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THE UK TAX BURDEN:

Can Labour be called the 'party of fairness?'

By David Byrne and Sally Ruane

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THE UK TAX BURDEN: 'can Labour be called the party of fairness?'

By David Byrne and Sally Ruane

In the context of Labour's presentation of itself as the 'Party of fairness'1, this paper describes and comments upon the distribution of the tax burden in the UK. Its focus is on direct and indirect taxes levied on individuals and not on corporation taxes or capital taxes. It builds upon the analysis in our last Thinkpiece2 and draws upon the data recently provided by the Office for National Statistics (ONS)3. We are now able to see the average distribution of the tax burden across the first ten years of the Labour administration. We are also able to examine how the current distribution of the tax burden affects different household types. The figures do not tell us anything about individual households but relate to average gross household income and average taxes paid within each category.

The figures relate to income data held by HM Revenue and Customs and exclude income not known to the Revenue and Customs; they do not relate to wealth. Gross household income includes 'original income' (such as wages, occupational pensions and investment income) plus cash benefits, both contributory and non-contributory (such as retirement pension, job seeker's allowance and child benefit). It does not include benefits in kind such as health care. We have analysed the data in terms of deciles (where households are ranked according to size of equivalised disposable income and then divided into ten equal sized groups) rather than quintiles (where they are divided into five groups). This allows us to see what is happening to the bottom or least well off 10% of households and what is happening to the top 10%. It is in relation to these groups that the tax system can be seen to be most unfair. In addition we develop a more detailed analysis of tax paid by different household types.

The paper is largely a descriptive piece setting out the overall tax incidence by decile and household type. It does not develop a comprehensive strategy for righting the wrongs of the tax system although it does highlight one proposal which would be relatively simple to implement and likely to be widely perceived as fair.

The average distribution of the tax burden during Labour's first ten years, 1997/8 – 2006/7

The ten year average for deciles 3-8 is about 1% higher than for 2006/7. The distribution of the tax burden has been modified over Labour's first ten years in office but not hugely. The remaining analysis concerns data for 2006/7.

Upper line is average over ten years. Lower line is 2006/7.

Figure 1: The average distribution of the tax burden

Average gross household income by household type

Table 1 provides average gross household income for each household type by decile for 2006/7.

Table 1: 2006/7 Average gross household income by different household type and decile.

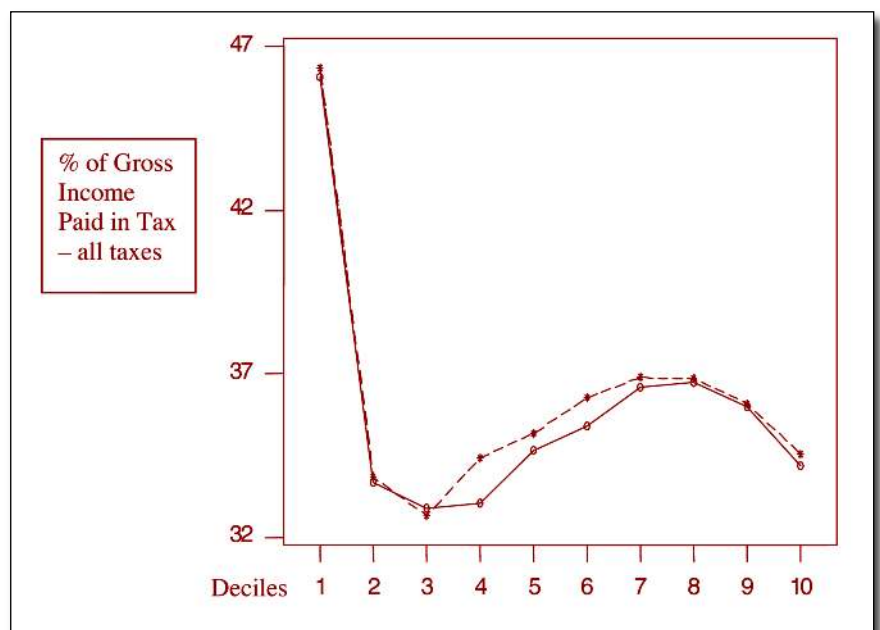


Figure 1



Decile	All households	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	£9,076	£12,724	£7,836	£7,032
2nd	£13,616	£16,875	£15,884	£9,898
3rd	£16,826	£22,900	£22,442	£11,537
4th	£20,362	£26,968	£26,998	£12,144
5th	£25,795	£31,216	£32,040	£13,171
6th	£29,938	£37,103	£37,914	£14,533
7th	£37,100	£43,561	£44,526	£17,379
8th	£44,759	£51,470	£49,099	£20,336
9th	£54,609	£64,357	£59,817	£24,764
Top 10%	£94,524	£123,217	£96,123	£44,688
Average gross household income	£34,661	£43,039	£39,268	£17,548

Gross household income and the total tax take

Table 2: 2006/7 Proportion (%) of gross household income taken in tax (all taxes) by different household type. (Figures in brackets are average gross household income for the decile.)

Similar income levels across different household types have been highlighted to facilitate a comparison of tax rates. In each household type, the bottom 10% pay a greater proportion of their gross household income in tax than all other deciles. Taking 'all households' into consideration, in 2006/7, the top 10% pay a smaller proportion of their gross household income in tax than all but the second, third and fourth deciles.

