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Revenue and reform

What tax changes could – and should – we see in Autumn Budget 2024?

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Summary

The new Government's first Budget is approaching rapidly. Already the Chancellor has said that new tax rises will be needed, while the Prime Minister has indicated that the Budget is "going to be painful". There are various reasons to expect substantial tax changes, given Labour's manifesto policies, a legacy of future tax rises bequeathed to the Chancellor from the past Conservative Government, and a likely need for more revenue if the Government wants to ease the pressures on public services or increase public investment. The Government's commitment to a single fiscal event per year, rather than leaving some decisions until March, should also increase the weight of this Budget. This report discusses what tax changes we can expect to hear given previous commitments, and what other reforms the Chancellor could – or should – announce.

The last Conservative Budget envisaged taxes rising this Parliament, and Labour's commitments have added to that

It is a certainty that Rachel Reeves's first Budget will confirm at least some future tax increases. This is not just because that is the historical pattern – with £21 billion a year being the combined average across the two fiscal events after recent elections – but because Labour's manifesto promised some specific tax rises and, more significantly, because the public finance forecast left to her by her predecessor assumed the tax burden would rise over this Parliament due to specific tax changes that will take effect over the next few years.

The Labour manifesto contained five specific tax measures that together raise around £4 billion a year: higher taxes for private schools; closing further 'non-dom' tax loopholes, including for Inheritance Tax; 'carried interest' reform; a small Stamp Duty rise for non-UK residents; and extensions to the North Sea 'windfall tax'. In addition – and potentially bigger than all of those combined – was an intention to raise £6 billion a year extra revenue through targeted HMRC spending.

The Chancellor's legacy from Jeremy Hunt includes planned tax rises between 2025 and 2027 that add up to an estimated £24 billion a year. These include a continuation of Income Tax and National Insurance threshold freezes, as well as some significant tax rises set to happen next Spring, where three decisions for the new Chancellor stand out. First, pandemic-era business rates relief for retail and hospitality should be allowed to expire (as Jeremy Hunt had planned) – or at least begin to be phased out. Second, the temporary 5p Fuel Duty cut that has been in place since 2022 should also be allowed to expire (as planned) next March, and regular uprating should return, given that real Fuel Duty and petrol prices would be historically low in any case. On the other hand, the Stamp Duty threshold is set to fall next Spring, adding £6,250 to the cost of moving for

many households. Stamp Duty is a particularly economically inefficient tax, and this tax rise should be cancelled now (costing up to £2 billion a year) both to avoid a tax-deadline drama and to boost residential mobility.

Despite ruling out some of the big revenue-raising tax options, there is still scope to raise tens of billions in ways that make our tax system more efficient

But the Chancellor may want to go beyond the tax plans bequeathed to her by the previous Government. In October, we will explore the fiscal context in detail, but we already know that plans inherited from the previous government imply that around £19 billion a year of extra spending would be needed to avoid real-terms per capita cuts for unprotected departments – and more to avoid cuts to public sector investment – while the Chancellor has identified a £22 billion overspend in 2024-25, much of which will likely continue into 2025-26. Addressing these pressures without borrowing more would require additional tax revenue: crucially, the Spring 2025 tax rises discussed above are already included in the fiscal outlook, and the tax rises identified in the manifesto were at the time allocated to specific spending rises.

But Labour's manifesto ruled out any increases in Corporation Tax, National Insurance (NI), Income Tax or VAT, at least in terms of headline rates. The Government has also indicated that it wants to avoid putting taxes up on working people and that those with the broadest shoulders must pay the largest share. If more revenue is required, then the challenge for the Chancellor is to find tax changes that pass the 'triple tax test' of moving the tax system in a more efficient direction that supports rather than undermines the Government's pro-growth agenda; falling on those with the broadest shoulders; and not breaking her self-imposed manifesto commitments. Three areas stand out, where there are a range of distortionary and low value-for-money tax reliefs and preferential tax rates that could be rationalised or removed. In each there is a range of possible action from smaller revenue increases to major reform.

- Inheritance Tax could raise more revenue if its reliefs and exemptions were reviewed. Pension pots should be brought within scope, and business and agricultural relief should be ended – or much more restricted with caps and family business tests: for example, owning AIM-listed shares should no longer be sufficient justification for not applying Inheritance Tax. These changes could raise up to £2 billion. Going further, the Government could end the complicated residence nil-rate band, which was introduced in 2017 and provides an extra tax-free allowance if a main residence is left to a direct descendant, raising a further £2 billion. If these tax rises were deemed too large a change, they could be coupled with adding lower Inheritance Tax rate bands, recycling up to £2 billion and delivering a simpler and potentially better-perceived tax.

- Capital Gains Tax (CGT) should be a key focus (beyond the manifesto commitment to raise taxes on carried interest) and would ideally involve significant reform of the tax system. Employees face a top tax rate of 47 per cent and dividends are taxed at up to 39.35 per cent (ignoring employer NI and Corporation Tax for now), but the top CGT rate for shares is 20 per cent, with relief potentially lowering that to 10 per cent, and there are ways to pay zero tax. We have previously suggested that marginal CGT rates for shares be aligned with dividend tax rates, and that property capital gains should be taxed like wages, with inflation-indexing needed so as not to over-tax capital gains. Pre-behavioural-response calculations suggest this fair combination – creating both winners and losers – would raise around £8 billion per year. A consistent approach to tax rates would also imply that those for rental income and basic-rate dividends should rise. In addition, there should be CGT exit charges when moving country, and the tax should certainly be applied at death (or rolled over), as these are currently ways to escape CGT entirely.
- There are many options for reforming some of the unfairnesses in pension tax reliefs, but one of the simplest options is to levy employer NI on employers' pension contributions. After reimbursing public sector employers for the additional costs, up to £12 billion could be raised by ending this tax break that arbitrarily favours employer pension contributions over worker contributions. Of this, £3 billion would then ideally be used to give full employee NI relief on employee pension contributions, which would particularly benefit basic-rate taxpayers. This combination – raising up to £9 billion – would level the playing field between employer and employee pension contributions, and leave an auto-enrolled worker with typical earnings marginally better off.

It is clear that these changes have the potential to raise significant revenue (with these options totalling over £20 billion a year). There would no doubt be some vocal losers – as well as potential winners. But they are all changes that would make the tax system more neutral and efficient, rather than less.

Progress is also needed to kick-off much-needed reform of other parts of the tax system

Although the focus may be on immediate decisions to help the public finances, the Chancellor should also get going on some other longer-term and much-needed major tax reforms. We explore three of these.

Labour has committed to replacing business rates, but it remains to be seen what that really means. We suggest that it moves over time to a far more growth-friendly land tax – exempting all new structures and improvements as soon as possible and phasing out

rates on existing structures – while acknowledging that this will likely require tax rises elsewhere. In contrast, the Government has not set out any intention to reform Council Tax, but it is well-known that change is warranted. A comprehensive overhaul is needed but if this is not an option then two key partial reforms would be a long-awaited Fair Funding Review, which could rebalance the geographical distribution of local government funding so it more closely aligns with local need, and empowering local authorities to choose the right level and even the best structure of Council Tax. Finally, and much more significantly in terms of tax revenue, the loss of Fuel Duty due to vehicle electrification will be an £8 billion problem by 2029-30 and grow further every year. We have previously suggested a per-mile EV charge. There are other options, including doing nothing, but – as the number of EV drivers grows dramatically – some of these choices will get harder to make each year, and therefore the governmental process of exploring all the possibilities should start immediately.

The Budget may well involve some tough decisions on tax, perhaps for those making large capital gains or who are bequeathing very large estates, but the prize can be a more dependable spending and revenue outlook, coupled with a more neutral, efficient tax system.

Introduction

In this report we explore what tax policy may be in store in the next Budget. We begin by summarising the known policies from the Labour manifesto. There are also a large number of tax rises scheduled by the previous government that the new Chancellor will need either to enact, or to find alternatives for (including spending less or borrowing more). The fact that the Government has "committed to one major fiscal event a year, giving families and business due notice of tax and spending changes", suggests that these decisions will need to be made now, rather than waiting until Spring as might previously have happened.[1]

On top of this, further tax rises may be needed to fill an apparent fiscal hole, or ease pressure on public services, or pay for additional investment, so we discuss some of the best options for doing this in progressive ways that do not undermine the Government's ambition for higher growth and that respect their manifesto commitments.[2] (Future work will explore the fiscal situation in more detail). Finally – recognising that there are limits to how quickly and comprehensively the tax system can be reformed in just a few months, we also set out areas where the Government should get the ball rolling on important future reforms.

