and presents an attractive option for business investment, supporting economic growth and creating prosperity.
- **Simplicity** - We want to create a tax system that is simpler, easier to understand and comply with, and more predictable; with fewer and less complicated rates and reliefs - especially for individuals and small businesses.

- **Environmentalism** - We strongly believe that the tax system should be used to tax environmental pollution and resource depletion, and should provide bigger incentives to sustainability, green economic growth, and the responsible use of resources.

1.0.6 As set out in the 'Devolution of Taxation' Chapter of this paper, Liberal Democrats support moving towards fiscal federalism, transferring greater fiscal powers to Scotland and Wales, and therefore it should be noted that proposals set out in this paper only apply to Scotland and Wales to the extent that the underlying fiscal powers are retained at federal level.

Personal Taxation

2.1 Income Tax Personal Allowance

2.1.1 In Coalition Government, Liberal Democrats have successfully delivered our 2010 manifesto commitment to raise the tax free personal allowance to £10,000, lifting 2.7 million of the lowest paid employees out of paying income tax altogether, and delivering a £700 annual tax cut to 24 million others.

2.1.2 We believe it is right to continue to target our support on those who are earning less than the minimum wage, and on low and middle income earners; indeed we believe that anyone earning less than the minimum wage should not pay income tax.

2.1.3 We therefore propose that the threshold for paying income tax should continue to rise to an income level equivalent to full-time employment on the National Minimum Wage (around £12,300 from October 2013) during the next Parliament. By increasing the tax-free personal allowance in this way, we will give individual taxpayers a further tax cut of up to £460 per year, and make the UK tax system simpler and more progressive.

2.1.4 This proposal, combined with the proposals set out in policy paper 108, *A Balanced Working Life*, such as increased levels of free childcare, will strengthen the economy by letting low paid workers keep more of their income, and create a fairer, more equal society which encourages and rewards employment.

2.1.5 We would then seek to permanently link the personal allowance to the NMW, in order to protect low income households and ensure they are not subsequently dragged back into paying income tax by future increases in the NMW - which we would expect to increase in line with inflation in order to protect workers' real incomes.

2.1.6 Once we achieve our aim of aligning the income tax personal allowance to the National Minimum Wage, in future we would then look to reduce the National Insurance Contributions (NICs) which are currently still paid by many of the lowest paid employees.

2.2 Income Tax Rates

2.2.1 Income tax rates are currently 20%, 40% and 45%. The most recent figures (2010-11) indicate that approximately 90% of taxpayers pay income tax at the basic rate, and 10% of taxpayers (3.2 million people) pay income tax at the higher or additional rates, which for 2010-11 broadly applied to incomes of £43,875 or more¹ (due to be £42,285 for 2015-16). Those on very high incomes now pay more in tax than they did under the previous Labour Government.

¹ HMRC, *Income Tax liabilities statistics*, p7, Apr 2013, <http://www.hmrc.gov.uk/statistics/tax-statistics/liabilities.pdf>

Option A

2.2.2 As Liberal Democrats we believe our tax system has been unfair for many years. As set out in Chapter 4 of this paper, we believe it should focus on taxing wealth as well as income. We therefore welcome policies introduced by Liberal Democrats in Government to cap pension tax relief for the very wealthy, to crack down on avoidance of Stamp Duty Land Tax on the most expensive properties and to increase the rate of Capital Gains Tax for higher and additional rate taxpayers. In addition we will continue to campaign for further wealth taxes, such as the Mansion Tax, and we will look to make further changes to Capital Gains Tax and Inheritance Tax (as set out in this paper).

2.2.3 In this context, and of the changes above which we propose making so that those on low and middle incomes pay less, we believe the current UK rates remain appropriate and fair.

Option B

2.2.2 As Liberal Democrats we believe our tax system has been unfair for many years. As set out in Chapter 4 of this paper, we believe it should focus on taxing wealth as well as income. We therefore welcome policies introduced by Liberal Democrats in Government to cap pension tax relief for the very wealthy, to crack down on avoidance of Stamp Duty Land Tax on the most expensive properties and to increase the rate of Capital Gains Tax for higher and additional rate taxpayers. In addition we will continue to campaign for further wealth taxes, such as the Mansion Tax, and we will look to make further changes to Capital Gains Tax and Inheritance Tax (as set out in this paper).

2.2.3 However, a transparently fair tax system would mean that the tax rate on incomes over £150,000 would be significantly higher than that on incomes of £42,285. We therefore favour in principle a return to a 50% top rate of income tax on incomes over £150,000 per year. However it is necessary that any higher tax rate actually raises net extra revenue. We propose that the next Government should commission an independent study to report by the time of the 2016 budget. Unless such a study demonstrated that it was likely (on the balance of probabilities) that the revenue raised was less than the cost of making the change over rest of the life of the Parliament (i.e. 2016-2020), and in the context of the proposed higher wealth taxes which should prevent avoidance, then the rate would be 50% on income over £150,000.

2.2.4 Otherwise, and in the context of the changes above which we propose making so that those on low and middle incomes pay less, we believe the current UK rates remain appropriate and fair.

2.3 Pension Tax Relief

2.3.1 The government incentivises certain investments through reliefs from income tax. The largest such relief is pension tax relief. In total the tax relief granted on registered pension schemes is worth around £35bn² p.a., and historically this has disproportionately favoured the wealthy; in 2009/10, 58% of its value benefitted the top 10% of earners.³

2.3.2 In government, Liberal Democrats have successfully overseen the introduction of automatic pension enrolment for employees, which will bring many millions of people into pension saving for the first time, and those who will benefit most are those at the lower end of the income scale.

2.3.3 At the other end of the scale, Liberal Democrats have also reduced the excessively generous relief previously granted by Labour so that the pension tax relief (i.e. the amount of income that can be invested in a pension tax-free) has been limited to £40,000 each year (from £255,000 each year under Labour) and the lifetime allowance to £1.25m (£1.8m under Labour). Liberal Democrats believe this still remains excessively generous to people who are very well off, and therefore we further propose to restrict the lifetime allowance limit to £1m.

2.3.4 A £1m lifetime allowance would still be a generous regime; a top earner on £100,000 a year could expect to contribute 15% of their salary a year for over 35 years before relief was withdrawn, and a £1m pension pot for a typical pensioner would provide a tax-free lump sum of £250,000 on retirement plus an inflation-linked pension of around £25,000 a year (or £45,000 per year fixed).⁴ In practice these limits are far beyond the means of the vast majority of pension savers; the average contribution to employee personal pension schemes was just £3,260 in 2010-11.⁵

2.3.5 We propose to retain the existing £40,000 annual allowance, in order to protect individuals who may only make sporadic pension contributions during their working life due to irregular income patterns, such as entrepreneurs. We also do not propose to change the 25% tax-free lump sum which can be taken out of the pension pot upon retirement.

2.3.6 While Liberal Democrats recognise the merits, in principle, of moving to a single rate of relief, there are significant practical obstacles to such a proposal, which would introduce significant extra complexity to the tax system, particularly in respect of how to apply such a system to defined benefit schemes.⁶ Liberal Democrats in government have already greatly simplified pensions through the introduction (from 2016) of a flat rate

² HMRC, *Cost of Registered Pension Scheme Tax Relief (2011-12)*, Feb 2013, <http://www.hmrc.gov.uk/statistics/pension-stats/pen6.pdf>

³ PQ Rachel Reeves, House of Commons, *Hansard Column 1247W*, 6 Jul 2011, <http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110706/text/110706w0002.htm>

⁴ [Based on calculations for a single non-smoking male born in 1948], Apr 2013, <http://pluto.moneyadvice.service.org.uk/annuities>

⁵ HMRC, *Personal pensions average annual contribution per employee for 2011-12*, Sep 2012, www.hmrc.gov.uk/statistics/pension-stats/pen3.pdf

⁶ Pensions Commission, *A New Pension Settlement for the Twenty-First Century*, p319, Nov 2005, <http://www.webarchive.org.uk/wayback/archive/20070802120000/http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf>

pension, and therefore we support limiting lifetime relief as a more effective way of restricting the pension tax relief given to the wealthiest.