Table 1

Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	46.1 (£9,076)	41.9 (£12,724)	51.467 (£7,836)	45.9 (£7,032)
2nd	33.7 (£13,616)	33.6 (£16,875)	37.6 (£15,884)	31.4 (£9,898)
3rd	32.9 (£16,826)	34.1 (£22,900)	36.0 (£22,442)	31.4 (£11,537)
4th	33.0 (£20,362)	33.9 (£26,968)	38.7 (£26,998)	27.9 (£12,144)
5th	34.6 (£25,795)	35.8 (£31,216)	37.2 (£32,040)	29.3 (£13,171)
6th	35.1 (£29,938)	34.4 (£37,103)	38.2 (£37,914)	28.4 (£14,533)
7th	36.6 (£37,100)	35.8 (£43,561)	37.2 (£44,526)	27.6 (£17,379)
8th	36.7 (£44,759)	36.4 (£51,470)	36.6 (£49,099)	28.6 (£20,336)
9th	36.0 (£54,609)	37.0 (£64,357)	36.9 (£59,817)	31.0 (£24,764)
Top 10%	34.2 (£94,524)	33.0 (£123,217)	34.0 (£96,123)	32.2 (£44,688)
Average	35.3 (£34,661)	35.0 (£43,039)	36.7 (£39,268)	30.8 (£17,548)

Amongst non-retired households with children, the top 10% pay a smaller proportion of their gross household income in tax than all other deciles. The same is true for non-retired households without children. Non-retired households comprise around 18.3m out of a total of 24.8m households. Although there is an appreciable leap in the gross household income of the tenth decile when compared with the 9th (and greater than any other income leaps between deciles lower down the distribution ladder), the total tax rate paid is in fact smaller for the tenth decile than for the 9th in all cases except for the retired households. For instance, across 'all households', the gross household income for the top decile is 73% greater than that for the 9th decile but the percentage paid in tax declines by 1.8 percentage points. This pattern is even starker for non-retired households with children where the top 10% have almost double the gross household income of the 9th decile (an increase of 92%) and yet the tax take from the top 10% is almost 4 percentage points less.

The bottom 10% of non-retired households without children are paying over half of their gross household income in tax. By contrast, the top 10% of non-retired households with children are paying less than one third of their income in tax.

There is a significant difference between the tax incidence of the bottom 10% and that of the second decile. This is partly accounted for by the different composition of the two decile groups and the fact that at the lowest levels of income, indirect taxes have a particularly hard impact. However, this difference between the bottom and second decile is worth further analysis.

Figure 2: shows the tax burden across deciles for all households. We see here the substantial pressure on 'middle income' to bear the brunt of the tax burden.

Figure 2: 2006/7 % of Gross Income paid in Tax by Decile for All Households.

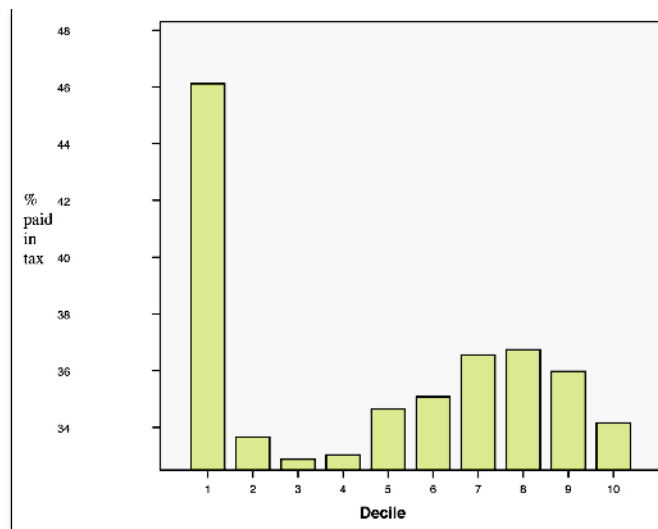


Figure 2

¹ See, for example, Gordon Brown's speech at the Labour Party Conference, September 2008 2 D Byrne and S Ruane (2007) Proportionate Tax Take from Gross Household Income – The Rich Pay Less, Compass Thinkpiece No.22 3 F Jones (2008) The effects of taxes and benefits on household income, 2006/7, Economic and Labour Market Review Vol 2, No.7, July, Office for National Statistics. Comparable for previous fiscal years can be found from the same website (<http://www.statistics.gov.uk/cgi/article.asp?id=1551>)

Figure 3: 2006/7 % of Gross Income Paid in All Taxes by Decile and Household Type.

Figure 3 shows the distribution of the tax burden as a percentage of gross income for different household types. Non-retired households with no children have a higher tax burden in all deciles but one and an exceptionally high tax burden in the lowest decile. The very low level of National Insurance payments contributes significantly to the lower rate overall of tax paid by retired households (although it should be noted that they pay a higher proportion of their incomes in Council Tax and indirect taxes than non-retired households).

