REFORMING THE TAXATION OF INCOME FROM WEALTH

REVENUE ESTIMATES FOR LABOUR, THE CONSERVATIVES AND THE LIBERAL DEMOCRATS

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INTRODUCTION

Taxation is the means by which governments raise revenue and fund the welfare and public services on which a civilised society depends. The IPPR Commission on Economic Justice identified a need to move to a higher tax, higher spend economy – with future public spending challenges likely to increase over time (IPPR CEJ 2018). We also seek a tax system that is more progressive – so that those with the greatest ability to pay contribute the most – as well as more transparent and efficient. The UK is one of the most unequal countries in the developed world, and income inequality could be set to worsen as capital and property ownership become more important sources of income generation. Redistribution is essential for economic justice.

This briefing paper focuses on the proposal that income from wealth should be taxed the same as income from work, with a focus on capital gains. It is profoundly unjust that those who work for their incomes are taxed more highly than those whose income is derived from wealth. This situation is all the worse when we consider that the wealthiest are less likely to generate their income from labour than the rest of us. Among the richest 1 per cent, over one-quarter of total income is generated from dividends and partnership income alone. Economic justice demands change.

Following this principle would mean that capital gains would be taxed at the same rates as income from employment, and the separate reliefs applied to capital gains tax (CGT) would be abolished. A similar policy was last implemented by Conservative chancellor Nigel Lawson. Capital gains tax rates are substantially lower than they were prior to 2008 and are currently much lower than income from work. Lower tax rates for the wealthy than for ordinary earners are fundamentally unfair; they also distort economic behaviour and create opportunities for tax avoidance.

In a previous report, *Just Tax* (Nanda and Parkes 2019), we estimated the revenue impact of these changes to the taxation of capital gains. Here, we present a revised version of these estimates, which suggest that these changes could raise up to £130 billion of additional revenue over five years, falling to £90 billion when accounting for potential behavioural effects. Removing the exemption of capital gains upon death could raise up to an additional £25 billion over the same time period, falling to £15 billion with behavioural effects. There are inevitably large uncertainties around these estimates, but even if the behavioural effects were larger, we would still expect these changes to raise significant sums.

In this paper, we consider the impact of these changes if made alongside the new income tax schedules likely to be proposed by Labour, the Conservatives and the Liberal Democrats. We find that under Labour's new schedules, the amount of additional revenue raised would instead be up to £140 billion over five years, falling to £100 billion when accounting for potential behavioural effects. The removal of death relief could raise up to an additional £30 billion, falling to £20 billion with behavioural effects.

Under the Conservative's proposals, these changes could instead raise an additional £130 billion over five years, falling to £90 billion with behavioural effects. The removal of death relief could raise up to an additional £25 billion, falling to £15 billion with behavioural effects.

Under the Liberal Democrats' proposals, these changes could raise an additional £130 billion over five years, falling to £90 billion with behavioural effects. The removal of death relief could raise up to an additional £25 billion, falling to £15 billion with behavioural effects.

Policies

Labour has proposed lowering the 45 per cent additional rate income tax threshold from £150,000 to £80,000 and reintroducing the 50 per cent rate for those earning above £125,000 (The Times 2019).

During the 2019 Conservative party leadership contest, Boris Johnson announced plans to raise the higher rate income tax threshold from £50,000 to £80,000 (Johnson and Waters 2019). While recent reports have suggested this may not feature in the manifesto, we include it here as the only trailed policy which would affect the revenue estimates (The Times 2019a).

And in 2017, the Liberal Democrats proposed a 1p rise in the rate of income tax, bringing rates up to 21 per cent, 41 per cent and 46 per cent (Hood 2017). The Liberal Democrats have recommitted to their policy of taxing capital gains in line with income (The Guardian 2019).

Modelling

The changes we model are:

- Taxing capital gains at the same rate as income
- Removing the annual exempt amount
- Removing Entrepreneurs' Relief
- Introducing a rate of return allowance or an indexation allowance
- Removing death relief

We have modelled these changes using data from HMRC on capital gains (HMRC 2018) and estimates of behavioural impact from HM Treasury (HM Treasury 2010). *Just Tax* (Nanda and Parkes 2019) contains a full explanation of the methodology used.

We have also made some revisions to our methodology since the publication of *Just Tax*. To estimate the split of capital gains between residential and non-residential assets, we previously used the share of disposals by value on residential assets. We now use the share of taxable gains by value on residential assets.