2.4 NICs on Benefits in Kind

2.4.1 Class 1 employee NICs are currently only payable on earned income (broadly cash and cash-equivalents). Unlike income tax, they are not currently levied on many benefits-in-kind, such as company cars or private medical insurance. These benefits however are often taken in lieu of salary (under 'salary sacrifice schemes') and include many goods and services which other employees, without access to such schemes, must purchase out of their post-tax (and post-NICs) income. We believe that these benefits, which are effectively a form of income, would in a fair system be taxed in the same way as income, and therefore propose that Class 1 employee NICs should be applied to benefits in kind. Employers already pay Class 1A employer NICs on these amounts, so this change would not create any additional administrative complexity, as the information required will already be contained within employers' payroll systems.

Tax Evasion and Avoidance

3.0.1 In recent years there has been an increasingly widespread view that some wealthy individuals and some large and apparently successful multinational businesses have quite simply not contributed their fair share of tax. In the boom years before the financial crisis there was resentment at extremely rich individuals apparently regarding paying tax as optional, famously paying less tax than their cleaners. Since the crisis this resentment has increasingly hardened into anger at those who did well in the good years not making a fair contribution to the costs of resolving the crisis which many millions of people who had no responsibility for it are having to shoulder, often at the cost of great hardship.

3.0.2 Liberal Democrats are clear that both companies and the people who run them are part of our society. Their success depends on society - for example through access to well-educated staff, and a secure environment - and they must play their part in that society. The vast majority of British businesses and business owners respect and embrace this. They play a vital role in promoting prosperity, and Britain must certainly remain a good place to do business, where success is rewarded. But this cannot justify making no or almost no financial contribution when so many others with so much less are contributing so much.

3.1 General Anti-Abuse Rule

3.1.1 Relatively few examples of paying very little tax were the result of illegal activity, or tax evasion. Most were permitted by the rules in place at the time. Although we believe that Government must change those rules to make unfair tax avoidance more difficult, and we have acted to do so, this kind of response will always be playing catch-up with tax avoiders. Liberal Democrats have therefore argued since before the financial crisis that a more comprehensive approach to prevent tax avoidance was necessary.

3.1.2 In Coalition Government we have made a significant stride towards this; eliminating the most egregious cases of tax avoidance through the introduction of the UK's first General Anti-Abuse Rule (GAAR). The GAAR gives HMRC the ability to strike down highly artificial schemes and arrangements, and, just as importantly, will act as a significant deterrent to the small minority of taxpayers who would consider using such schemes.

3.1.3 We firmly believe that this is the logical first step towards introducing, in due course, a stronger General Anti-*Avoidance* Rule, which we have advocated for previously and continue to support. This would further strengthen HMRC's powers to challenge tax avoidance, denying the tax advantage of any measure taken by a company or individual where the principal aim was to avoid tax in ways not intended by parliament.

3.1.4 People are entitled to go about their business however without a fear that they may have inadvertently taken an action which may fall foul of the GAAR. We will therefore also introduce a straightforward pre-clearance system, along the lines already in place in other countries (for example Canada), to allow taxpayers to seek clearance from HMRC in advance of undertaking any transaction. In practice, the impact of the General Anti-Avoidance Rule will fall on an extremely small number of people who are deliberately focussed on identifying and exploiting loopholes in the tax code.

3.2 Non-dom Tax Status

3.2.1 The non-domicile (non-dom) tax status is contentious, and frequently misunderstood. As explained by HMRC:

“Domicile is not the same as nationality or residence... Questions of domicile can be complex but broadly speaking you have your domicile in the country that is your 'real' or permanent home which, if you have left, you intend to return to. You cannot be without a domicile, and you can only have one domicile at a time.”

3.2.2 Non-dom taxpayers (UK residents who are 'domiciled' elsewhere) are permitted to elect to be taxed on the 'remittance' basis, which broadly excludes from UK tax any non-UK income and capital gains that they do not bring (or 'remit') to the UK. Once they have been resident in the UK for 7 of the preceding 9 years, they are required to pay a 'Remittance Basis Charge' of £30,000 per year if they wish to retain this beneficial status. Once UK resident in at least 12 of the previous 14 tax years, this charge increases to £50,000 per year.

3.2.3 The advantage of the non-dom tax status is that it helps attract highly skilled workers to come and work in the UK, and we recognise the positive contribution these employees make to the economy; HMRC estimates that in 2010/11, 116,000 non-doms contributed £8.2bn in income tax, CGT and NICs.⁸ A balance needs to be struck between retaining the UK's attractiveness as a place to live and work, and ensuring that everyone pays their fair share of tax. However we believe the length of time that non-doms can be resident in the UK and opt to be taxed on the remittance basis without any charge (up to 7 consecutive years) is currently excessively generous.

3.2.4 We therefore propose that the Remittance Basis Charge should become payable once a non-dom has been resident in the UK for tax purposes for 4 of the preceding 6 years, and that the charge should be increased to £50,000 per year. We also propose that the higher remittance basis charge should become payable once a non-dom has been resident in the UK for at least 8 of the preceding 10 years, and should be increased to £75,000 per year.

3.2.5 We would also align the domicile definition for income tax with that for inheritance tax so that anyone resident in the UK for 17 out of the past 20 years would become deemed domiciled for income tax purposes (as well as Inheritance Tax) and unable to claim the remittance basis.

3.2.6 It is also currently the case that non-dom tax status can effectively become hereditary, with children who have been born in the UK and grown up here benefitting from the status of wealthy parents with origins abroad. We would end the ability for people in that category to possess non-dom tax status.

⁷ HMRC, *Meaning of 'domicile'*; <http://www.hmrc.gov.uk/international/domicile.htm>

⁸ HMRC, *FOI response 10-11*, 22 Feb 2013; <http://nondom.com/wp-content/uploads/2013/02/FOI-response-10-11.pdf>

3.2.7 This adjusted regime would represent a better balance between retaining the UK tax revenues and economic growth generated by non-domiciled individuals, and ensuring they make a fair contribution in return for the advantages that living in the UK offers.

3.3 Investment in HMRC

3.3.1 HMRC don't only need the legislative tools to fight tax evasion and avoidance however, they also need sufficient financial resources and appropriately qualified staff. After all, for 2010-11, HMRC estimate that the 'tax gap' in the UK (the difference between the tax actually collected and that which HMRC estimate should be collected) was as much as £32bn⁹.

3.3.2 In government, Liberal Democrats have driven a rebalancing of HMRC's budget, to focus greater resources on tackling tax evasion and avoidance. A £900m investment made in this way between 2012 and 2015 is expected to result in £7bn per year in additional tax revenues by 2014-15.¹⁰ We continue to believe that smart investment in this way will continue to demonstrate a good return on investment, protect UK tax revenues, and help to close the tax gap.

3.3.3 However we also recognise that it costs money to collect the right amount of tax, at the right time, from taxpayers at the lower end of the income scale. Therefore we would also seek to ensure that sufficient funds are devoted to continuing efforts to improve the speed, quality and accessibility of the service HMRC provides to all taxpayers, particularly small businesses and individuals. We outline a range of proposals to achieve this in the 'Simplification' section of this paper.

3.4 Tackling Evasion and Avoidance Internationally

3.4.1 Tax havens (countries with low or zero tax rates) and countries with secretive banking regimes currently represent a significant threat to UK tax revenues as they present an opportunity for certain taxpayers to move or hide income, profits and wealth outside of the UK, thus avoiding or evading the tax that they would otherwise have to pay. Liberal Democrats recognise that this is a cross-border problem, not unique to the UK, which must be addressed through international co-operation.

