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Summary

- Over the past quarter-century, as the tax burden has risen, so too has the structure of the tax system become markedly worse. The level of tax and structure of the tax system did not create the UK's post-2008 growth slowdown, but they have made recovery much harder.
- Although headline rates of income tax have not increased dramatically, the effects of fiscal drag mean that more people pay higher rates. In 1990 just 3.5% of adults paid higher rates of income tax, by 2010 this had increased to 8.5% and it is projected to rise to 14% by 2027. At the same time hundreds of thousands of people have been sucked into the '60p tax trap' created by the withdrawal of the personal allowance from those earning over £100,000.
- While the burden of income tax on above-average earners has increased the share of revenue attributable to consumption taxes (such as VAT and excise duties) has fallen from 28 to 22.5% between 2000 and 2024. Economic evidence suggests that taxing income is more detrimental to economic growth than taxing consumption.
- After both great economic shocks Britain faced in the 21st century, the 2008 Global Financial Crisis and Covid, governments responded by sharply raising taxes on investment. The result has been lower business investment and capital accumulation, with predictable results for productivity growth.
- Britain raises more in property taxes as a proportion of GDP than any other country in the OECD. While well-designed property taxes are generally less damaging than taxes on investment or income, the UK's property tax system is extremely poorly designed. Stamp duty is particularly harmful, inhibiting both housebuilding and labour mobility.
- As Britain's tax burden is expected to rise to a post-war high by the end of the decade, the flaws in the structure of the tax system will likely become a more biting constraint on future growth than they have been over the last two decades.

About the author

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About the publication

This briefing is a version of a chapter that will appear in a forthcoming IEA book, *The Great Stagnation: Why Britain Stopped Growing*, along with contributions from other authors. Each chapter presents and analyses a distinct explanation for the decline in British economic growth over the last two decades.

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Has the British tax system undermined growth?

How should we assess how supportive of economic growth, or how destructive of it, a tax system is?

Much commentary focuses on the overall tax burden, and with good reason. All things being equal, funds are more likely to be deployed productively when they are left in the hands of the private sector, rather than being put at the disposal of the government. Moreover, as a rule, the more you tax something, the less you get of it. Heavy tax burdens are likely to depress the private sector economic activity that adds up to economic growth – even if the taxes themselves are well structured.

But that leads to a second consideration: it is clear that the *quality* of a tax system matters as well as the *quantity* of revenue it produces. At any given level of revenue, there are more and less growth-friendly ways for a government to bring in cash. Indeed, if taken to extremes, a relatively lower-tax system could be more growth-destructive than a higher-tax one, as a consequence of how those taxes were levied. As a result, simple comparisons of the overall tax burden cannot wholly explain differential paths for economic growth – even if you control for other policy differences.

How, then, to assess the economic quality of a tax system? The crucial concept is *neutrality*: the degree to which taxes impact economic decision-making. A well-designed tax system will raise necessary revenue while minimising its impact on whether and how to work, save, invest and spend. The less neutral a tax system is, the more distortionary it becomes. The more policy factors come to outweigh economic ones, the more growth will suffer.

Of course, neutrality is easier to maintain when the tax burden is lower. However, this briefing will suggest that Britain's tax system has become less neutral – more distortionary – in ways that are not explained simply by a higher tax burden.

One indicator of a tax system's neutrality is its composition: which broad categories of tax are employed, and what is the relative weight of each of them? This matters because research has revealed a clear hierarchy of taxes (Johansson et al. 2008). Economists tend to believe that corporation tax has the most negative effect on GDP per capita, followed by taxes on personal income. Taxes on consumption are less damaging, and well-designed property taxes are less damaging still. (That 'well-designed' caveat is important.) The more a tax system relies on relatively benign sources of tax revenue, the more pro-growth it is likely to be.

Marginal tax rates are also important. The higher tax rates are at the margin, the more heavily they weigh on people's choices, and the more distortionary they will be. A low marginal tax rate may be an annoyance; a high one can be prohibitive. At any given level of revenue, a lower tax rate levied on a broader tax base is likely to be preferable from an economic perspective.

However, we need to be cautious when talking about tax bases, because the choice of *what* to tax can have profound economic implications. In particular, taxes on personal and corporate income tend to create a bias against saving and investment –

the seed corn of future growth. Structural features of the tax system that offset this ‘double taxation’ effect, such as tax relief for saving and capital allowances for investment, may appear to be an unwise narrowing of the tax base; in fact, they are essential modifications from a pro-growth perspective.

Taxes are also likely to be especially burdensome when they weigh on business inputs. Capital is one such input, but there are others – labour, land and energy chief among them. We should also consider the complexity of taxation, and its associated administrative burden. The more complicated a tax system and the harder it is to comply with, the greater its deadweight costs are likely to be.

When combined with the tax burden, these factors – the tax system’s composition, the tax rates it imposes at the margin, the definition of the base it taxes, the degree to which it weighs on transactions and business inputs, and its complexity – allow us to form a judgement of how pro-growth a tax system is. In the sections that follow, we will trace the evolution of Britain’s tax system on these fronts, with a particular focus on the period from 2000 to the present day. In doing so, we will see how much the tax system is implicated in Britain’s economic slowdown.

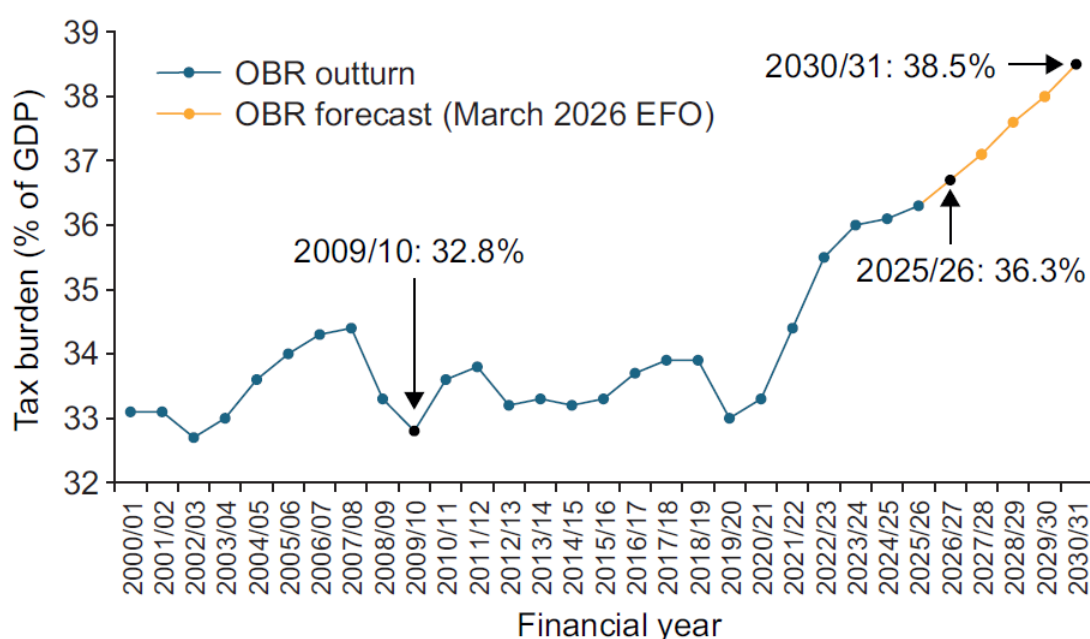
We will see that over the past quarter-century, as the tax burden has risen, so too has the structure of the tax system become markedly worse. Accordingly, while tax is far from the only factor in Britain’s ongoing stagnation – other essays in this collection will attest to that – it must be considered a contributing factor, and a worthy focus for further research.

What’s more, the current trajectory of the tax system suggests that it will prove a more significant barrier to growth in the 2020s than it was in the 2010s. From a tax perspective, the 2030s could be even worse.