The Labour manifesto set out a number of tax changes for this Budget...

Some of the policies that will appear in the Budget are not hard to predict. The Labour manifesto set out a number of specific changes, which they estimated would together raise around £4 billion a year:[3]

- Applying VAT to private school fees and removing private school business rates relief in England. It has already been announced that this VAT rise will apply from 1 January 2025.[4] These changes are projected to raise around £1.5 billion a year.
- Strengthening the Energy Profits Levy ('windfall tax'), which is being extended by a further year to 2029-30 with a higher headline tax rate and reduced allowances.[5] This is intended to raise around £1.2 billion a year on average across the Parliament.
- Closing further 'non-dom' tax loopholes, including for Inheritance Tax, to raise around half a billion pounds a year. (Note that this is on top of the previous government's provisional non-dom Inheritance Tax proposals that are not yet reflected in the fiscal outlook.[6])

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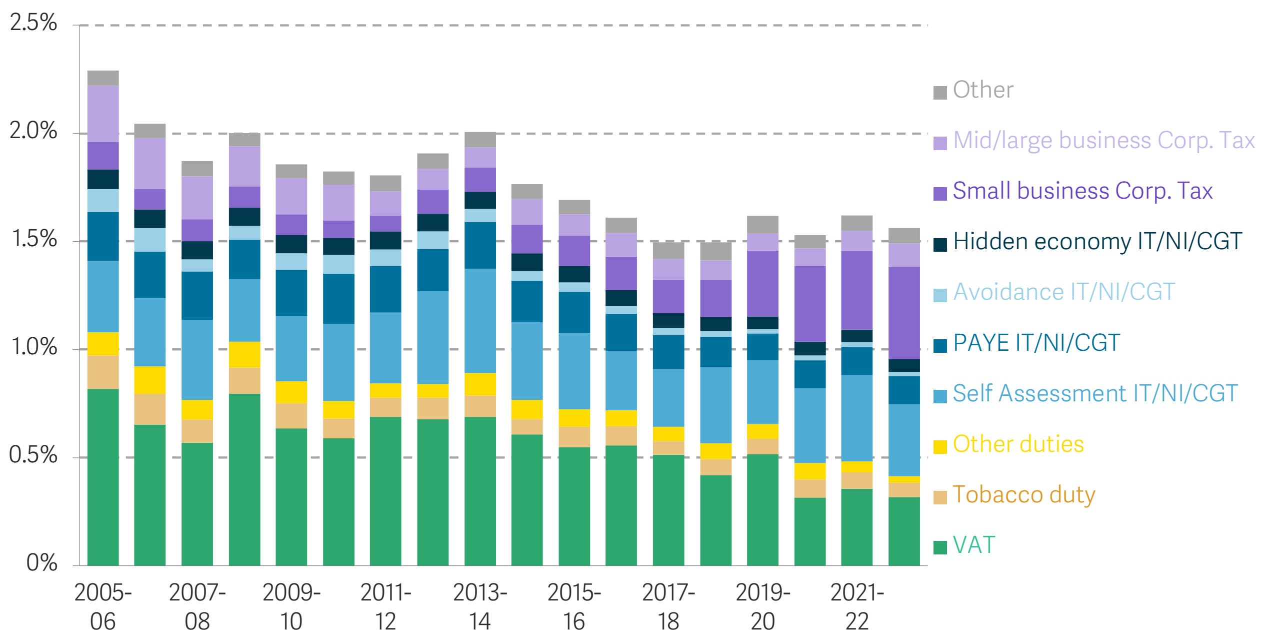
1 HM Treasury, Fixing the foundations: public spending audit 2024-25, July 2024.
2 We draw heavily on: M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023; and Resolution Foundation & Centre for Economic Performance, LSE, 'Ending Stagnation: A New Economic Strategy for Britain', Resolution Foundation, December 2023.
3 Costings from Labour's fiscal plan, accessed August 2024. Unless otherwise stated, these costings are done on a 2028-29 basis.
4 HM Treasury, VAT on Private School Fees & Removing the Charitable Rates Relief for Private Schools, July 2024.
5 HM Treasury, Changes to the Energy (Oil and Gas) Profits Levy, July 2024.
6 As of Spring Budget 2024, the Government intends to move IHT from a domicile-based system to a residence-based one. HM Treasury, Technical note: Changes to the taxation of non-UK domiciled individuals, April 2024.

- A 1 per cent Stamp Duty Land Tax rise for non-UK residents, raising just £40 million a year.
- Changing the tax treatment of carried interest for fund managers, potentially raising £600 million a year. Box 1 discusses this further, given that little detail was given before the election (we discuss the broader topic of potential Capital Gains Tax reform later in this report).

There was also a pledge to raise £6 billion a year extra revenue by reducing the tax gap, via targeted increases in HMRC spending. Conversations will no doubt be ongoing to try and ensure that the proposed £855 million a year investment in HMRC can lead to this £6 billion a year in extra revenue by 2029-30, and that the Office for Budget Responsibility (OBR) will include this in their upcoming forecast. As Figure 1 shows, there is a large (estimated) 'tax gap' – totalling around £40 billion in 2022-23 – and this has been reduced before, so it is not implausible that this could be reduced by £6 billion (around 0.2 per cent of GDP).[7]

FIGURE 1: **There is scope to close the tax gap, and the small business Corporation Tax gap deserves particular scrutiny given its recent rise**

Estimated 'tax gap' as a share of GDP: UK



SOURCE: RF analysis of HMRC, Measuring tax gaps 2024 edition; OBR, Economic and Fiscal Outlook, March 2024.

7 One notable implication from these HMRC estimates is that the small business Corporation Tax gap should be a particular priority, with this having risen by £7 billion (or 0.3 per cent of GDP, from £4 billion to £11 billion) between 2018-19 and 2022-23.

BOX 1: Reforming the tax treatment of carried interest

Carried interest is a form of remuneration for fund managers (primarily for private equity) and there is a strong case that it should not be classed as a capital gain, as it is now. The Government has said it "believes that the current tax regime does not appropriately reflect the economic characteristics of carried interest and the level of risk assumed by fund managers in receipt of it",[8] and there is even some question about whether the existing treatment has a basis in law at all.[9]

Carried interest is currently taxed at a special CGT rate of 28 per cent. For comparison, other top tax rates in the UK are 39.35 per cent in the case of dividend income (or over 54 per cent if we account for Corporation Tax paid); 45 per cent for Income Tax; 47 per cent if we include National Insurance (NI) for non-pensioner workers; and 53.4 per cent if we also account for employer NI.[10]

It remains to be seen what tax schedule will be chosen; whether this will be done through CGT or by no longer treating it as a capital gain; and whether there will be any important nuance (such as differing treatment in cases where fund managers are also investing substantial capital of their own up-front). Fairness with other taxpayers and other sources of income would suggest that a rate of 47 per cent or 53.4 per cent would be appropriate (and, as Table 1 shows, the small number of people in question receive extremely high incomes – even if an individual manager may only receive such a large payment once every seven years for example). However, the Government will also be considering the potential behavioural responses – in particular how much business can and will move abroad – which could possibly lead the Government to suggest a somewhat lower rate.

8 HM Treasury, The tax treatment of carried interest – A call for evidence, July 2024.
9 D Neidle, Carried Too Far? A Challenge to the Tax Treatment of Carried Interest in the Private Equity Industry, British Tax Review 1, 2023.
10 If an additional-rate-paying employee is paid an extra £100, their employer would pay £13.8 extra in employer NI. Together with the £47 of extra Income Tax and employee NI paid, this would be £60.8 of tax out of £113.8 of extra labour cost, or an effective 53.4 per cent tax rate.

