IPPR National Renewal Programme

TAXING TIMES

POLICIES, POLITICS, AND PRINCIPLES

DISCUSSION PAPER

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August 2026

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This paper was first published in August 2026.

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ACKNOWLEDGEMENTS

The author acknowledges helpful suggestions and criticism from Nick Garland, Parth Patel, Will Davies, Jane Gingrich, Jacob Edenhofer, Arun Advani, Carsten Jung, Gary Gerstle, Nick O'Donovan, Emma Killick, Harry Quilter-Pinner, Rachel Henry and Chris Bick.

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Citation
If you are using this document in your own writing, our preferred citation is:
Ansell B (2026) *Taxing: Policies, politics, and principles*, IPPR. http://www.ippr.org/articles/taxing-times

CONTENTS

SUMMARY

Britain's tax system isn't fit for purpose. As this paper shows, the historical evolution of our tax system has produced one marked by a great deal of complexity, but which struggles to raise the revenue required to meet the public's demands on the state.

At the same time, almost two decades of weak economic growth and an ageing population have left British taxpayers in an invidious position: where the critique of the public was once that they wanted a European-style welfare state on American levels of taxation, they are now facing something more like an American-style welfare state on European levels of taxation. Fiscal pressure will only continue to grow as our population ages, immigration falls, and governments grapple with the demands of our growing defence needs and the climate transition.

Many sensible proposals for tax reform have been put forward over several decades. But few really big reforms have come to pass. This paper attributes that inertia to three pathologies.

A **public pathology,** whereby the British public shies away from the tax implications posed by their expectations of public services.

The **political pathology,** whereby in response to the public pathology, politicians have continually sought easy fixes – like freezing thresholds or stealth taxes – rather than confront the public with honest fiscal truth.

The **press pathology**, which amplifies the losers of any tax rise, and distorts political debate and public perceptions.

This paper sets out proposals for the path to a better system, which is able to meet the demands of both the public and a more dangerous world, based on three principles: funding, fairness and future.

Funding: we will need to raise more revenue, and soon. How do we raise enough money over the next five to 10 years?

- There are limits to the revenue that governments can raise while leaving the 'big three' taxes – income tax, employees' national insurance (NI) contributions and VAT untouched. One option mooted is to reverse the Conservatives' 2022–24 NI cuts, which – especially if hypothecated – could command public support.
- The most obvious alternative in the immediate term would be equalisation of capital gains tax with marginal rates of income tax, offset by an investment allowance.

Fairness: the current tax system has become too tilted in favour of age and wealth. How can we adjust the balance of responsibility to reflect a new fiscal contract between groups in society over the medium run? Proposals include the following.

- Extending the 2 per cent NI surcharge, currently paid by employees under 65 on earnings above the upper earnings limit (£50,270), to pensioners.
- Replacing stamp duty and council tax with a new proportional property tax. A rate of around 0.65 per cent would be required to compensate for the revenues of both the abolished taxes.
- Taxes on speculative, extractive industries – what the author calls 'Spiv Britain' – including a tax on the net gambling winnings of amateur gamblers, which

could raise £1–3 billion; greater auditing and monitoring of crypto asset sales; and on commercial property transactions.

Future: how should Britain's tax system be prepared for the wealth concentration – and potentially mass unemployment – brought about by AI and related transformations?

- A progressive consumption tax, offset with a tax-free consumption allowance, negative income tax or universal basic income, in response to widening inequality.
- An AI token tax, to directly trap a portion of the value created by AI models. Given that this would require consistent auditing of AI companies, it would likely rely on international cooperation.
- An AI unearned rents tax, in the extreme scenario in which AI wealth is extremely concentrated and tax on capital is necessary to sustain consumption for the majority.

Together, such measures are designed to outline a tax agenda which not only raises revenue and takes on the myriad economic inefficiencies and perversities of the existing system, but which can also bring British citizens along with it. But that will rely on politicians willing and able to tell a convincing story about rebalancing the tax system so that it is fairer to the young and those in work, and is equipped to harness technological changes to the benefit of all British citizens.

1.
INTRODUCTION: BRITAIN'S PATHOLOGICAL TAX SYSTEM

There is a hoary quotation from Benjamin Franklin that begins most analyses of taxation: "Nothing in this world can be said to be certain, except death and taxes." One might, however, add a third certainty: that any British government attempting major tax reform faces political death.

Economists and tax specialists may disagree on many aspects of an optimal or desirable tax system. But they uniformly agree that the British tax system is, and has been for decades, too complex, too unwieldy and in dire need of reform.

The Nobel prize-winner in economics, Sir James Mirrlees, headed up a multi-year review of the British tax system with the Institute for Fiscal Studies, which reported in 2011. The *Mirrlees Review* recommended several major tax reforms, but none came close to political enactment. Major changes to British taxation have been passed but typically have been precisely the types of reform that economists denounce – the introduction of stealth taxes, increasing employer NI, increases in stamp duty and so forth.

This all raises an obvious question. Why are British politicians unable to reform the UK's tax system in ways that economists recommend?

The answer lies in the political incentives facing all governments of different political stripes. In particular, any government intent on tax reform faces three pathologies: the public pathology, the political pathology and the press pathology.

The **public pathology** emerges from a basic mismatch in what the British public demand of the state and how much they are willing to pay for it. Public opinion usually finds a consensus for both higher taxation and spending. However, when the public are asked what degree of tax rises they would be willing to countenance to, for example, increase NHS spending, their willingness to make fiscal sacrifices is minimal. At the same time, an ageing population and slow economic growth mean that ever larger tax revenues are needed to fund the social services that citizens expect. Crudely put, where once the critique of the public was that they wanted a European-style welfare state on American levels of taxation, they are now facing an American-style welfare state on European levels of taxation.

The **political pathology** emerges in the incentives of politicians to respond to these mismatched public demands. If taxes are to rise to pay for the public spending that citizens demand but are less willing to pay for, then those tax rises need to be disguised. The simplest way to do this is to refrain from raising tax thresholds with inflation – this 'bracket creep' drags ever more people into higher brackets but without the 'sticker shock' of other tax rises. Other alternatives include so-called 'stealth taxes' on pension or employer contributions, or on irregularly bought services such as insurance or, indeed, residential properties. This has produced a growing tax base over time, but one that is ever more complex, with associated distortions to economic activity, from labour force participation to choices among consumer goods. This complexity raises the need for tax simplification, but large broad-based tax reforms face strong political resistance.

That political resistance is accentuated by the **press pathology**. Media outlets bemoan growing national debt but amplify any tax rise, no matter how minor in aggregate, if it affects small, easily organised groups such as farmers. The same outlets typically also complain of the overall tax burden while resisting cuts to big ticket items, from pensions to healthcare. The public as a whole, in part responding to media concerns, systematically over-estimate the cost of minor spending areas, from MP salaries to foreign aid, while under-estimating the cost of popular major welfare programmes. And so, we circle inevitably back to the original **public pathology**.

Given these pathologies, how can we build a tax system that both commands public support and underpins much needed investment while restraining public debt? This paper starts by asking how we got to this place (a highly complicated tax system with an ever-growing tax burden that still cannot meet our spending needs), why tax reform is so challenging, and what kinds of principles might help us in producing a system up to the needs of the mid-21st century.

2.
HOW DID WE GET HERE? THE HISTORY OF TAXATION IN BRITAIN

Why does Britain have the level of overall taxation and the mix of tax types it has today? The pathologies of taxation are not new, though public and press concerns were not at the front of the exchequer's mind until recently. Because of the inherent political challenge of tax reform, moments of major tax change have been rare. Consequently, the British tax system we have today was produced by the historical layering of past major tax reforms, themselves the product of epochal political moments, from wars to revolution.

Taxation is an inherently political problem. How does the state attain the funds it needs for its goals from its citizenry? Taxation forces governments to impose serious financial costs on citizens. Why would citizens be willing to accept those costs?