Britain’s tax burden

Let’s start with the tax burden. As Figure 1 shows, tax receipts as a percentage of GDP have recently risen to 37 per cent of GDP. Looking at the tax burden since the turn of the millennium, we can see a few distinct phases. From 2000 to 2007, the burden steadily rose as a percentage of GDP, as the Labour government increased taxes to pay for higher spending on public services. The financial crisis triggered a sharp drop in tax receipts, as profits fell and unemployment rose. Tax revenue ticked up as a percentage of GDP immediately afterwards, and then hovered between 33 and 34 per cent of GDP through the rest of the 2010s, under Coalition and Conservative governments. The trajectory was upward, but modestly so. Things changed quite dramatically after the pandemic, as inflation and frozen tax thresholds combined to send the tax burden sharply upwards. Forecasts show the tax burden continuing to rise through to the end of the decade, to a peak of 38.5 per cent of GDP in 2030/31.

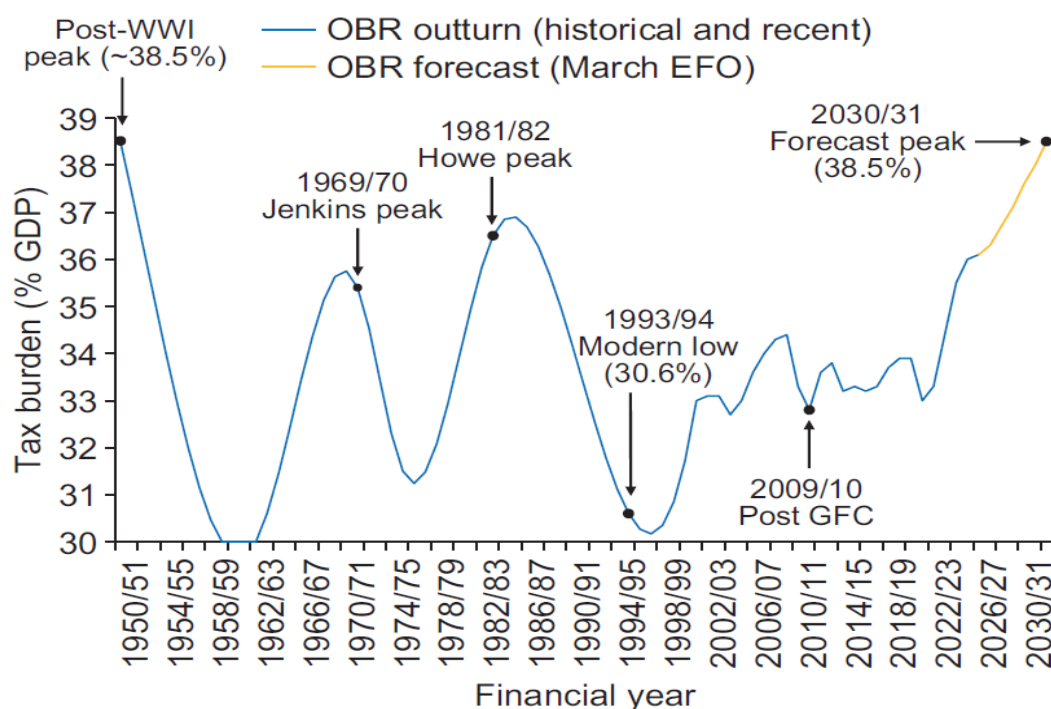
Figure 1: UK tax burden since 2000/01 (national accounts taxes as % of GDP)



Source: Office for Budget Responsibility.

As Figure 2 shows, the tax burden has not been this high since 1948, when Britain was still emerging from the shadows of World War II. The tax burden fell in the 1950s, rose in the 1960s and 70s, and then fell through the 1980s to reach a record low in 1993, at 30.6 per cent of GDP. To put that in context, the 7.4 percentage point difference from today equates to more than £200bn – or nearly three quarters of annual income tax revenue. This is a very significant change.

Figure 2: UK tax burden since 1948/49 (national accounts taxes as % of GDP)



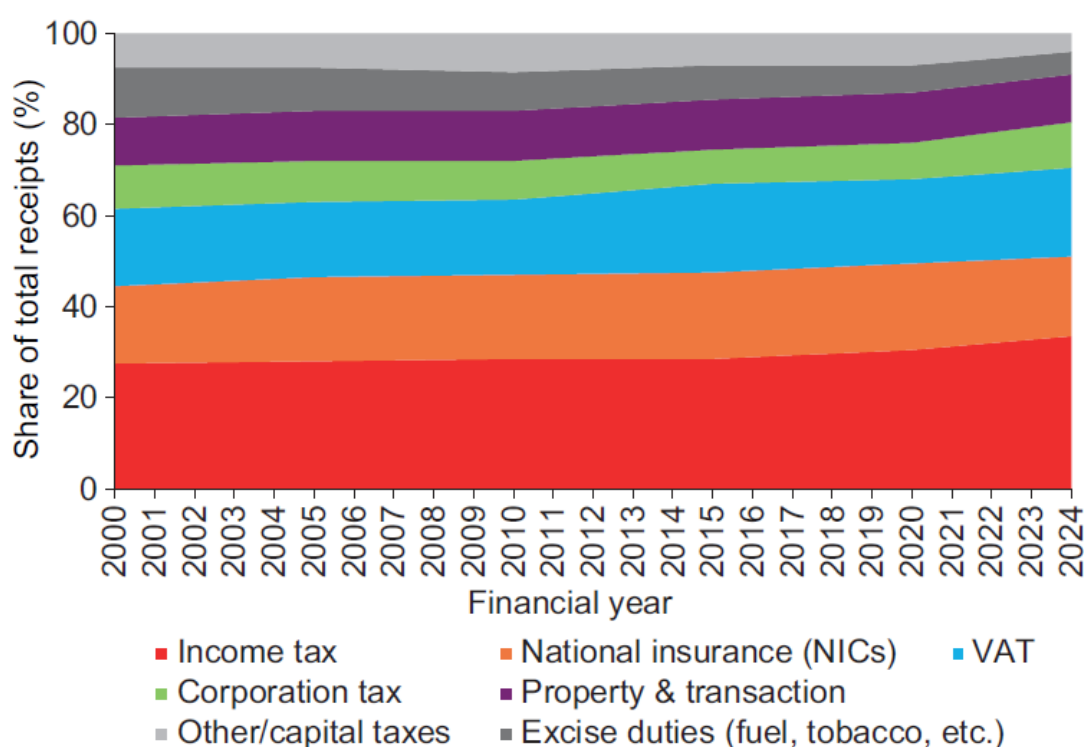
Source: Office for Budget Responsibility.

Examining these data, one could make the case that Britain's tax burden has risen significantly as its economy dropped to a lower trend rate of economic growth following the financial crisis. Look closely, however, and questions present themselves. Britain's growth rate dropped straight after the financial crisis; the bulk of the increase in the tax burden is concentrated in the period after 2020. And while the tax burden did rise over the course of the 2010s, it did so less rapidly and less substantially than it did during the apparently prosperous decade spanning the late 1990s to the late 2000s. You cannot rule out delayed or cumulative effects, but it seems safe to say that the tax burden alone does not tell the whole story.

The Composition of British tax revenue

As noted above, OECD research has established a clear 'growth hierarchy' among the main categories of taxes, with corporate and personal income taxes relatively more damaging to GDP per capita, and consumption and property taxes relatively less damaging. So, with this in mind, how has the composition of the British tax system changed over the past quarter-century?

Figure 3: Evolution of the UK tax mix (2000–24) percentage share of total government receipts



Source: Office for Budget Responsibility.

Figure 3 shows the main British taxes' percentage share of total revenues between 2000 and 2024. The most immediate observation is that the combined share of income tax and national insurance contributions – essentially 'personal income taxes' in the broader sense, although some smaller such taxes, such as capital gains tax, fall under

‘other’ in this categorisation – has risen from 44.5 per cent of tax revenue in 2000, to 51 per cent of tax revenue in 2024.

At the same time, although VAT revenue has risen slightly, excise duties – the other bit of consumption taxation – have dropped significantly, in large part because of the declining real-terms value of fuel duties. As a result, the consumption tax share of total tax revenue fell from 28 to 22.5 per cent.