TABLE 1: **People making over £5 million account for the majority of carried interest**

Number of individuals and total gains from carried interest by gross gains, 2020-21: UK

Range of gains	Individuals		Gains	
	People	Share	£m	Share
Below £10,000	360	14%	1	0%
£10,000 to £24,999	270	10%	5	0%
£25,000 to £49,999	280	11%	10	0%
£50,000 to £99,999	280	11%	21	1%
£100,000 to £249,999	380	15%	62	2%
£250,000 to £499,999	290	11%	103	3%
£500,000 to £999,999	230	9%	160	5%
£1m to £1,999,999	180	7%	253	7%
£2m to £4,999,999	160	6%	489	14%
Over £5m	150	6%	2,308	68%
Total	**2,580**		**3,412**	

NOTES: Number of individuals rounded to nearest 10. Gains rounded to nearest £ million. Totals might not sum up due to rounding. These figures were extracted in January 2023 and may be subject to future revision due to late filers.
SOURCE: FOI of HMRC.

...And the previous Government scheduled a number of tax rises for Spring 2025 that Rachel Reeves will need to ponder

In addition to the tax changes that were pledged in Labour's manifesto, there are also a range of upcoming tax rises that were announced by the previous Government and are already built into the public finance forecasts. These planned tax rises, due to take effect between 2025 to 2027, add up to an estimated £24 billion a year (in 2029-30) and the Chancellor will have to either go through with these, find alternative tax rises, offset them with spending cuts, or increase borrowing.[11]

It seems likely that most of the changes will happen as scheduled, including the continued, significant freezing of Income Tax and National Insurance thresholds until April 2028. But some of the tax rises are potential headaches for the new Chancellor, delivering significant jumps in tax bills in Spring 2025, most notably: business rates relief for retail and hospitality; Fuel Duty; and Stamp Duty. We discuss these in turn below.

11 A Corlett, Hiding in plain sight: The Government's record on taxes and the challenges ahead, Resolution Foundation, June 2024.

Business rates relief

The Covid-19 pandemic led to various policies that reduced business rates bills. One legacy is that qualifying retail, hospitality and leisure businesses get 75 per cent off their bills this year (as in 2023-24).[12] But this relief is set to expire after 31 March. We discuss later in this report how business rates in general should be reformed, but there is no good theoretical reason why retail, hospitality and leisure premises should continue to benefit from a special relief.

There will no doubt be calls for this relief to be extended. Fully extending it would be very costly, at around £2.6 billion a year by 2029-30.[13] A compromise option could be to phase the discount out over two or more years: in Wales, for example, the relief fell from 75 per cent to 40 per cent this year. Either way, giving businesses certainty – even if it's the certainty of a tax rise – would be better and more fiscally responsible than the recent pattern of this being a rolling one-year relief.

Fuel Duty

There are not one but two Fuel Duty rises planned for 2025. A 'temporary' 5p Fuel Duty cut has been in place since 2022 – introduced by Chancellor Rishi Sunak when the cost of oil rose markedly after Russia's full-on invasion of Ukraine – but is due to expire on 22 March, which would take the rate from 52.95p per litre to 57.95p. On top of this, the Government's default policy is for Fuel Duty to rise in line with RPI inflation each year (specifically – and oddly – the OBR's projection for Q2). If this inflation projection remains at 2.1 per cent, then Fuel Duty could rise in April by around a further 1.2p, to roughly 59.2p.

It should be stressed that these rises – together with uprating in 2026 and beyond – are already included in the OBR's fiscal outlook and would not represent a change of policy. Allowing Fuel Duty to rise in this way would not 'raise' any new revenue from the Chancellor's perspective. Instead, not implementing these increases in full would mean foregoing revenue, compared to the OBR's assumptions. In the last election, none of the major parties' manifestos set out plans to do this. The cost of cancelling all of the scheduled rises would be an estimated £4.8 billion in 2028-29,[14] while doing 'only' the 5p rise and no further increases would still cost around £2 billion.

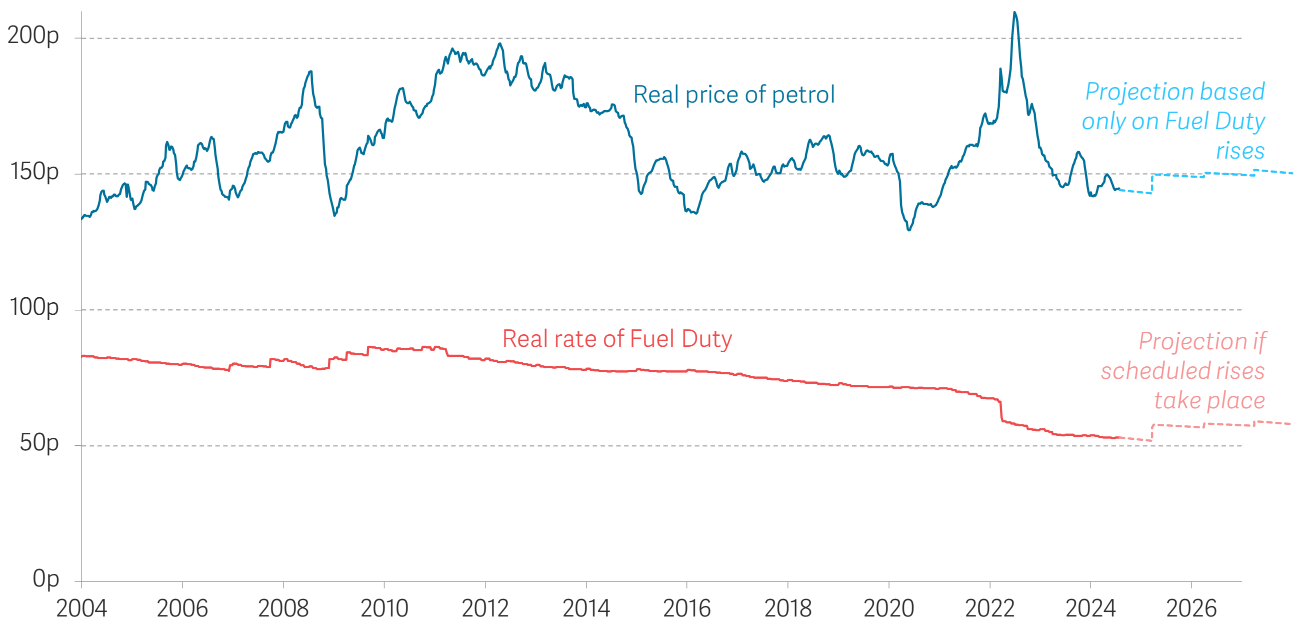
As depicted in Figure 2, even with these scheduled rises, the future real value of Fuel Duty would not only be lower than at any point from 2004 to 2021, but also lower than it was immediately after the temporary 5p cut was introduced. The total inflation-adjusted

12 The discount is most valuable to those that are not already eligible for 'small business rate relief' and are not affected by the maximum discount cap.
13 Unless otherwise stated, costings in this and subsequent sections are in 2029-30 terms, reflecting the current OBR forecast window.
14 OBR, Economic and Fiscal Outlook, March 2024.

cost of petrol, even if we conservatively assume that a 5p Fuel Duty rise were passed on in full,[15] would also remain relatively low by historic standards, unless wholesale prices rise significantly. Given this, it is hard to see that foregoing these tax rises is a fiscal priority.

FIGURE 2: **Real Fuel Duty and petrol prices are low by the standards of the past two decades**

Real value of unleaded petrol Fuel Duty and average petrol pump price: UK



NOTES: CPI adjusted to July 2024 prices. Petrol price projection based only on the real price from 29 July 2024, plus projected changes in Fuel Duty (plus VAT).
SOURCE: DESNZ, Weekly road fuel prices; ONS, Consumer Price Index; OBR, Economic and Fiscal Outlook, March 2024; Bank of England, Monetary Policy Report, August 2024.

It would of course be possible to choose a new uprating rule for the future, rather than annual increases in line with projected RPI inflation. We have previously suggested an option of monthly Fuel Duty uprating – removing the drama of larger annual jumps – and a fixed uprating rate of 2 per cent a year (equivalent to roughly 0.1p per month) – so that higher inflation does not lead to the politically unrealistic outcome of higher default Fuel Duty rises.[16]

Aside from the choice about how Fuel Duty rates should actually change, one temptation that Rachel Reeves should avoid is to continue the disreputable 'fiscal forecast fiction' practiced by successive Chancellors since 2010 of telling the OBR to assume in its

15 The RAC has argued that drivers have not been benefiting from the 5p cut, with retailer margins being boosted instead. BBC News, Fuel duty cut could be scrapped, says RAC, 29 August 2024.
16 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023. Monthly uprating was proposed in S Adam & R Stroud, A road map for motoring taxation, IFS, October 2019.

outlook that annual RPI uprating is Government policy while cancelling this policy each year.[17] This temptation will also be present in other areas of taxation, such as with the business rates relief discussed above. To deliver better governance, the Government should make credible plans and then stick to them where possible.

