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When it comes to the VAT base, the freedom to narrow is best ignored

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The temptation is near irresistible. Brexiteers want “wins” from freshly repatriated policy freedoms. One tax-related power we get back upon EU exit is determining the structure of VAT.

Those dastardly Brussels menaces have long constrained governments’ desires to slash rates on certain products. Freed from their obstinance, some Leavers want Philip Hammond to deliver popular rate cuts on products such as women’s sanitary products and domestic fuel.

The Chancellor, in this case, must resist Brexiteer demands. Further complications of our dysfunctional tax code should be no Brexit priority. Carve-outs of products from the VAT base will jack up compliance and administrative burdens, distort consumer choices, necessitate higher, more damaging taxes elsewhere and deliver relief for its supposed beneficiaries in a maddeningly inefficient manner. Worse, it will open the floodgates to a baying mob of vested interests encircling the Treasury.

During the referendum campaign, Vote Leave advocated reducing the VAT rate on household gas and electricity to zero. Brexiteers jumped too upon the bandwagon of zero-rating the “tampon tax” – the 5pc VAT currently imposed on sanitary products. The EU has since ceded this, albeit kicking the can for countries’ ability to zero-rate women’s sanitary products to 2022.

UKIP, laughably, pledged last year to scrap VAT on fish and chips. A long-running holiday industry campaign wants VAT on domestic tourism to be jettisoned. Now, with this ever-loudening hum of demands and buoyed by rhetoric against online corporations, the property consultancy Colliers International has suggested a two-tier VAT system across business types, with a 15pc rate for purchases in stores and a much higher 22.5pc VAT for online transactions.

No wonder all sense an opportunity. VAT is one of very few taxes almost entirely overseen by Brussels. EU rules make VAT compulsory, set a minimum main rate of 15pc, and restrict us from expanding the list of zero-rated items. The rationale is to stop back-door protectionism through zero-rating items produced at home and applying full rating to types of goods imported. After Brexit, we are at liberty to change all that.

But change we must not. At least, not in the proposed direction. We Brexiteers might be loath to admit it, but in this area the EU has generally pushed us towards economic literacy. Broad bases and low tax rates are the goal. We shouldn’t be discriminating between activities or products.

These new suggestions would complicate an already infuriatingly daft system. The UK VAT exempts entirely sports activities, most gambling and museums. It zero-rates most food, books, children's clothes and newspapers. A lower rate of 5pc is set for energy, sanitary products and much more.

The estimated lost revenue of major reliefs alone stands at £52bn, according to HMRC. That's a full 42pc of the current £125bn in VAT revenues. The main rate could be reduced from 20pc to around 15pc if VAT was applied uniformly. That's not to mention the benefits to businesses and government on administration and compliance, including not having to deal with continual court cases about products that fall into definitional grey areas.

The major justification used for targeted lower rates, in counter, is that a uniform VAT would be regressive. The poor spend disproportionately on food, clothing and domestic energy. Low or zero-rating, it is said, can implicitly subsidise these products. Just as campaigners today bemoan "period poverty" or "fuel poverty" in pushing for zero-rating tampons and domestic fuel, a uniform VAT rate would create "food poverty", "children's clothes poverty" or maybe even "newspaper poverty".

Yet it can be shown easily that applying social redistribution through the VAT code is inefficient. Tax relief applies to all that product's consumers, irrespective of their means. One can always provide targeted assistance to those on low incomes (the metric that ultimately matters) more efficiently.

The Institute for Fiscal Studies has previously calculated that one could replace VAT exemptions entirely and achieve the same distributional goals through raising the income tax personal allowance and making tax credits more generous, and still have a cool £3bn or more left over. Talking of individual product "poverty" might be a good soundbite, but one does not need every tax or every spending item to be individually "progressive" to assist those in need.

If there is little case for VAT-based social policy, the case for industrial policy is weaker still. A zero rate for domestic fuel, already subsidised implicitly due to its lower 5pc rate, directly works against green policies that deter consumption.

There is no case for supporting domestic tourism over other leisure activities, fish and chips over curry or high streets over online. Such tax incentives merely distort our decision-making away from our true preferences, undermining economic efficiency. This in a system that already discriminates between cakes against biscuits, chocolate buttons used for cake decorations and those not, and apparel designed for children either side of clothes sized for 14-year-olds.

Then there's the politics. Favourable rates, once implemented, become impossible to remove, and encourage those seeking their own special treatment. In 2012, the coalition government attempted modest base-broadening through levying VAT on food in takeaways supplied above the ambient temperature. The so called "pasty tax" was subsequently rejected and described as "unfair".

The lessons there were important. Daft narrowing of the VAT base creates a baseline sense of entitlement. And only very broad tax reform that genuinely levels the playing field will ever be considered reasonable. Sadly, in their desire to highlight a meaningful Brexit, some Leavers

would instead confer more of these tax privileges on certain businesses and activities. It would be better for the UK, in the case of VAT, if freedoms gained were freedoms ignored.

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