Both of these trends have continued since 2024, too, with the tax threshold freeze driving up personal income taxes’ share of total revenue, and the continued fuel duty freeze (and temporary 5p cut) continuing to diminish excise revenue. Those fuel duty measures are set to begin being phased out from August 2026. As for personal income taxes, inflation remains stubbornly above target, and thresholds are frozen until April 2031. There is life in this trend yet.

In short, it appears that, since 2000, Britain has increased personal income taxes and reduced consumption taxes. This is the opposite of what the ‘tax-growth hierarchy’ would suggest, and has likely made the tax system more distortionary, and less pro-growth, over time.

As for the other taxes, corporation tax ends the period slightly higher as a share of tax revenue than it began it (10 per cent vs. 9.5 per cent), having fallen as low as 7.5 per cent in 2015. Property and transaction taxes remained stable between 10.5 and 11 per cent of tax revenue throughout. (There’s a fall in other/capital taxes towards the end of the period; falling road tax played a part here, as did reducing the ‘bank surcharge’ when the headline corporation tax rate went up.)

It is worth adding a few caveats. Firstly, the fact that the shift from consumption to income taxes made the tax system’s composition less supportive of economic growth does not mean that raising VAT or fuel duty would boost Britain’s economic performance. It may be, however, that reformed consumption taxes, with a broader-based, lower-rate VAT and excise duties targeted strictly at externalities, could provide the revenue necessary to lower taxes on personal income. *This* would be a pro-growth move.

Secondly, one might ask why, if corporate income taxes are the most damaging to economic performance, their decline as a share of overall tax revenue through the first half of the 2010s didn’t result in stronger growth. There are two responses. For one thing, we do not know the counterfactual; maybe growth would have been even worse if corporation tax was higher. For another – and we will come back to this – the way corporation tax cuts were implemented may have blunted their potential pro-growth effects.

Thirdly, we should not assume that the stable revenue-share of ‘property and transaction taxes’ bodes well for the British tax system. As noted above, the ‘well-structured’ qualification to property taxes’ place in the tax-growth hierarchy is very important. Recurrent taxes on residential property – even land value taxes – fit the bill here. They may not be popular, but as taxes go they are relatively non-distortionary.

Yet Britain relies heavily on stamp duty land tax, a highly distortionary transaction tax that has a claim to being, in economic terms, the worst levy on the statute books. (Research by the Australian Treasury suggests that *their* stamp duty has a much higher 'excess marginal burden' than corporation tax; their findings otherwise line up with the OECD's (Cao et al. 2015).) Britain also raises a lot of its property tax revenue from business rates – a tax on a business input that discourages investment. *Well-structured* property taxes these are not.

Marginal tax rates

High-level analysis of the tax burden and its composition can only take you so far. If you want to understand the impact of a tax system on economic behaviour, you need to examine the elements of tax that people confront when they make economic decisions. Let's start with marginal tax rates on personal income.

On the face of it, there's a pretty straightforward story to tell here. From Nigel Lawson's famous 1988 budget until the financial crisis, Britain had a top income tax rate of 40p. At his 2009 budget, then-chancellor Alastair Darling announced a new *additional* rate of income tax, at 50p on earnings over £150,000, to take effect from April 2010. That rate fell back to 45p from April 2013 and has stayed there ever since. All of this is true, but it is also only one part of the story.

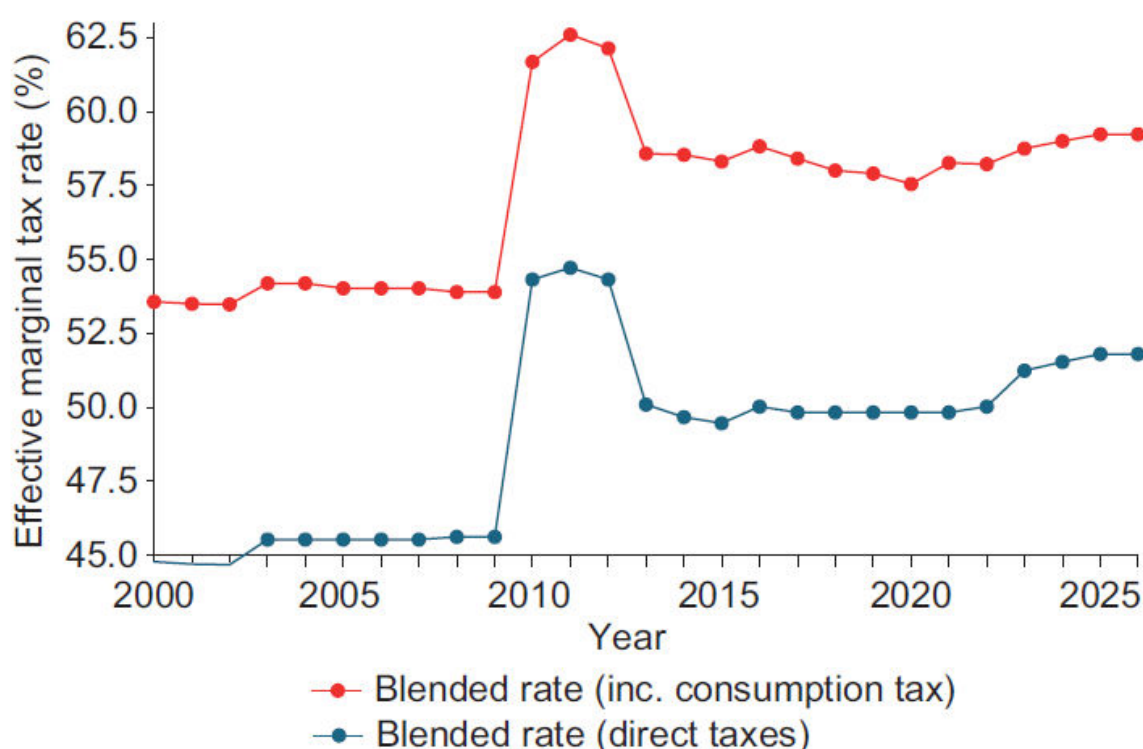
In reality, the effective marginal tax rates that people face are more complicated. Take national insurance. Until 2003, it wasn't levied on higher earnings at all. Gordon Brown introduced a 1p 'upper rate'; that rate rose to 2p under the Coalition government. But that's just the employee side of national insurance. Employers pay a higher flat rate levy on all earnings over a threshold; over the last quarter-century, that tax has risen from 11.8 to 12.8 to 13.8 to 15 per cent. And while paid by businesses, the economic incidence of the tax is felt by employees in the form of lower wages. You cannot understand the taxation of labour income without factoring in employers' national insurance contributions.

Then there's another complication: not all income comes from employment. Particularly at higher income levels, income from self-employment, partnerships, dividends and capital gains (collectively, these last two are 'capital income') is also important. What's more, capital income is usually subject to corporation tax before it is taxed at the individual level. Understanding marginal tax rates over time means integrating all of those taxes into a single, comparable measure.

Figure 4 shows a 'blended direct tax rate' from 2000/01 to 2026/27. This is composed of the top marginal rates for income tax, national insurance (both sides), corporation tax, capital gains tax and dividends tax, weighted according to a rough estimate of the income breakdown for the top 1 per cent. That is, 55 per cent employment, 20 per cent dividends, 10 per cent capital gains, 10 per cent partnership income and 5 per cent from other sources.¹ It shows how much tax would be paid by a model 'one-percenter' on the next slice of economic value they created.

¹ The marginal tax rate on employment incorporates income tax and both sides of national insurance. Self-employment income is assumed to be taken in dividends at the margin. The tax rate on dividends and capital gains reflects the prior impact of corporation tax. 'Other' income is assumed to be taxed at income tax rates. The income composition is a rule of thumb, rather than the result of detailed

Figure 4: Blended top marginal tax rate in the UK over time



The lower line displays this blended tax rate over time. The upper line adds in the impact of consumption taxes, using ONS figures on indirect taxes as a percentage of expenditure for the top quintile of households as a proxy for the marginal tax rate, and assuming that all income is consumed.²

What does this visualisation tell us? It is immediately clear that marginal tax rates are fairly high – a high earner captures less than half of the marginal economic value they create after direct taxes; with consumption taxes factored in, the high earner's share of marginal value creation is closer to 40 per cent. Marginal tax rates at this level are likely to have a powerful disincentive effect.