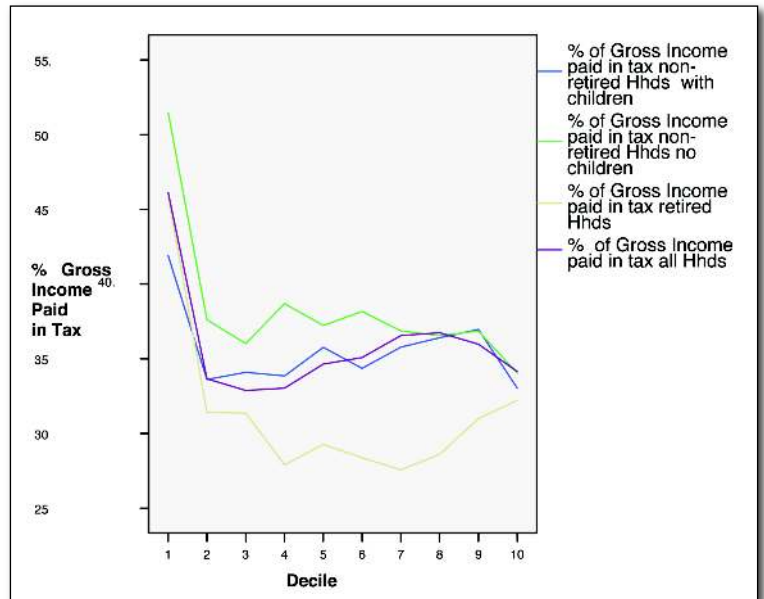


Figure 3

Figure 4: 2006/7 Gross Income and Post-Tax Income All Households by Decile - £

Figure 5: 2006/7 Gross Income and Post-Tax Income Non-Retired Households with Children by Decile - £.

Figures 4 and 5 show gross household income compared with post-tax income, for 'all households' and for non-retired households with children, respectively. What is evident is that, regardless of the type of household, there is a radical break in both gross and post-tax income levels for the top decile of households. For all other deciles, income increases in a reasonably smooth straight line way. For the top decile, it increases much more rapidly. This reflects both the low rate of tax paid by the top 10% and the Pareto nature of the income distribution.

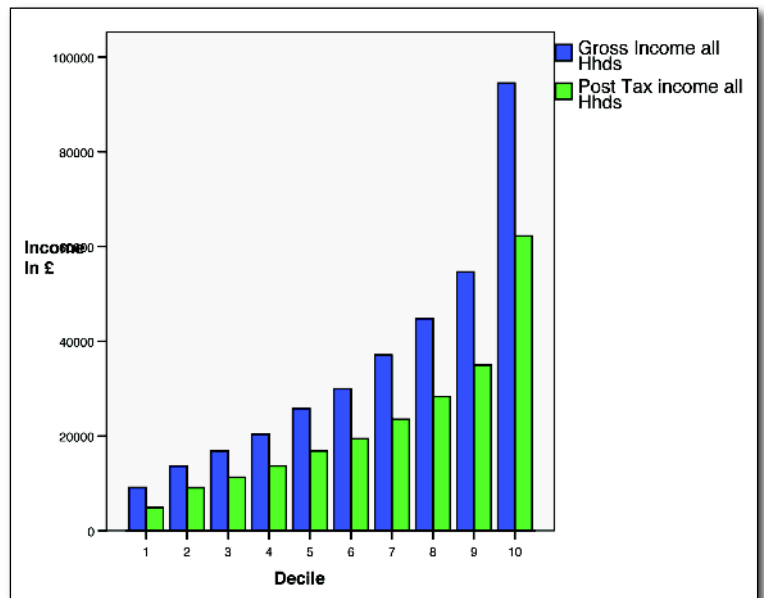


Figure 4

Income Tax

Table 3: 2006/7 Proportion (%) of gross household income taken in net income tax by different household type (i.e. after taking tax credits into consideration). (Average gross household income for each decile is shown in brackets.)

The tax is consistently progressive for 'all households'. The tax is consistently progressive for non-retired with children. The tax is mainly progressive for non-retired without children except for a blip at deciles 4 and 5. The tax is progressive for retired households except for the bottom 10%. Although the gross household income between the 9th and 10th deciles leaps by 73% for 'all households', income tax increases by just 25.1% (or 4 percentage points). Although the gross household income between the 9th and 10th decile for non-retired households with children leaps by 92%, the income tax rate increases by just 24% (4 percentage points).