Even the most unconstrained tyrant cannot simply extract whatever fiscal resources they want from their citizens: draconian taxation will produce hoarding, evasion or even emigration (Levi 1989, 1997). The history of English taxation for several centuries following Magna Carta in 1215 was about the fortunes of 'fiscal contracts' between the monarch and their subjects, typically to raise money for fighting wars. Where such contracts broke down, so too did the polity: Charles I's forced loans ultimately led to his execution.

The supremacy of parliament over the monarch was finally established in the Glorious Revolution in 1688. Although the monarchy had lost power, because parliament held the reins, the monarch was now able to access finance at much lower interest rates and to establish a more reliable basis of taxation. By the French Revolution, Britain ironically had a far more developed, centralised and successful tax bureaucracy than allegedly absolutist France could call upon.

The modern income tax has its origins in the Revolutionary and Napoleonic wars with France. Whereas previous direct taxes had been on property, Pitt's income tax was levied on all sources of income at a rate between 1 and 10 per cent. The system of 'schedules' of income subject to taxation, introduced in 1803 under Addington, lasted until 2005, although Pitt's own income tax lasted only as long as the war that compelled it. Inheritance taxes were introduced in modern form in 1894 in the Harcourt death duties and, unlike flat rate income taxation, death duties were progressively structured, rising with the size of the estate.

By the start of the 20th century, the scene was set for a tax system based on a democratic bargain between newly enfranchised working and lower-middle classes and the wealthy. Lloyd George's People's Budget of 1909 recommended a super tax on high incomes, higher inheritance taxes and a land value tax, with both annual rates and a transfer duty. The budget was to pay for military rearmament – a traditional aim – and to help fund national insurance – a very modern one. But it was also explicitly redistributive in aims, seeking to curtail the income and wealth of the most affluent.

The most affluent fought back. The House of Lords rejected the budget. In return, the Liberals ended the Lords' veto power over money bills. Ironically, the hated land value tax was barely implemented and was abandoned by 1920. So ended the principle inspired by the American economist Henry George in his 1879 *Progress and Poverty*, that the tax system should target unearned rents on land. Henry George's arguments had become enormously popular worldwide – *Progress and Poverty* sold three million copies, and explicitly Georgist political parties were formed around his idea of a single tax on unearned rents, including in Denmark (Linklater 2014). But the People's Budget proved the height of Georgism in Britain. Instead, income rather than wealth formed the basis of taxation over the following century.

The two world wars were the key moments in the mass expansion of income tax to almost all British workers. By 1918, the income tax was set at 30 per cent and the annual income threshold to pay had been lowered, bringing in working class voters. In combination with Lloyd George's super tax, the highest earners were now paying over 50 per cent marginal tax rates. The second world war not only saw further rises in income tax rates (a standard rate of 50 per cent!) but in 1944 the introduction of pay as you earn (PAYE), to ensure high compliance and early payment of taxes. A purchase tax was also introduced to supplement customs and excises – the forerunner of the modern VAT.

Attlee's mass welfare state expansion reflected a new fiscal compact between citizen and state, in response to wartime commitment and loss. With income and consumption taxes high and stable, it became feasible to finance cradle-to-grave social security. Income taxes remained extremely high – with a standard rate of 45 per cent and high incomes taxed at rates of up to 97.5 per cent in the post-war decade.

The 1960s and 1970s saw the layering onto the British tax system of a variety of other taxes that remain to this day. Capital gains tax and the modern corporation tax were introduced in 1965, and VAT arrived in 1973 as Britain entered the European Economic Community.

Perhaps surprisingly, given ostensibly high tax rates, the relative size of taxes as a share of national income remained fairly consistent across the period – usually varying between just under 30 per cent and 35 per cent of national income.

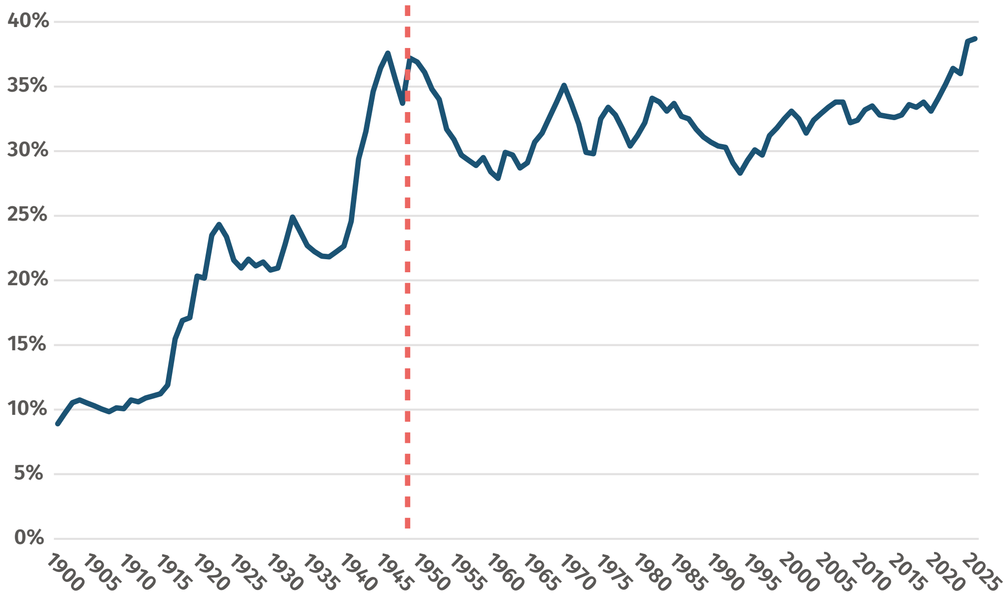
Margaret Thatcher's initial tax reforms shifted the balance of the fiscal compact, if not the size of national revenues. Geoffrey Howe's budget of 1979 reduced top rates to 60 per cent, the standard rate to 30 per cent, and increased VAT from 8 per cent to 15 per cent. High income tax rates in the 1970s had distorted economic behaviour and led to evasion but they reflected a social compact where the rich were heavily leaned on to finance public spending. That compact would shift under Thatcher: the pressure was taken off higher earners and applied instead to lower earners with the expansion of indirect taxes.

This shift in the fiscal compact became ever clearer as the Thatcher era rolled on. Nigel Lawson's 1988 budget slashed the top income tax rate to 40 per cent and the standard rate to 25 per cent, and created a flat inheritance tax rate of 40 per cent that meant a lower burden on the largest estates. By contrast, this was followed by the poll tax in Scotland in 1989, and England and Wales in 1990, which replaced the property tax proportional system of rates with a lump-sum per person fee. The argument for the poll tax was that it was non-distortionary – the tax could not be easily avoided, and it did not affect incentives to work. Its problem was not its purported efficiency but its total violation of norms of equality and fairness, particularly on the heels of major tax cuts for wealthier Brits.

Save for the brief interlude of Liz Truss's mini-budget, the shape of British taxation has not been fundamentally altered since the failure of the poll tax and its replacement by the somewhat more progressive council tax. The Blair and Brown eras saw a lowering of the basic rate of income tax and, during the financial crisis, an increase in the top rate of income tax. VAT rates have crept up slowly over time along with NI contributions. But policy change has largely been limited, although fiscally progressive at the margin. A new fiscal compact emerged in the post-Thatcher era – gradually shifting the tax burden away from lower-income to higher-income groups, but in a gradualist and often disguised fashion. For example, the top 10 per cent of taxpayers paid 50 per cent of incomes taxes in 2000, but by 2025 this had increased to over 60 per cent.

FIGURE 2.1: THE RISE OF TAX

UK tax revenue as a share of national income 1900–2025



Source: National account taxes as a percentage of GDP taken from Bank of England (2026) for 1900–1948 and IfS (2026) 1948–present. Note that the series changes in methodology from 1948.

