

Tax Reform and UK Fiscal Policy

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Introduction

When economists talk about fiscal policy and fiscal issues, they are referring to all government policies and actions which directly and indirectly relate to the raising and spending of tax revenues. In the UK, the Budget is the vehicle by which that taxation is raised and expended and is therefore the most tangible manifestation of government fiscal policy. UK fiscal policy has never been more in the spotlight than it is at the present time. This is because of historically high levels of government borrowing and high interest payments on the national debt, the toll on many people of the years of austerity and neglect of the public realm, and the ever-increasing demands on public spending and public services created by Britain's large and growing older population.

This paper proposes a set of specific personal and business tax reforms but, importantly, it also provides a strong fiscal policy steer for the period of the current parliament, which sadly has been so lacking so far from the current government. The tax reforms specified cannot all be implemented in a single budget and are likely to take several budgets; however, with the false start made by the government in their Autumn 2024 Budget it is now essential that they do not waste the opportunity of the Autumn 2025 Budget to establish a clear sense of fiscal purpose and direction as recently called for by Helen Miller, the Director of the Institute of Fiscal Studies. I have also attempted to address the immediate need to raise more tax revenue as well as the longer-term fiscal challenges for the UK.

Without the benefit of the Treasury's sophisticated taxation models and databases it is difficult to calculate the exact effects of any tax change. However, information derived from the Institute for Fiscal Studies, the Intergenerational Foundation, the Resolution Foundation, and Tax Justice UK has provided me with an estimate of over £100bn per year of additional revenue which could be raised through a combination of the equalisation of income tax, the closing of deliberate tax loopholes, the unmasking and

criminalisation of the use of offshore tax havens, and the prohibition of using trusts for tax avoidance purposes by settlors. I propose that these additional tax revenues are used in reducing the current level of government borrowing, in creating a much fairer and sustainable tax base, and for the improvement of public services and infrastructure. It is envisaged that by the end of this parliament the UK tax system would have been improved in the following fundamental ways:

1. Earned income and investment income treated in the same way for the purposes of individual taxation.
2. Personal taxation and some aspects of business taxation simplified and made less susceptible to tax evasion and tax avoidance.
3. Tax revenue levels increased to fund better public services, more public investment, and lower levels of government borrowing.

This paper also supports a fiscal policy which better promotes sustainable economic growth and a more certain environment for UK households and businesses.

Budget Principles

All too often, UK fiscal policy has been about making tentative adjustments to pre-existing taxes to gain a little more revenue - here and there - to finance a pre-election tax cut or to cope with funding crises in areas such as the NHS and social care. This type of fiscal management over many years has made the UK tax system incredibly complex and thereby more susceptible to tax avoidance and tax evasion than it would otherwise be. The Budget process itself is heavily influenced by establishment narratives and tropes alleging insurmountable difficulties in achieving tax compliance from wealthier individuals and multinational companies; and, if all else fails, a false argument is rolled out that increases in taxation will only result in decreases to tax revenues! In this way the UK Budget, and even the budgetary process itself, is self-constrained long before the Chancellor and her Treasury team pose for the media on the steps of No.11 Downing Street.

What is urgently needed in the UK is an overhaul of the tax system itself to allow for a wider range of responses to the fiscal challenges we currently face. So let's start at the beginning. What should be the overarching policy aim of the UK Budget? In practice, the answer to this question will depend on the knowledge, experience, values, and instincts of the Chancellor of the Exchequer but my appeal is for the question to be put and for an answer to be demanded which contextualises any UK Budget within a comprehensive fiscal policy framework. As an example of what I mean, I would suggest the following overarching aim for any UK Budget:

'A transparent, simple, and fair UK tax system and fiscal policies promoting sustained economic growth, high social mobility, and good public services and facilities within an overall balance of revenue income and expenditure.'

This overarching policy aim would be supported by the following objectives:

1. An overall balance between tax revenue and government expenditure (including national debt interest) in the Treasury Revenue Account.
2. Government borrowing reserved for investment expenditure on real projects that have been assessed as being economically viable and socially beneficial, and fully feasible within the available factors of production: land, labour (including project management), and capital.
3. Government money creation measures (such as quantitative easing) will no longer entitle nor permit the payment of interest to commercial banking institutions.
4. A combination of monetary and fiscal policy will be used to mitigate the detrimental effects upon the asset-poor of property and financial asset price inflation related to government money creation measures.
5. The common tax treatment of all forms of personal income - both earned and unearned - that is wages, pensions, profits, dividends,

capital gains, rents, interest, and large gifts will be delivered through a Combined Personal Income Tax (CPT) system.