Stamp Duty

In contrast to business rates relief and Fuel Duty, there is one tax rise planned for next Spring that the Government should look to cancel. Since September 2022, the threshold for paying residential Stamp Duty Land Tax (SDLT) in England and Northern Ireland has been £250,000 (and for first-time buyers it has been £425,000). Jeremy Hunt announced in November 2022 that this rise would be reversed on 31 March 2025, when both thresholds would fall by £125,000. If this happens, then more housing transactions will need to pay some SDLT rather than being tax-free and – with a starting tax rate of 5 per cent – the cost of moving home will rise by £6,250 for properties above £250,000.

Keeping this planned tax rise will have negative short-term consequences by driving people to complete purchases before the end of March, when some would otherwise have chosen different timings, and will feel unfair for those who are unable to meet the deadline. More fundamentally, SDLT is a bad form of taxation. It may be one of the most economically harmful ways of raising revenue,[18] and means the UK's housing stock is not used as efficiently as it could be.[19] As a rough indication of the potential benefit, making the higher SDLT threshold permanent could be expected to boost the number of transactions each year for homes around £300,000 (for example) by around 9 per cent in the long-term, relative to the scheduled tax rise.[20] Ideally, the Government would go further in cutting SDLT (both residential and non-residential) – in tandem with reforming Council Tax – but cancelling this planned rise would be a good start.[21]

Cancelling this tax rise would cost around £1.8 billion a year by 2029-30.[22] The Conservative manifesto suggested doing this only for first-time buyers, but the case is just as strong for existing homeowners. The cost to the Exchequer could be reduced by retaining the higher threshold only for people's main homes (i.e. not additional dwellings or non-UK residents). As we will show, there are more efficient ways of raising revenue than through SDLT, and so cancelling this tax rise would be pro-dynamism and pro-growth.

17 House of Commons Treasury Committee, Fuel Duty: Fiscal forecast fiction, January 2023.
18 L Cao et al., Understanding the economy-wide efficiency and incidence of major Australian taxes, Australian Treasury Working Paper, April 2015.
19 IFS, Tax by Design, September 2011; and C Hilber & T Lyytikäinen, Transfer taxes and household mobility: Distortion on the housing or labor market?, Journal of Urban Economics, September 2017.
20 RF calculation based on elasticities set out in OBR, Residential SDLT elasticities, October 2017. Transaction impacts will vary by property value, with the threshold change being relatively less important for more expensive homes.
21 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
22 HMRC, Stamp Duty Land Tax – temporary increase to thresholds, November 2022.

Many tax rises have been ruled out, but there is plenty of scope for revenue-raising, efficiency-improving tax changes

So, we should expect the Budget to confirm multiple tax rises, as set out either in the Labour manifesto or by the last government. But it also seems very likely that the Budget will feature additional tax rises that will help build back headroom against the Government's fiscal targets, or allow for higher spending on public services or public investment.

Future work will explore the fiscal context in detail, but the spending plans inherited from the previous Government imply that an additional £19 billion a year would be needed to avoid real-terms per capita cuts to unprotected departments, and the plans also pencil in growth-sapping cuts to public-sector investment.[23] Since then, the Chancellor has identified a £22 billion overspend in 2024-25 – much of which will likely continue into 2025-26.[24] Crucially, of the tax rises we have discussed already, those announced by the previous Government are already factored in to public finance forecasts, and the manifesto's revenue-raisers are in principle allocated to fund new current and capital spending priorities. So, on the face of it, if the Government wants to change the fiscal outlook, then it will need to announce additional tax rises. More generally, most parliaments in recent history have begun with tax rises, in part to create more flexibility in the face of uncertainty, with £24 billion of net tax rises announced in 1997-98; £17 billion in 2010; and £22 billion in 2015, for example (all in 2029-30 terms).[25] Given all this, it is unsurprising that the Chancellor has said that "I think we will have to increase taxes in the Budget", and the Prime Minister has said that the Budget is "going to be painful".[26]

On the other hand, the Labour manifesto ruled out any increases in Corporation Tax, National Insurance (NI), Income Tax or VAT, at least in terms of headline rates, and said that they "will not raise taxes on working people". These are major pledges, and have attracted criticism for unduly tying the hands of the Government,[27] given that, in general terms, some of the least-distorting ways of raising large amounts of tax revenue would be through broad-based taxes like Income Tax or VAT. (It is not clear whether the Government would view freezing major tax thresholds as breaking their pledges; we discuss the scope for threshold freezes in Box 2).

But these pledges do not mean that there is no scope to increase tax revenues. In our view, there are still at least three significant revenue-raising areas that would not be a direct contradiction of the Labour party's manifesto commitments, and would be roughly consistent with the Prime Minister's comment that "those with the broadest shoulders

23 C McCurdy, C Pacitti & J Smith, Debt dramas: Putting the public finances in context ahead of general election 2024, June 2024.
24 HM Treasury, Fixing the foundations: public spending audit 2024-25, July 2024.
25 A Corlett, Hiding in plain sight: The Government's record on taxes and the challenges ahead, Resolution Foundation, June 2024.
26 BBC News, We'll have to increase taxes, says Reeves, 30 July 2024; GOV.UK, Keir Starmer's speech on fixing the foundations of our country, August 2024.
27 G Tetlow, Ruling out tax rises undermines Sunak's and Starmer's credibility on public services, Institute for Government.

should bear the heavier burden."[28] These are Inheritance Tax, Capital Gains Tax (plus dividends and rents) and pension tax reliefs, and in each there are a broad range of potential options, from the relatively minor to very significant reform.[29]

In all of these areas, there are good economic and equity arguments for looking again at the UK's many tax reliefs and preferential rates, which often offer low value-for-money and notably distort taxpayers' decisions in unwanted ways. Reform would therefore mean moving towards a more – rather than less – neutral and efficient system, in which different ways of doing business or investing must then compete with each other based more purely on efficiency rather than often arbitrary tax advantages.

Box 2: There is some potential for further threshold freezes to raise revenue

One key revenue-raising option – and one that has not necessarily been ruled out by the Government's pledges – is the use of threshold freezes. But the most important thresholds, such as the starting point for Income Tax and NI, are largely already frozen until April 2028. These could be extended by a further two years – raising around £7 billion from personal tax in 2029-30 and £1 billion in the case of the employer NI threshold, but it would be easy to argue that these represent a tax rise for working people and a rise in NI.

There are a small number of less important thresholds where freezes could be extended. The £20,000 annual subscription limit for ISAs could – and should – be set permanently at its current level of £20,000, and the 'starting rate for savings' band could be kept at £5,000 permanently (though ideally this unnecessary complexity should be phased out).[30] These changes could raise several hundred million pounds a year, and – mirroring Fuel Duty – end the poor practice of having a default rule (in this case CPI uprating) that is then overruled each year in turn, with the ISA contribution limit having been kept at £20,000 in every year (requiring a separate budgetary policy change each time) since it was boosted to that level in 2017.[31]

The Inheritance Tax thresholds could also be frozen for a further two years, or permanently, to remain at a combined £1,000,000 that a couple can bequeath tax-free, although the potential revenue gain is not huge compared to more radical Inheritance Tax reform options.[32]

28 GOV.UK, Keir Starmer's speech on fixing the foundations of our country, August 2024.
29 These sections draw heavily on previous work in M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
30 The starting rate for savings allows up to £5,000 of savings income to be received tax free, if your other income is less than £17,570. Its use is limited and it is separate from the Personal Savings Allowance which allows basic rate payers to receive up to £1,000 of savings income tax-free. Freezing the top of the savings band at £17,570, rather than the value of the personal allowance plus £5,000, would be one way to phase out this relic over the long-term, simplifying the Income Tax system.
31 The latest one-year freezes raised £130 million in the case of ISAs and £20 million from the savings rate.
32 As an indication of the revenue potential of an extra two-year Inheritance Tax threshold freeze, a three-year freeze from 2015-16 raised an estimated £260 million in 2028-29; the five-year freeze from 2021-22 is expected to raise £500 million; and the last two-year extension was expected to raise £35 million (assuming very low inflation).