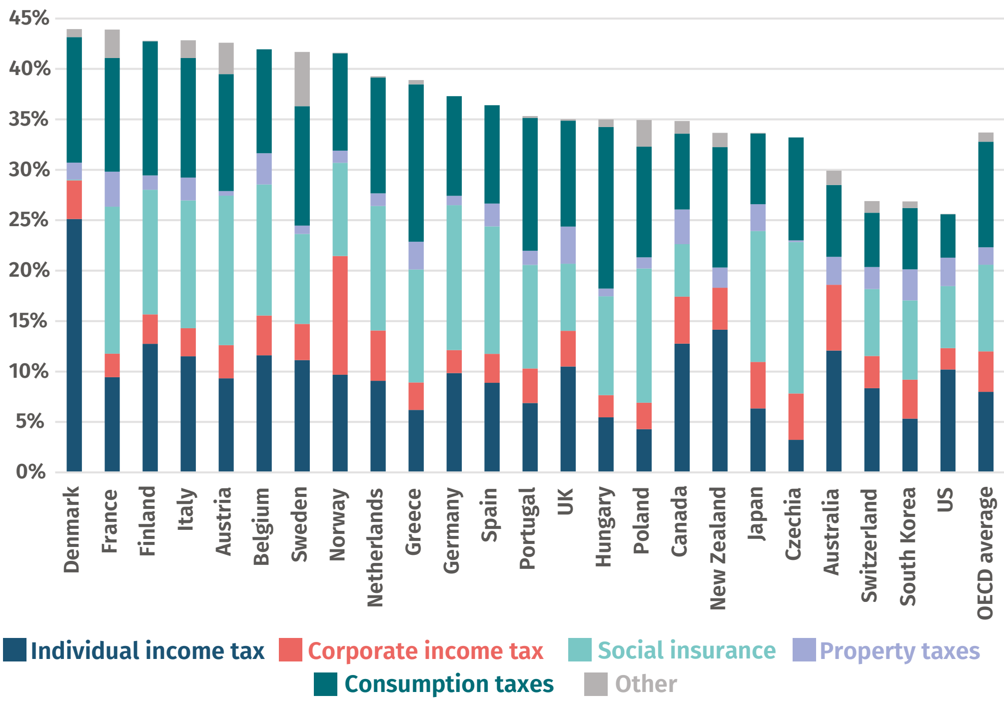
At the same time, the overall size of taxation finally broke out of the holding pattern that dominated most of the post-war era – as figure 2.1 shows, by 2024 taxation as a percentage of national income was higher than at any time since 1948. In part, this reflects a highly progressive income tax system operating on a more unequal income distribution than in the post-war era. It is also a function of a cross-partisan reluctance to raise nominal thresholds for income tax rates, meaning far more people pay the higher and additional rate of income tax than in the past.

Finally, the tax system has become more complicated: ever-changing taxation of pension contributions, a 9 per cent tax on incomes of those who took student loans, new taxes and fewer deductions for landlords, limits on childcare allowances and child benefits for higher income voters. The new fiscal compact, advantaging poorer and older voters, has dealt with rising demands on the state, not by widening the base of taxation but by seeking new ways to tax high-income, if not high-wealth, citizens.

The growing reliance on stealth taxes and a complicated tax code targeting a myriad different behaviours – family, education, pensions, housing – was already apparent when the *Mirrlees Review* was published in 2011, arguing for radical simplification of what was arguably the world's longest tax code. Rather than heeding its advice, successive governments have simply added complexity, seeking to keep revenues high enough to pay for growing spending needs without fundamentally disturbing Britain's current consensus around tax. Even crises such as Covid have not challenged this – the NI reform implemented in response was quickly abandoned.

FIGURE 2.2: MIDDLING BRITAIN

Tax revenue composition as a share of GDP across OECD countries



Source: OECD Revenue Statistics 2025

So where does Britain stand today compared to its peers? As shown in figure 2.2, using data drawn from OECD (2025), the country remains in the middle of the pack cross-nationally in terms of the overall size of taxation, despite recent tax increases. Indeed, many European countries, including Denmark, France and Italy have tax revenues well over 40 per cent of national income. The UK, at around 35 per cent, resembles Canada, Poland and Czechia.[1]

Where the UK stands out is in its tax mix. It is among the top dozen countries in terms of the size of income taxation, in part because NI contributions are relatively small compared to most European countries. Income taxes are also substantially more progressive than in most other countries, at least in terms of the tax schedule, with income tax and NI rising from around 29 per cent for average workers to 45 per cent for the top 10 per cent. Finally, the UK has the highest dependence on property taxes of any OECD country, despite not having

1 Figure 2.2 shows a subset of 24 countries out of the OECD's 38 members. Excluded from the figure are the Latin American members, Türkiye, Israel, and several European countries with small populations. The OECD average at the right of the figure includes all 38 members.

a proportional property tax system, although this still amounts to less than 5 per cent of national income.

What did the *Mirrlees Review*, the last major attempt to reform British taxes, recommend? It developed an 'optimal taxation' model, which assumes a fixed amount of money to raise, and then asks how the burden should be distributed and what effects different taxes will have on the behaviour of citizens and firms. The advantage of this model is that it tries to view the whole tax and benefit system in sum, in a way that balances concerns about efficiency and equity.

The *Mirrlees Review* produced a list of recommendations that followed this balancing act: (1) merge income taxation and national insurance, reduce the tax wedge for low earners and simplify the income tax schedule; (2) remove most VAT exemptions; (3) replace council tax and stamp duty with a proportional property tax; (4) a single carbon tax and replace fuel duty with congestion charging; (5) replace inheritance tax with a lifetime gift tax and only tax 'excess' returns to capital.

In common was the aim to simplify and make more legible the tax system and to avoid distorting consumption, labour force participation and business activity. At the same time, the progressive nature of UK taxation would be maintained, perhaps enhanced, by clearer and more proportional taxation of property. Fine ideas. But none have been implemented. Why has implementing tax reform along these lines been so hard for successive governments?

3.
THE POLITICS OF TAXATION IN MODERN BRITAIN

The complicated and sometimes contradictory nature of contemporary British taxation reflects the layering of past political compromises. Any future reform will be subject to the same partisan battles and public outcry. Accordingly, it is as likely that future reforms further complicate, rather than simplify, the British tax code.

In this section we examine public opinion around taxation. How do voters in Britain feel about the level of tax they currently pay and the level of spending they want? How progressive should the tax system be? What types of taxes appeal to voters? Is there political space for a wealth tax, for example?

(A) HOW MUCH TAXATION AND SPENDING?

There is one commonality across all polling on taxes and spending in Britain, at least since the advent of consistent public opinion surveys – the group of people who think the government should reduce taxes and spend less is a small minority of the public. The real action is between those who think the level of both is about right and those who want to increase taxes and spend more.

The British Social Attitudes survey has asked a question along these lines since 1983. The percentage of people who prefer higher taxes and spending typically varies between 30 and 65 per cent, and the percentage who would keep both as they are varies between 30 and 55 per cent. The former group has been larger than the latter for most of the past 40 years, save for the early 1980s, the period between 2006 and 2016, and most recently the 2025 survey. Broadly speaking, the public asks for higher tax and spending under Conservative governments and trends back towards stability under Labour governments. Hence there is a thermostatic reaction, at least to perceptions of the parties (if not the actuality).

There has been a notable rise in the support for lowering taxes and spending – from around 4 per cent in 2016 to its highest ever level of 19 per cent in 2025. While this remains a minority view, it now commands a sizable share of public opinion in a way that has never previously been true.

(B) HOW PROGRESSIVE SHOULD THE TAX SYSTEM BE?

The British income tax and national insurance system is progressive by international standards, particularly in the case of the former, due to a high personal allowance. Other parts of the tax system have a weaker connection to progressivity – for example, council tax owed does increase with the (1991) valuation of the property but within a very limited range, such that the highest payment is usually around three times the lowest. Inheritance tax is also progressive but only in the sense that estates up to £325,000 (or £500,000 for primary residence) are not subject to tax, and thereafter at 40 per cent.