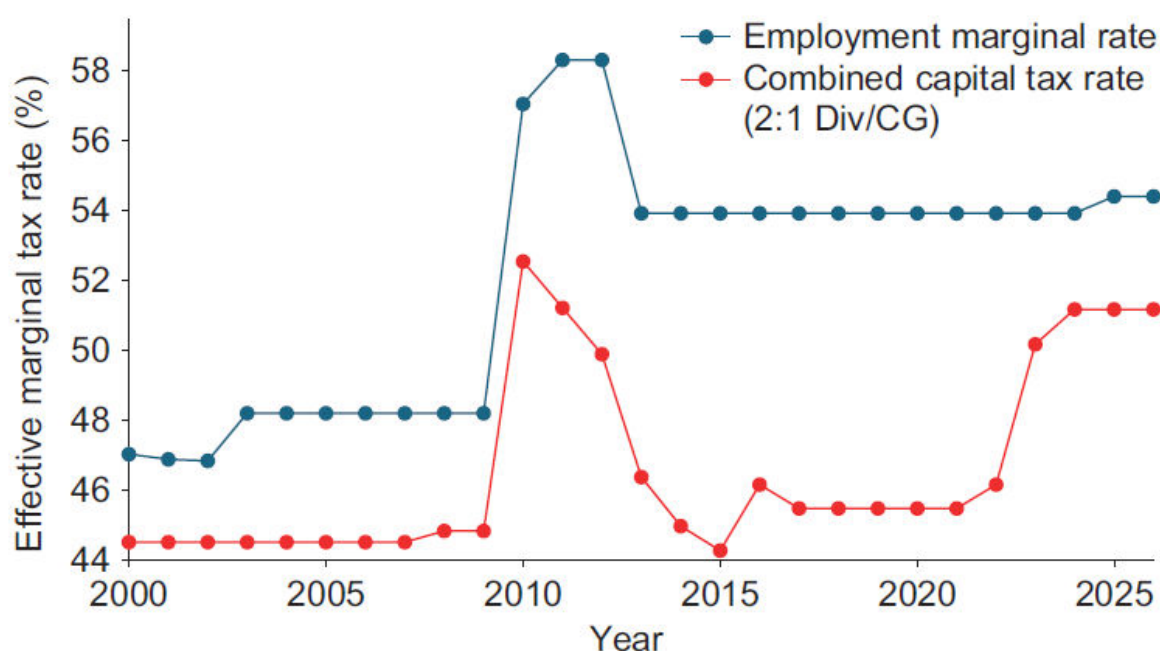
Secondly, we can see that marginal tax rates have trended up over time. They rose gently through the 2000s, then jumped sharply after the financial crisis. Marginal rates fell in the mid 2010s, but not to pre-crisis levels. They flatlined for about five years, and then began to rise again after the pandemic. Economic incentives for high earners got much worse when the 50p additional tax rate was introduced, and have not really recovered since.

analysis of tax microdata. It is inspired by Delestre et al. (2022) and Advani and Summers (2020), with income shares rounded and merged as necessary for ease of presentation.

² The consumption tax rate used here is based on indirect taxes as a percentage of expenditure for all individuals in the top quintile by equivalised household disposable income, as derived from the Office for National Statistics' annual 'The effects of taxes and benefits on household income' datasets. Where that figure is not available for a specific year, the rate from adjacent years is extended forward (or back) as appropriate.

Again, though, let's dig beneath the headline numbers. Figure 5 compares the integrated employment tax rate from 2000/01 to 2026/27 (that is, the combined effect of income tax and both sides of national insurance) with a 'combined capital tax rate' over the same period. This combined tax rate consists of corporation tax and capital gains/dividends tax, with the latter weighted according to their respective shares of the one-percenter's total income.

Figure 5: Top marginal tax rates, employment vs. capital in the UK



What this shows is that, first, before the financial crisis, there was a good deal of stability in the tax system. Corporation tax was 30 per cent. The top rate of income tax was 40 per cent. The effective marginal tax rate on capital gains was 10 per cent (thanks to taper relief, which meant that only a quarter of any gain was taxable provided the asset had been held for a certain period of time) and the effective marginal tax rate on dividends was 25 per cent (due to a so-called 'notional tax credit').

The combined capital tax rate jumps first, with Alastair Darling's abolition of taper relief and introduction of an 18 per cent flat-rate capital gains tax in 2008. Then both lines climb sharply in the wake of the financial crisis – the employment line because of the introduction of the additional rate of income tax (which also pushed up the tax rate on dividends), and the capital line because the top rate of capital gains tax was raised to 28 per cent by the Coalition government.

In the space of a few years, the integrated employment tax rate and the combined capital tax rate each increased by about 10 percentage points – at a time of maximum economic weakness. Tax hikes on this scale can hardly have failed to have a deleterious growth effect.

The tax rate stability of the 2000s did not carry on in the 2010s. The integrated employment tax rate dropped in 2013 when the additional rate was cut to 45p, but that reversed less than half the previous increase. Employment taxation carried on at the same marginal rate until the recent increase in employers' national insurance contri-

butions. The capital income rate fell slowly, eventually dipping below the pre-crisis level in 2017/18.

That downward shift was driven by the corporation tax rate falling progressively from 28 to 19 per cent, and the top rate of capital gains tax coming down from 28 to 20 per cent. By contrast, the top rate on dividends rose sharply in 2016. For six years, from 2017/18 to 2022/23, the effective marginal tax rate on capital income was stable, just above where it sat before the financial crisis. It has since risen again, thanks to increases in corporation tax (19–25 per cent), dividends tax (38.1–39.35 per cent) and capital gains tax (20–24 per cent).

In only one year this century has the combined marginal tax rate on capital income been higher than it is now. And once again, we have followed a severe economic shock (in this case the pandemic) with a sharp increase in capital tax rates. To make matters worse, there is almost constant speculation that these tax rates will rise even further, to plug some fiscal hole or other in the government's finances. None of this bodes well for Britain's economic future.

It is also worth noting that this analysis does not account for inflation. Since capital gains taxes are levied on nominal gains, rather than inflation-adjusted ones, a period of high inflation like the one we have just been through (the price level is around 30 per cent higher than it was in 2020) can mean that the effective tax rate on *real* gains is much higher than the unadjusted rates shown above. In the low inflation environment of the 2000s and 2010s, this did not matter much – but the longer Britain suffers above-target inflation, the more problematic its capital gains tax regime will become.

Of course, some people object in principle to taxing capital income at lower rates than employment income. For some, it is a question of equity – a sense that the wealthy have 'tax breaks' available to them that ordinary workers cannot access. Others complain that this differential taxation is itself distortionary. Certainly, it does give people an incentive to incorporate and shift as much of their income into capital as possible.

Much of the tax-reforming energy on the centre-left goes into this issue and, indeed, the ability to lower marginal tax rates by shifting into dividends has now been eliminated. (In fact, the integrated tax rate on dividends is now higher than it is on employment income, at 54.5 vs. 53.9 per cent). But those who can take their income as capital gains can still benefit from a somewhat lower marginal tax rate.³

Yet this point of view misses important considerations. Firstly, as we will see below, using an income base for taxation can create a structural bias against saving and investment. Lower marginal rates are an (imperfect) way to mitigate that effect. Secondly, capital income is different from labour income in that it involves risk – investors can lose their money. If you socialise too much of the reward from economic

³ The main way this occurs is by people building up cash inside a limited company, and taking that cash as a capital gain – rather than as ordinary income – when that company is liquidated or sold.

risk-taking, while the downside is strictly privatised, you upset the balance of incentives and may end up with a stagnant entrepreneurial environment. Finally, it may be that the behaviour that generates capital income is highly elastic – that is, it responds more to tax rates than employment does.

