Call for Evidence:
Tax after Coronavirus

To: Treasury Select Committee

By: The Intergenerational Foundation

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The Intergenerational Foundation (www.if.org.uk) is an independent think tank researching fairness between generations. IF believes policy should be fair to all – the old, the young and those to come.

Introduction
As IF is the UK's leading think tank which exists to promote the rights of younger and future generations, we think that reducing intergenerational inequalities should be one of the main aims of the UK's post-COVID recovery.

This is particularly important because there is now clear evidence which suggests that this crisis has affected different generations in the UK in distinct ways: whereas older people have been far more vulnerable to becoming seriously ill from, and dying with, COVID-19, younger adults have so far borne the brunt of the economic hardship which the crisis has caused. The distinct ways in which the COVID-19 crisis has affected different age groups means that government support measures which are intended to help the UK recover from the crisis will need to be targeted at different groups in a nuanced way in order to have their desired effect.

We already knew that young adults were still feeling the impacts of the 2008 financial crisis on their living standards, particularly with regard to stagnating real incomes and lower wealth accumulation compared to when previous generations were at the same stage in life. So we think it's important that the UK economy doesn't simply return to "business as usual" in the aftermath of the COVID-19 crisis.

In the rest of our response, we will present evidence to demonstrate that young adults have been disproportionately affected by the economic impacts of the COVID-19 crisis and then propose some policy ideas which we think the UK government should adopt in the post-COVID world.

1) COVID-19 has harmed the living standards of young adults disproportionately

Prior to the beginning of the COVID-19 crisis, young adults in the UK were already lagging behind where previous generations were at the same stage in life on a number of measures.

As the final report by the House of Lords Intergenerational Fairness and Provision Select Committee argued in 2019, members of the Millennial generation (those born between 1980 and 2000) were not earning any more in real terms than the previous generation were at the same stage in life, despite a much higher proportion of them holding a university degree; they were also more likely to be working in temporary or insecure forms of employment, much less likely to have got on the property ladder, less likely to be saving towards their retirement via a defined benefit pension scheme, and the members of this generation who have been to university are burdened by high levels of student debt.

IF published research last year in collaboration with Yorkshire Building Society which highlighted how young adults' living standards today have declined in comparison to those of the previous generation when they were at the same stage in life. By analysing the household expenditure of different age groups, we found that almost two-thirds of all the money which is spent by households in which the Household Reference Person is under 35 goes on "essential" goods and services such as housing, transport, clothing and food; this figure is higher than for any other age group and has increased by nearly 10% since the early 2000s. By contrast, the proportion of their total household budget which is spent on essentials has fallen for the average household where the Household Reference Person is over 65.[1]

Since the COVID-19 crisis began, a number of pieces of evidence have emerged which suggest that young adults have also taken an especially large hit to their living standards from the pandemic. Firstly, we know that younger adults disproportionately work in sectors of the economy which have seen reduced activity since social distancing measures began, such as retail, hospitality and tourism, which means more of them have been unable to work and face a higher risk of unemployment going forwards. These industries also tend to disproportionately provide employment for young adults who have recently left education, which means there is a significant risk of this year's generation of school and university leavers experiencing unemployment at the beginning of their working lives.

Secondly, younger workers are conversely more likely to have been furloughed than older workers, which means that many of them will have suffered a fall in their incomes. Thirdly, we know that this age group is less likely to be able to cope with suffering a sudden decline in their incomes than people in older age groups because they are less likely to have enough savings to be able to maintain their previous standard of living.

[1] Kingman, D. (2019) *All Consuming Pressures: The cost-of-living crisis facing younger generations;* London: Intergenerational Foundation

Finally, we also know that this crisis is likely to have a severe impact upon the housing situation on this age group, as they are more likely to be living in the private rented sector than older households. Although the government has so far placed a ban on evictions throughout the period when social-distancing measures have been in effect in the UK, this is currently due to expire on 23 August, and there could be a wave of evictions at that point if large numbers of private renters still cannot afford to pay their rent. Additionally, there is the problem that tenants who've been granted rent holidays have been accumulating debts throughout this crisis that they have an obligation to pay back to their landlords in future, which is likely to have a further negative impact on their living standards.