How do the public feel about the level of progressivity in the tax code? Ansell, Cansunar and Elkjaer (2026) use a series of experiments where respondents are asked to choose between different income tax schedules to discover what rates of taxation the British public prefer for different income groups. They find that the public have preferences roughly in line with the current tax code, albeit somewhat more progressive. For example, the modal preferred marginal tax rate for incomes between £12,500 and £50,000 is 10 per cent, rather than the actual 20 per cent; for incomes between £50,000 and £150,000, 30 per cent rather than the actual (at the time) rate of 40 per cent, and for incomes over £150,000, 60 per cent rather than the actual (at the time) rate of 45 per cent. On the whole, the public want lower rates for average earners and higher rates for the highest earners.

The British Social Attitudes survey finds a similar picture, albeit using the looser categories of high, middle and low incomes. There has been a shift since the mid-2000s towards thinking taxes on high earners are ‘too low’, and 2024 saw the highest number recorded thinking taxes on middle earners are ‘too high’.

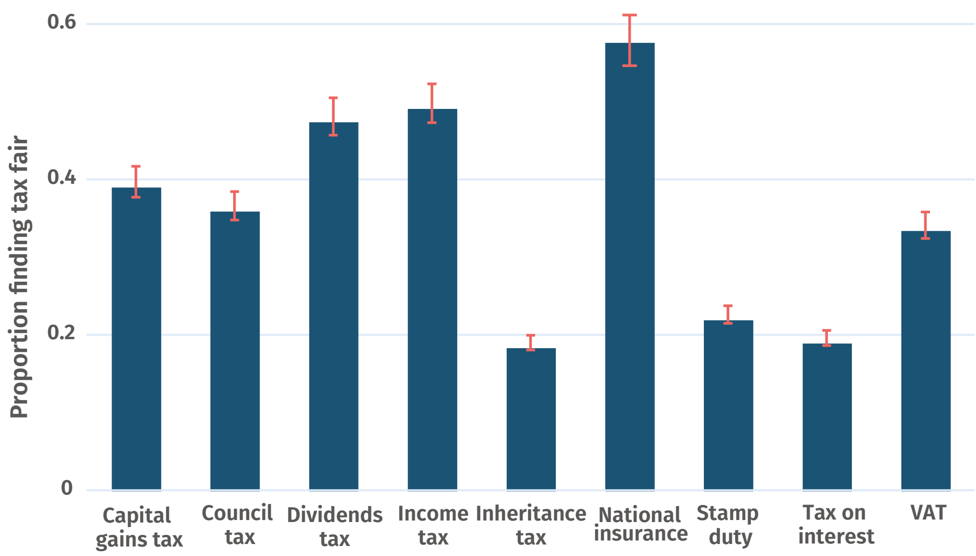
A similar pattern applies with inheritance taxation preferences. Elkjaer et al (2025) find that the British public’s preferred inheritance tax schedule is 0 per cent for inheritances under £125,000, 10 per cent for inheritances between £125,000 and £500,000, 20 per cent for inheritances between £500,000 and £1 million, and 60 per cent for inheritances above £1 million. Again, we see the British public typically wants lower rates for middle-class inheritances and higher ones for the most affluent.

(C) WHAT SHOULD BE TAXED? WEALTH OR WORK?

But we must be slightly careful in terms of assuming the public would like inheritance to be taxed more. The analysis above comes from forced choice experiments over rates. When asked about inheritance taxes more generally, the British public usually believes they are too high. Furthermore, prompting survey respondents to think of inheritance taxes as ‘death taxes’ or ‘double taxation’ reduces support for inheritance tax even further.

3.1: WHAT THE PUBLIC THINKS

Survey evidence from the UK on tax fairness



Source: Ansell (2022)
Totals reflect proportion of all respondents giving an answer who felt the tax was ‘fair’ or ‘very fair’. All averages adjusted are for sample weights. Error bars refer to 95 per cent confidence intervals.

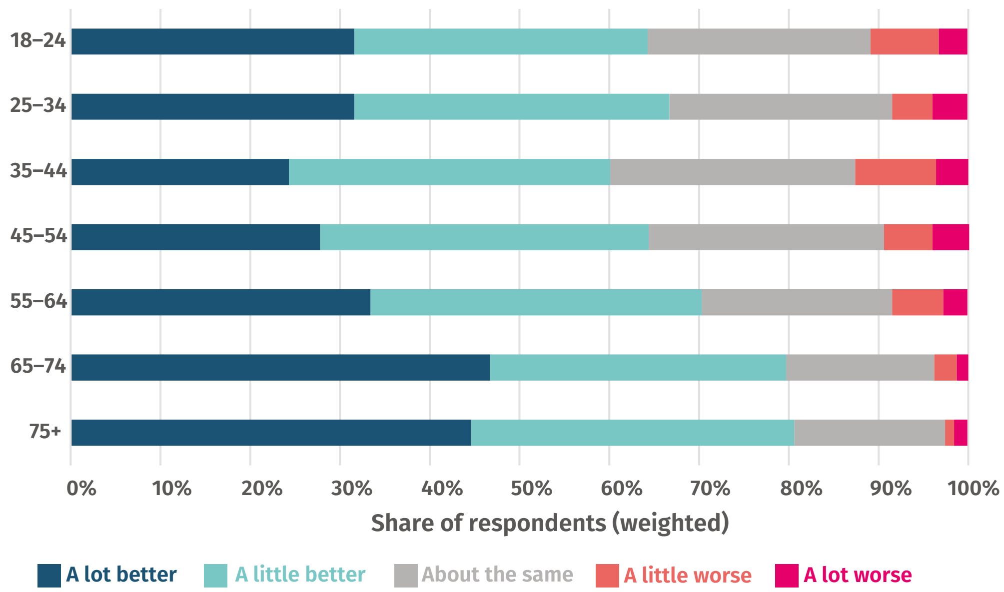
This distaste for inheritance taxation reflects a general antipathy to many forms of wealth taxation among the British public. A series of YouGov surveys (Ansell et al 2022) have shown that the British public tends to find taxes on wealth to be 'less fair' than those on work. Figure 3.1 shows that only around one-fifth of the British public think that inheritance tax, stamp duty or taxing interest is 'fair' compared to around half finding NI or income tax 'fair'. Other forms of wealth taxation, including taxing interest and stamp duty, are also viewed as unfair. However, taxes on investments, such as capital gains tax and dividends tax are viewed as more fair, as is council tax.

Ansell et al (2022) asked British survey respondents for their views about whether taxes should come more from work or from wealth. Although most British citizens pay far more annually in income taxes than they do in any taxes on wealth, more people preferred the tax mix to be balanced towards taxing work than wealth. There was particular antipathy towards taxing wealth in the south-east, including in many swing constituencies, and among older people and homeowners. In open-ended survey responses, the most common critique of wealth taxation was the view that it penalised saving and amounted to double taxation. So, taxes on wealth fare better if viewed either as a tax on gains to assets (as opposed to on the underlying asset) or as essentially hypothecated for local services, as with council tax.

There is also widespread understanding among the public that older British citizens have had a much easier time acquiring and affording property. Figure 3.2 below, also from Ansell et al (2022), shows whether respondents felt they had opportunities to acquire education (top panel) or housing (bottom panel) similar to their parents. Most British citizens (correctly), regardless of their age, believed that educational opportunities expanded over the past decades. However, with housing, people in their fifties or older answered that they had an easier time than their parents acquiring housing, whereas the reverse is true for those under 45. Housing shows Britain's intergenerational economic tensions at their strongest.