Indeed, this is why the foregoing analysis has focused on marginal rates at the top of the income distribution. Average tax rates on ordinary workers determine household budgets. But the danger in punishing top marginal rates is not that the wealthy end up with less money to spend. It is that the cohort of people we rely disproportionately on to allocate capital, scale businesses, and drive productivity gains decide that generating the next unit of economic value is no longer worth the effort.

Fiscal drag and tax traps

One underappreciated phenomenon in the British tax system is that the highest marginal tax rates no longer apply solely to those at the very top of the income distribution.

The combined basic rate of income tax and national insurance have fallen over time, and the tax-free personal allowance has risen (increased employer NICs dampen but do not undermine this effect). Yet the point at which higher rates kick in has fallen in real terms quite significantly. According to the Institute for Fiscal Studies, only 6 per cent of adults paid higher rates of tax in 2000 (and only 3.5 per cent in 1990). That rose to around 8.5 per cent in 2010, around 9 per cent in 2020, and is projected to reach 14 per cent in 2027 (see Delestre and Waters 2023, Figure 1). That adds up to about 5.5m extra higher and additional rate taxpayers since the turn of the century. If high marginal tax rates are a disincentive to economically beneficial activity, then subjecting many more people to them must be bad for growth.

It is also the case that the most punitive marginal tax rates are not always targeted at the highest earners – by design. Those transitioning from welfare into work often face brutal tax rates (although this is something that has actually improved in the last 15 years). The tapering of child benefit, introduced in 2013 for parents earning more than £50,000 (now £60,000), created elevated tax rates that rose depending on how many children you had. Most discussed, however, is the withdrawal of the personal allowance for those earning more than £100,000, which makes the effective marginal income tax rate in that band of income 60p rather than 40p.

When this measure was introduced in 2010, it was a minor quirk in the tax system, likely affecting well under 150,000 people. But thanks to the increase in the personal allowance over the 2010s – which extended the band of income withdrawal applied to – and inflation pushing up earnings, this 60p tax rate now hits around 723,000 people, according to a recent Freedom of Information request (the number affected has more than doubled since 2017/18).⁴

⁴ FoI request from NFU Mutual to HMRC (18 June 2025), cited in ‘How you can beat the 60% tax trap’ (9 December 2025), St. James’s Place.

In fact, these numbers are understated: there is ‘bunching’ of earners just under the threshold, which suggests that many people are managing their incomes down (see, for example, Joyce and Xu 2019). Some of them will be parents of young children, who also face the loss of childcare subsidies if they earn a penny over £100,000. This can mean that they would have to earn tens of thousands of pounds more before tax, to be left any better off at all.

These tax traps clearly have an enormous impact on economic behaviour at the relevant margin, with many highly skilled people reducing or turning down work to avoid punitive tax rates. The degree to which this has affected or is now affecting economic growth is a good area for future research.

The tax base

Marginal tax rates are very important, but they are not the only thing that matters in tax policy. The definition of the tax base is also crucial to how pro- or anti-growth a tax system is. What’s more, the choice of the correct tax base likely becomes more important the higher the tax burden, and the higher the associated marginal rates become. If the tax base is distortionary, higher levels of tax exacerbate the effect.

It is commonly assumed that ‘income’ is the best tax base. Hence the frequently heard plea for a tax system that applies the same, progressive set of tax rates to all forms of income. As a rule, however, free market economists tend to prefer that the bulk of taxation is based on *consumption*. Why the difference of opinion?

It comes back to neutrality. Unless comprehensive income tax systems make certain adjustments – which effectively turn them into a tax on *consumed income* – they usually embed a structural bias against saving and investment into the tax system. Or, to put it another way, they are not neutral when it comes to the choice over whether to consume now or later.

To see why, imagine two people – let’s call them Spender and Saver – who each earn £100.⁵ Spender consumes his income straight away. Saver invests his in a productive asset that rises in value by 5 per cent a year for a decade. In a tax-free world, Spender gets to consume £100, while Saver eventually gets to consume £160 after realising his gain.

Now imagine that we have a 40 per cent flat tax on all income, regardless of its source. The £100 earned by Spender and Saver becomes £60 in take-home pay. For Spender, the tax situation is straightforward: a 40 per cent income tax means he gets to consume 40 per cent less than he would in a world without taxes.

For Saver, though, things are more complicated. For one thing, rather than investing £100, he can only invest £60. So a decade later, his investment is worth about £98, rather than £160. And once his £38 gain is taxed at 40 per cent he is left with just £82.80 to consume (£98 minus £15.20 in tax). That’s roughly 48 per cent less than in a world without taxes.

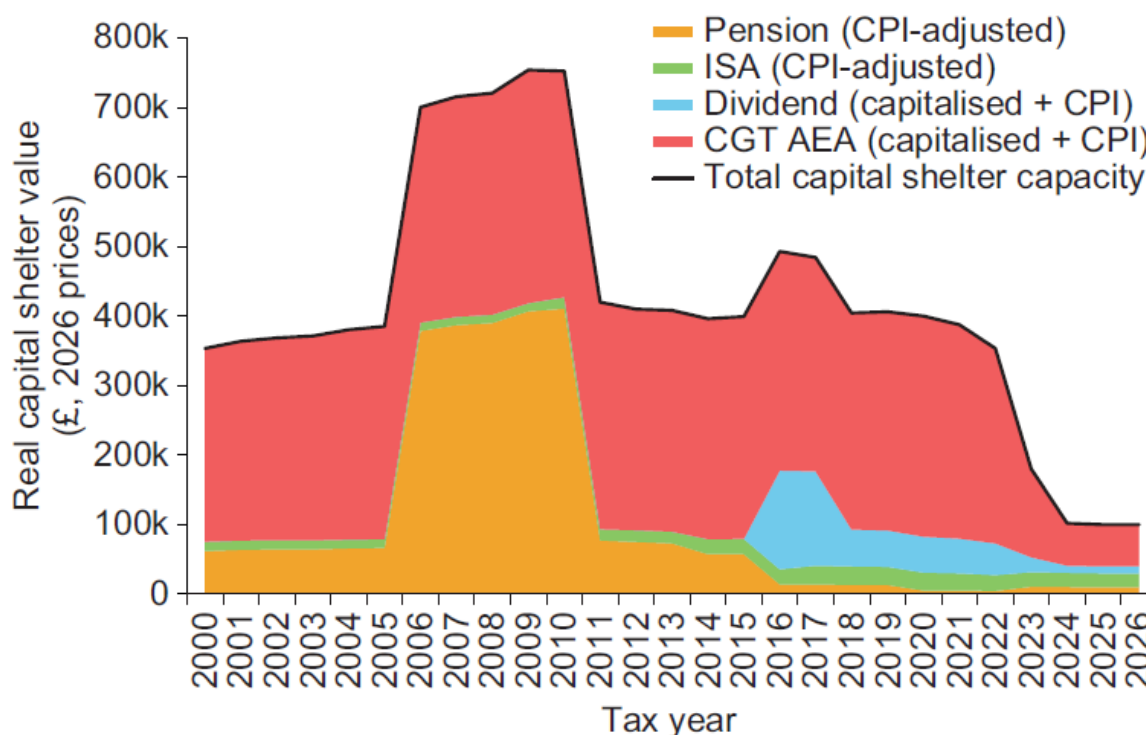
⁵ This example is inspired by a similar one in Carroll and Viard (2012).

In other words, Saver faces a higher overall tax burden than Spender, solely because he wants to consume in the future, rather than today. Note that we are not factoring corporation tax into this calculation. Nor are we taking account of inflation. If we assume that capital gains tax is levied on nominal gains, and that annual inflation throughout this period was just 3 per cent, then Saver's *real* gain is only about £17 – and the tax owed eats nearly 90 per cent of it. Why save or invest in a tax environment like that, where there is no reward for deferring consumption?