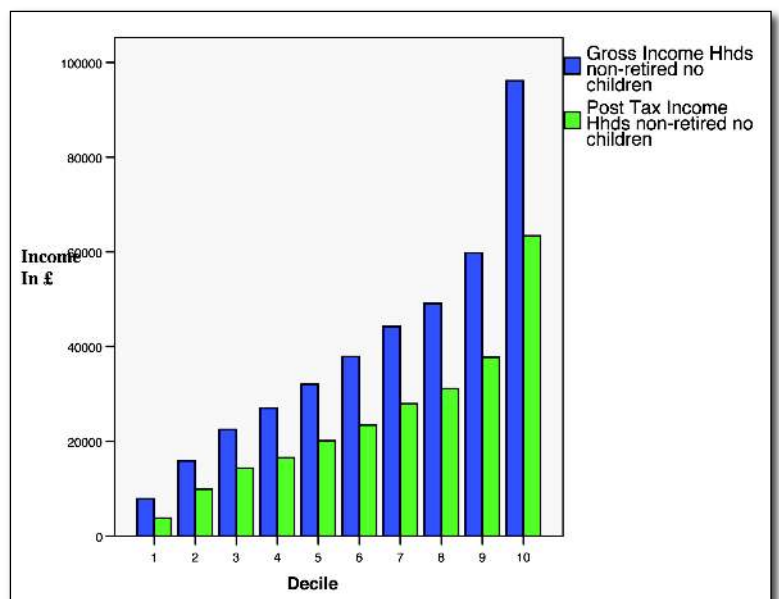


Figure 5



Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	3.1 (£9,076)	2.8 (£12,724)	4.1 (£7,836)	3.1 (£7,032)
2nd	3.8 (£13,616)	4.0 (£16,875)	6.9 (£15,884)	2.7 (£9,898)
3rd	5.3 (£16,826)	5.5 (£22,900)	9.7 (£22,442)	2.9 (£11,537)
4th	7.4 (£20,362)	7.4 (£26,968)	13.0 (£26,998)	3.4 (£12,144)
5th	9.7 (£25,795)	8.5 (£31,216)	12.6 (£32,040)	3.8 (£13,171)
6th	11.2 (£29,938)	10.5 (£37,103)	14.0 (£37,914)	5.1 (£14,533)
7th	13.1 (£37,100)	12.2 (£43,561)	14.3 (£44,526)	6.5 (£17,379)
8th	14.5 (£44,759)	14.6 (£51,470)	15.4 (£49,099)	7.8 (£20,336)
9th	16.0 (£54,609)	16.8 (£64,357)	17.0 (£59,817)	10.1 (£24,764)
Top 10%	20.0 (£94,524)	20.9 (£123,217)	20.2 (£96,123)	15.1 (£44,688)
Average	13.9 (£34,661)	14.0 (£43,039)	15.3 (£39,268)	8.2 (£17,548)

Table 3

Figure 6: 2006/7 Gross Income and Net Income Tax by Deciles Non-Retired Households with Children - £

Figure 6 shows the amount of net income tax paid as against original gross income for non-retired households with children. This demonstrates how the top decile of households (by income) pay less in income tax than is generally thought in relation to their very high incomes.

National Insurance Contributions

Table 4: 2006/7 Proportion (%) of gross household income taken in Employees' National Insurance Contributions. (Average gross household income for each decile is shown in brackets).

For 'all households', the 2004/5 figures showed NIC progressive until the 9th decile and then falling back for the 10th. The 2006/7 figures show that NICs are now progressive until only the 8th decile (and in fact only the 7th for non-retired households without children). Non retired households without children pay consistently higher proportion of their gross household incomes in NICs than all other categories and this applies where income levels are similar.

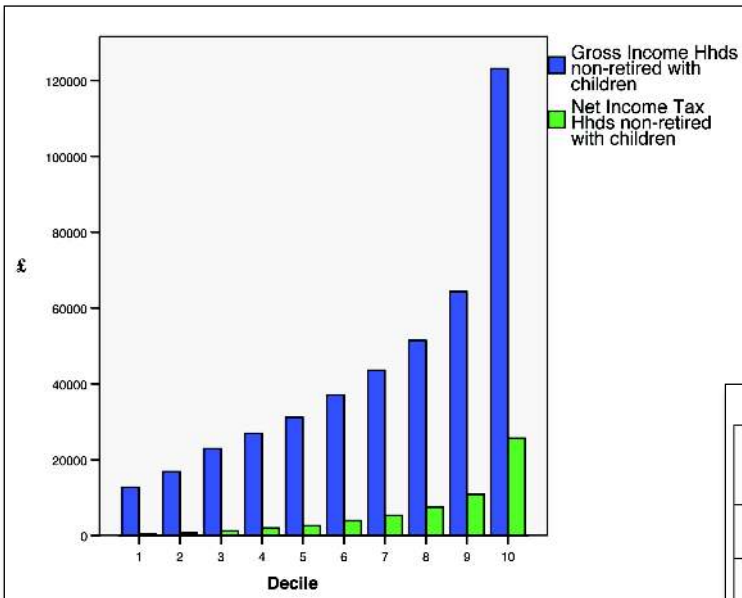


Figure 6

Decile	NIC All households	NIC Non-retired With Children	NIC Non-retired No children	NIC Retired
Bottom 10%	1.3 (£9,076)	1.7 (£12,724)	2.0 (£7,836)	0.1 (£7,032)
2nd	1.8 (£13,616)	2.7 (£16,875)	3.3 (£15,884)	0.1 (£9,898)
3rd	2.8 (£16,826)	4.3 (£22,900)	4.6 (£22,442)	0.1 (£11,537)
4th	3.4 (£20,362)	4.8 (£26,968)	5.5 (£26,998)	0.1 (£12,144)
5th	4.2 (£25,795)	5.2 (£31,216)	6.1 (£32,040)	0.0 (£13,171)
6th	4.9 (£29,938)	5.7 (£37,103)	6.5 (£37,914)	0.1 (£14,533)
7th	5.1 (£37,100)	5.8 (£43,561)	6.5 (£44,526)	0.1 (£17,379)
8th	5.7 (£44,759)	6.0 (£51,470)	6.3 (£49,099)	0.2 (£20,336)
9th	5.6 (£54,609)	5.4 (£64,357)	6.1 (£59,817)	0.3 (£24,764)
Top 10%	3.8 (£94,524)	3.3 (£123,217)	4.0 (£96,123)	0.3 (£44,688)