To estimate the impact of introducing a rate of return allowance or an indexation allowance, we previously assumed that taxable gains could go back to 1st April 1980. We have now updated our modelling to reflect the fact that capital gains tax is only levied on gains made after 31st March 1982 (HMRC 2019).

To estimate the percentage of gains that would remain taxable under a rate of return allowance or an indexation allowance, we previously compared the compound average annual rate of bond yields or inflation to the compound annual average rate of capital gains. Now, for each period we look at, we compare the total performance of bond yields or inflation to the total capital gain in that period. This is to better reflect how such an allowance would be calculated, based on the previous method used to calculate the indexation allowance between 1982 and 2008[1] (Thomson Reuters 2019).

We present a revised version of our original estimates below, as well as estimates of the impact of these changes under the parties' proposals.

[1] For individuals.

Results

Current system

Table 1 shows the impact of all our proposed changes, if implemented together and in this order, under the current income tax schedule. We do not anticipate changes in year one, as most capital gains tax payments are made in the year following accruals.

TABLE 1

Direct impacts of changes under current income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+11	+12	+13	+14	+49
Remove the annual exempt amount		0	+10	+10	+10	+11	+41
Remove entrepreneurs' relief		0	+8	+8	+9	+10	+35
Introduce a rate of return allowance	**RRA based on bond yields**	0	-17	-18	-19	-21	-75
	Indexation allowance	0	-9	-9	-10	-11	-39
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	12	12	13	13	**50**
	Indexation allowance	0	20	21	22	23	**86**
	No allowance	0	29	30	32	34	**125**
Total with removal of death relief	*RRA based on bond yields*	*0*	*15*	*16*	*17*	*18*	*65*
	Indexation allowance	*0*	*24*	*26*	*27*	*29*	*106*
	No allowance	*0*	*34*	*37*	*39*	*41*	*151*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Note: This is a revised version of Table 2.2 in Just Tax.

Table 2 shows the post-behavioural impacts of all our proposed changes, if implemented together and in this order, under the current income tax schedule.

TABLE 2

Post-behavioural impacts of changes under current income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+9	+11	+10	+10	+39
Remove the annual exempt amount		0	+7	+9	+7	+6	+29
Remove entrepreneurs' relief		0	+5	+7	+6	+5	+23
Introduce a rate of return allowance	**RRA based on bond yields**	0	-13	-17	-15	-15	-60
	Indexation allowance	0	-7	-9	-8	-8	-31
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	7	10	8	6	**31**
	Indexation allowance	0	13	18	15	13	**60**
	No allowance	0	20	27	23	21	**91**
Total with removal of death relief	*RRA based on bond yields*	*0*	*9*	*13*	*10*	*8*	*40*
	Indexation allowance	*0*	*16*	*22*	*18*	*16*	*73*
	No allowance	*0*	*24*	*32*	*27*	*25*	*108*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Notes: Impacts include additional CGT and income tax revenue. This is a revised version of table 2.5 in Just Tax.

Labour

Table 3 shows the impact of all our proposed changes, if implemented together and in this order, under Labour's proposed income tax schedule.

TABLE 3

Direct impacts of changes under Labour income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+13	+14	+16	+17	+60
Remove the annual exempt amount		0	+11	+11	+12	+12	+46
Remove entrepreneurs' relief		0	+9	+9	+10	+11	+39
Introduce a rate of return allowance	**RRA based on bond yields**	0	-19	-20	-22	-23	-83
	Indexation allowance	0	-10	-10	-11	-12	-43
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	14	15	16	16	**60**
	Indexation allowance	0	23	24	26	27	**101**
	No allowance	0	33	35	37	39	**144**
Total with removal of death relief	*RRA based on bond yields*	*0*	*18*	*19*	*20*	*21*	*77*
	Indexation allowance	*0*	*28*	*30*	*32*	*33*	*123*
	No allowance	*0*	*39*	*42*	*45*	*47*	*173*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.

Table 4 shows the post-behavioural impacts of all our proposed changes, if implemented together and in this order, under Labour's proposed income tax schedule.