Inheritance Tax

The Inheritance Tax (IHT) system as it stands leaves much to be desired.[33] It currently only raises around £8 billion a year, with an effective tax rate of only around 3 per cent in 2019-20 when compared with the total flow of inheritances and large gifts.[34] Yet it is unpopular. Among other reasons, this may partly be because the tax is regressive among high-value estates, with those worth over £7.5 million consistently facing lower effective tax rates than those worth £2-3 million.[35] Indeed, in opposition, the new Chancellor wrote about the case for addressing these problems.[36]

The first change that should be made is to bring pension pots within IHT. It makes no sense to exempt one form of saving, and the existing rules will increasingly encourage people to run down their other assets first while leaving pension pots as vehicles for bequests (aided by the abolition of the pension lifetime allowance) – which is not the intended point of our pension systems. Ending this loophole would raise an estimated £0.4 billion in 2029-30, and more in the longer-term.[37]

Action is also warranted to reform or end Business Relief and Agricultural Relief, which ensure that relevant assets can be passed on entirely free of Inheritance Tax, and together cost £1.7 billion in 2023-24 (or a projected £2 billion by 2029-30). In brief, the implied argument for these reliefs is that it might be harmful if family-owned businesses and farms needed to be broken up at the owner's death in order to provide the liquidity to pay IHT. But the economic case here is not strong. The OECD says that "the macroeconomic benefit of relief for family-business assets is unclear. Liquidity risks tend to be confined to a small number of businesses, and evidence shows that heirs who inherit a business tend to perform less well than their parents."[38] And, what's more, the link between the beneficiaries and the businesses in question is often not at all as strong as may be implied. Business Relief applies to shareholdings in the London Stock Exchange's AIM market, for example; while portfolios of business and agricultural property may be held in trusts and go untaxed; and there is nothing to prevent any property that is inherited tax-free as a family business from being immediately sold on (in the case of AIM shares, while IHT relief is an important benefit, it is right that the Government should periodically reconsider the value-for-money and distributional impact of subsidising a particular form of financing in this way.)

33 Ideally, IHT would be entirely replaced with a recipient- rather than donor-based tax, which would treat (large) lifetime gifts the same as inheritances, but the steps described in the main text would nonetheless represent major improvements, and ones that could be implemented more quickly.
34 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
35 HMRC, Inheritance Tax liabilities statistics: commentary, July 2024.
36 R Reeves, The Everyday Economy, March 2018. In that, she wrote: "Inheritance tax is not popular, but George Osborne's 2015 reform was not only unjust in deepening wealth inequality and the North-South divide, but it left untouched the loopholes through which the 'healthy, wealthy and well-advised' can avoid paying tax. It needs to be either reset or shifted wholesale to a tax on the receipt of any gifts throughout a lifetime, making tax on all gifts equal and thus avoidance more difficult."
37 A Advani & D Sturrock, Raising revenue from closing inheritance tax loopholes, IFS, April 2024.
38 OECD, Inheritance Taxation in OECD Countries, May 2021.

There are a number of ways in which these two reliefs could be reformed.[39] The costs of the reliefs are very dominated by the most valuable estates, so – for example – a £1 million cap on what could be inherited tax-free (in addition to other nil-rate bands) would raise substantial revenue while only affecting 12 per cent of Business Relief claims and 23 per cent of Agricultural Relief claims (or around 600 estates a year in total). A 'farmer' test and 'family business' test could be added, as is internationally common, e.g. requiring that the recipient's assets are predominantly agricultural (as in Ireland and France), or that the recipient actually works within the business – or at least has significant control over it. The minimum ownership period could be extended beyond two years, and relief could be clawed back if assets are later sold on – again drawing on approaches in some other countries such as Ireland, where there are conditions for the six years after inheritance. However, there is a strong case for the more straightforward option of abolishing these reliefs entirely.

There is also a good case for abolishing the Residence Nil-Rate Band, which can raise the effective IHT threshold from £650,000 to £1 million if a main residence is left to a direct descendant of the deceased (with various caveats). This is a complex and distortionary relief, first introduced in 2017, and costs around £2 billion a year.

If the Chancellor did decide to sweep away all of these reliefs, she might feel able then to introduce lower tax bands into IHT to reduce popular concern over potential 40 per cent tax bills (even if often unfounded), lessen the impact of relief removal, and show the benefits of base broadening. As an example, IHT could have a 20, 30 and 40 per cent rate structure, with the top rate only kicking in beyond £1.5 million, and this would cost an estimated £2 billion (still leaving a potential net £2 billion tax rise).

Capital Gains Tax (and dividend and rental income tax)

CGT presents a significant chance to raise revenue while improving the efficiency of the tax system. It should be noted at the outset that there are a wide range of options, and that the detail can be complex. Here we attempt to briefly cover the possibilities (on top of the earlier discussion of carried interest), grouping them into three sets of changes.[40]

First, the loopholes that allow CGT liabilities to be entirely avoided need to be ended. This could be done with two changes:

- an Australian-style exit charge should be introduced that levies CGT when people move out of the country (with a counterpart of suitable rebasing when people enter the UK);[41] and,
- the forgiveness of CGT at death (or 'step-up in basis') needs to end if any other

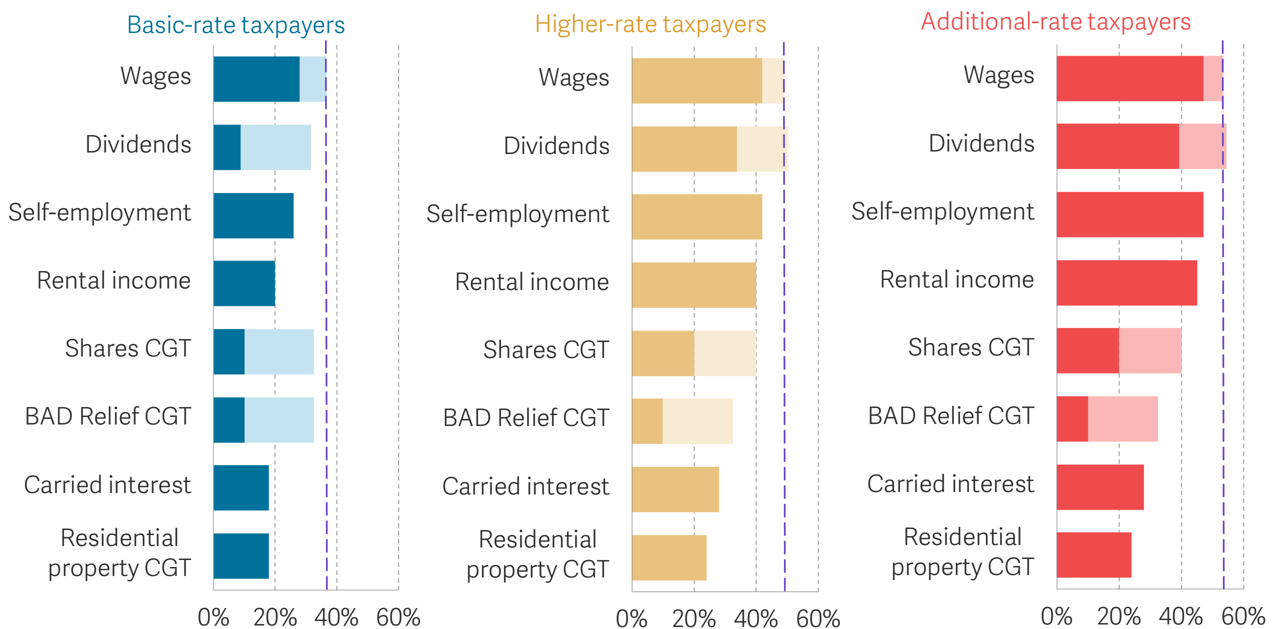
39 See also: A Corlett, Passing on: options for reforming inheritance taxation, Resolution Foundation, May 2018.
40 For further discussion, see: M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023; IFS, Tax by Design, September 2011; S Adam & H Miller, Taxing work and investment across legal forms: pathways to well-designed taxes, IFS, January 2021.
41 Disposals of real estate by non-residents are already covered.

reforms are to work well: there is no economic justification for encouraging people to hold on to their assets until death.[42]

Second, there are efficiency and equity arguments for taxing different forms of income at the same marginal tax rates. Figure 3 shows that the UK is very inconsistent in this: taxing different people on similar incomes very differently, and biasing the ways people structure how they work, invest and receive income. As noted in the discussion of carried interest (Box 1), the real top rate of tax for employees is 53.4 per cent (including the effect of employer NI), with a similar 54.5 per cent rate for dividend income (including the main rate of Corporation Tax). But capital gains on shares can be taxed at a rate as low as 33 per cent for additional-rate taxpayers, while the highest residential property CGT rate has been lowered to 24 per cent. So, one key test of the Budget will be whether it can reduce the gaps shown in Figure 3.