Table 4



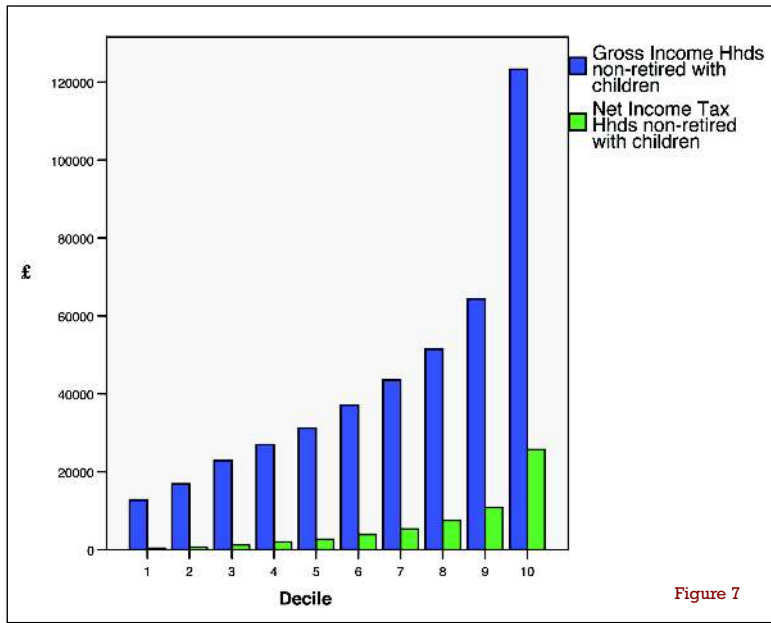


Figure 7: shows the amount of NI paid as against gross income for non-retired households with children. Again, this demonstrates how the top decile of households pay less than often thought in relation to their incomes.

Council Tax (and rates in Northern Ireland)

Table 5: 2006/7 Proportion (%) of gross household income taken in Council Tax (or Northern Ireland rates) for different household types (after taking into account rate rebates and council tax benefit). (Average gross household income for each decile is shown in brackets.)

Across 'all households', Council Tax is a consistently regressive tax. The income group with the lowest average gross household income is the bottom 10% of the retired. This group pays the highest proportion of gross household income in Council Tax of all household types and deciles.

Decile	Council Tax ⁴ All	Council Tax Non-retired With Children	Council Tax Non-retired No children	Council Tax Retired
Bottom 10%	7.5 (£9,076)	4.8 (£12,724)	6.7 (£7,836)	12.6 (£7,032)
2nd	4.6 (£13,616)	3.2 (£16,875)	4.0 (£15,884)	7.2 (£9,898)
3rd	4.3 (£16,826)	3.4 (£22,900)	3.7 (£22,442)	6.4 (£11,537)
4th	3.8 (£20,362)	3.0 (£26,968)	3.5 (£26,998)	5.8 (£12,144)
5th	3.7 (£25,795)	3.1 (£31,216)	3.0 (£32,040)	4.9 (£13,171)
6th	3.3 (£29,938)	2.9 (£37,103)	2.7 (£37,914)	4.7 (£14,533)
7th	2.9 (£37,100)	2.82 (£43,561)	2.4 (£44,526)	4.7 (£17,379)
8th	2.6 (£44,759)	2.5 (£51,470)	2.3 (£49,099)	4.8 (£20,336)
9th	2.3 (£54,609)	2.1 (£64,357)	2.0 (£59,817)	4.2 (£24,764)
Top 10%	1.5 (£94,524)	1.3 (£123,217)	1.4 (£96,123)	3.2 (£44,688)

Table 5

Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	11.9 (£9,076)	9.3 (£12,724)	12.8 (£7,836)	15.8 (£7,032)
2nd	10.2 (£13,616)	9.9 (£16,875)	14.1 (£15,884)	10.0 (£9,898)
3rd	12.4 (£16,826)	13.2 (£22,900)	18.0 (£22,442)	9.3 (£11,537)
4th	14.5 (£20,362)	15.6 (£26,968)	22.1 (£26,998)	9.2 (£12,144)
5th	17.6 (£25,795)	16.8 (£31,216)	21.6 (£32,040)	8.7 (£13,171)
6th	19.4 (£29,938)	19.1 (£37,103)	23.1 (£37,914)	9.8 (£14,533)
7th	21.4 (£37,100)	21.0 (£43,561)	23.2 (£44,526)	11.2 (£17,379)
8th	22.8 (£44,759)	23.0 (£51,470)	24.0 (£49,099)	12.8 (£20,336)
9th	23.8 (£54,609)	24.3 (£64,357)	25.0 (£59,817)	14.7 (£24,764)
Top 10%	25.3 (£94,524)	25.4 (£123,217)	25.6 (£96,123)	18.7 (£44,688)

Table 6

The highest income group is the top 10% of non-retired households with children and this group pays the lowest proportion of its gross household income in Council Tax. Retired households pay a higher proportion of their gross household income in Council Tax than the average for all households, including where similar income levels apply.

4 In this paper, 'Council Tax' is taken to include rates in Northern Ireland

Direct Taxes

Table 6: 2006/7 Proportion (%) of gross household income taken in all direct taxes by different household type. (Figures in brackets are average gross household income for the decile.)

For 'all households', the tax incidence is progressive except for blip at bottom 10% and 2nd decile; for non-retired households without children, it is progressive except for blip at 4th/5th decile; and for non-retired households with children, it is consistently progressive.