Saving and investment leads to capital accumulation, which drives productivity increases, which translate into economic growth. In extremis, then, comprehensive income tax systems can be very problematic from an economic perspective. As noted, that's one reason most countries levy lower tax rates on capital income than labour income. It is also why we have a variety of tax reliefs and allowances intended to at least partly restore the economics of saving and investment.

Most prominently, Britain gives tax relief when people put money into a pension (in effect, tax is deferred until you withdraw the income to consume it); you can save tax free in an Individual Savings Account, or ISA; and at various times, various 'annual allowances' have been put in place so that modest amounts of capital income are sheltered from tax.

Figure 6: The rise and fall of tax neutrality (2000–26) total inflation-adjusted shelter capacity for the top 1%



But how extensive are these modifications to the income tax system? How have they changed over time? And might they help explain the British tax system's impact on growth over the past quarter-century?

Figure 6 visualises the annual value of four such features of the tax system: the annual allowance for pension contributions, the annual allowance for ISA contributions, the annual exempt amount (AEA) for capital gains and the dividends allowance. In each case, the figures applicable to the highest earners have been used. All numbers have been adjusted for inflation, so that they are expressed in today's money. For the sake of comparison, the AEA and dividend allowance have been capitalised based on a 5 per cent rate of return, so that, for example, a £5,000 allowance is taken to shelter the return on £100,000 of investment.⁶

What this visualisation shows is that the ability to shelter capital income from tax has been on something of a rollercoaster ride in recent years. Tax shelter capacity rose sharply in the mid 2000s when Gordon Brown simplified the pension system, replacing a complicated 'earnings cap' with a straightforward annual allowance of £215,000. At the graph's 2009 peak, £753,000 of capital could effectively be placed outside the personal income tax system in a single year. That fell sharply with the imposition of a tapered annual allowance from 2011 onwards. Nevertheless, total tax shelter capacity continued at roughly pre-2006 levels, in real terms, through the 2010s.

It is only after the pandemic, with inflation starting to eat away at the ISA allowance (frozen in nominal terms since 2017) and the AEA and dividends allowance cut at successive budgets, that tax shelter capacity really started to plummet. Today, it stands at £100,000 (as modelled), down from around £350,000 in 2000, around £750,000 in 2010 and around £400,000 in 2020.

Given the timing of these changes, it seems unlikely that such alterations to the personal income tax base played a significant role in the UK's growth slowdown after the financial crisis. However, more recent shifts, coming as they do in concert with higher inflation and significantly higher marginal tax rates, do fundamentally make the British tax system less neutral towards saving and investment, and may therefore cause problems now and in the future.

Before moving on, it is worth noting that wealthy individuals still have routes open to them to shelter investments from tax. Capital gains on gilts and primary residences are exempt from tax, for example. The Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs) each offer a variety of up-front and downstream tax reliefs, which remain generous even as annual allowances have been eroded by inflation over time. However, creating schemes which channel investment in certain, politically approved directions hardly amounts to a restoration of tax neutrality, however well-meaning or welcome-in-context they may be.

⁶ Of course, this methodology somewhat exaggerates the importance of the AEA and the dividends allowance, since they are not cumulative in the way pensions and ISAs are. What this chart really shows is how much investment can be sheltered from tax in Year 1, assuming the investor starts from zero.

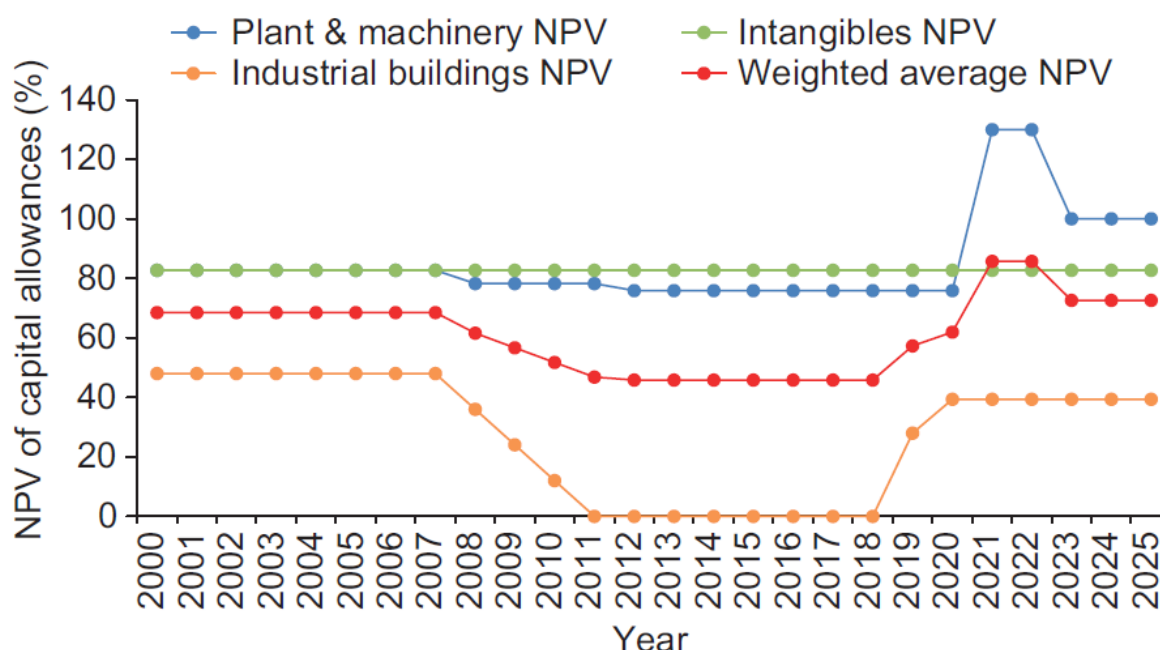
Corporation tax and capital allowances

Similar thinking can be applied to corporation tax. Corporation tax is a tax on profits, so logically it should be a tax on a business's income, *less* the costs of generating that income. However, most tax systems – Britain's included – depart from that simple model in important ways. In particular, they draw a distinction between operating expenses (paying wages, purchasing supplies) that are immediately deductible from taxable income and capital expenses (investment in machinery or factories, say) which must often be deducted gradually via a system of annual capital (or 'writing-down') allowances.

In a way, this makes sense. Investment takes time to produce a return, so why not spread out the tax deduction too? The problem is inflation and opportunity cost. A tax deduction in ten years' time is less valuable than one today. The longer a capital allowance is drawn out, and the worse inflation is, the less accurate a reflection of the initial investment cost the tax deduction is going to be. In this sense, corporation tax can embed a bias against capital investment in the tax system – and that can be bad for economic growth. The solution is either 'full expensing', in which capital investment is immediately deductible without limit, 'neutral cost recovery', whereby rolled-forward capital allowances are uprated in line with inflation and the time value of money, or both.

Understanding these dynamics helps to make sense of the potential growth impact of changes to corporation tax over the past quarter-century, and particularly since the financial crisis. On the one hand, you have the steady reduction in the headline corporation tax rate, beginning with the reduction from 30 to 28 per cent in 2007, and then falling gradually to 19 per cent from 2010 to 2017. Later, you have the abrupt increase back to 25 per cent in 2023.

Figure 7: UK capital cost recovery, 2000–25; NPV of capital allowances by asset class



Source: Author's calculations using Tax Foundation methodology (capital cost recovery across the OECD); UK rules from HMRC. Weighted-average uses 44/41/15 weights.

Yet the headline is only part of the story. As Figure 7 shows, just as the tax rate was falling, the Net Present Value (NPV) of the associated capital allowances was falling – fairly gently for plant and machinery, and quite dramatically for structures and buildings (from 2011 to 2017, these investment costs were not deductible *at all*). The structures and buildings allowance was reintroduced in 2018 and made more generous in 2020, but has not returned to its pre-financial crisis NPV. When the headline rate increase was *announced* in 2021, it was accompanied by a 130 per cent super-deduction for plant and machinery. That was replaced by standard full expensing when the higher, 25 per cent headline tax rate came into force.

In short, the effect of falling headline rates was dampened by stingier capital allowances; the impact of a much higher headline rate was ameliorated by more generous ones.