3.4.2 One of the most important tools for tackling this issue is the exchange of information between countries and their respective tax authorities, and we welcome the significant progress made by the Coalition Government in this area during the current Parliament, notably in reaching disclosure agreements with numerous territories, including Switzerland, the Isle of Man, Jersey, Guernsey, the British Virgin Islands and the Cayman Islands, agreements which are expected to secure more than £9bn of UK tax receipts by 2018.¹¹

3.4.3 The Coalition Government has also played a leading role in pushing for an increased focus on tackling tax evasion and avoidance within Europe, and we welcome the emphasis that the G8 has given to tackling tax evasion and tax avoidance in 2013 under

⁹ HMRC, *Measuring tax gaps 2012*, Oct 2012, www.hmrc.gov.uk/statistics/tax-gaps/mtg-2012.pdf

¹⁰ HMRC, *HMRC Business Plan 2012-15*, p9, Apr 2012, www.hmrc.gov.uk/about/business-plan-2012.pdf

¹¹ HMRC, *HMRC Offshore Evasion Strategy*, Mar 2013, <http://www.hmrc.gov.uk/budget2013/offshore-strategy.pdf>

the UK's presidency. Liberal Democrats strongly support the UK government's commitment, in conjunction with France, Germany, Italy and Spain, to develop a 'multilateral tax information exchange agreement', and we support the implementation and expansion of such an agreement within the EU and beyond at the earliest opportunity.

3.4.4 Tackling tax avoidance and evasion is also an issue that Liberal Democrats continue to work closely on with other ALDE colleagues in the European Parliament, where we aim to halve the EU tax gap by 2020, and create a public European blacklist of tax havens by the end of 2014.

3.4.5 Liberal Democrats would also continue to work closely with other governments and the OECD to reform international tax rules, in order to increase the consistency of tax treatment and reduce the ability of large businesses to avoid tax by shifting income and profits between countries. On this matter we welcome the OECD's on-going 'Base Erosion and Profit Shifting' project, which represents an important step in the right direction.

3.5 Naming and Shaming Offenders

3.5.1 A further power possessed by HMRC, used for the first time during this Parliament, and one which we support, is a 'name and shame' approach, publishing the names of people and companies penalised for deliberate default on taxes of £25,000 or more.

3.5.2 We believe this measure can be an effective deterrent to potential tax evaders, and we would seek to lower the threshold above which offender's names can be published to £5,000 in order to increase its applicability and impact.

3.5.3 We also welcome the new powers granted for the first time under the Coalition Government, allowing HMRC to both fine and name and shame tax agents found to have acted dishonestly. This new measure, applicable from 1 April 2013, will encourage disclosure, and act as a powerful deterrent to the small minority of tax advisors who are prepared to act dishonestly.

3.6 Tax Treatment of Interest Expenses

3.6.1 One of the major contributors to the financial crisis was an excessive reliance on debt, both at a corporate and a personal level. In the years running up to 2008, Liberal Democrats consistently warned Parliament about the dangers of this. One of the reasons for this persistent reliance on debt from a corporate perspective was (and still is) the tax treatment: as the IMF have noted, the deductibility of interest on debt for corporate tax purposes creates a preference for debt over equity finance.¹² While clearly borrowing is a major component of normal economic development, over-generous rules on treatment of interest distorted financing of companies to the point where some large companies were almost entirely funded by debt, and in recent years these rules have been a contributing factor to some high profile examples of very large and profitable companies paying very little or no tax. This was widely, and rightly, perceived as unfair.

3.6.2 By international comparison, the UK's current regime is significantly more generous than most in the level of interest payments which it allows companies to offset against taxable profits, and in some cases this enables companies to all but wipe out their corporate tax liabilities through debt – particularly so in the case of corporate takeovers. We have seen this fact exploited a number of times in recent years with overseas-funded takeovers of high-profile British businesses (including manufacturers, private utility companies and football clubs), often to the detriment of both consumers and the UK Treasury.

3.6.3 Liberal Democrats would therefore introduce rules in the next Parliament which would prevent earnings stripping through payments of excessive interest on related party debt. Our proposals would limit net deductible interest (over a *de minimis* threshold) to a percentage of a company's adjusted taxable profits before interest. This would both reduce the incentive for large businesses to take on unsustainable levels of debt, which should help avoid another financial crisis, and greatly reduce the opportunity for tax avoidance on large cross-border corporate transactions.

3.6.4 Through setting an appropriate *de minimis* level - permitting full deductibility of net interest expenses up to, say, £1m (subject to existing rules) - we would ensure that the vast majority of UK businesses in the UK would be unaffected, and provide greater certainty over the tax treatment of corporate interest for all. Overall, this measure will be a significant simplification of the UK's overly complex and largely ineffectual 'worldwide debt cap' rules, and will also make a clear statement about the expectation that multinational companies contribute appropriately to the society of which they are a part, and from which they draw their profits.

¹² IMF, *A Fair and Substantial Contribution by the Financial Sector*, p63, Jun 2010, www.imf.org/external/np/q20/pdf/062710b.pdf

3.7 Tackling Multinational Tax Avoidance in the Developing World

3.7.1 The involvement of large multinational companies in developing countries continues to grow. This involvement can be very powerful in helping to promote development, linking developing countries to the world economy, developing local capability and skills, and contributing to local tax revenues. However in some circumstances global companies are able to take advantage of arrangements which allow them to pay extremely low or no tax in some of the developing countries in which they work. This is fundamentally wrong, as well as distortive of the global economy.

3.7.2 Liberal Democrats believe that the UK must continue to take a lead in global action to tackle this kind of abuse of tax rules. As a first step, we would require tax authorities to automatically share information relating to UK citizens and corporations. We would also continue to provide support to tax assessment and collection authorities in developing countries to further develop their own expertise, and would assess all new primary and secondary UK tax legislation against its likely impact on poverty reduction and revenue-raising in developing countries.

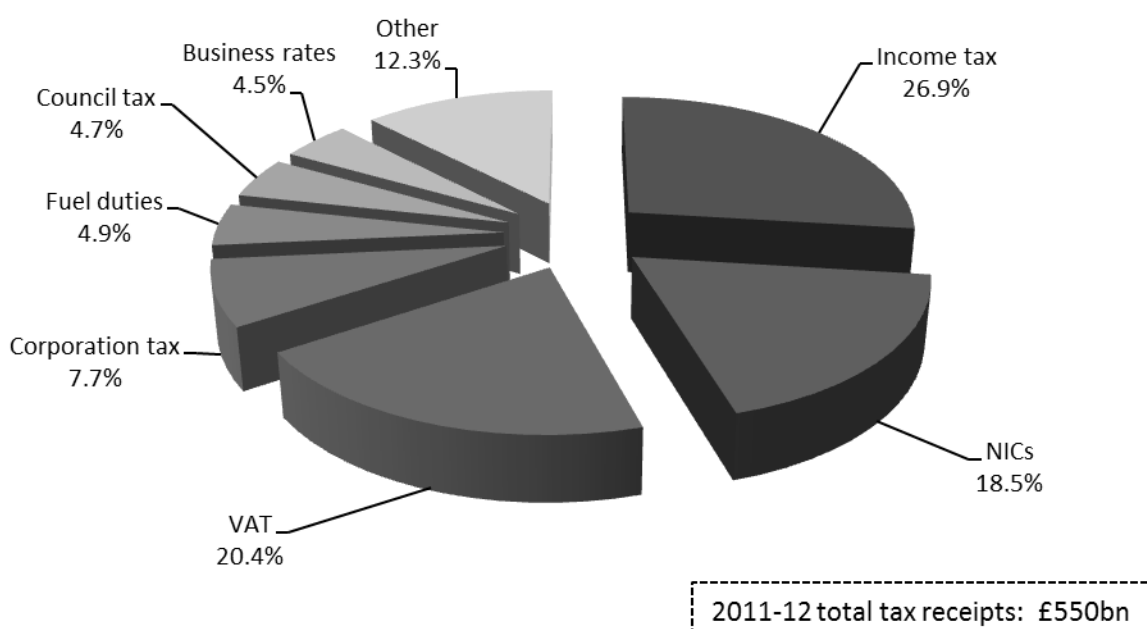
3.7.3 Greater transparency is helpful in ensuring large companies pay their fair share of tax in developing countries, and therefore we would continue to work to achieve international agreement, at European level and beyond, to require multinational corporations to report their tax payments on a country-by-country basis.