FIGURE 3.2: EDUCATION ACROSS GENERATIONS

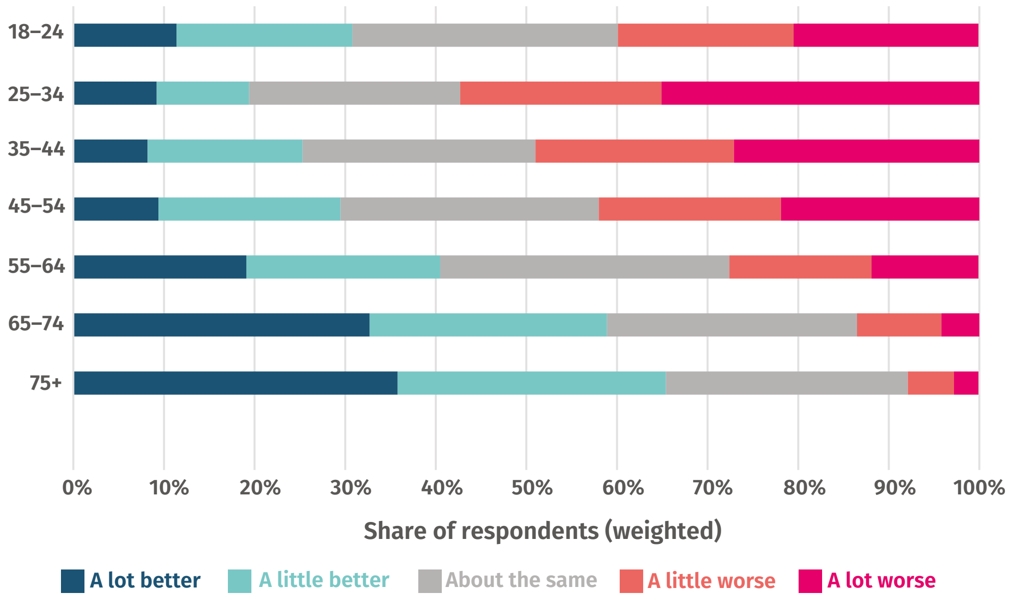
Your education compared to your parents at the same age



Source: Ansell, Bokobza, Cansunar, Elkjaer, Haslberger and Nyrup (2022)

FIGURE 3.3: HOUSING ACROSS GENERATIONS

Your housing situation compared to your parents at the same age



Source: Ansell, Bokobza, Cansunar, Elkjaer, Haslberger and Nyrup (2022)

4.
PRESSURES ON THE UK TAX SYSTEM

Public opinion and political responses to it make tax reform challenging. But it may be unavoidable. This chapter examines five pressures on the contemporary British tax system that both necessitate potentially higher taxes and complicate the raising of them.

AGEING

All industrialised societies now face the challenge of an ageing population. Britain's percentage of people over 65 rose from 14 per cent in 1974 to 18 per cent by 2024, and is expected to be 27 per cent by 2074, which looks fairly typical compared to its peers. However, as the OBR's David Miles noted to the House of Lords' Economic Affairs Committee: "Being in the same boat when the boat is in trouble is not a good boat to be in."

So, what is that boat? The basic challenge is not ageing *per se*, it is who is in the labour force. The old-age dependency ratio (the number of people above the state pension age divided by the number of working people between 16 and that age) is projected to rise from just over 30 per cent to 47 per cent over the next 50 years. Assuming benefits remain the same, that would push the cost of the state pension from 5 per cent of GDP to 7.7 per cent. Adding in healthcare costs – rising with age – and social care, some estimates have the fiscal impact of ageing adding up to almost an extra 10 per cent of GDP by 2075 (OBR 2024b).

Although benefits for older Britons will become costlier, they are also among the more tax-advantaged of groups. Chiefly, people at the state pension age do not pay NI if they continue to work, and there is strong political and press resistance to letting the personal allowance threshold fall below the state pension – in other words, to taxing the state pension. The state pension age is due to rise over the coming decades and the number of under 15-year-olds (also dependent on the working age population) will decline, which will partly but far from fully address these pressures.

IMMIGRATION

One solution to a growing old-age dependency ratio is to directly increase the denominator by adding to the working age population through migration. Over the past few years, the British death rate has crept above the birth rate, meaning the UK's population would now be in decline in the absence of net migration. Recent reforms have also shifted the inflow of migrants towards higher paying jobs, meaning the fiscal impact of current immigration is strongly positive. The Office for Budget Responsibility (OBR 2024a) estimates each 100,000 increase in net migration to be worth just under £7 billion to the exchequer. The sharp decline in net migration since 2024 is thus likely to have placed extra fiscal constraints on the government.

Why then is the government engaged in what might seem like fiscal irresponsibility? First, immigration flows are not entirely at the behest of the government and depend on labour market conditions and global politics – witness large numbers of Ukrainian and Hong Konger arrivals. Second, and more obviously, there are strong political pressures on the government to reduce immigration numbers, partly due to public concerns about 'demographic change' and partly due to perceived pressure on public services (themselves often also dependent on immigrant workers, so perceptions and reality may not line up). Finally, there is the inevitability that immigrants too will age, so it is not tenable to base the very long-run fiscal health of the tax system on immigration, unless we were to ruthlessly (and likely illegally) throw out immigrants once they reached retirement age.

GREEN TRANSITION

The British government has a legal commitment to reach net zero carbon emissions by 2050. While the investment in green technologies that the government must directly pay for or subsidise is extremely large if this goal is to be met, the broader fiscal implications are slightly more complicated and more concerning. The OBR (2025) estimates that the direct investment cost to 2050 will amount to around 6 per cent of GDP cumulatively – just over £10 billion per annum until around 2040 and declining thereafter. These costs are ultimately dwarfed by the loss in tax revenues, chiefly from fuel duty and vehicle excise duty. By 2050, these would amount to around £40 billion per annum in lost revenues.

That assumes that no replacement for fuel duty is adopted – and indeed that fossil fuel-burning cars are a thing of the past in two decades. Nor does it include the benefits of net zero if the policy would aid in reducing climate change – the estimated effect of climate change damage and mitigation is around 1 per cent of national income per annum. Whether the UK's own net zero policies ultimately affect the globally-produced level of temperature increase is of course an open question.

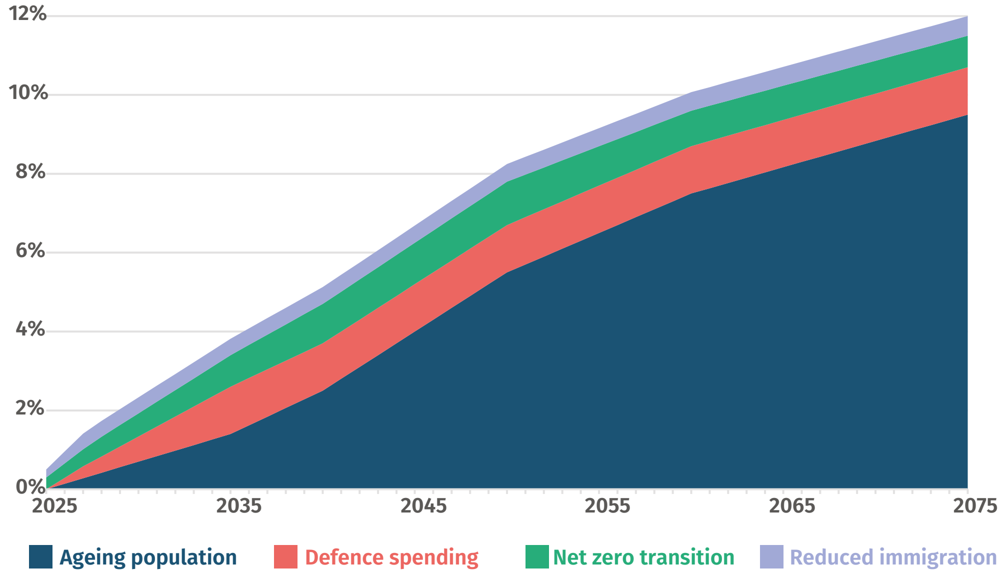
DEFENCE

The immediate post-cold war era of declining defence budgets is long past. With Russia's invasion of Ukraine, further conflicts in the Middle East, and the challenges of keeping a decades-underfunded British military at fighting strength, defence spending will have to rise substantially. The UK's Strategic Defence Review recommends a rise from 2.3 per cent of national income to 2.6 per cent by 2027 and 3.5 per cent by 2035. In addition, the government has committed to an extra 1.5 per cent of national income on wider national resilience and homeland security (though some of this latter spending may already be in place).