TABLE 4

Post-behavioural impacts of changes under Labour income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+10	+13	+12	+12	+47
Remove the annual exempt amount		0	+7	+10	+8	+7	+32
Remove entrepreneurs' relief		0	+6	+8	+6	+6	+25
Introduce a rate of return allowance	**RRA based on bond yields**	0	-15	-18	-17	-16	-66
	Indexation allowance	0	-8	-10	-9	-8	-34
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	9	12	9	8	**38**
	Indexation allowance	0	16	21	17	16	**70**
	No allowance	0	23	31	26	24	**104**
Total with removal of death relief	*RRA based on bond yields*	*0*	*11*	*16*	*12*	*10*	*49*
	Indexation allowance	*0*	*19*	*26*	*21*	*19*	*84*
	No allowance	*0*	*27*	*37*	*31*	*28*	*123*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Note: Impacts include additional CGT and income tax revenue.

Conservatives

Unlike the Labour and Liberal Democrat proposals, the Conservative proposals would affect the revenue raised under the current capital gains tax system, as they would shift the higher rate income tax threshold, which is also a determinant of the capital gains tax schedule. However, this change does not have a material effect on estimated revenues, as most capital gains fall into the higher tax bracket in either scenario.

Similarly, our estimates of the impact of these reforms under the Conservative income tax schedule is not materially different to their estimated impact under the current income tax schedule. Again, this is because most capital gains fall into the higher tax bracket in either scenario.

Table 5 shows the impact of all our proposed changes, if implemented together and in this order, under the Conservatives' proposed income tax schedule. We do not anticipate changes in year one, as most capital gains tax payments are made in the year following accruals.

TABLE 5

Direct impacts of changes under Conservative income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+11	+12	+13	+14	+49
Remove the annual exempt amount		0	+10	+10	+10	+11	+41
Remove entrepreneurs' relief		0	+8	+8	+9	+10	+35
Introduce a rate of return allowance	**RRA based on bond yields**	0	-17	-18	-19	-21	-75
	Indexation allowance	0	-9	-9	-10	-11	-39
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	12	12	13	14	**50**
	Indexation allowance	0	20	21	22	23	**86**
	No allowance	0	29	30	32	34	**125**
Total with removal of death relief	*RRA based on bond yields*	*0*	*15*	*16*	*17*	*18*	*65*
	Indexation allowance	*0*	*24*	*26*	*27*	*29*	*106*
	No allowance	*0*	*34*	*37*	*39*	*41*	*151*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.

Table 6 shows the post-behavioural impacts of all our proposed changes, if implemented together and in this order, under the Conservatives' proposed income tax schedule.

TABLE 6

Post-behavioural impacts of changes under Conservative income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+9	+11	+10	+10	+39
Remove the annual exempt amount		0	+7	+9	+7	+6	+29
Remove entrepreneurs' relief		0	+5	+7	+6	+5	+23
Introduce a rate of return allowance	**RRA based on bond yields**	0	-13	-17	-15	-15	-60
	Indexation allowance	0	-7	-9	-8	-8	-31
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	7	10	8	6	**31**
	Indexation allowance	0	14	18	15	13	**60**
	No allowance	0	20	27	23	21	**91**
Total with removal of death relief	*RRA based on bond yields*	*0*	*9*	*13*	*10*	*8*	*40*
	Indexation allowance	*0*	*16*	*22*	*18*	*16*	*73*
	No allowance	*0*	*24*	*32*	*27*	*25*	*108*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Note: Impacts include additional CGT and income tax revenue.

Liberal Democrats

Table 7 shows the impact of all our proposed changes, if implemented together and in this order, under the Liberal Democrats' proposed income tax schedule. We do not anticipate changes in year one, as most capital gains tax payments are made in the year following accruals.

TABLE 7

Direct impacts of changes under Liberal Democrat income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+11	+12	+13	+14	+52
Remove the annual exempt amount		0	+10	+10	+11	+11	+42
Remove entrepreneurs' relief		0	+8	+9	+9	+10	+36
Introduce a rate of return allowance	**RRA based on bond yields**	0	-17	-19	-20	-21	-77
	Indexation allowance	0	-9	-10	-10	-11	-40
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	12	13	13	14	**52**
	Indexation allowance	0	20	22	23	24	**89**
	No allowance	0	29	31	33	35	**129**
Total with removal of death relief	*RRA based on bond yields*	*0*	*15*	*16*	*17*	*18*	*67*
	Indexation allowance	*0*	*25*	*27*	*28*	*30*	*110*
	No allowance	*0*	*35*	*38*	*40*	*43*	*156*

Source: Author's analysis based on methodology outlined above and in *Just Tax*.

Table 8 shows the post-behavioural impacts of all our proposed changes, if implemented together and in this order, under the Liberal Democrats' proposed income tax schedule.