3.7.4 Liberal Democrats would also require multinationals operating in the UK to disclose further details of their intra-group transactions on their Company Tax Returns, in order to make it easier for HMRC to identify any cases where these arrangements might be used to shift taxable profit out of the UK. Finally, we will also review how best to achieve greater transparency of the details of out-of-court tax settlements agreed between HMRC and corporations.

Wealth, Property and Land Taxation

4.0.1 The existing UK tax system currently places the burden of tax squarely on direct taxes (e.g. taxes on income and profits), with income tax, NICs and corporation tax between them accounting for around 53% of the UK's total tax revenues (as shown in Figure 1). Taxes on wealth on the other hand account for less than 7% of tax revenues. Excessive taxes on income risk disincentivising economic activity, and at a time when it is more important than ever that we seek to create jobs and encourage economic growth, that is a risk we should minimise. We therefore support shifting away from taxing income in favour of taxing un-earned income (such as inheritance) and wealth held speculatively (such as unused land) instead.

Figure 1: Breakdown of total UK tax receipts, 2011-12¹³

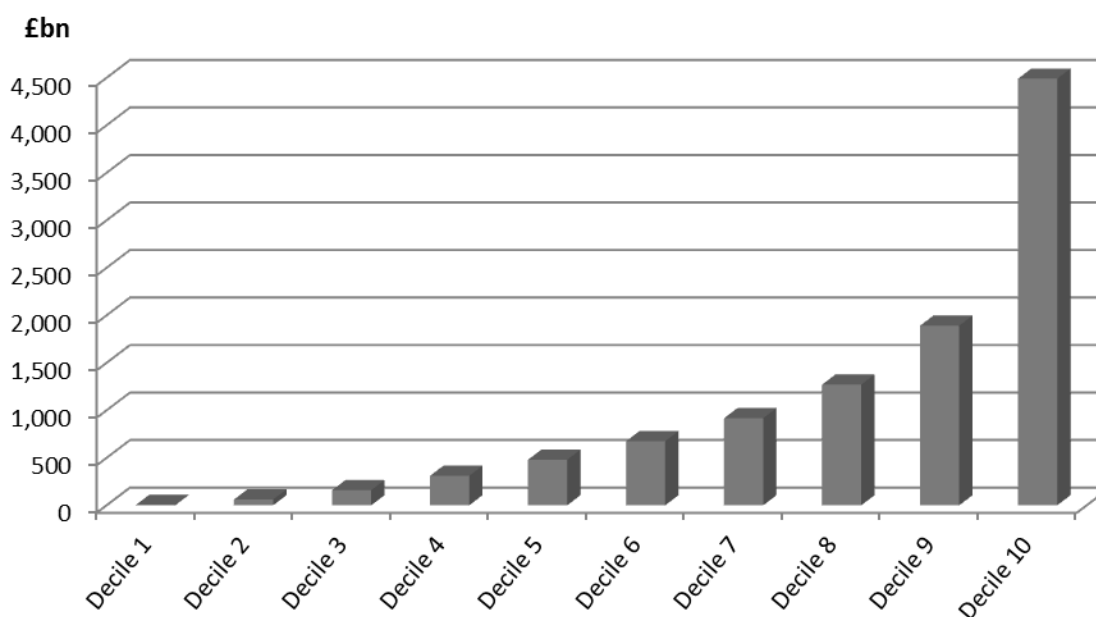


¹³ OBS, *Economic and fiscal outlook charts and tables*, Table 4.7, Mar 2013, <http://budgetresponsibility.independent.gov.uk/pubs/Copy-of-March-2013-EFO-charts-and-tables.xls>

4.1 Mansion Tax

4.1.1 Figure 2 shows just how stark wealth inequality in the UK has become; the wealthiest tenth of the country own 44% of the UK's total wealth, which includes 35% of the country's property wealth. And no single aspect of the UK's wealth inequality has come to represent the issue more than residential property, which constitutes a third of UK net wealth overall.

Figure 2: Aggregated Household Wealth per Decile, Great Britain, 2008-10¹⁴



4.1.2 Liberal Democrats therefore continue to propose the introduction of a Mansion Tax of 1% on the excess value of residential properties above £2m, which represents the top quarter of 1 per cent of the country's homes. This tax would result in the owner of a residential property worth £2.1m paying £1,000 per year, and the owner of a property worth £3m paying £10,000 per year. We believe it is right to ask this wealthiest fraction of our society to contribute more in this way.

¹⁴ ONS, *Wealth in Great Britain Wave 2 - Wealth of the Wealthiest 2008-10*, Dec 12, http://www.ons.gov.uk/ons/dcp171776_289407.pdf

4.2 Land Taxation

4.2.1 The value of real estate derives principally from the land on which the property is built, and the value of the land depends on two things; its location, and the use to which planning laws permit it to be put. That value broadly correlates to the benefits which the owner of that land is able to enjoy, such as access to public infrastructure and/or rental income.

4.2.2 Land is in fixed supply, and its value is independent from its owner's use of it. It therefore provides a unique opportunity to form a basis for economically efficient taxation which does not distort behaviour (such as moving income or wealth offshore). Indeed properly applied, land value taxation (LVT) would encourage desirable behaviour and promote the conservation and efficient use of finite resources. Specifically we believe it would have the following benefits:

- Reducing tax avoidance, as it is based on an unchangeable physical location.
- Dampening speculation in the property market, if introduced at a national level.
- Helping restore a regional balance to the UK economy, as LVT levied by central government would be less of a burden to low-value areas away from London.
- Incentivising development of under-used sites where it is needed and approved, stimulating the construction industry, and especially the housing market, and hence promoting economic recovery.

4.2.3 For all these reasons, Liberal Democrats remain committed to introducing LVT, which we anticipate would replace business rates and property taxes, and enable other taxes to be reduced or abolished. LVT would require a significant level of change to the tax system, and therefore Liberal Democrats would launch a full-scale review early in the next parliament to look at how it might best be implemented. An initial step may be to trial LVT based on the land value of commercial or residential properties (we continue to believe there is a clear case for reforming business rates so that the charge is based on land value, not property value, and borne by the land owners, not the tenants).

4.2.4 However implemented, it would be important to ensure LVT is applied fairly. Therefore we anticipate that any implementation would include some or all of the following measures:

- Exemptions or deferrals for the limited number of 'asset-rich, income-poor' individuals (e.g. pensioners on low incomes).
- Exemptions for low value residential and business properties, (e.g. through a tax-free allowance).
- Using income tax / corporation tax systems to collect LVT, thus avoiding separate billing.

4.3 Capital Gains Tax Reform

4.3.1 Capital Gains Tax (CGT) only accounts for around 1% (£4.3bn in 2011-12) of UK tax revenues, but nonetheless it is an important part of the existing tax system, as often the wealth of the most well-off individuals is held in the form of capital assets, such as properties and shareholdings, assets which do not necessarily fall within the remit of income taxes. Therefore it is important to ensure that income from these types of asset is taxed appropriately.

