London First

The Case for a Competitive Personal Tax Regime

Briefing Note

The Government has stated that the 50% top rate of income tax is a temporary measure[1] to meet the current economic pressures. While the political tensions regarding the removal of this rate are understood, if we are to address the threat that it poses to the UK's long-term competitiveness, it is vital that the Government makes a clear and early commitment to removing the 50% rate by the end of the current Parliament.

A service-sector economy's success is, to a large extent, dependent on its ability to attract and retain the right workforce and to maximise its productivity. The UK is a service-sector economy and the dependency on this sector is clearly apparent in London.

London is a global city and home to the headquarters of many international organisations. As a result it has a different workforce composition to the rest of the UK, with a greater proportion of highly skilled, globally mobile workers. This brings many benefits to both the city and the UK as a whole; however it also brings a greater vulnerability to the international movement of talent.

To date, London has been recognised for the deep talent pool it can offer to a diverse range of business sectors. However, recent changes to UK tax policy, specifically personal tax policy, have put London's attractiveness to highly skilled workers under threat.

Over recent years, London's economy has been an important driver of UK growth through its position as a hub for international investment into the UK and its trading links with the rest of the country. London's success has not only generated jobs and GVA but also, until the most recent economic downturn, contributed between £14.3 billion and £19.4 billion[2] net to the Exchequer.

If London is to deliver the growth and investment needed to help secure the UK's economic recovery, it is vital that it can compete for, and retain, the best global talent. To achieve this, the UK needs an internationally competitive personal tax regime.

This briefing note sets out, at a glance, the key evidence supporting the case for a more competitive personal tax regime, as well as London First's recommendations to Government. A longer issues paper is also available on our website.

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1 David Cameron, Andrew Marr show, 9 January 2011: Said that measures to tackle the budget deficit would have to be "pretty permanent" - but he hoped the 50p tax rate for top earners would be scrapped.
George Osborne, Spectator interview, December 2010: "I didn't introduce the 50p tax," ... "I'll make it again clear, this is a temporary feature of our tax system. I am not someone who believes that high marginal tax rates are good for an economy. I don't think - in the long run - they encourage enterprise and investment so it is a temporary feature of our tax system"

2 London's Place in the UK Economy, 2009-2010, City of London, October 2009.

Competitiveness of the 50% tax rate

- With the imposition of the 50% tax, the UK is the highest taxed regime among the world's top 10 financial centres[3].
- Evidence from the CBI/KPMG London business survey (July 2010) found that 57% of businesses thought the 50% top rate of income tax was damaging London's competitiveness.
- Prior to 2010, the UK's top rate of personal tax was 40%. Comparing this rate with key competitor countries (rates including national and sub-national taxes) shows the UK rate to be below that of New York (US: 41.9%); Frankfurt (Germany: 47.5%); and Paris (France 47.8%)[4]. With the increase to 50%, the UK is no longer competitive.

Risks of an uncompetitive personal tax regime

- The UK is a service-driven economy: a situation that is heightened in London where 95% of jobs are in service-driven sectors (34.8% financial and business services; 21% hotels, restaurants, retail and wholesale; 22.2% in health, education and public admin; 7.4% in transport and communications; and 7.2% in other services)[5].
- In service-driven economies, the ability to attract the right people and skills is vital. With global competition for talent, an uncompetitive personal tax regime puts the UK at risk of losing out.
- Businesses choose to locate in London for a range of reasons, but a major factor is its deep and skilled talent pool[6]. If the talent pool shrinks, as people decide not to come to London or choose to leave, this draw will be diminished.
- If the best international talent no longer chooses the UK, specifically London, businesses will begin to choose to locate elsewhere. This results not only in a loss of the higher paid jobs but also the wide range of jobs provided by such businesses and the other businesses that support it.
- A loss of a small portion of the highest paid individuals has a major impact on the Exchequer. The top 1% of UK earners pays a quarter of all income tax and the top 5% pays almost half (45.5%)[7]. With 2009-2010 total income tax receipts at £134bn, the top 5% of income tax payers are paying for more than the entire education budget[8].

Revenue-maximising rate of income tax

- The 50% tax was initially forecast to raise an additional £1.13bn in 2010-2011, £1.18bn in 2011-2012, increasing to £2.4bn by 2012-2013[9]. While there are likely to be short-term gains from this increased rate as people and businesses take time to relocate or adjust their working arrangements, what is less clear is its longer term impact. For example, how many new businesses have been deterred from setting up in the UK, how many businesses have decided to expand operations elsewhere, and how many talented individuals have decided not to come to the UK or are making plans to leave?

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[3] Research by pwc. Source: Sunday Times,16 January 2011.
[4] OCED tax database
[5] GLA economics: Economic Evidence Base , May 2010
[6] CBI/ KPMG London Business Survey (2010); Cushman & Wakefield European Cities Monitor (2010)
[7] ONS: Survey of Personal Incomes
[8] Spending Review 2010: Table A.9 Total Departmental Expenditure Limits: Education 2010-2011 £58.4bn. Top 5% of income tax payers pay 45.5% of total income tax. Income tax receipts at £134bn multiplied by 45.5% is £61bn.
[9] HM Treasury; Economic and Fiscal Strategy Report and Financial Statement and Budget Report, April 2009 Table 1.2: Budget 2009 policy decisions

- Research considering the impact of taxes on the UK financial services sector found that 23% of institutions had considered or were currently considering leaving the UK and 25% of senior managers thought it likely that their organisation would move operational parts of teams out of the UK over the next few years, while only 2% believed that their organisation would add to their UK operations in the same time frame[10].
- When considering the potential drift away from London of a key sector such as financial services, it is important to understand the wider impact. For example, if London lost its leading financial services city status, it is likely that business services companies would no longer consider London as the obvious place to locate - a situation which then has knock on impacts across a range of business sectors.
- Given the current economic climate, it is now more important than ever to ensure tax rates are set at revenue-maximising levels, i.e. rates that accurately assess the behavioural impacts and the opportunity costs associated with competing tax regimes. The IFS estimates the revenue-maximising top rate of income tax to be 40%[11].

Recommendations

To restore competitiveness to the UK's personal tax regime, the Government should:

- remove the additional 50% rate of income tax and return to a top rate of tax of 40%;
- make a similar commitment regarding the UK's personal tax regime as has been made regarding the corporate tax regime, i.e. for the UK to have the most competitive personal tax regime in the G20, and set a timetable as to when this will be achieved;
- undertake further analysis to establish the long-run revenue-maximising top rate of income tax and link the higher tax rate to this analysis to ensure the UK's competitiveness over time;
- create a clear framework for the setting, and direction of travel, of personal taxes to give certainty and predictability; and
- consistently make the case and ensure policy reflects the need for the UK and London to be home to the best talent.

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[10] Policy Exchange research note: Not with a bang but a whimper, December 2010

[11] IFS briefing note 84: Can more revenue be raised by increasing income tax rates for the very rich? Mike Brewer and James Browne, 2009. Report responded to the then proposed increase in the top rate of tax to 45%