6. Full tax compliance by individuals and organisations will be expected and rigorously pursued in the interests of fairness and lower tax rates for all.

Due to the obvious political challenges for any government attempting to increase the tax take or to reduce spending, 'economic growth' becomes the go-to solution for any problem with the public finances. However, all too often, economic growth is a longer-term prospect which does not address immediate issues, many of which in themselves are a brake on the very economic growth which is so desperately needed.

Following a 15-year period in which economic growth flatlined and social conditions declined, Britain now needs to raise more tax revenue to support its revenue and capital expenditure plans and to kick start a more hands-on economic growth strategy which many years of austerity failed to achieve. How we could do this is explained in some detail in this paper, but some priority must also be given to improving tax compliance by both individuals and business organisations as this has the potential to lower tax rates for all, by sharing the tax load! The Institute for Fiscal Studies (IFS) and the Office for Budget Responsibility (OBR) periodically provide data for tax evasion and avoidance in the UK, but a recent estimate by Tax Justice UK put this figure at a minimum of £47bn per year. Many thinktank reports have indicated that there is an annual shortfall in tax revenues of many more tens of billions of pounds due to undeclared income and sophisticated tax avoidance whereby income is 'lost' from scrutiny. Whilst some of this lost revenue will not be recoverable, there is a need for a 'new tax deal' with the British public that says something like this:

'We will keep UK tax rates at the lowest reasonable level commensurate with a prosperous and efficient economy and a compassionate society, but this is conditional upon all of us accepting that it is our duty to be personally tax compliant and in our business dealings with others.'

Non-compliance in tax matters needs to be seen as behaviour which is as reprehensible as bigotry and gender inequality. For the UK Government, tax compliance must become both a regulatory matter and a national cultural campaign based on the longstanding British sporting notion of 'fair play.' And this must include the way in which HM Treasury, itself, operates in compiling, reviewing, and revising tax legislation. It is time for the government to admit that there is very little in this world that is more deliberate and intentional than a British tax loophole!

There is a tradition in Britain of not taxing personal wealth as such, despite the increasing polarisation of individual wealth which has occurred from the adoption of neo-liberal and globalist economic and fiscal policies by all UK governments over the past 50 years. However, in recent years there have been increasing calls in Britain to tax high levels of personal wealth as more people have become aware of the 'windfall' nature of much of that wealth, for example in the form of house price inflation, financial asset inflation, and inherited wealth. But if we are going to tax personal wealth in ways that cannot be easily evaded or avoided then we must not rely on Inheritance Tax (IHT) and Capital Gains Tax (CGT) as the means to do so. As currently configured, IHT and CGT are not actually wealth taxes but merely wealth-related taxes and they are so riddled with 'loopholes' that they have become almost voluntary! The use - or should it be misuse - of trusts and similar financial instruments is responsible for an increasing volume of tax avoidance in general and especially in relation to the collection of IHT and CGT. This tax avoidance device needs to be turned off.

It is also time to recognise the ever-expanding life-style chasm which exists between higher-income / asset-rich pensioners and lower-income / asset-poor pensioners, and that our current 'universal' pensioner benefits system is a highly embarrassing historical remnant of an era in which pensioners were typically the least affluent of all age-groups rather than the most affluent as they are today. These 'old age' benefits should now be subject to means testing and the considerable savings which would accrue could then be used to support a more generous state pension for all pensioners as

advocated later in this paper. The State Pension should of course continue to be paid to all people reaching the state pension age who have satisfied the qualifying criteria; however the qualifying criteria, currently based on employee NICs, should be based on an individual's wider income tax record in keeping with the proposed CPT system [see later].

With regards to smaller businesses, they urgently need reform of the local tax system to better reflect their social contribution to local communities; a good example being independent high street shops. With regards to multinational and global companies, they should not be allowed to avoid taxes on their UK sales by virtue of being headquartered overseas. In relation to all businesses, large and small, they would benefit from reform to make employer and employment taxes simpler to administer and more supportive of their business operations.

Finally, it should be a rule that every government funded investment project proposal has to positively address the following four questions:

1. Is the investment likely to increase the UK's net national product?
2. Is the investment likely to reduce the net operational costs or increase the quality of the associated service?
3. Is the investment likely to increase UK net economic welfare?
4. Have the financing costs of any government borrowing requirement been included in the planned costs of the project?