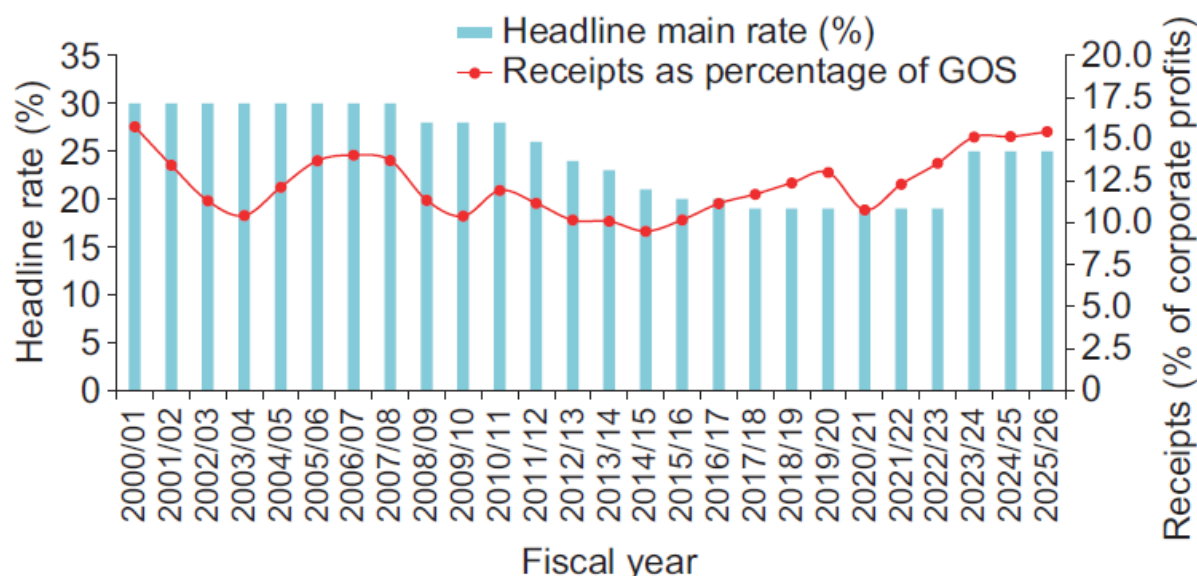
Naturally, it is difficult to work out exactly how all these factors combine, and what their net effect is likely to be. In reality, different kinds of businesses will benefit more or less from different mixes of rates and capital allowances. In general, the more capital-intensive a business is, the more important capital allowances will be versus the headline rate, and vice versa.

Figure 8 underlines the offsetting impact of less generous capital allowances on corporation tax revenues.⁷ Even as the headline tax rate fell through the 2010s, tax revenue as a percentage of corporate profits remained fairly stable, falling in the first half of the decade (to a low of 9.5 per cent in 2014/15) but then rising again (to a high

⁷ Tax expert Dan Neidle (2023) has made the same point using a variety of different methodologies.

of 13 per cent in 2019/20). Perhaps, then, we should not be surprised that falling statutory corporation tax rates failed to spark growth, or make Britain any less of a laggard among advanced economies on business investment.⁸

Figure 8: UK corporation tax: headline rate vs receipts as a share of corporate profits; fiscal years from 2000/01 to 2025/26



Source: HMRC tax receipts and National Insurance contributions for the UK, March 2026; ONS series CGBZ (gross operating surplus of corporations); IFS Tax Lab.

In 2022, when the government was considering various options for permanent reform of capital allowances, the Tax Foundation and the Centre for Policy Studies modelled various alternative scenarios (Clougherty et al. 2022). The findings suggested, first, that incremental improvements to the status quo ante (i.e. before the super-deduction) would boost long-run GDP by 0.1–0.3 per cent. It seems reasonable to offer this as a rough estimate of the *downside* of tightening capital allowances in earlier years, all else being equal. The same modelling suggested permanent full expensing for plant and machinery would boost long-run GDP by 0.9 per cent, but that this effect would be more than cancelled out by raising the headline rate of corporation tax to 25 per cent.

So what can we say, in the end, about the economic impact of changes to corporation tax since the financial crisis? Perhaps only that the changes in the headline rate probably had the effect you would expect – tax cuts positive, tax increases negative – but that changes to the corporation tax *base* softened those effects, in both directions.

⁸ See Resolution Foundation (2023), which suggests that ‘[i]f UK business investment had matched the average of France, Germany and the US since 2008 our GDP would be nearly 4 per cent higher today, boosting wages by around £1,250 a year.’

Other tax distortions

We have already noted that while property taxes can be relatively non-distortionary, and therefore an efficient source of revenue, in practice, the UK's system of property taxes is quite problematic. This is important because according to OECD figures, Britain raises more as a percentage of GDP from property taxes than any other advanced economy.⁹ Problems with our property tax base are therefore magnified compared with other, similar countries.

Stamp duty land tax is a key part of the issue. Its effect is to deter transactions at the margin, so that there are fewer property sales and a less liquid market. Over time, that means that real estate becomes increasingly misallocated compared with what would happen in a free market. The property stock is not used efficiently, with many people who would, for example, otherwise downsize remaining in properties that are too big for their needs. And since there is a pretty durable link between transaction volume and construction, deterring transactions means that fewer new homes are built too (see Morton 2019). These effects will be particularly economically damaging in a market that already suffers regulatory supply constraints and mounting shortages.

It is unfortunate, then, that SDLT has become much more problematic over the last 30 years. In 1997, it was levied at a rate of 1 per cent on properties that sold for more than £60,000 (at that point, £60,000 was the price of a median home in England). Before the financial crisis, that threshold had risen to £125,000 and extra tax rates had been introduced (3 per cent on properties costing between £250,000 and £500,000; 4 per cent above that). By the early 2010s, we also had rates of 5 per cent over £1m and 7 per cent over £2m. Crucially, this was a so-called 'slab' system: once you crossed a threshold, you paid the relevant tax rate on the whole purchase price. Naturally, this had a big impact on transactions around those thresholds.

This changed in 2014 to a more rational system of progressive marginal tax rates, so that homebuyers paid 0 per cent on the first £125,000; 2 per cent up to £250,000; 5 per cent up to £925,000; 10 per cent up to £1.5m; and 12 per cent beyond that. In 2016, the government introduced a 3 per cent surcharge on additional properties, and in 2021 another 2 per cent was introduced for non-UK resident buyers. From a top marginal tax rate of 1 per cent in 1997 to a potential 17 per cent today, SDLT has come to have a very pronounced effect on the top end of the property market in particular. But these effects cascade down. Modelling by the Taxpayers Alliance in 2022 suggested that abolishing SDLT and its Scottish equivalent would raise long-run GDP by 0.85 per cent. No one has put a precise number on the impact of changes to SDLT over the last 30 years, but it is unlikely a 1 per cent levy on property prices above the median would be anywhere near as damaging as what we have today.

SDLT's lesser-known twin, a 0.5 per cent stamp duty on share purchases, also has a negative effect on growth. Modelling by Oxera (2024) for the Centre for Policy Studies

⁹ According to the OECD, the UK raised 3.7 per cent of GDP from property taxes in 2024. Its nearest competitors were France (3.4 per cent), Luxembourg (3.3 per cent), and Belgium (3.2 per cent). The OECD average is below 2 per cent of GDP. (OECD Data Explorer, Global Revenue Statistics: Comparative tax revenues.)

suggested that scrapping it could boost long-run GDP by 0.2–0.7 per cent. Earlier modelling using the same methodology had found a similar (but very slightly larger, at 0.24–0.78 per cent) effect in 2007 (Oxera 2007). So while the tax is undoubtedly a drag on growth, it has probably not had a particular effect since the financial crisis that it did not have before. To be clear, though: transaction taxes are bad taxes, and should play no role in a modern tax system.