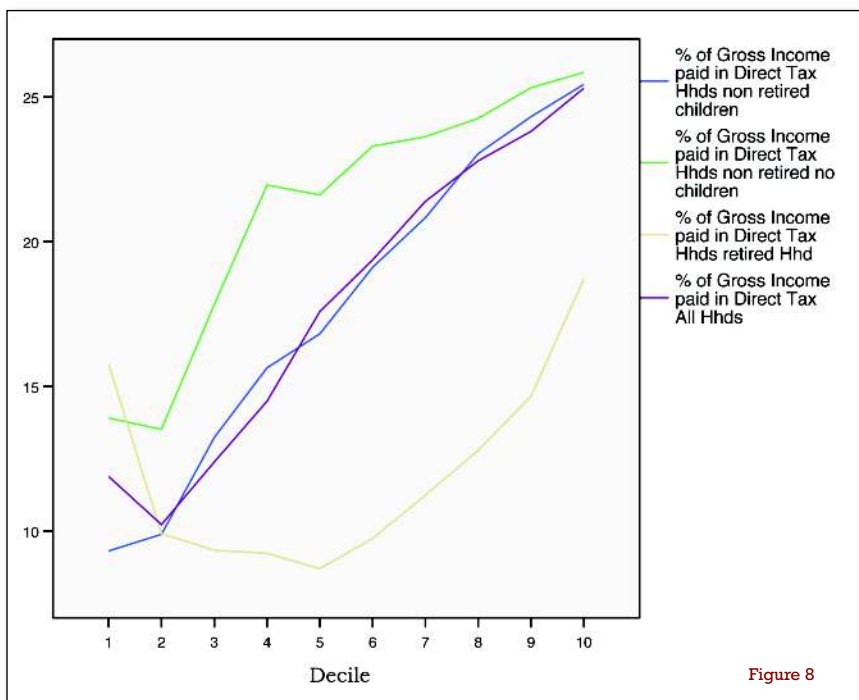


Figure 8

A different picture emerges for retired households where tax incidence is regressive between the bottom 10% and 5th decile but then progressive between the 5th decile and the top 10%. There is no appreciably high rate for the bottom 10% with exception of retired households. At similar income levels, the highest rate of all direct taxes is paid by non-retired no children. The rate between 9th and top decile differs noticeably only for retired households.

Figure 8: 2006/7 Proportion (%) of gross household income taken in all direct taxes by different household type.

Indirect Taxes

Table 7: 2006/7 Proportion (%) of gross household income taken in indirect taxes by different household type. (Average gross household income for each decile is shown in brackets.)

Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	34.2 (£9,076)	32.6 (£12,724)	38.7 (£7,836)	30.1 (£7,032)
2nd	23.4 (£13,616)	23.7 (£16,875)	23.5 (£15,884)	21.5 (£9,898)
3rd	20.5 (£16,826)	20.9 (£22,900)	18.0 (£22,442)	22.0 (£11,537)
4th	18.5 (£20,362)	18.2 (£26,968)	16.6 (£26,998)	18.7 (£12,144)
5th	17.1 (£25,795)	18.9 (£31,216)	15.6 (£32,040)	20.6 (£13,171)
6th	15.7 (£29,938)	15.2 (£37,103)	15.0 (£37,914)	18.6 (£14,533)
7th	15.2 (£37,100)	14.9 (£43,561)	14.0 (£44,526)	16.3 (£17,379)
8th	14.0 (£44,759)	13.4 (£51,470)	12.5 (£49,099)	15.8 (£20,336)
9th	12.2 (£54,609)	12.6 (£64,357)	11.8 (£59,817)	16.3 (£24,764)
Top 10%	8.8 (£94,524)	7.6 (£123,217)	8.4 (£96,123)	13.5 (£44,688)
Average	14.3 (£34,661)	14.0 (£43,039)	13.6 (£39,268)	17.4 (£17,548)

Table 7

Indirect taxes taken together are consistently regressive for 'all households' and for non-retired household without children. They regressive for non-retired with children except for a blip at 4th and

5th deciles and although the picture is more complex for retired households, they are regressive overall. The top 10% pay lowest rate of indirect taxes in every household type while the bottom 10% pay highest rate of indirect taxes in every household type. Non-retired households with children pay the highest rate where income levels are similar.



Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	13.6 (£9,076)	14.0 (£12,724)	13.8 (£7,836)	12.4 (£7,032)
2nd	9.3 (£13,616)	9.0 (£16,875)	9.0 (£15,884)	9.2 (£9,898)
3rd	8.1 (£16,826)	8.7 (£22,900)	7.0 (£22,442)	9.0 (£11,537)
4th	7.3 (£20,362)	7.1 (£26,968)	6.5 (£26,998)	7.4 (£12,144)
5th	7.0 (£25,795)	7.8 (£31,216)	6.2 (£32,040)	8.2 (£13,171)
6th	6.5 (£29,938)	6.5 (£37,103)	6.0 (£37,914)	7.4 (£14,533)
7th	6.5 (£37,100)	6.7 (£43,561)	6.0 (£44,526)	6.8 (£17,379)
8th	6.1 (£44,759)	6.1 (£51,470)	5.4 (£49,099)	7.1 (£20,336)
9th	5.4 (£54,609)	5.8 (£64,357)	5.5 (£59,817)	7.6 (£24,764)
Top 10%	4.1 (£94,524)	3.4 (£123,217)	3.9 (£96,123)	6.3 (£44,688)

Table 8

Table 8: 2006/7 Proportion (%) of gross household income taken in Value Added Tax by different household type. (Figures in brackets are average gross household income for the decile).

For 'all households', VAT is consistently regressive and, although the impact by decile is more complex with non-retired households with children and retired households, the overall picture remains regressive.

Table 9: 2006/7 Proportion (%) of gross household income taken in duty on hydrocarbon oils by different household type. (Figures in brackets are average gross household income for the decile.)

Perhaps surprisingly, duty on hydrocarbon fuels is also regressive and although the impact by decile is more complex for retired households, the duty remains broadly regressive.