FIGURE 3: **The UK applies a wide range of tax rates to different forms of income**

Marginal tax rates before (dark) and after (light) considering employer NI and Corporation Tax: UK excluding Scotland



NOTES: Purple lines are aligned with the tax rates for wages. Wage rates shown with and without accounting for employer NI. Dividend and share CGT rates shown with and without accounting for Corporation Tax. Assumes a 25 per cent Corporation Tax rate. BAD Relief = Business Asset Disposal Relief.
SOURCE: RF analysis.

42 There is a design question of whether death should trigger a CGT bill, or whether a 'carryover basis' (or 'no gain, no loss') should apply – whereby the inheritor of an asset faces no immediate CGT bill but, instead, when they dispose of the asset will pay CGT on any gains relative to the original acquisition price (rather than the stepped-up value at death). This also relates to the question of the ideal interaction with any IHT. Recipients could have the option of paying CGT prior to the calculation of IHT, reducing the latter (see: M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023), or IHT could be paid and a credit given against any relevant future CGT (see: A Advani, A Lonsdale & A Summers, forthcoming).

Making progress on reducing these inconsistencies in marginal tax rates would involve the following changes:[43]

- Marginal CGT rates for shares should be raised to equal dividend tax rates (reflecting the impact of Corporation Tax on both, and removing a bias in how people take their income), with a top rate of 39.35 per cent and no Business Asset Disposal Relief. CGT rates for other property should be even higher – potentially up to 53.4 per cent for full alignment with wage taxes (although a more politically likely approach may be to align with more explicit top tax rates – i.e. 45 per cent or 47 per cent).
- The basic rate of dividend tax is relatively low compared to that facing employees – even after recent NI cuts for workers – and should rise from 8.75 per cent to around 15.6 per cent (with this also becoming the basic CGT rate for shares). This could raise an estimated £1 billion a year.
- And rental income tax rates should rise, which is perhaps best done through a new class of NI, including for pensioner landlords. This could raise up to £3 billion in the case of full alignment with taxes on wages (including employer NI) – though there are likely limits on how rapidly tax rates should rise.

The third and final element of desirable CGT reform, however, would move in the direction of lower capital taxes – offsetting some of the above rises. Having similar marginal rates for different forms of income would reduce or remove some important distortions, but an ideal tax system would also try to avoid reducing incentives to save: it should aim to be (fairly) neutral about whether or not people defer some consumption to a later date. CGT policy has often struggled with balancing these two sets of objectives, but it is possible to achieve both (more or less) if – alongside higher marginal rates – a tax-free rate of return is allowed.[44] To this end, we have previously suggested that inflation-indexing – which existed in full from 1988 to 1998 – should be reintroduced.[45] To illustrate, if a consultant was working through a personal service company for just a few years and then liquidated the company, with the receipt of any retained earnings being counted as a capital gain, inflation-indexing would be of little value – and the proposed marginal rates would therefore ensure that those earnings were taxed equally to dividend income or (roughly) employment income. But if someone were to invest £100

43 As Figure 3 suggests, tax rates on self-employment income are also low compared to dividend and employment income. (Additionally, the pension tax relief proposals we set out later in this report might ultimately be of greater benefit to the self-employed than employees.) Ideally action would be taken to shrink this gap, starting by cancelling the recent NI rate cuts for the self-employed, but we presume that the Labour manifesto's NI pledge makes this difficult. Reducing the VAT threshold would be a related step in the right direction, and ultimately a pro-growth change, but we do not cover that in this paper. See: M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.

44 S Adam & H Miller, Taxing work and investment across legal forms: pathways to well-designed taxes, IFS, January 2021.

45 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023

in a company and ten years later sold their share for £122, then in real terms their return (assuming 2 per cent annual inflation) would be zero and no CGT would be due – unlike in the current system where purely inflationary gains can be taxed.

An alternative suggestion is for CGT to exempt a normal, risk-free rate of return from tax – which at times may be either higher or lower than inflation-indexing, but should be more generous if (e.g.) real gilt yields tend to be positive.[46] Inflation-indexing has the advantage of prior experience in the UK, and being relatively easy to understand as a principle, and Israel can be looked at as an example of CPI-based indexing. On the other hand, a risk-free rate of return allowance can be seen in Norway, which has an elegant 'shareholder model', and provides theoretical neutrality over time.

Previous calculations show that the combination of higher marginal CGT rates along with full inflation-indexing would represent a significant net tax rise, of potentially £8 billion a year by 2029-30, before allowing for behavioural responses.[47] This is in addition to revenue from ending step-up in basis at death (an estimated £2 billion) and from rental and dividend tax changes (where around £2 billion would seem realistic in the medium-term). As suggested above, there would be both winners and losers, with owners of residential property receiving a big net CGT cut on average – further adding to the case for also considering rental income taxation. (One additional design question is whether all historic gains should be inflation indexed in full, and being less generous in this respect – particularly if marginal rates did not fully account for NI – may be one option.)

In sum, although we do not pretend that these changes would be uncontroversial or necessarily straightforward, the Budget is an opportunity to improve the efficiency of how we tax investment income while also raising additional revenue.

Pension tax relief

Alongside IHT and CGT changes, reform of pension tax reliefs also deserves consideration. By one estimate, pension saving benefits from around £50 billion a year of preferential tax treatment relative to up-front taxation like wages, through a complex mix of policies that lead to varying degrees of tax relief for different people and forms of pension saving.[48]

Many reform proposals have been made to make the system fairer, to reduce unnecessary tax relief, or to redistribute its benefits.[49] Ideally, the tax-free lump sum

46 S Adam & H Miller, Taxing work and investment across legal forms: pathways to well-designed taxes, IFS, January 2021.
47 It should be stressed that the responsiveness of CGT revenues to tax changes is heavily influenced by the ability of individuals to hold assets until death, or leave the country before sale, but if these avoidance routes are closed off, then the potential behavioural responses are more limited.
48 S Adam et al., A blueprint for a better tax treatment of pensions, IFS, February 2023.
49 The Government may also wish to look at the merits and costs of the Lifetime ISA, which was introduced after a 2015-16 review of the pension tax system.

would be diminished, but there is an unavoidable trade-off there between raising revenue quickly and trying to avoid taxing some age cohorts much more heavily than slightly older ones.[50] The option of reforming up-front Income Tax relief is often suggested and has merit, but comes up against some important counterarguments.[51] In opposition, the Labour Party suggested that it would reintroduce the lifetime allowance (scrapped by Jeremy Hunt in Spring Budget 2023), but this did not make it into the manifesto.

But one area where reform could particularly make the pension tax system more consistent and less arbitrary regards the NI treatment of pension contributions, which we now focus on.[52] Most employee remuneration – including contributions to a pension made by an employee – attracts employer NI at a rate of 13.8 per cent, but employer pension contributions do not. As pension income received in retirement also does not attract this tax, pensions are therefore exempt from employer NI at every stage. With an estimated cost of £18 billion in 2029-30, this is a significant – and unnecessary – tax relief that is of varying, arbitrary advantage to different workers, depending on their split between employee and employer pension contributions. Some will have arrangements to allow salary sacrifice whereby all pension contributions can benefit from the relief, but others will not. One particularly perverse outcome is that the default auto-enrolment system, affecting millions of employees, is not tax efficient.

Levying employer NI on employer pension contributions would raise up to £18 billion.[53] However, around one third of such a tax rise would come from the public sector itself and so – to avoid effectively cutting departments' budgets – after reimbursing these employers, the net potential Exchequer gain may be a maximum of £12 billion.

This could clearly be a significant tax rise, and – unlike IHT and CGT – would not only impact on the wealthiest. Even though the tax is formally levied on employers, employees would be likely to pay over the long-term through lower wages or pension contributions (this would lower the revenue gain somewhat, but we do not model this).