Stamp duties provide close to a fifth of property tax revenue. Around a third comes from business rates. To quote the Institute for Fiscal Studies' Mirrlees Review (Adams et al. 2011: 376): 'Business property is an input into the production process and, on efficiency grounds, should not be taxed.' (In the end, that review shied away from calling for abolition, on the grounds that it would 'provide a windfall gain to the owners of business land and property'.) A particular problem with business rates is that they don't just tax underlying site value, but also any improvements a business makes to it. In other words, it acts as a tax on, and deterrent to, business investment.

When Tata Steel spent £185m upgrading a blast furnace at Port Talbot, they famously saw their business rates bill rise by £400,000 per year (Pickard and Pooler 2016). A 2018 report by Corlett et al. suggested that simply replacing business rates with a revenue-neutral levy on underlying site values could boost long-run GDP by 0.4 per cent (Corlett et al. 2018).

It is worth noting, too, that the business rates multiplier (the tax rate) has risen quite significantly. In 2000/01, there was a single national multiplier in England set at 41.6p (the tax is levied per pound of assessed rental value). That peaked in 2025/26 at 55.5p (and 49.9p for small businesses), up from 46.2p in 2008/09. A new system with five different rates, ranging from 38.2p to 50.8p, came into effect this April. And over the years, a variety of different targeted 'reliefs' have come and gone. But none of this changes the fundamental point: that the burden of business rates has risen over time, and that when you combine that with changes to SDLT around half of Britain's property tax system (by revenue) has grown more distortionary over the last quarter-century, as growth rates have slowed.

Council tax, the other half of property tax revenue, may be deeply unpopular and equally badly designed, but it is worth noting that business rates tax property six times more heavily than council tax does (this too is a potentially harmful economic distortion).¹⁰ And while critics will point out that business rates ultimately capitalise into lower rents, and are therefore incident on commercial landlords, around 45 per cent of commercial property is actually owner-occupied – so that landlord and tenant are one and the same.

¹⁰ Author calculations based on council tax revenue as a percentage of the capital value of residential property, and business rates revenue as a percentage of the capital value of commercial property. Capital value figures taken from IPF Research, 'The size and structure of the UK property market: end-2023' (February 2025). Tax revenue figures for 2023/24 taken from the OBR. If anything, 'six times' is an underestimate given the extensive business tax reliefs that were in place that year.

There are additional taxes on business inputs. Other contributors to this collection note the impact of energy costs on business and growth: a large part of that cost comes from policy, and some of it from taxes. The Climate Change Levy, introduced in 2001, and the Carbon Price Support, brought in in 2013, both drove electricity prices much higher than they otherwise would have been. The Renewables Obligation and Feed-in Tariffs are also classed by the ONS as ‘taxes on production’, even if other parts of government regard them more as regulatory measures. Taxes on energy have surely had an impact on productivity and growth.

The same fine line between taxes and regulatory costs is present when we think of labour too. Employment rights are clearly a regulatory measure. The minimum wage may be viewed similarly, but you could also argue that it acts as a tax on low-skilled labour, by raising its cost above the competitive market rate. In real terms, the minimum wage has risen by more than 60 per cent since 2000, to reach two-thirds of median earnings – one of the highest ‘bites’ in the developed world.¹¹ Employers’ national insurance contributions have gone up too, with the rate rising from 12.8 per cent before the financial crisis to 15 per cent now, and the threshold above which that rate applies falling by around 44 per cent in real terms. In the long run, the tax incidence falls on workers, in the form of lower wages. In the immediate aftermath of policy changes, however, there is a real and damaging impact on businesses and their profitability.

Whether you look at capital – as we did earlier – or land, labour and energy – as we have done here – it appears that taxes on business inputs have become more burdensome over time. That cannot be good for growth.

One final point. Tolley’s Tax Handbooks – the definitive guide to UK tax legislation – have expanded from around 7,250 pages in 1997 to more than 23,522 pages today (ICAEW 2026). That suggests a remarkable rise in tax complexity in recent years, which may increase the deadweight costs of the tax system. It is hard to see that effect in the World Bank’s ‘Time to comply’ metric, which was pretty flat between 2006 and 2020, but it may show up in rising fixed costs (like accountancy) that weigh particularly heavily on small businesses.

An international perspective

The Tax Foundation’s *International Tax Competitiveness Index* uses an intellectual framework similar to the one deployed in this briefing to rank the 38 tax systems of the OECD according to how supportive of economic growth they are. It is carefully calibrated to judge tax systems on their structure and neutrality, rather than on how large (or small) the overall tax burden is. Tax systems are ranked across five equally weighted categories: corporate taxes, income taxes, consumption taxes, property taxes and cross-border tax rules. Since 2014, the UK has ranked between 29th and 33rd in the overall rankings. (Its high point came when the 19 per cent headline corporation tax rate was briefly combined with the ‘super-deduction’ for investment in plant and machinery, which resulted in a much better corporate taxes ranking than usual.)

¹¹ See OECD Data Explorer, Minimum relative to average wages of full-time workers.

As of 2025, the UK sits in 32nd place out of 38 OECD countries (Mengden and Nieder 2025). A wide network of tax treaties means it scores well for cross-border tax rules (2nd place). It ranks 25th for income taxes (the third-highest top rate on dividends is a drag here) and 28th for corporate taxes (thanks to raising the headline rate to 25 per cent). The UK scores extremely badly on consumption taxes (33rd, thanks to a relatively high VAT rate and a comparatively very narrow VAT base) and property taxes (37th, because revenues are more than twice as high, as a percentage of the capital stock, as the nearest competitor, and because the tax base is particularly distortionary).

Of course, since the UK's ranking has only moved within a narrow band, and in both directions, over the last decade or so, it is hard to use the *International Tax Competitiveness Index* to draw definitive conclusions about the role tax policy has played in the UK's growth slowdown. What we can do is simulate where the UK would sit in those rankings, had marginal tax rates on personal income remained at their pre-financial crisis lows, and had corporation tax not been hiked by a third after the pandemic. In that scenario, the UK would sit 14th in the corporate tax category, 11th in personal tax one and in 26th place overall.¹²

Further improvements would rely on shifting to a broader-base, lower-rate consumption tax, and adopting a less distortionary system of property taxes. If Britain copied New Zealand's exemplary VAT, abolished stamp duty land tax, and based business rates on unimproved site values, it would rise to 27th in the property tax category, tie for 1st place in the consumption tax one and finish in 3rd place overall, behind only Latvia and Estonia. Overall, such a tax reform package would be strongly revenue-positive, providing revenue for broad-based tax cuts or significantly narrowing the budget deficit.

Conclusion

This briefing has surveyed developments in British taxation since 2000, in an effort to highlight policy changes – and underlying structural weaknesses – that have contributed to the country's economic stagnation since the financial crisis. It is clear that the tax burden has risen, and that the 'tax mix' has become less favourable to growth over the period in question. Both factors are likely to weigh on Britain's economic performance. However, the biggest shifts at this 'macro' level have come since the pandemic and likely played only a minor role in the lacklustre 2010s.

Spikes in top marginal tax rates after both the financial crisis and the pandemic look like missteps in retrospect. Future research could usefully examine in more detail the (negative) growth effect these tax increases likely had, particularly in an immediate post-recession context. It would also be helpful to study the economic consequences of fiscal drag – as many more people come to face higher marginal tax rates – and growing 'tax traps', which seem to be playing an increasingly significant role in affected

¹² Author simulations using RStudio and the data at github.com/TaxFoundation/international-tax-competitiveness-index.

households' economic decision-making. Analysis that disentangled the countervailing impacts of lower corporation tax rates and less generous capital allowances, followed by the precise opposite, might also aid our understanding of Britain's persistent shortfall in business investment and, indeed, its deindustrialisation.

While it is hard to say, at this point, precisely what effect the tax system has had on growth since the financial crisis, what we can say with some confidence is that there are many aspects of the tax system that have long exerted a negative effect on GDP in Britain, including taxes that deter transactions, discourage corporate investment and raise costs for business. Reforms that eliminated these features of the tax system, and perhaps offset lower marginal tax rates on corporate and personal income with overhauled property and consumption taxes, would undoubtedly boost the long-run level of GDP. In the short term, that would translate to higher annual rates of economic growth.

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