4.3.2 Prior to April 1998, capital gains were effectively treated as the top slice of income, and tax was applied at the taxpayer's marginal income tax rate. Investors in capital assets were also protected from having to pay tax on purely inflationary gains through the grant of an indexation allowance. To this day, this is still how the capital gains regime applies to companies.

4.3.3 The current CGT regime for individuals was introduced by Labour from April 2008 as a flat rate of 18%, applied to all gains over and above the annual exemption, regardless of the size of the gain or the wealth or income of the taxpayer. The 18% rate was significantly lower than the marginal income tax rate (between 40% and 50%) of higher and additional rate taxpayers, who CGT tends to be applicable to. This not only made the tax system more regressive, but also created an incentive for some high earners to seek to shift income into capital in order to lower their tax rate.

4.3.4 In Coalition Government, Liberal Democrats acted quickly to make the regime progressive by introducing a higher rate of 28% for gains made by higher and additional rate taxpayers (retaining the 18% rate for basic rate taxpayers), and thus limiting the incentive for wealthy individuals to avoid tax by converting income into capital. The higher 28% rate is still lower than the marginal income tax rate of the taxpayers to which it applies (40% or 45%) however, so the existing regime can still be both overly generous to wealthy higher rate taxpayers generating short term gains, and overly punitive on less well-off taxpayers realising long term gains that may simply be due to inflation of asset prices, rather than a result of any 'real' gain.

4.3.5 We therefore propose to return to a regime where capital gains are taxed at the taxpayer's marginal income tax rate, and to restore the indexation allowance for individuals, linked to inflation. This is, in plain language, fairer. It would align the CGT regime with the income tax regime, restore progressivity to the tax system, and remove the incentive for wealthy individuals to shift income into capital.

4.4 CGT Annual Exemption

4.4.1 Currently each individual gets a generous annual tax-free capital gains allowance (£10,900 for 2014-15) in addition to the income tax personal allowance (£10,000 for 2014-15). This allows some wealthy taxpayers to effectively double their tax free allowance by realising some of their income in capital form (e.g. through the sale of shares); an option clearly not available to the vast majority of taxpayers.

4.4.2 We propose to address this by reducing the CGT 'annual exempt amount' (the capital gains equivalent of the income tax personal allowance) from £10,900 to £2,000, thereby all but eliminating the scope for personal tax avoidance through converting

income into capital. We would also enable any individual to use their annual income tax personal allowance against capital gains if they so wish (which in 2014-15 would allow them CGT-free gains of up to £12,000, for example). Together these measures will ensure that modest capital gains for ordinary tax payers are still not subject to tax.

4.5 Focussing Entrepreneurs' Relief

4.5.1 Entrepreneurs' Relief is a measure which, along with other measures (such as the Enterprise Investment Scheme), the government uses to incentivise entrepreneurs and business angels to invest in businesses. Both of these groups have a vital role to play in funding the small and medium-sized companies which play an important part in growing and developing our economy.

4.5.2 Currently Entrepreneurs' Relief allows shareholders owning 5% or more of a company to pay CGT at a reduced rate of 10% on lifetime capital gains of up to £10m, which equates to potential tax savings of up to £1.8m per person. Therefore as it stands a significant portion of the benefit goes to wealthy individuals who own a relatively small portion of the businesses concerned, often for a relatively short period of time.

4.5.3 We wish to focus Entrepreneurs' Relief to better serve the purpose for which it is intended; incentivising entrepreneurs and start-up business owners, and prevent it from simply being used as a way for wealthy investors to reduce their tax bills. We would therefore increase the shareholding requirement to 25%. We would also seek to target future relief on investments made in 'green' businesses and on enterprises investing in new and environmentally friendly technologies.

4.6 Inheritance Tax

4.6.1 Inheritance tax (IHT) only makes up around half a per cent of total tax receipts, partly because as currently structured, it is easy for very wealthy taxpayers to avoid. This is simply not acceptable to Liberal Democrats. As outlined earlier in the paper, we wish to shift the burden of taxation away from earned income, and raise a greater proportion of tax revenues from wealth. Therefore inheritance tax must be reformed.

3.6.2 As a first step, Liberal Democrats would extend the current seven year look-back period for IHT to fifteen years. In other words, only gifts made at least fifteen years before the death of the donor would be completely IHT free. This measure would significantly reduce the scope that currently exists for avoiding inheritance tax, without penalising ordinary taxpayers.

4.6.3 We also propose to end the injustice of the current system where beneficiaries can end up being liable for paying IHT before they have received the inheritance which will be due to them. Eliminating this anomaly will prevent the current situation in which receiving a large legacy can sometimes unfairly cause severe short-term hardship.

4.6.4 Liberal Democrats believe that ultimately inheritance tax would be better replaced by an accessions/capital receipts tax, where tax would be paid by the recipient(s) of bequests (those over and above a tax-free lifetime allowance), based on their income and circumstances, instead of the current system where it is paid by the deceased's estate

based on the value of the total estate. A number of other countries, including Ireland, already use such a system.

4.6.5 A move to an accessions tax would have a number of clear advantages; it would encourage testators to spread bequests over a larger number of beneficiaries, it would be harder for wealthy estates to simply avoid (except through the welcome spreading of bequests), and it would reduce the current disparity between the treatment of inheritance and earned income. We would therefore seek to launch a consultation in the next Parliament in order to explore the viability of moving to an accessions tax.

Business Taxation

5.0.1 UK businesses are a crucial driver of economic growth and improved living standards. In Coalition Government, we have introduced significant reforms to the UK tax system to make life easier for businesses operating in the UK, and improve the UK's competitiveness on the global economic stage. Some of the ways we have done this include:

- Lowering the corporation tax rate to 20% (from 28% under Labour), to help businesses invest in jobs and growth.
- Creating an Employment Allowance for the first £2,000 of a business's NICs bill, helping businesses with the cost of employing staff – equivalent to the NIC cost of employing four employees on the minimum wage.
- Introducing a range of simplification measures to help small and medium-sized businesses (as outlined in the 'Simplification' section of this paper).
- Reforming research and development tax credits to better incentivise and reward businesses carrying out market-leading research and development in the UK.

5.0.2 Creating and maintaining a stable economic environment is a key way in which government can help businesses make long term investment decisions. This principle has been at the heart of the policy which Liberal Democrats have successfully pursued in government, and this approach has been widely recognised and welcomed by businesses - in stark contrast to previous concerns about economic instability resulting from Britain's first peacetime coalition government. And at 20%, the UK now has the most competitive headline corporation tax rate amongst the G8 economies, which will help continue to encourage investment and growth in the UK, and develop a broad tax base in the process. We therefore believe the rate should not fall any further; in the global economy tax rates must not become a race to the bottom among nations.

5.0.3 Liberal Democrats are highly concerned however about the continuing propensity of some large multinational corporations to seek to avoid paying their fair share of UK taxes. We have set out a number of proposals to address this in the 'Tax Evasion and Avoidance' Chapter of this paper.

5.1 Measures to Help Small Businesses

5.1.1 Small and medium sized enterprises (SMEs) are crucial parts of the economy, and often also play key roles in their local communities. Liberal Democrats are determined to support and encourage more small businesses. The Employment Allowance is a measure introduced from April 2014 by the Coalition Government to provide tax relief to UK companies for the first £2,000 of their employer NICs liability. We welcome this measure which will help small businesses with the costs of employment and boost jobs, and in the next Parliament would look at ways to extend this measure to further assist small businesses taking on new employees.