Clearly finding an extra 1.2–2 per cent of national income to spend on defence and related matters will be highly challenging given other fiscal pressures. Politicians are already talking about trade-offs with existing welfare spending, though typically not that spent on pensioners, where the real pressures lie. Even so, a 3.5 per cent target is far from unusual by British standards – it was a typical figure in the 1980s and defence spending had declined only to 3.3 per cent at the end of the cold war. It is conceivable that increases to defence spending might also stimulate British industry and provide employment opportunities (armed forces personnel numbers were twice as high at the end of the cold war as today).

FIGURE 4.1: FISCAL PRESSURES

Indicative estimate of cumulative fiscal pressures as % of GDP 2025–2075



Sources: OBR (2024a, 2024b, 2025)

Using figures set out in OBR (2024a, 2024b, 2025), figure 4.1 provides an indicative estimate of the sheer magnitude of fiscal pressure on the United Kingdom over the next half-century, should OBR predictions hold and relative to the 2025 baseline. It assumes that net migration is kept at a lower 200,000 level and otherwise aligns with net zero commitments, the Strategic Defence Review and the OBR estimates of the fiscal cost of ageing, given current pensions, health and social care policy.[2] While population ageing accounts for under half of these pressures over the next decade, by 2050 it makes up two thirds and by 2075, just under 80 per cent of the overall fiscal pressure. Reforms to pensions, healthcare or social care could of course reduce the magnitude of this pressure but as discussed above, politicians have previously found it hard to make extra taxes (or spending cuts) stick.

2 Some of the net zero commitments included in this analysis are accounted for in the current spending review, so not all of this spending is a new unbudgeted fiscal pressure.

5. PRINCIPLES FOR A BETTER TAX SYSTEM

Pressures on spending mean that taxes will have to rise to cover the gap over the next decades. But this creates a temptation for ministers to fall back into the pathologies of taxation: assume the public don't really want to pay higher taxes, so disguise tax rises in one-off Treasury magic tricks that avoid changes to broad-based, visible taxes, in the hope of avoiding bad press headlines.

Proposals about taxation often look for 'quick wins' that can be pulled out of a Treasury filing cabinet, dusted off, and implemented at budget time in order to satisfy the OBR and ward off the media. That kind of reactive policymaking explains why the British tax system is elaborate and often contradictory (see the critiques in Mirrlees 2011, Johnson 2023 and Neidle 2026). It also pushes away the issue of what kind of fiscal contract reflects Britain's current needs and how to balance political winners and losers in a coherent way.

Throughout this paper we have argued that the current British fiscal system has become not only too complex but also slanted towards the interests of older Britons with large amounts of accrued wealth, and away from younger earners. There are further risks to Britain's economic model becoming ever more dictated by the needs of speculative industries, from gambling to crypto, and likely to face an intensifying of wealth inequality from the rise of AI.

Designing principles for a better tax system needs to take three challenges into account.

The first challenge is one of **funding**: we will need to raise more revenue, and soon. How do we raise enough money over the next 5–10 years?

The second is one of **fairness**: the current tax system has become too tilted in favour of age and wealth. How can we adjust the balance of responsibility to reflect a new fiscal contract between groups in society over the medium run?

And the third is one of the **future**: how should Britain's tax system be prepared for the wealth concentration – and potentially mass unemployment – brought about by AI and related transformations?

FUNDING

Every chancellor faces an unenviable problem. With the tax share already at a post-war high, how should they go about raising another 3–4 per cent of GDP that might be needed over the next decade to deal both with demographic pressures and defence and environmental commitments? The current government entered office having ruled out changes to the big three taxes on 'working people' – income tax, employee NI and VAT. It quickly opted to raise employer NI, which met the words if not the spirit of that commitment, and may in turn be blamed for slowing down employment growth and pressures on the small business sector.

This leaves two options for current or future chancellors. The first is to maintain the commitment in the Labour manifesto and seek extra funds from sources outside the big three. In doing so, they will face the force of the pathologies of taxation: the public believe they are over-taxed already (despite aggregate spending being consistently higher than taxation); the temptation to choose narrow, less visible taxes in the hope of avoiding political punishment from broad tax rises; and the incentives of the press to leap on any tax policy that seems particularly newsworthy, regardless of its overall fiscal impact.

This is likely to push governments towards slicing less visible tax benefits and deductions, rather than increasing more visible tax rates. We have already seen this with the planned cuts to the generosity of salary sacrifice pension schemes. The Treasury has long talked about more aggressive cuts to the tax deductibility of pensions, although such changes are likely to be a political minefield, not least because of already low private pensions savings rates.

The other manifesto commitment-friendly option is to raise those taxes ostensibly not placed on 'working people'. The best known such option is a rise in capital gains tax rates, perhaps to equal marginal income tax rates, and potentially offset by an investment allowance that deducts a standard rate of return on the underlying asset. Proposals from Advani et al (2024) with a similar setup nearly double the amount raised from capital gains tax (from £16.2 billion to just over £30 billion) and would accordingly make up about 0.5 per cent of GDP – roughly equalling, for example, the loss of 200,000 immigrants per annum.

Other options that could be implemented in the near future without breaking the manifesto commitments include an adjustment in business rates that lowers them on high-street retail while raising them on out-of-town warehousing and shopping; removing various reliefs on ISAs and gambling winnings; or altering the treatment of various assets following death or exiting the country.

The dilemma in most of these 'rabbits out of a hat' is that they raise relatively small sums in each case – usually £1–2 billion – while complicating the tax code further and producing howls of displeasure from those affected. This was the situation the current government entered with small but salient taxes on private schools and farm inheritances. By avoiding major, broad-based tax reform, the government plucks many small feathers from the fiscal goose rather than one big feather, leading to much honking for meagre benefit. In an attempt to solve the public pathology of not wanting higher taxes, governments end up in the political pathology.

The second option is for government to break the commitment not to raise any of the big three taxes. During the past decade, broad-based increases in VAT (under Osborne) or employee NI (under Sunak) were arguably less controversial than other smaller and targeted tax rises including those on pasties, pension contributions or landlords. Of course, breaking a manifesto commitment comes with other political costs, which would need to be weighed against the economic (or possibly even political) benefits of tax reform.

One possibility would be to partially reverse the NI cuts made by Jeremy Hunt on the eve of the 2024 general election. A rate that stood at 13.25 per cent in 2022 was reduced to 8 per cent over the two years preceding the election. These cuts included the removal of the health and social care levy of 1.25 per cent introduced by chancellor Rishi Sunak to help post-Covid recovery in the health service.

Hypothecated taxes such as this are not popular with the Treasury but they are more sellable to the public. Politically, an increase in employee NI, while breaking the manifesto commitment, might be viable if hypothecated in a similar fashion. This kind of increase resolves the political pathology of avoiding broad-based reform while at least in part addressing the public pathology, in that hypothecated taxes tend to poll better and tell a clearer story to the country about the government's vision.

FAIRNESS

It is easy to get caught in the immediate budget cycle needs for chancellors to pull a tax policy out of the hat to appease the OBR. But doing so without a broader economic *and* political strategy simply worsens the decay in British fiscal policy and gets governments through a week of bad headlines rather than an electoral term's worth of implementing their vision for Britain.