We also know from our own original research that the COVID-19 crisis has also exposed pre-existing inequalities in the amount of living space which different generations have access to, which is significant given that many households have been spending most of their time at home since the lockdown began. Using data from the English Housing Survey, we found that half of all households in England where the Household Reference Person is aged 16 to 29 have less than 29.9 square metres of living space per person, whereas households where the HRP is aged 65 or over have almost twice as much (57.3 square metres per person).[2]

2) The UK could raise substantial additional tax revenues by raising taxes on unearned income

IF believes that the COVID-19 crisis would be a good moment for the government to think about the overall design of the UK's tax system, given that significantly higher tax revenues are going to have to be generated in its aftermath to help pay for the cost of mitigating it.

One of the most obvious ways of making the design of the UK's tax system more intergenerationally fair would be to shift some of the burden of taxation from earned income on to wealth, as taxes on earned income fall more heavily on younger people whereas the fact that much of the UK's private wealth is owned by older households would result in them contributing more towards the recovery.

IF has proposed a number of ways in which tax could be levied on unearned income which we estimate could raise up to £52 billion per year in additional revenue:

[2] Kingman, D. (2020) *Room to breathe? How the COVID-19 lockdown highlights age inequalities in living space*; London: Intergenerational Foundation

Table 1: Figures demonstrating at least £50bn for tax-take from charging National Insurance (NI) on unearned income plus reduction of reliefs on Capital Gains Tax (CGT)

Figures demonstrating at least £50bn for tax-take from charging NI on unearned income plus reduction of reliefs on CGT. Unearned Income is principally from rents, dividends and interest. National Insurance assumed charged at flat rate of 12%	
Item	**Total raised per annum (£bn)**
Rental Income assumed to be £130bn (ONS) therefore levying extra tax from adding National Insurance	15.6
Dividend income circa £70bn (ONS) assuming that UK residents and institutions receive foreign dividend income that roughly matches the dividends paid to foreign owners)	8.4
Interest income assumed it is negligible at the moment	------
Total extra National Insurance on unearned income	**£24 billion**
Tax revenue lost through CGT exemptions/allowances, based on latest HMRC Figures (2016/17) on disposal of only or main residence.	28
Total:	**£52 billion**

The first reform which IF has proposed would be to charge National Insurance Contributions on income which the owners of investment properties receive in the form of rents. At present, landlords may be eligible to pay Income Tax on these properties, but not having to pay National Insurance Contributions gives them an incentive to invest money in property in order to enjoy an additional income stream which is effectively taxed at a lower rate than earned income. Based on ONS data which suggest that landlords collectively receive £130 billion per year in rental income, levying National Insurance Contributions would raise £15.6 billion per year if it was levied at a flat rate of 12%.

The second proposed reform would involve charging National Insurance Contributions on unearned income from dividends. The ONS estimates dividend income to be approximately £70 billion and levying national insurance on this would raise around £8 billion.

The third reform which we've proposed would involve removing the primary residence relief which homeowners receive from Capital Gains Tax (CGT) when they sell their main home. Historically, the UK has not levied CGT on the gains which sellers realise when they dispose of a property which was their main residence. However, IF believes there are now very strong arguments in favour of doing so.

Firstly, it would be in the interests of both intergenerational and intragenerational fairness to tax the large gains which older homeowners who got on the property ladder in the 1970s and 1980s, when property prices were generally far lower than they are now, have enjoyed. The

Social Market Foundation (SMF) has recently estimated that £4.2 trillion worth of historic capital gains are likely to be realised on the sale of UK property over the next 25 years, and under our present tax regime a very large proportion of these gains are likely to go untaxed because of the extremely favourable treatment which capital gains on main residences receive under both the CGT and Inheritance Tax frameworks.[3]

Although it would be politically unpopular, taxing these gains appears to be one of the fairest ways of finding additional tax revenue to help repair the damage which COVID-19 has done to the public finances, and it should also help reduce wealth inequalities both within and between generations.