Decile	All	Non-retired With Children	Non-retired No children	Retired
Bottom 10%	2.8 (£9,076)	2.5 (£12,724)	3.5 (£7,836)	2.3 (£7,032)
2nd	1.9 (£13,616)	2.1 (£16,875)	1.9 (£15,884)	1.6 (£9,898)
3rd	1.8 (£16,826)	2.2 (£22,900)	1.7 (£22,442)	1.8 (£11,537)
4th	1.7 (£20,362)	2.0 (£26,968)	1.6 (£26,998)	1.4 (£12,144)
5th	1.6 (£25,795)	1.8 (£31,216)	1.5 (£32,040)	1.3 (£13,171)
6th	1.6 (£29,938)	1.7 (£37,103)	1.7 (£37,914)	1.4 (£14,533)
7th	1.5 (£37,100)	1.6 (£43,561)	1.5 (£44,526)	1.2 (£17,379)
8th	1.5 (£44,759)	1.4 (£51,470)	1.2 (£49,099)	1.3 (£20,336)
9th	1.2 (£54,609)	1.2 (£64,357)	1.1 (£59,817)	1.2 (£24,764)
Top 10%	0.8 (£94,524)	0.7 (£123,217)	0.7 (£96,123)	1.0 (£44,688)

Table 9

Conclusion

It is difficult to conclude on the basis of the figures presented here that Labour is the 'Party of fairness'. Although Labour might claim fairness in other areas of policy, taxation policy is so central to broader social and economic policy, that it must form a key part of any assessment of Labour's claims.

- The top 10% do not pay their fair share of tax.
- The bottom 10% face a highly punitive tax burden.
- 'Middle England' bear the brunt of the tax burden.

Figure 9: shows all direct and indirect taxes in comparison with household income.

Figure 8: 2006/7 Total Direct Taxes, Indirect Taxes and Gross Household Income for All Households.

Why do the top 10% enjoy a comparatively low incidence of tax? The top 10% pay a relative small proportion of their gross household incomes in tax because of the non-progressive character of all main taxes other than income tax and because much of their income in forms other than earnings which itself enables them to pay lower rates of tax. For the top decile of non-retired households, 25% of gross income comes from sources other than wages and salaries compared with 18% for the next two deciles. Much of this is from self employment income where the top decile of non-retired households receive 17% of their income from self employment compared with 10% for the second highest decile and 8% for the third. The allowance treatment for income tax of self employment incomes is significantly more generous than for employees on PAYE and covers a much wider range of allowable expenses.

When we come to look at highest income households we can turn for insight to the study by Brewer et al5. Below we have copied the key figure from that publication which uses HMRC data which gives a better picture of the most affluent than our source for all households. It should be noted that, in contrast to the data presented elsewhere in this paper, this figure shows the pattern for individuals rather than households.

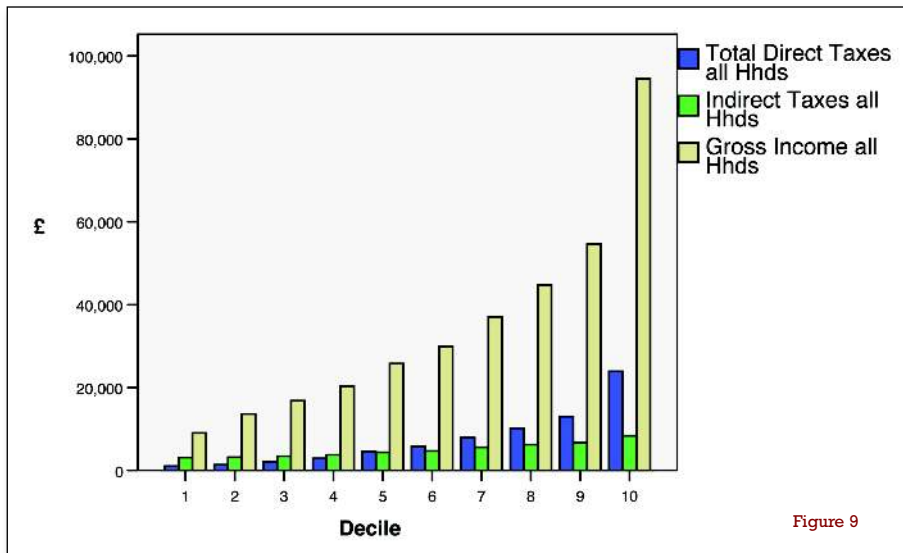


Figure 9

The significance of investment income for the very affluent top 1% is evident. Taxes on investment income do not include NI payments. Again, the figures above relate to income declared for revenue purposes. It is much easier to avoid tax legally on investment income than on earned income.

5 M Brewer, L Sibieta and L Wren-Lewis (2008) Racing Away: Income Inequality and the Evolution of High Incomes, Institute for Fiscal Studies, <http://www.ifs.org.uk/bns/bn76.pdf>