If implemented, though, we recommend that this levelling up of employer NI treatment should be paired with a levelling down of employee NI on pension contributions. Pension contributions made by employers currently do not attract employee NI (and still wouldn't under the proposal above), but contributions made by workers do. This tax should be

50 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.

51 First, with a flat rate of up-front relief, would Income Tax rates in retirement be limited to avoid pensions being taxed on the way in and again at (e.g.) 40 per cent on the way out? Second, it is not at all straightforward to value implied defined benefit contributions for each taxpayer separately.

52 In relation to Labour's manifesto, one can debate whether this would count as a rise in NI, but it is clearly a broadening of the NI base. For comparison, the extension of VAT to private school fees is not considered a rise in VAT.

53 Because this could be a flat 13.8 per cent rate of tax, all employer pension contributions – including deficit payments – could be straightforwardly taxed without having to value each worker's share separately, unlike with Income Tax relief reforms. For symmetry, where employers receive surplus payments from pension schemes, they would presumably also receive some form of employer NI rebate. This would be the mirror opposite of the Income Tax treatment of these payments and the two would partially cancel each other out in these cases.

ended. This would reduce NI on employee contributions from 8 per cent to zero for basic rate payers, and from 2 per cent to zero for higher earners (due to the regressive structure of worker NI). We estimate that this would cost around £3 billion a year – with the cost being lower than when we last looked at this issue, thanks to the previous Government's cuts in employee NI.

The combination would represent a rationalisation of the pension tax system, with no arbitrary differences in the treatment of different workers, and no tax incentive for employers and employees spending time arranging salary sacrifice arrangements. If employer NI was levied on employer contributions at the full rate and employee contributions were made free of employee NI, then an employee on the median earnings of around £29,000 who is contributing under the auto-enrolment rates (i.e. with an employee contributions of 5 per cent and an employer contribution of 3 per cent), would see their take-home pay rise by around £100 a year, and their employer would see a tax rise of a similar scale.[54] Higher-rate taxpayers would also see an overnight take-home pay boost, but – because they face only a 2 per cent marginal NI rate on their pension contributions currently – the size of their tax cut would be smaller than the extra tax paid by their employers and so we would expect them to lose out in the long-run. There would be no tax cut for those currently benefiting from pension salary sacrifice.

It would be worth beginning this rebalancing even in a revenue-neutral manner (i.e. with a £3 billion cut in employer NI relief and a £3 billion rise in worker NI relief), while the full combination would raise up to £9 billion – and any choice in between would also be possible, by applying employer NI to employer pension contributions but at a rate lower than the main rate of 13.8 per cent. And while there is a good case for increasing the nation's pension saving overall, increasing the minimum auto-enrolment contribution rates would be the best way to do this.[55]

In total, these options could raise over £20 billion

The policy suggestions we have explored could together raise a net estimated total of £22 billion a year.[56] This sum includes a net £2 billion from IHT reforms; a net £10 billion from CGT, with a further £2 billion from dividend and rental income tax rate rises; up to £9 billion a year from pension contribution NI relief reform; and the negative £2 billion cost of cancelling next year's SDLT rise. This potential revenue would be in addition to the earmarked tax rises set out in the Labour manifesto.

54 Even if the employer tax rise were passed on to the employee through lower wages or lower pension income, the post-tax impact of this on the individual would be smaller than their direct gain.

55 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.

56 There is a high degree of uncertainty – in both directions – around the potential revenue impacts of some of these policies. With the exception of SDLT figures, which derive from HMRC, we have not modelled potential behavioural responses, but comprehensive reform along the lines that we have suggested will leave fewer options for tax avoidance strategies than piecemeal reform. This total also includes multiple significant tax cuts: the gross potential for tax rises would be higher.

This is not to say that these are the ideal sums to be raised at the Budget, or a prediction of what might happen, and we have set out a wide range of options, from minor to major reform. But it demonstrates that there are still significant revenue-raising options that are consistent with Labour's manifesto commitments, fall on those with the broadest shoulders and improve the design of the tax system.

Getting the ball rolling on further tax reforms

The policy suggestions above would raise revenue while improving the efficiency and fairness of the tax system, but there is a strong case for the Government to kick-off long-term reform in other areas too. We look briefly here at business rates, Council Tax, and electric vehicle (EV) taxation. These are areas where additional time for policy development and consultation may be needed.

Business rates

The Labour manifesto proposed to "replace the business rates system" which "disincentivises investment, creates uncertainty and places an undue burden on our high streets."[57] It is not yet clear what this "new system of business property taxation" would entail,[58] but a new approach – if done right – does have the potential to bring real benefits. Replacing business rates in England is probably unlikely to be a quick process, however, and delivering on this commitment within this parliament could well require that policy development is started now.[59]

We have proposed that business rates should ultimately become a land value tax, to end the status quo of taxing non-residential buildings and infrastructure; and that the most cost-effective way to get to that point would be to exempt all new structures and improvements, while only slowly phasing out the tax on existing property (in line with depreciation).[60] A simple model suggests that this could ultimately boost GDP by around 1 per cent, and even a much lower impact would still be distinctly worth pursuing. The direct benefit of removing structures from business rates to tax only the underlying land value would also be largest in parts of the country with lower land values, with the North and Midlands being the biggest winners.[61]

In practical terms, our proposal would be to do one initial valuation that separated land rental values from the value of the structures on top. This is already done for some properties (the 'Contractor's Basis') so is not an entirely novel concept. The business rates bill for pre-existing structures would then decline over time to reflect depreciation (e.g. 5 per cent a year), while future valuations would only re-assess land values.

57 Labour, Labour Party Manifesto 2024, June 2024.
58 Labour, Labour's business partnership for growth, February 2024.
59 Based on the current revaluation schedule, valuations will change in 2026 (based on 2024 values) and 2029 (based on 2027 values).
60 M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
61 A Corlett et al., Replacing business rates: taxing land, not investment, September 2018.

The estimated cost of this would be around £4 billion after five years (in 2029-30 prices) and £10 billion in the long-run (if implemented UK-wide, with no offsetting changes within the business rates system, and before accounting for any impact on growth). The Labour manifesto suggested that business rates replacement could be revenue neutral, but it may be that a net tax cut is needed to help deliver major reform. As with cutting Stamp Duty, the potential to enact a particularly growth-friendly tax cut here only adds to the case for ending some of the low value-for-money tax reliefs explored earlier in this paper.

Council Tax

Unlike in the case of business rates, the Government has not given any indication of planning Council Tax changes, with pre-election comments that they would not be "changing Council Tax banding" and that this is not where the Chancellor would put her political energy.[62] There is also some potential practical trade-off between major business rates and Council Tax reforms, to the extent that the Valuation Office Agency in particular would have significant potential work to do on both, and the Government is already committed to some form of business rates replacement.

But even if the Government does not want to embark on the much-needed overhaul of the entire English Council Tax system in the near term, there are still at least two important ways in which the tax could start to be improved.[63]

First, one of the key problems with Council Tax is its geographical unfairness, with extremely valuable Westminster properties charged less than a typical three-bed semi in Blackpool, for example. But this can be adjusted through the local government financing process – by reassessing the relative needs and available resources of councils across England. Indeed, back in 2016 it was considered necessary to update the relevant calculations through a Fair Funding Review, but this was then repeatedly delayed and so has still not happened.[64] The question of how to revive this process must now be in the inbox of new MHCLG ministers.[65] It is likely that any review would bring an improvement in terms of aligning cash with needs – with some parts of the funding calculation being very out of date – but hopefully this can also begin to address the unfair geographic distribution of Council Tax relative to property values. To be clear, fair reform would feature Council Tax rising faster in London and the South East than elsewhere – over a number of years. (This would also complement our proposal, earlier

62 Financial Times, A dash for growth: the shadow chancellor prepares for government, 16 June 2024.
63 For discussions of root and branch reform, see: M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023; and S Adam et al., Revaluation and reform: bringing council tax in England into the 21st century, Institute for Fiscal Studies, March 2020.
64 Department for Communities and Local Government, Business Rates Reform Fair Funding Review: Call for evidence on Needs and Redistribution, July 2016.
65 For further discussion, see: D Phillips, Devolution may be sexier, but updating the local government finance system is vital, IFS, September 2024.

in this report, to keep Stamp Duty bills down, given that a greater proportion of homes in more expensive regions will benefit from a higher tax-free threshold.)