The Balanced Budget

Following the Covid-19 pandemic it is now obvious to all sides of British political opinion that there are times when the government of a sovereign nation needs to run a budget deficit to address specific risks to its economy and society such as natural disasters and pandemics, financial crises, and severe economic recessions. However as soon as economic circumstances permit, the Government should aim to regain a balance between taxation and revenue spending, to avoid, a) a reliance on government borrowing for day-to-day expenditure and, b) the need for central bank asset purchases

(Quantitative Easing). The former is a cause of general inflation and the latter a major cause of inflation in house prices and many other financial assets which, eventually, also feed through to general price inflation.

A policy of aiming for a 'medium-term balance' between tax revenue and public expenditure will help to ensure that public spending is not the cause - and is not seen to be the cause by capital markets - of unacceptable levels of a general price inflation which can be linked to excessive competition for factors of production (land, labour, capital) between the public and private sectors. UK public spending itself - that is both capital and revenue spending - should also be better deployed to increase the overall capacity of the UK economy, thereby reducing inflationary pressures by facilitating increases to national productivity and national product.

Some good examples of public service provision which can help to increase a nation's economic capacity in the medium and longer term include housing and amenities, health and social care, education and training, and security and justice. To take one example, the UK phenomenon of persistent unemployment and under-employment coinciding with high levels of job vacancies is the product of many years of cuts to per capita funding for further education and training (including adult retraining), a lack of high-quality apprenticeships for young people in the workplace, and the millions of working-age people languishing on NHS waiting lists for essential medical treatment.

A Combined Personal Income Tax

In the interests of equality and intergenerational fairness alone, it is high time for all forms of personal income: wages, pensions, profits, dividends, capital gains, rents, interest, and large gifts - that is, both earned and unearned income - to be treated the same for tax purposes and for Employee National Insurance contributions to be fully merged with Income Tax. I have long proposed that the very term 'Income Tax' be redefined as 'Combined Personal Income Tax' (CPT) to allow for the inclusion and common treatment of all forms of personal income taxation. CPT would have a Combined

Personal Income Allowance (CPA) below which no tax is payable at all. Above the CPA limit, tax would be payable at a basic percentage rate and at a higher percentage rate as applies to income tax at the present time. CPT would mean that there was no longer a distinction made between working income and retired income, enabling retirees to contribute their fair share of income tax revenue - but only, of course, those retirees who continue to have an annual income level above the prevailing CPT tax threshold.

The argument often made is that retired people cannot afford to pay income tax and national insurance contributions combined; however, I would argue that most working people cannot afford to do this either - yet they still must! To address this issue it is proposed that there is a substantial increase in the personal income tax allowance to £15,000 per annum by the end the current parliament. In this way, no-one will start to pay any form of income tax until their income reaches approximately 60% of the minimum wage of a full-time worker. The current use of a 'basic' and 'higher' rate of income tax should continue but the collection of income taxes under my proposed CPT would be more fairly spread between people with different income types, different work patterns, and different ages.

In addition to this reform of common personal taxation, universal pensioner benefits - except for free medical prescriptions, eye and hearing tests - should be targeted at 'state-pension-dependent' pensioners and not at the several million higher-income / asset-rich pensioners who now represent the single most affluent social group that has ever existed in the UK.

If the basic rate of CPT were set at 28% (20% income tax plus 8% for NICs) and the higher rate was set at 48% (40% income tax plus 8% for NICs) this would be unfair as CPT would not contain the Upper Earnings Limit and 2% Additional Rate which currently applies to Employee NICs. Therefore it is proposed that the basic and higher rates for CPT be as follows:

CPT Basic Rate 28%

CPT Higher Rate 45%

With a CPT Higher Rate at 45% there is a compelling case to withdraw the current 45% income tax band in keeping with the principle that any increase in personal income should result in the recipient retaining (after CPT) a clear majority of that income.

The Institute for Fiscal Studies (IFS) recently estimated that (what it calls) a unified personal tax system would produce £30bn in additional tax revenue. This alone would fund many proposed tax reforms and provide substantial funding to reduce the current level of government borrowing.

Business Employment Taxes

A common Combined Personal Income Tax (CPT) would also provide a useful opportunity to reform business employment taxes and to discontinue the complex and administratively costly system of Employer National Insurance contributions. In the second quarter of the twenty-first century it is time to recognise that the original funding link between National Insurance contributions and the provision of welfare services no longer exists. So instead of Employer NICs, I propose the setting up of a new system of Employer State Pension contributions (EPCs) to be collected at a level which would fund most of the cost of a revised UK State Pension, with an annual benefit level of £15,000 - or 60% of the minimum wage - by the end of the current parliament for all qualifying people from Age-65. For simplicity, all employers would pay a set fixed percentage of the value of each employee's monthly gross pay and submit this monthly to the HMRC.