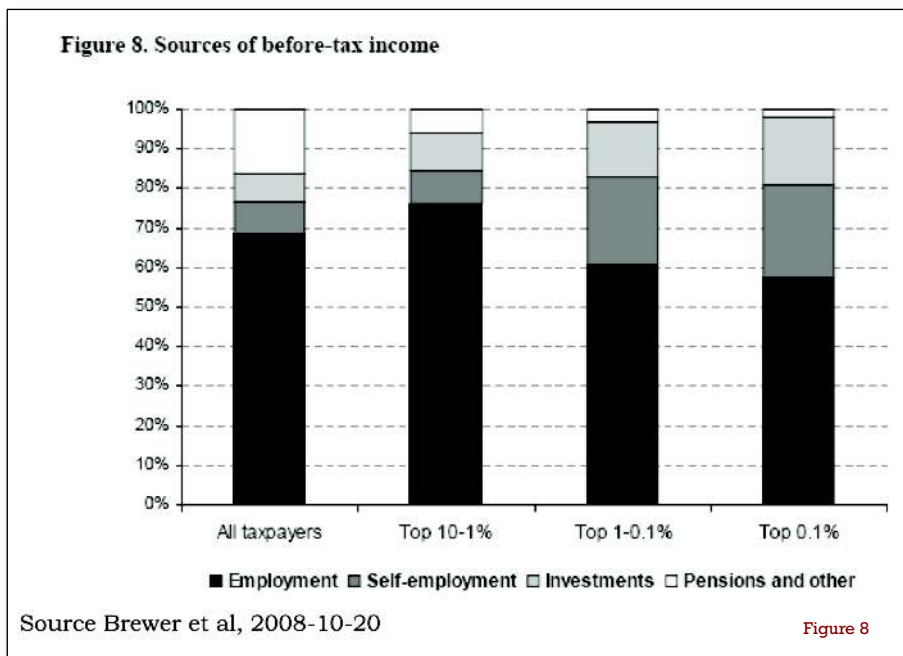


Figure 8. Sources of before-tax income

Figure 8

Source Brewer et al, 2008-10-20

Why do the bottom decile pay such a high proportion of their income in tax?

The bottom 10% pay in the region of one third of their gross household income in indirect taxes on consumption. (In fact, the bottom decile of non-retired households with children pay almost 40% of their income in indirect taxes.) Indirect taxes are now characteristically flat rate whereas historically they were often higher on 'luxury goods'. So since most of the lowest decile spend all their income on consumption they pay high indirect taxes. The high proportion of income paid in Council Tax is more surprising. Sixty percent of the gross income of the lowest decile of all households comes as state benefits; those in receipt of many means tested state benefits are eligible for 100% rebates on Council Tax.

For retired households the explanation is that many of these households in the lowest decile of retired households will have assets and small retirement pensions – this decile receives 12.5% of gross income in the form of occupational pensions or annuities. This disqualifies them from council tax benefit. Sixty one percent of households in the lowest decile of retired households are owner occupiers and many will have relatively high banded dwellings which will lead to higher council tax. The resentment by pensioners of Council Tax becomes entirely understandable. For non-retired households, the picture is more complex.

For bottom decile households without children the explanation seems to be that a high proportion of their income comes from wages – 58% for the bottom decile of such households⁶. Low waged people are often just over eligibility levels for Council Tax benefit. Again a lot of the households in the bottom decile derive a substantial part of their income from incapacity benefit and may have some assets or another adult working part-time, which would also place them just over the Council Tax benefit threshold. So Council Tax hits lowest income people hard.

Discussion

It is hard to avoid the conclusion that the top 10% are not paying their fair share. Indirect taxes are regressive and this regressive character is not outweighed by direct taxes. Even among direct taxes, the only consistently progressive tax is income tax and here we see that income tax fails to 'keep pace' with the rising incomes of the top 10%. This is partly a result of tax avoidance by the better off and particularly the ability by some to define income gains as 'capital gains' and to pay capital gains tax instead of income tax. This needs to be considered alongside the effects of National Insurance and Council Tax where tax 'caps' operate in the financial interests of the top deciles. The removal of the cap in Council Tax and a higher rate of income tax for earners of over £100,000 annually would go some way to addressing this inequity. However, here we focus on National Insurance.

National Insurance is now a tax levied on earned incomes. For most people it is charged at the rate of 11% on earned incomes of between £4,680 p.a. and £40,040 p.a. (2008-9) with a 1% charge on earned incomes above that level. A number of points should be noted. First, it is charged only on earned incomes so the finance 'wizards' who are able, with the apparent agreement of New Labour, to take their earnings as capital gains not only pay a lower rate of tax than they would as income tax (capital gains tax for individuals is expected to be 18% in 2008-9, much lower than the 40% incurred by income tax) but altogether avoid National Insurance. NI is exactly half the basic rate of income tax and therefore a substantial payment for most workers.

Second, the income cap for the full rate makes the tax inherently regressive at the upper end. Third, originally high NI payments were associated with higher benefits but now NI benefits are again flat rate whilst payments are earnings related.

We can see that only for retired households does the top decile pay more tax proportionate to income than do middle income households. This reflects the way in which the marginal rate of real tax increases sharply for retired households from 22% to 40% as they pass the higher tax threshold. For non-retired households the increase is only from 33% to 41% in consequence of the impact of National Insurance payments. Richard Crossman in his 1960s Fabian pamphlet *Paying for the Social Services*⁷ suggested that people did not understand National Insurance as a tax and it was therefore easier to increase it than to increase income tax. We can see the consequences of this in tax income ratios to this day. There is an overwhelming case for the extension of the full rate of National Insurance across all earnings so that it redistributes among all workers. This raises the question of whether income tax and National Insurance should now be unified with much steeper marginal rates of tax introduced. This should be coupled with the closing the loophole through which earnings can be taken as capital gains rather than income, prevalent in Private Equity and Hedge Funds.

⁶ It is important to remember that the bottom decile of all households does not contain all the households in the bottom decile of the respective sub-categories.

⁷ R Crossman (1969) *Paying for the Social Services*, London: Fabian Society

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