Every substantial decision about fiscal policy requires making a political choice. Reshaping the tax system means a new set of winners and losers, even if only in relative terms. For the past decades the chief beneficiaries of British fiscal policymaking have been older, wealthier citizens – typically, the retired.

By contrast, the hardest hit have been those in work, particularly younger people repaying student loans through the tax system. That same group of people struggle to afford housing comparable to their parents and grandparents. And they have largely shifted their vote intention towards the left of the political spectrum yet have not seen the current government make tax policy reflecting that new progressive coalition of support – even though previous governments elected on the votes of older homeowners made fiscal policy accordingly.

This means that on both economic and political grounds, there is a strong argument for a broad-based tax reform that shifts the intergenerational balance of burden from young workers to older homeowners. There are broadly two ways of doing this: within the income tax and national insurance system; and through property taxation.

Income tax and NI reform

On income taxation, the current system is iniquitous for younger earners, particularly those on moderate-to-high salaries. As an example, pensioners earning £45,000, £70,000 and £105,000 pay marginal tax rates of 20 per cent, 40 per cent and 60 per cent at those income levels. Young graduates, paying back student loans as well as employee NI, will pay marginal tax rates of 37 per cent, 51 per cent and 71 per cent at those same points. On top of this, the highest earning group will also lose their access to tax-free childcare. Given that today's pensioners would have attended university for free (indeed may have received maintenance grants), it is hard to make a case for such a divergence on horizontal equity grounds.

Higher education financing is difficult territory – it is not obvious that a system that applied 'graduate taxes' to all graduates of UK universities, regardless of whether they went before or after 2012, would be technically feasible or remotely viable politically. So, some of this gap will remain, although it would certainly be viable – if costly – to reduce the interest rate recent graduates pay on their loans.

However, the NI gap is harder to justify – not least since NI payments do not go into a 'national insurance lockbox' to pay for pensions. A number of economists have called for merging income tax and NI, which would certainly remove this discrepancy but would be rare in international terms, and potentially reduce public support for policies the public believes – if technically inaccurately – are funded by NI. Moreover, as we saw in figure 3.1, the tax that British citizens find 'fairest' is NI. So, whether it is hypothecated or not in reality, the public believe it to be so and support it for that reason.

A more viable policy would be to extend the 2 per cent NI surcharge, paid by current employees under 65 on earnings above the upper earnings limit of £50,270, to pensioners. This could be done in exact mirror – 2 per cent on all earnings above the upper earnings limit. Or, to raise more revenues, and partly reset questions of intergenerational fairness, it could be applied to earnings above the personal allowance or at some intermediate level. While any tax increase on retirees does risk the press pathology, it has the merit of being broad-based (overcoming the political pathology) and because NI is well understood and popular, may even retain some popularity with the public.

Proportional property taxation

Property taxation is the other way to address questions of intergenerational fairness. As we saw above, most Brits agree that younger people have had much greater challenges in affording a property than their elders. Yet property taxation remains entirely tied to valuations conducted at the time of the poll tax/council tax reform in 1991. Furthermore, local authorities are limited in the changes they can make to council tax rates. Accordingly, we have the unfortunate situation of band D properties in some of Britain's wealthiest local authorities – Wandsworth and Westminster, for example – paying just over £1,000 per annum – while band D properties in Gateshead and Nottingham pay over £2,700.

The other part of British property taxation, stamp duty land tax (SDLT), is also hard to justify in its current form. A tax that was just 1 per cent of the value of a purchased property above £60,000 in 1993 now reaches up to a marginal rate of 12 per cent above £1.5 million. This means that those very homeowners who have benefited most from Britain's three-decade long property boom likely paid the least in terms of direct property tax. Although there are stamp duty reductions for first-time buyers, these are still many multiples of the rate prevailing in the 1990s, and in any case are cut out for properties worth over £500,000.

A broad tax reform would attempt to address these intergenerational and regional inequities by replacing both council tax and SDLT with a proportional property tax, levied on the current assessed value of the property. Such systems are globally widespread – this is how local taxation is levied across the US and Canada, and is in place in European countries including Portugal, Spain and Switzerland. To replace the combined tax take of council tax and SDLT would require a proportional rate of around 0.65 per cent, which is similar to that in many countries.

Clearly, there would be both winners and losers from such a change. The most obvious winners would be people at the point of purchasing a property, who would now no longer need to find tens of thousands of pounds in SDLT to proceed with the transaction – and on the whole, this would be younger citizens.

Property owners in relatively low-valued houses in high council tax districts would also win out – for example, anyone in Gateshead in a band D property worth less than £415,000 (the median house price in Gateshead being £159,000 in 2026). Symmetrically, homeowners in Wandsworth would take a large hit. A transition could, however, be managed by allowing homeowners to defer the gap between current council tax rates and new assessed rates until the sale of property or death. The larger challenge would be to avoid the problem of low-property value local authorities facing major budget costs as revenues declined – this would require central government reallocation across councils.

This is not a free lunch and politicians should not expect to be thanked by future homebuyers who no longer have to pay stamp duty, or even by those whose council tax declines. However, such a policy does allow government to tell a story about better reflecting the challenges of younger generations and poorer regions, something the public broadly understands (see figures 3.2 and 3.3). And with a transparent and simple valuation system it might improve public trust in fiscal policymaking. Moreover, as we saw in figure 3.1, the public find council tax to be much 'fairer' than stamp duty or indeed inheritance taxation, so a proportional property tax may be a more effective way of selling a popular vision of wealth taxation than some of the alternatives.

In terms of the pathologies of taxation, a proportional property tax clearly fares best in terms of the political pathology – it would be a genuinely broad-based, simplifying reform, taking two complicated and unloved taxes and merging them into a single, transparent tax. With regard to the public pathology, if net revenues remain the same as combined council tax and SDLT then it avoids concerns about rising taxation. The concern here would be whether the losers from the reform shout louder than the winners. The former group will be smaller than the latter – they will also be richer – which leads us to the press pathology: stories about housing and about the threat of mansion taxes are a long-time press staple. So ultimately, the hardest challenge for a proportional property tax is overcoming likely media opposition.

Taxing 'Spiv Britain'

The final area where Britain's fiscal compact could be reset is in the balance between productive and non-productive assets. A number of highly lucrative British industries are premised on rent-seeking or the 'greater fool' theory. Gambling, crypto-currency and payday lending industries have become enormously profitable. There is the danger that our industrial strategy unwittingly becomes 'Spiv Britain', where fortunes are made largely through speculation or preying on low-income citizens.

A progressive government, seeking to centre British growth on productive, growth-driving industries, be they manufacturing, pharmaceuticals, higher education or AI, might wish to incentivise investment in these sectors rather than more speculative ones. The UK does not currently tax the net gambling winnings of amateur gamblers (unlike the US), which could raise £1–3 billion. Crypto is taxed like another capital gains tax-eligible asset, but greater effort could be placed into auditing and monitoring crypto asset sales. Finally, commercial property transactions could become subject to standard SDLT rates (or a new rate, should SDLT be merged into a proportional property tax).

These types of policies will necessarily target particular industries and transactions, so they do run some risk of complicating the tax system – the public pathology – or creating new avenues of avoidance. But politically, they fit neatly together under an attack on 'Spiv Britain'. So, in terms of the public pathology, they may be viewed as being paid by 'someone else', and in terms of the press pathology, an effective communications strategy ought to be able to maintain public support even among some media pushback by interested parties.

FUTURE

Designing a tax system for the longer horizon is no simple task given the impossibility of predicting what the world might look like in a decade, let alone by 2050. Still, we do have some sense of the challenges posed by current technological developments. In particular, the advent of AI large language models in the past five years raises crucial questions about what many jobs will look like in a decade, and indeed whether they will still exist. We may find ourselves in a world where companies no longer require anywhere near the level of employment that they previously needed.