The fixed percentage figure of the EPCs should be set at a level to raise a similar amount of revenue to current Employers NICs (£146bn in 2025/26), but with no salary cut-off point for higher earners and with no lower salary nil rate there is an opportunity for EPCs to be set at a lower percentage point than the 15% for current Employer NICs. Importantly, the revenues collected from EPCs should be earmarked (hypothecated) for the purpose of funding the costs of the revised UK State Pension. The overall costs of this reform for employers should be neutral, but it would reduce the tendency of some employers to structure their staffing around employment tax considerations

rather than strictly business considerations; for instance some businesses employ a higher proportion of part-time staff than is optimal for their operations and in the process they deny full-time employment to some staff who would wish to work more weekly hours!

The EPC would also remove the historic anomaly whereby employers are asked to pay towards social benefits that they don't see as beneficial to their businesses. I believe however that employers will come to see themselves as 'co-beneficiaries' of a revised state pension scheme and EPCs because of some real advantages for themselves, including the following:

1. Employees will know that their employment and their employer is the main source of the funding required for their future state pension and for the opportunity of future retirement.
2. Without a more generous state pension provision (of £15,000), employers will come under increasing market pressure to provide employees with improved pension benefits, or higher wages in lieu of the additional costs to their staff of extremely expensive private pensions.
3. Without a more generous state pension age (of 65-years), and with the imminent prospect of the state pension age being increased to 70-years, employees are already having to pace themselves through an indefinite working life with negative consequences for both worker productivity and business profitability. There is already proof of higher rates of long-term sickness absence for workers over the age of 65.

Wealth and Property Taxes

In the UK and elsewhere there is currently increasing interest in the case for a generalised wealth tax. Given the increasingly 'windfall' nature of wealth accumulation this is very understandable. My preference, however, is to tax all personal income fairly and comprehensively; my concern is not so much with private wealth ownership as such but that there should be some benefit for all members of society from the income accrued from private ownership

of significant wealth - hence my CPT proposals above. But due to the finite nature of land and its special role in economic and social policy, I do see an urgent need for a new tax on domestic property.

It is long overdue to make taxation on domestic property more proportionate to its value and to abolish our highly regressive system of Council Tax. In addition, property-based taxation needs to be simple and should encourage mobility within the housing market to make better use of the volume of the existing housing stock at any point in time.

There have recently been several proposals in this direction. For example, Professor John Muellbauer has suggested replacing the top two Council Tax bands with an annual wealth tax of 0.5% and the introduction of a land value tax of 1% on the value of farmland, forestland, and unoccupied land (on excess value above £40,000 per hectare).

My own preference is to abolish both Council Tax and Stamp Duty Land Tax on domestic properties altogether, and to replace them with an Annual Property Tax (APT) calculated as a percentage of current market values*. This percentage is likely to be about 0.6% but an exact figure can only be determined by using HM Treasury modelling software and this is not available to the author. However, this proposed reform of domestic property taxation would achieve a more proportional taxation of the existing and future UK housing stock, and encourage downsizing, employee mobility, and economic productivity - all of which are likely to lead to better economic growth and thus additional tax revenues.

[* Current market valuations of domestic properties should be made by an approved person/body within a period of 12 months of the APT assessment.]

To reduce the number of empty homes in the UK the proposed APT would be doubled after each 6-month period in which a property is left unoccupied, unless and until it is purchased by a local authority for redevelopment as a council house. Second, third, and subsequent homes would face an ATP of

1% and would, upon sale, be subject to the Capital Gains Tax which would apply under the terms of the proposed Combined Personal Income Tax.

The proposed APT would be collected centrally with local authorities funded fairly by nationally agreed formula. Some of the APT revenue collected by central government should be used to help fund a substantial and ongoing programme of council house building and refurbishment* and to improve public amenities. In this way (relative) house price inflation and private rent inflation will be contained as it was between 1950 and 1980.

[*That is: proper 'council' houses let by local councils and not the so-called 'social housing' let by 'housing association charities.']

The proposed Annual Property Tax will constitute a substantial disincentive to own second and subsequent homes, thereby ensuring that the existing UK housing stock is much better utilised, reducing some of the need to build new homes on greenfield land and its related environmental damage. Where second and subsequent homes persist, communities will be reassured that multiple homeowners are at least making some additional contribution to the nation's finances.

The net effect of these personal tax reforms will be to reduce the tax burden on lower-income / asset-poor younger adults and on the less affluent regions of the UK. Higher-income / asset-rich older adults will contribute a little more, but this will help to redress the extraordinary tax and benefits imbalance which has favoured older people throughout this century.