A second set of options relate to devolution. The new Government will need to decide its approach to capping Council Tax increases. Given what it has said about wanting to devolve more powers, it may be logical to remove these caps.[66] Local authorities could also be given greater autonomy over policies such as the Single Person Discount (at least for more valuable properties). And councils – or perhaps broader areas with devolution deals – could even be allowed to begin changing the basic Council Tax structure, with the option of additional banding at the top of Band H (building on Westminster's voluntary Council Tax contribution for the most valuable properties) or sub-divisions for the bottom Band A. Given the momentum behind greater English devolution, and the long-term failure of central government to reform Council Tax, it may be time to try such new approaches.

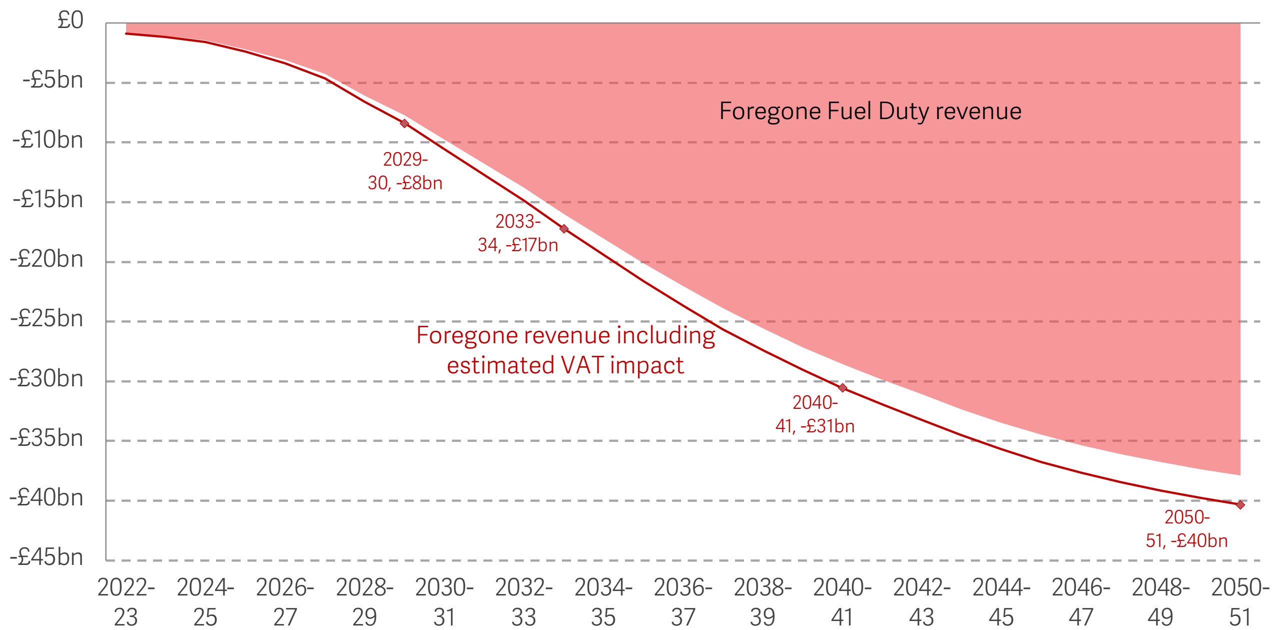
A 'Road Duty' for electric vehicles

A final and critical area where the Government should be getting the ball rolling on reform is the taxation of electric vehicles. It is well-known that electrification will reduce – and is already reducing – Fuel Duty revenue. As Figure 4 shows, by the end of this parliament in 2029-30 this hole will have grown to an estimated £9 billion. And by 2033-34 – which will be the final year of the OBR's fiscal outlook in the potential last Budget of this parliament, in 2028 – this will have risen to £17 billion. So this is an increasingly significant problem that the current Chancellor will need to tackle one way or another. Indeed, it will ultimately dwarf all of the tax options that we have discussed in terms of scale.

66 For further discussion, see: M Sandford, Council tax: local referendums, House of Commons Library, January 2023.

FIGURE 4: **By 2033, the lack of a Fuel Duty equivalent for electric vehicles will be costing the Treasury around £17 billion a year**

Foregone Fuel Duty (and VAT) revenue per year due to vehicle electrification, 2029-30 terms: UK



NOTES: Foregone Fuel Duty revenue based on ZEV total mile projections, including a rise in miles driven. Potential VAT impacts assume car Fuel Duty spending is redirected to other spending (or saving) with an average VAT rate of 10 per cent.
SOURCE: RF analysis of Department for Transport modelling in Decarbonising Transport: A Better, Greener Britain, 2021. Outturn electric car mile shares from OBR, Car engine types in the fuel duty forecast, March 2024.

This is an issue where both the previous and current Government have said very little. The previous Government said that "we will need to ensure that [...] revenue from motoring taxes keeps pace with this change, to ensure we can continue to fund the first-class public services and infrastructure that people and families across the UK expect".[67] But the only example of policy flowing from this principle was the extension of annual Vehicle Excise Duty to electric vehicles from April 2025. The new Government is yet to comment on the matter, but is committed to bringing the ban on new petrol and diesel cars forward to 2030 again – perhaps hastening the decline of Fuel Duty.

Our proposals for motoring taxes are set out in detail in previous work.[68] In short, we do not think that the taxation of petrol and diesel vehicles needs fundamental change. But to address the revenue challenge and deliver a degree of tax fairness across drivers, electric vehicles should face a per mile 'Road Duty' charge that roughly equates to Fuel Duty – so perhaps 6p per mile (plus VAT) for a typical car. This should be done in part using the software and communication hardware that is already ubiquitous in new

67 UK Government, The Ten Point Plan for a Green Industrial Revolution, November 2020.
68 J Marshall & A Corlett, Where the rubber hits the road: Reforming vehicle taxes, Resolution Foundation, June 2023.

cars, and this would also give city regions the option of delivering additional per mile congestion charges through this system if desired.

There are, of course, other options. The UK could try to move to a fully dynamic road-pricing model based on the precise time and place. At the other extreme, doing nothing is one option. The drawbacks of that would be that a much lower marginal cost of driving would be expected to lead to greater congestion, which could have real costs in terms of productivity, and that other taxes would need to rise over the long-term to fill the gap left by Fuel Duty.

Whatever the eventual decision, it would be best to explore the options and come to a decision soon. Delay will likely only make the choice more painful, as the number of electric vehicle drivers grows daily – and it is easier to raise taxes for future drivers than current ones. Given the possible need for significant legislation, real-world piloting and standards that need to be set for manufacturers, there should now be a sense of urgency. We should probably not expect a major new motoring tax to appear in this Budget, but the foundational internal civil service work of setting out the full range of choices and their various likely consequences needs to begin imminently, if it has not already, and ministers will need to consider these in the not-too-distant future.

Conclusion

Most post-election Budgets end up being tax-raising ones – with £21 billion a year being the combined average across the two fiscal events after recent elections – and this one looks set to be no exception.[69] As well as Labour's manifesto commitments and the future tax rises bequeathed to the Chancellor by the past Conservative Government, a likely need for more revenue if the Government wants to ease the pressures on public services or increase public investment means we can expect further, as-yet unannounced, reforms. We have shown how the Chancellor can find revenue-raising tax changes that pass the 'triple tax test' of moving the tax system in a more efficient direction that supports rather than undermines the Government's pro-growth agenda, falling on those with the broadest shoulders, and not breaking self-imposed manifesto commitments. There is no time like the present to start making both rapid and long-term improvements to the tax system to make it more economically efficient,[70] while also contributing to building a somewhat more equal and meritocratic country.

And the Budget is also an important chance to demonstrate that the Chancellor is

69 A Corlett, Hiding in plain sight: The Government's record on taxes and the challenges ahead, Resolution Foundation, June 2024.
70 See: IFS, Tax by Design, September 2011; and: M Broome, A Corlett & Greg Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.

serious about improving fiscal processes.[71] That could mean sticking to the proposal to only have a single event for major tax announcements each year; being more honest with the OBR about Fuel Duty policy, for example; and setting realistic departmental spending numbers (as we will explore nearer the Budget).

71 HM Treasury, Fixing the foundations: public spending audit 2024-25, July 2024.

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The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged.

We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

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