This will create fiscal challenges on two ends. First, the loss of a large share of the base for income taxation. Importantly, this might also come from people who had previously been major tax contributors – graduate, service sector professionals. Second, a demand for support from those made redundant by algorithmic replacement. Whether this amounts to a universal basic income, much beloved of AI thinkers, or something more attuned to previous earnings is unclear. But clearly mass unemployment will require some fiscal response from the state. In sum, the fiscal take from labour will go down just as demands from ex-workers rise.

Progressive consumption tax

Current thinking from AI economists such as Anton Korinek recommends a transition first away from income taxation to taxing consumption, possible through a progressive consumption tax. Taxing consumption is typically viewed as regressive, given that poorer citizens tend to spend a greater share of their income, although the UK's VAT regime does already zero-rate food, children's clothes and public transport. Income taxation by contrast has a progressive schedule.

If, however, the share of national income going to employees as wages and salary declines rapidly, offset by increased returns to capital, then consumption taxation may look more attractive, since this much of the rising income from capital will be spent on consumption. Higher VAT and lower income tax rates could therefore shift some fiscal burden onto wealthy citizens.

In order to ensure that poorer citizens don't bear the burden of higher VAT, a progressive consumption tax would need to provide a consumption allowance, similar to the income tax's personal allowance, that would be untaxed. Rather than requiring vendors to ascertain customer income, or asking poorer citizens to file for consumption tax credits at the end of the year, this might be best set up like a negative income tax or universal basic income. Accordingly, a progressive consumption tax looks much like combining lower income taxation, higher VAT rates and a universal basic income.

AI Token Tax

Rather than taxing consumers, if the labour share does decline dramatically, we might instead need to structure our taxation around the AI companies and their products. Over the past decade there has been a debate among economists about so-called 'robot taxes', which tax the usage of robots or their equivalent in production. The idea behind them is that robots may replace workers because labour is systematically over-taxed relative to capital, leading companies to favour the latter. Early versions of the robot tax level that playing field by making the use of robotics relatively more expensive – for example, by charging the equivalent in NI contributions that would have been paid to employ a displaced worker.

There are two challenges of that kind of robot tax. The first is measurement and the incentives for companies to misrepresent how much labour-replacing technology they are employing. This is even more challenging as we move from physical robotics to AI agents, whose presence is not visible. The second is that making capital more expensive relative to labour is likely to reduce productivity and slow down growth, not least if Britain employs robot taxes whereas competitor economies do not.

An AI token tax avoids a number of these problems (Irwin et al 2026). Rather than directly taxing AI agents, the inputs to production, it taxes the output – tokens produced by large language models or their equivalent. In this way it operates somewhat like a VAT on token production: businesses and consumers using AI models directly or indirectly pay a proportionate tax. Provided that, as with VAT, business-to-business intermediate sales are exempt, the token tax can directly trap a portion of the value created by AI models. Similar alternatives include a floating point (FLOP) tax directly made on compute itself rather than the outputs, though this faces the risk of tax revenues declining as processing efficiency increases.

The main challenges to a token tax are in measurement – it requires AI companies to essentially permit auditing of the token production process – and international cooperation. If the UK were alone in implementing a token tax, it potentially faces competitiveness issues as high-value service sector AI app users in the UK pay taxes not faced by rival firms abroad. Moreover, with frontier AI models largely based in the US and China, Britain would face the difficulty of asking foreign companies to engage in continuous auditing for British fiscal needs. Thus, a token tax might ultimately need to be agreed among similar-minded countries, be they in Europe or with a future US administration less beholden to AI companies.

AI unearned rent tax

Should the concentration of wealth produced by AI become even more extreme, and indeed largely driven by the decisions of AI algorithms, the British tax system will face even larger challenges. Highly concentrated wealth disrupts collective notions of citizenship and responsibility.

Anton Korinek's view is that *in extremis,* should the AI sector be sufficiently concentrated, it would then make sense to shift taxation entirely to taxing capital in the form of unearned rents. The idea would essentially be to 'harvest' some of the returns produced by AI. Usually, economists argue capital taxation has a strong disincentive effect on investment – however, if resource allocation decisions are made by machines and either distributed to a small hyper-elite of AI-owning humans or are all fully invested in further AI rollout, then direct taxation of AI capital may be needed to ensure sufficient consumption goes around for us remaining humans.

This return to Georgist principles mirrors the response to hyper-capitalism and industrial concentration of the late 19th century. Once again, we are focussing on 'unearned rents', albeit not on the control of land but on the control of compute. Just as hyper-concentration of ownership of land for railways or in the centre of new industrial cities made fortunes for speculators and early investors, so too could the proceeds of 21st-century productivity be captured by the very few, the very wealthy.

Whether attempts to make tech billionaires responsible for upholding the tax system are likely to be politically successful is questionable. And the experience of the 1909 People's Budget suggests a furious backlash from the (AI) aristocracy. But a future fiscal contract needs to be based on our collective citizenship and making sure that as a voting public we retain the right to allocate and reallocate economic resources in a way that meets human needs and concepts of fairness.

How do these various fiscal responses to AI fare when confronted by Britain's three pathologies of taxation? In terms of the public pathology, all three have some merit. Taxing the capital of AI plutocrats and companies is likely to be popular with the public. Token or FLOP taxes are sufficiently low-visibility to be broadly popular. A progressive consumption tax ought to be able to mirror public support for our current progressive income tax system – considered relatively fair by the public – but there is some risk that a universal basic income used to sustain it may be viewed as too unconditional a benefit by the public.

For the political pathology, a progressive consumption tax would be the foundation of an extremely broad-based tax simplification, presuming a minimal number of exemptions. An AI capital harvesting tax presents some challenges of implementation but if the capital share does rise dramatically, some kind of unearned rent tax will be needed. Token and FLOP taxes present greater difficulties in terms of set-up and avoidance.

Finally, the press pathology likely depends on whether AI companies and the entrepreneurs who make vast fortunes from them are viewed as public enemies by the press or as titans of industry. The politicisation of AI in the United States over the next few years will provide a useful guide for policymakers about which way the media wind is likely to blow.

6. CONCLUSION

The choices we make about taxation reflect the choices we make about politics. When we choose how – and who – to tax, we are making decisions about how we as a collective are going to afford the promises we make to one another, and how to fairly distribute that burden. Needless to say, people will differ substantially in how they view the affordability of those promises and in how they define fairness. And that means taxation is, at its heart, a political question.

British politics has been in tumult over the past decade. It has not been easy to find collective agreement on much. The piecemeal and often contradictory set of tax reforms we have seen in that time reflect this dissensus. But ultimately, we have in common as citizens of the United Kingdom not only rights to services and benefits from the state, but also the responsibility to pay for them. When that responsibility seems to be shirked by some, or who benefits appears imbalanced, then public discontent follows.

Whoever is in government over the next decades will face a wave of demanding fiscal pressures – from defence commitments to an ageing population, from the green transition to AI, and reconciling the fiscal benefits of immigration with its political costs. None of this is simple, and previous governments have found themselves quickly overwhelmed by both the economic pressures to raise taxes and the political pathologies that make doing so hard. In the past it has typically required big crises in society to have 'big bang' reforms to taxation. It is understandable that in the absence of the overwhelming urgency of events, politicians might prefer an easy life. But that cynical attitude assumes the public will always punish bravery and underestimates the importance of providing a narrative about why the current system is failing the country and how, collectively, we can do better.

An effective, progressive, tax policy will have not only to take on the myriad economic inefficiencies and perversities of the existing system. It will also need to bring British citizens along with it. Politicians need to be able to tell a convincing story about rebalancing the tax system so that it is fairer to the young and those in work. They will need new targets for taxation – be they those whose fortunes come from speculation and gambling, or those plutocrats whose fortunes depend on controlling the digital means of production. And they will need to weave a story about both fairness and rebalancing the burden of taxation, and about the future – one where Britain's tax systems can fairly harness the potential growth from AI and technological innovation to the benefit of all British citizens.

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