TABLE 8

Post-behavioural impacts of changes under Liberal Democrat income tax schedule (£bn), marginal impacts

		2020/21	2021/22	2022/23	2023/24	2024/25	Total
Tax capital gains at the same rates as income		0	+9	+11	+10	+10	+41
Remove the annual exempt amount		0	+7	+9	+7	+6	+30
Remove entrepreneurs' relief		0	+5	+7	+6	+5	+24
Introduce a rate of return allowance	**RRA based on bond yields**	0	-14	-17	-16	-15	-61
	Indexation allowance	0	-7	-9	-8	-8	-32
	No allowance	0	0	0	0	0	0
Total	**RRA based on bond yields**	0	7	11	8	7	**33**
	Indexation allowance	0	14	19	15	14	**62**
	No allowance	0	21	28	23	22	**94**
Total with removal of death relief	*RRA based on bond yields*	*0*	*9*	*14*	*10*	*9*	*42*
	Indexation allowance	*0*	*17*	*23*	*19*	*17*	*75*
	No allowance	*0*	*25*	*33*	*28*	*25*	*111*

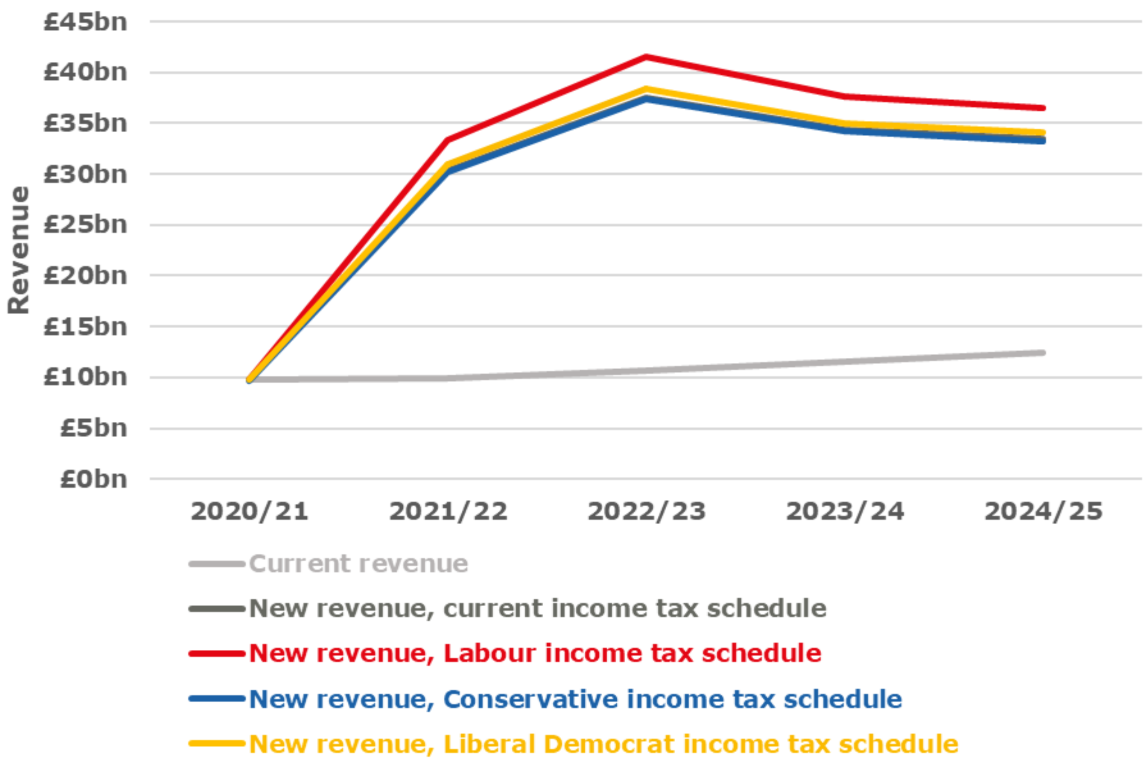
Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Note: Impacts include additional CGT and income tax revenue.

Summary

FIGURE 1

Our proposals will raise significantly more tax revenue over five years in all scenarios

Projected revenue under different parties' income tax proposals: post-behavioural impacts assuming no allowance and not including the removal of death relief



Source: Author's analysis based on methodology outlined above and in *Just Tax*.
Note: Impacts include additional CGT and income tax revenue.

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