5.1.2 We will also explore whether there is merit in allowing small start-up businesses to 'sell' losses made in the early years of trading to HMRC, in return for forgiveness or refund of an appropriate portion of their other tax liabilities (e.g. employer NICs and PAYE). Such a measure would need to be carefully designed to prevent abuse, but could provide valuable support to many start-up businesses, where cash flow difficulties are so often the reason for failure. Should a business take advantage of the measure and subsequently become successful and make profits, it would then pay corporation tax much sooner than it otherwise would have done, as the losses will have been extinguished.

5.1.3 We also propose to make dealing with tax administration and HMRC easier for small businesses, and set out a range of measures to achieve this in the 'Simplification' section of this paper.

5.2 'Shares-for-Rights'

5.2.1 Liberal Democrats are strong supporters of employee-ownership business models, which can help make businesses more entrepreneurial, sustainable, and successful, and which give employees a direct stake in the success of the business. In government we have sought to encourage such business models, both through our expansion of tax incentives such as Enterprise Management Incentives, and by simplifying the tax treatment of share schemes and cutting the red tape for businesses operating them.

5.2.2 Liberal Democrats however would repeal the so-called 'shares-for-rights' measures contained in the Growth and Infrastructure Act 2013, which will permit employers to offer CGT-exempt shares in the business to employees in return for employees giving up employment rights on unfair dismissal, redundancy pay, and flexible working. These measures risk fundamentally undermining the employee-employer relationship, giving far too much negotiating power to employers who may exclude employees not willing to participate in such a scheme. In any event, most businesses have shown little enthusiasm for the measures, which in reality are only likely to be used to facilitate tax avoidance, which it has been estimated could cost the Treasury up to £1bn in lost receipts.¹⁵

¹⁵ HMT, *Autumn Statement 2012 policy costings*, p52, Dec 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/185454/as2012_policy_costings.pdf.pdf

5.3 Beer and Cider Duties

5.3.1 Liberal Democrats welcome the Coalition Government's move in Budget 2013 to cut beer duty and abolish Labour's aggressive beer duty escalator, a move which we believe will make life that little bit easier for local pubs and the communities they support.

5.3.2 We also wish to improve the way that cider is taxed, and therefore we propose to re-design cider duty to apply differentiated rates based on fruit content, lowering the duty applied to high fruit content ciders, and increasing the rate applied to ciders with a low fruit and/or high concentrate content. This measure would support the small British businesses manufacturing high-quality ciders, and shift the burden of the duty onto the mass production of lower-quality, high strength ciders.

Simplification

6.0.1 The UK's tax system is unusually and unnecessarily complex. The length of existing legislation is an oft-cited measure of this, although that is perhaps a somewhat misleading measure to use, as the Office for Tax Simplification (OTS) has noted, concluding:

"In summary, length is not the key factor with legislation; practitioners welcome concise legislation, but not at the cost of legislation that is clear, can be understood and applied and achieves its objective."¹⁶

6.0.2 The fact is however that there are at least 30 different taxes and duties currently in operation as part of the UK tax regime, many of which contain significant levels of complexity, including different subcategories, varying rates, and no less than 1,042 specific reliefs and exemptions.¹⁷

6.0.3 A desire to simplify the tax system has been a core theme of our last two tax policy papers. The reason for this is that complexity often exacerbates economic inequality; the greater the level of complexity the more likely that there will be loopholes and inconsistencies. And it is the wealthiest taxpayers (individual and corporate) who have both the most to gain from exploiting them, and the resources to pay tax advisers and lawyers to help them do so. A simplified tax system is a truly liberal aim; empowering taxpayers from all areas of society by enabling them to manage their tax affairs with a minimum of fuss and worry.

6.0.4 In government Liberal Democrats have pursued this aim, and have already made significant strides along the road to simplification. We have:

- Raised the income tax personal allowance to £10,000, taking 2.7m people out of contact with the income tax system altogether.
- Set up the Office for Tax Simplification to focus specifically on ways in which the UK tax system can be simplified.
- Overseen a major expansion of online filing – a record 83% (8m) of people submitting self-assessment tax returns before the 31 January 2013 deadline filed online¹⁸, and effectively all corporate taxpayers now file online.
- Abolished stamp duty on AIM-listed shares.
- Abolished stamp duty reserve tax entirely.

¹⁶ Office for Tax Simplification, *Length of tax legislation as a measure of complexity*, Apr 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193496/ots_length_legislation_paper.pdf

¹⁷ Office for Tax Simplification, *Review of tax reliefs*, Mar 2011, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198570/ots_review_tax_reliefs_final_report.pdf

¹⁸ HMRC press release, *Record 9.61 million on-time tax returns*, 1 Feb 2013, <http://hmrc.presscentre.com/Press-Releases/Record-9-61-million-on-time-tax-returns-686f9.aspx>

- Simplified the tax treatment of many employee share schemes.
- Made disincorporation easier for small businesses.
- Enabled small unincorporated businesses to pay tax on a cash-accounting basis, rather than a more specialised tax-accounting basis.
- Allowed unincorporated businesses to use flat rates to calculate certain business expenses.

6.0.5 There is still more that can be done however, and thus we propose a number of further measures. The first of these is to renew the mandate of the Office of Tax Simplification for a further Parliament, which has demonstrated significant value since its inception in July 2010, and has played an integral part in many of the simplification measures outlined above.

6.1 Simplifying Tax Returns

6.1.1 We propose to work closely with the OTS to simplify tax returns for the majority of the 10m self-assessing taxpayers who must submit tax returns. In particular we would seek to pre-populate online returns with information already known to HMRC – for example information that HMRC will already have collected through PAYE under the new ‘Real Time Information’ (RTI) scheme - a measure introduced by HMRC in this Parliament to improve the accuracy and timeliness of PAYE information. Many taxpayers would then just need to confirm, correct, and add to this information as appropriate, and the return would be shorter, easier to understand and quicker to complete.

6.1.2 These simplified tax returns would also provide information on where tax receipts are spent by government, which would be a logical and straightforward step given that the Coalition has already committed (in Budget 2012) to creating a Personal Tax Statement for around 20m taxpayers from 2014-15.

6.2 Greater Flexibility for Small Businesses

6.2.1 The Liberal Democrats would greatly simplify the current administrative burden on small businesses in a number of ways. We would:

- Require HMRC to provide a single tax receipt account for small businesses to pay PAYE, VAT and Corporation Tax into.
- Provide a secure, integrated and accessible HMRC website, which small businesses can log into to obtain a single statement of account with HMRC, showing which returns have been filed or are outstanding, and which liabilities have been paid or are outstanding.
- Require HMRC to offer email correspondence as an option to all businesses, as reliable, modern, flexible hours alternatives to phone, fax and letters.

- Trial longer and weekend opening hours for being able to contact HMRC by phone.
- Consult on extending the right to pay tax on a cash-accounting basis (which we have introduced in Coalition Government for unincorporated businesses) to small incorporated businesses.
- Work with software suppliers to develop secure integrated online accounting systems to give a 'one-stop shop' service for small businesses' accounting needs.

6.3 Sunset Clauses

6.3.1 Liberal Democrats recognise that targeted tax reliefs and other fiscal measures can be a highly effective tool to assist those who need it most financially, eliminate inequality or inconsistencies, and encourage desirable economic behaviour.

6.3.2 However many targeted measures eventually (and sometimes quickly) become obsolete, cluttering up the legislation, or worse, facilitating tax avoidance. Therefore we propose to introduce 'sunset clauses' – essentially expiry dates – for all future targeted reliefs, and also to implement post legislative review processes for all major new tax legislation, to ensure it is meeting its intended purpose. This would ensure that reliefs and other measures which have served their useful purpose could be allowed to expire. Those which continue to be relevant and desirable could simply be extended through future legislation. This shift would ensure that targeted reliefs are kept under review and do not become outdated, irrelevant or subject to abuse.