Secondly, main residences are subject to CGT in some other OECD countries. Research carried out by IF suggests that out of 36 of the OECD's current member states (Colombia was excluded because of missing data), 14 already charge some level of CGT on the disposal of a main residence, including Sweden, Switzerland, Italy and Japan.

Thirdly, Private Residence Relief is complex to administer, with a large number of rules and exemptions which are designed to take account of special circumstances. If it was removed, the UK could potentially move over to a simpler system where CGT was levied on all disposals where the gains were above a certain threshold, and all gains below that threshold were completely exempt.

However, IF is also cognizant of the potential drawbacks of removing Private Residence Relief, particularly if other aspects of the UK's tax system were not reformed in tandem. For example, levying CGT on the sale of all main residences where the gains were above a certain size could create a perverse incentive for homeowners not to sell their homes while they are still alive, as the present rules would allow them to pass on the property to their heirs without them paying tax on the capital gains. Therefore, reforms in this area need to take a holistic view of how CGT interacts with other aspects of the UK's tax code, in order to ensure that the benefits of reform can genuinely be realised.

We have estimated that if CGT was levied on all disposals of main residences, then it would have raised £28 billion in 2016/17. For the reasons which were given above, it is unlikely that all of these transactions would become eligible for CGT under a modified CGT framework, but the size of this figure does highlight how much additional tax revenue could be raised even if it was only levied on the most valuable transactions.

3) The UK should introduce employee National Insurance Contributions for people who work beyond State Pension Age

[3] Social Market Foundation (2020) *£421 billion plan to tax rising house prices to pay for the Coronavirus crisis* London: SMF

IF has previously argued that people who continue working beyond State Pension Age should have to make employee National Insurance Contributions at the same rates which apply to all other employees, as there is no good justification for the exemption which they currently enjoy.[4] IF estimated that if the approximately 1.2 million people above State Pension Age who were still in work before the pandemic had to pay employee National Insurance Contributions then it would raise at least £1.5 billion in additional National Insurance revenue each year which could be used to help fund government services.

4) The UK should remove tax breaks which benefit polluting industries as part of a "Green Recovery"

IF also believes it is important that the UK government emphasises the idea of ensuring that the UK has a "green recovery" when it comes to thinking about what the future should look like. This would mean that the ambition of achieving net zero greenhouse gas emissions by 2050 should be one of the key targets for the UK's recovery, which will require targeted investments in key areas such as renewable energy, home insulation, and electric vehicles.

Previous research by IF has highlighted that the aviation industry currently benefits from significant tax breaks from the UK government, the removal of which would help to achieve the aims of shifting towards a low carbon economy while also raising additional tax revenue. IF's research has shown that the aviation industry benefits from tax subsidies which were worth £11 billion per year in 2012, principally through flying being zero-rated for VAT and subsidies on the cost of aviation fuel.[5] Given that the UK's aviation sector will almost certainly have to shrink in order for us to meet our climate change objectives, it is important for intergenerational fairness that the government doesn't provide additional financial support, including new tax breaks on top of the ones which already exist, which some figures within the aviation industry have called for to help it mitigate the impacts of the COVID-19 crisis.

If you would like to learn more about the work of the Intergenerational Foundation please contact:

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[4] Intergenerational Foundation (2018) *An Extraordinary Anomaly: Why workers over state pension age should pay National Insurance* London: Intergenerational Foundation
[5] Lockley, P. and Dresner, S. (2012) *Flying in the face of fairness: Intergenerational inequalities in the taxation of air travel* London: Intergenerational Foundation