Inheritance Tax should be a Gift Tax

Although it is not defined as a wealth tax as such, Inheritance Tax (IHT) has some of the features of one and is the nearest thing to a wealth tax that we currently have. To support the aim of intergenerational fairness, IHT should be reformed under the nomenclature of 'Gift Tax,' to better reflect the nature of passing on an inheritance. Inheritance is not mandatory so why not call it what it really is, that is, a gift from a deceased person's estate? In effect a

newly defined Gift Tax would incorporate two categories: Living Gifts and Estate Gifts. This would also acknowledge the fact that lifetime gifts are often used by wealth holders as a device to avoid potential IHT liability later. The size of any gift would be defined in terms of its unencumbered or net value.

To make Gift Tax more progressive than IHT, the nil rate band should be reduced. I propose that the Gift Tax should allow for untaxed gifting of up to £100,000 for an Estate Gift and £30,000 (in any one year) for a Living Gift. However, I would also propose that the Basic (CPT) tax rate applies and not the current higher 40% tax rate. In the case where a gift is in the form of property or a tangible asset and the recipient has insufficient funds to pay it, then the payment can be deferred until such time as the asset is sold or passed on. This would incur a rate of interest based on a measure of general inflation. Gifted family heirlooms, such as high value jewellery and art works, could be exempt from Gift Tax, as such, but as soon as they are sold or re-gifted outside of the family, or otherwise used for commercial purposes, they would immediately be subject to CGT. CGT, itself, would be set at the same tax rates as apply to all personal taxation under the proposed Combined Personal Income Tax.

Replacing Business Rates with a Social & Environmental Charge

There is an urgent need to rebalance the taxes paid by physical and virtual businesses, and especially between high street and online businesses. This should include the abolition of Business Rates and their replacement with a Social & Environmental Charge (SEC). There will clearly be a need to create the necessary criteria upon which to make each individual SEC judgement as well as a decision about the overall level of intended tax revenue from this form of business taxation.

The starting point for the calculation of SEC could be the notional land value for the business premises, but the intention should be for businesses with a relatively positive social and environmental impact to enjoy a lower charge and for businesses with a relatively negative social and environmental

impact to bear a higher charge. Importantly, this system would provide an incentive for all businesses to improve their social and environmental impact.

The SEC should be designed to extract more taxation from businesses with low employment to turnover ratios, or high levels of various types of pollution (e.g. CO2 emissions and electromagnetic radiation), or which cause traffic congestion, or local power outages, public nuisance, and which damage the appearance of the natural landscape or urban landscape. For example, this will result in large out of town warehouses and data centres paying more tax and independent high street shops paying less tax than under the current system of Business Rates.

Corporate Turnover Tax

With respect to corporation taxes, there is a pernicious problem of large overseas based corporations being allowed to pay their taxes in their home country and not to the UK Government. Therefore I propose a 'Corporate Turnover Tax' to be based on the amount of business turnover or sales which an overseas corporation conducts in the UK. I suggest that Corporation Tax payable within the UK continues to be set at a competitive rate (though never at the lowest rate internationally) but that Combined Personal Income Tax rules must fully apply to any corporate profits which are distributed to UK resident business owners and shareholders.

Value Added Tax

It is the case that many items purchased by consumers are zero-rated for the purposes of Value Added Tax (VAT). Notably, this zero-rating applies to most food and drink, children's clothing and footwear, and to financial services. On the surface this is supportive of lower income families until you realise that the greatest beneficiaries are higher income individuals able to buy high value food and who use a wide range of financial services. I therefore suggest an end to zero-rating on these items and other items which are not for medical or care purposes and for which there are no excise duties payable.

Instead, and importantly, I suggest that the extra revenues that will accrue from this measure are used in full mitigation to low-pay individuals and to families with children, through an increase in Child Benefit, the ending of the Child Benefit Cap, and by increasing Universal Credit (and particularly the Child Element of UC). I would also use the remaining revenue gains from this measure towards my proposal to increase income tax allowances (i.e. CPT allowances) towards the target of £15,000 per year.

Conclusions

This paper has sought to provide suggestions for consideration by the UK Government in its Autumn Budget 2025 and in subsequent budgets. There are tax reforms which could be implemented, or at least initiated, almost immediately, whilst others will require more time. But above all, this paper provides a keen sense of fiscal policy direction and a strategy framework for future budgets. If the reader disagrees with my proposals, as many will, my challenge as always is this: What would you do? It will be interesting to see how the UK Government and the Chancellor answer this question.

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