6.4 General Anti-Avoidance Rule

6.4.1 As set out in the 'Tax Evasion and Avoidance' section above, we would introduce a strengthened General Anti-Avoidance Rule, alongside a pre-clearance system. In time this should allow the repeal of a number of the existing specific anti-avoidance measures, significantly simplifying the overall tax code. And our pre-clearance system will allow taxpayers to reach certainty over their tax affairs quickly and efficiently in any situation where they are unsure whether the General Anti-Avoidance Rule applies.

Environmental Taxes

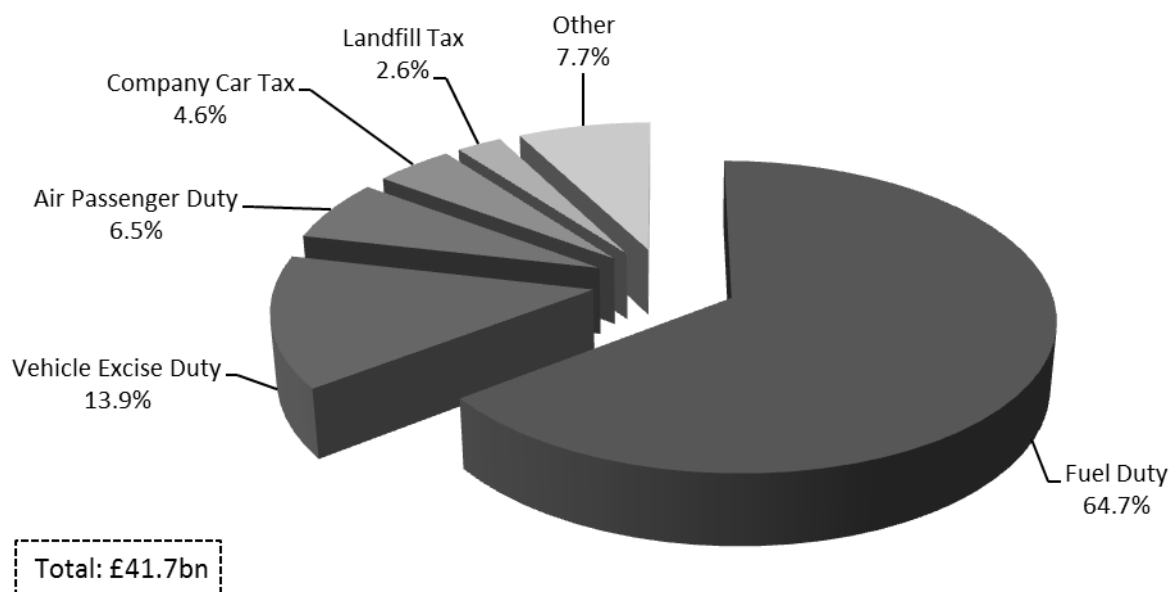
7.0.1 Liberal Democrats are clear about our commitment to protect our environment for future generations. Tax policy has a critical role to play in doing this, by incentivising environmentally beneficial behaviour, and discouraging environmentally damaging behaviour.

7.0.2 Tax policy must be used in the right way however; we recognise that simply applying heavy-handed and arbitrary taxes to particular activities risks hitting the people who can least afford it the hardest. Fuel duty for example, which alone accounts for 65% of revenue from environmental taxes, disproportionately impacts poorer households as a percentage of household income. That's why Liberal Democrats in government have acted to freeze fuel duty for three years, cancelling Labour's proposed rises of 13p per litre to ease the pressure on household budgets.

7.0.3 The UK Treasury's definition of which taxes are classed as 'Environmental Taxes', currently excludes taxes such as Vehicle Excise Duty, Fuel Duty and Air Passenger Duty which as shown in Figure 3, represent around 85% of the relevant revenues. Liberal Democrats therefore propose to adopt the definition used by the Office for National Statistics, which includes these taxes, in order to ensure that their impact on the environment and consumer behaviour continues to be given appropriate consideration.

7.0.4 Broadly we believe that environmental taxes are most effective when applied not as revenue raising taxes, but as redistributive mechanisms, reducing inequality and contributing to a fairer society while influencing behaviour in an environmentally beneficial way. We believe this is particularly true when power is given to local authorities to offer environmental incentives to their local communities, such as in the ways outlined in policy paper 109, *Green Growth and Green Jobs*.

7.0.5 Revenue from environmental taxes and taxes with environmental benefits totalled £41.7bn in the UK for 2011-12, equating to around 7% of total tax receipts. This includes a plethora of different taxes, levies and other charges, including four separate taxes on carbon emissions in varying forms.

Figure 3: Make-up of UK environmental (and related) tax revenue, 2011-12¹⁹

7.1 EU Emissions Trading System

7.1.1 The EU Emissions Trading System (ETS), set up in 2005, is designed as a 'cap and trade' system aimed at incentivising the reduction of CO₂ (colloquially 'carbon') emissions. A total cap is set on permitted emissions, and scheme participants must then purchase sufficient allowances to cover their individual emissions.

7.1.2 The ETS is intended to be the central part of the EU's climate change policy, aiming to 'promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner'.²⁰ However as it stands it is not effective. Allowances have been made far too plentiful, leading to an emissions price of no more than a handful of euros per tonne (hitting a record low of €3 per tonne in January 2013). As a result the scheme has not been effective at influencing the behaviour of large greenhouse gas emitters.

7.1.3 The failings of the ETS to date have led the Coalition Government to introduce the Carbon Price Floor (CPF) in the UK, which from April 2013 'tops up' the EU ETS price to an economically meaningful level (£16 per tonne for 2013-14). This measure is accompanied by a £250m package to assist energy intensive industries that would otherwise be adversely affected. Liberal Democrats support the CPF in the short term as a stop-gap measure to address some of the EU ETS's failings, however in the long term the solution should be to resolve, in conjunction with the rest of the EU, the existing shortcomings of the ETS. Liberal Democrats will therefore continue to campaign strongly for multilateral action within (and beyond) the EU to reform the EU ETS, as detailed in policy paper 109, *Green Growth and Green Jobs*.

¹⁹ Treasury Written Ministerial Statement, *Environmental Taxes*, 16 Jul 2012, <http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm120716/wmstext/120716m0001.htm>

²⁰ Article 1 of the EU ETS Directive 2003/87/EC, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625:EN:HTML>

7.2 Aviation and Shipping

7.2.1 In 2011, UK-originated aviation and shipping is estimated to have accounted for approximately 8% (43m tonnes of CO₂) of the UK's net greenhouse gas emissions²¹, yet these emissions are not currently included in the targets set by the Climate Change Act 2008. This is highly unsatisfactory, and Liberal Democrats would endorse the Committee on Climate Change's recommendation that emissions from both aviation and shipping should be included in the national emissions targets, in order to ensure emissions from these sectors are not simply overlooked by future governments.

7.2.2 The only existing tax on aviation is Air Passenger Duty (APD), a per passenger tax which raises around £3bn a year, but provides no environmental incentives. We continue to support the view that a per-plane duty, charged on each plane journey, would be a more efficient way to tax air travel than APD, as it would immediately create an incentive for airlines to use planes at higher occupancy levels, thus reducing the overall 'per passenger km' impact of aviation on the environment. Under international law there are currently significant barriers to implementing such a change, but we would continue to work with other governments and the airline industry to attempt to bring about what we believe is much-needed reform in this area.

7.3 Vehicle Excise Duty

7.3.1 Vehicle excise duty (VED) currently accounts for around £5.8bn (1%) of total tax revenues. It is a tax which has environmental benefits as the annual charge is higher for cars with higher emissions. With annual charges currently ranging from nil for the most efficient cars up to £490 per annum for the least efficient this is a valuable additional behavioural incentive for new car buyers on top of the obvious fuel cost savings of buying a car with greater fuel efficiency.

7.3.2 The policy of graduating VED based on emissions also complements current EU targets to reduce the fleet average carbon emissions for new cars to 130g CO₂/km by 2015 and to 95g CO₂/km by 2020. In the UK we are on track to reach this target; over the last decade average emissions for new cars have fallen from 172g CO₂/km in 2003 to 133g CO₂/km by 2012.²²

7.3.3 The UK car industry is a powerful and growing force for the production of ever lower emission cars in Europe and the wider world. For example Toyota already produces hybrid engine cars in the UK and this year the Nissan Leaf produced in Sunderland became the first 100% electric car to be manufactured in Europe. As a result of these types of investments, last year the UK became a net exporter of cars for the first time in 40 years.

7.3.4 We wish to support UK car manufacturers to produce ever more efficient cars, not only to reduce UK carbon emissions but also to reduce costs for motorists and to promote UK exports. To achieve this we propose working with the industry to create VED bandings which will continue to incentivise greater emissions efficiency into the 2020s. This could

²¹ Department of Energy & Climate Change, *Annual Statement of Emissions for 2011*, Mar 2013, <https://www.gov.uk/government/publications/annual-statement-of-emissions-for-2011>

²² SMMT, *2013 New Car CO₂ Report*, Mar 2013, <http://www.smm.co.uk/2013/03/new-car-co2-report-2013/>

include a subsidy for the cleanest vehicles, paid for by VED on the highest emission vehicles. Our bandings would operate in tandem with EU targets to drive down car emissions and would provide certainty for consumers and manufacturers alike, as well as protecting revenue

7.4 VAT on Home Renovations

7.4.1 The maintenance and energy efficiency of existing housing stock must play a critical role in any plan to reduce carbon emissions; domestic fossil fuel use alone accounts for around 13% of the UK's greenhouse gas emissions.²³ Under the Climate Change Act 2008 the Government's target is to reduce the UK's carbon emissions to below 20% of 1990 levels by 2050. Liberal Democrats want to go further; as set out in policy paper 109, *Green Growth and Green Jobs*, we aim to have achieved a carbon neutral Britain by 2050.

7.4.2 In Coalition Government, Liberal Democrats have introduced the 'Green Deal' scheme, helping to incentivise and fund homeowners to carry out energy-saving improvements to their home. However currently there exists a tax anomaly in the construction industry. Although many energy-conserving items are currently subject to VAT at the reduced 5% rate, renovation work itself is standard rated (therefore subject to VAT at 20%), while the construction of new build housing is zero rated for VAT purposes. Environmentally this is unhelpful, as it disincentivises home maintenance over new build.

7.4.3 We believe there is an opportunity to correct this anomaly and simultaneously incentivise energy efficient renovations. Subject to affordability, we therefore propose to reduce the cost of repair, maintenance and improvement work on residential properties by applying the reduced 5% rate of VAT to such work rather than the full 20% rate, on the condition that a proportion of the cost is spent on improving the dwelling's Energy Performance Certificate (EPC) rating by two grades or more.

²³ DECC, *2011 UK Greenhouse Gas Emissions*, Feb 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/180823/ghg_national_statistics_release_2011_final_results.pdf

7.5 Start-up/Green ISAs

7.5.1 Liberal Democrats would introduce new tax-free investment opportunities for individuals in the form of additional ISA allowances for investments into enterprises with environmental and/or technological benefits, such as local renewable energy generation projects and technology companies carrying out research and development.

7.5.2 Funds invested into these ISAs would be available for investment in and lending to qualifying small and medium sized enterprises, allowing and incentivising savers to invest in the renewable technologies and environmental projects that will be at the heart of developing the UK's green economy. Further details on these proposals are set out in policy paper 109, *Green Growth and Green Jobs*.

7.6 Carrier Bag Levy

7.6.1 During the current Parliament, both Wales and Northern Ireland have introduced a 5p minimum levy on single-use carrier bags, and Scotland has launched a consultation exercise on bringing in a similar measure. Evidence from Wales shows that the measure has successfully reduced the number of single use bags being handed out by up to 96%.²⁴

7.6.2 We therefore propose to introduce a similar charge for England of 5p per bag, in order to encourage people to re-use bags, promote sustainability, and ultimately reduce the number of bags which end up as landfill or litter (currently 86% of single use carrier bags end-up in landfill).²⁵

²⁴ Welsh Government, *Reduction in single-use carrier bags*, Jul 2012, http://wales.gov.uk/topics/environmentcountryside/epq/waste_recycling/substance/carrierbags/reduction/?lang=en

²⁵ Welsh Government, *What happens to single-use carrier bags?* <http://www.carrierbagchargewales.gov.uk/consumers/?lang=en>

Devolution of Taxation

8.1 Tax Powers for Scotland

8.1.1 As set out in the Scottish Liberal Democrats' policy paper *Federalism: the best future for Scotland*, Liberal Democrats support the allocation to the Scottish Parliament of further tax powers, enabling it to raise the greater part of its own spending. This includes further powers over income tax bands and rates, and powers over inheritance tax and capital gains tax, which combined with the powers over income tax and stamp duty already scheduled to apply from 2015, would give the Scottish Parliament control over substantial tax levers on income and wealth. Scottish Liberal Democrats also support allocating control of air passenger duty and the aggregates levy to the Scottish Parliament in order to broaden the powers on the environment and transport that the Scottish Parliament already exercises.

8.2 Tax Powers for Wales

8.2.1 We continue to believe that the National Assembly for Wales should have some tax-varying powers in order to ensure it is able to boost economic growth and is more accountable to taxpayers. That is why the Liberal Democrats in the UK government established the Commission on Devolution in Wales (the Silk Commission). The Commission's first report recommended that a series of taxes should be placed under the control of the National Assembly rather than the UK Parliament, recommendations that Liberal Democrats believe should be implemented. Along with a presumption that any new taxes should be devolved to Wales, this would include the devolution of low-yield taxes such as:

- Business rates
- Stamp Duty Land Tax
- Landfill Tax
- Aggregates Levy
- Air Passenger Duty

8.2.2 Liberal Democrats would also implement the Silk Commission's recommendation that the UK and Welsh Governments should share the yield of income tax, and that the Welsh Government should have responsibility for setting income tax rates in Wales. As recommended by the Silk Commission, we would ensure that the issue of fair funding is resolved alongside devolving income tax.

Fairer Taxes – Policy Paper 111

This paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats, the Welsh Liberal Democrats and the Northern Ireland Local Party determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. The Party in England has chosen to pass up policy-making to the Federal level. If approved by Conference, this paper will therefore form the policy of the Federal Party on federal issues and the Party in England on English issues. In appropriate policy areas, Scottish, Welsh and Northern Ireland party policy would take precedence.

Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to implement all these proposals immediately. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.

Working Group on Taxation

Note: Membership of the Working Group should not be taken to indicate that every member necessarily agrees with every statement or every proposal in this Paper.

Jeremy Hargreaves (Chair)
Cllr Louise Bloom
Cllr Steve Bradley
Gareth Epps
Toby Fenwick
Paul Harden
David Laws MP
Tahir Maher
Dominic Mathon

Tessa Munt MP
Chris Saunders
Lord Shutt
John Simpkins
Lisa Smart
Neale Upstone
Tony Vickers
Stephen Williams MP

Staff:

Holly Hale-Sutton
Bess Mayhew

Simon Morris
Kevin Norton

Comments on the paper are welcome and should be addressed to:

Policy Unit, Liberal Democrats, 8-10 Great George Street, London, SW1P 3AE

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Liberal Democrat Image, PO BOX 443, Farnborough, Hampshire, GU14 4DA

Tel: 01252 510 005 Email: libdemimage@ldimage.demon.co.uk

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