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# Top income inequality and tax policy



Economic  
and Social  
Research Council

# Top income shares were rising from early 1980s

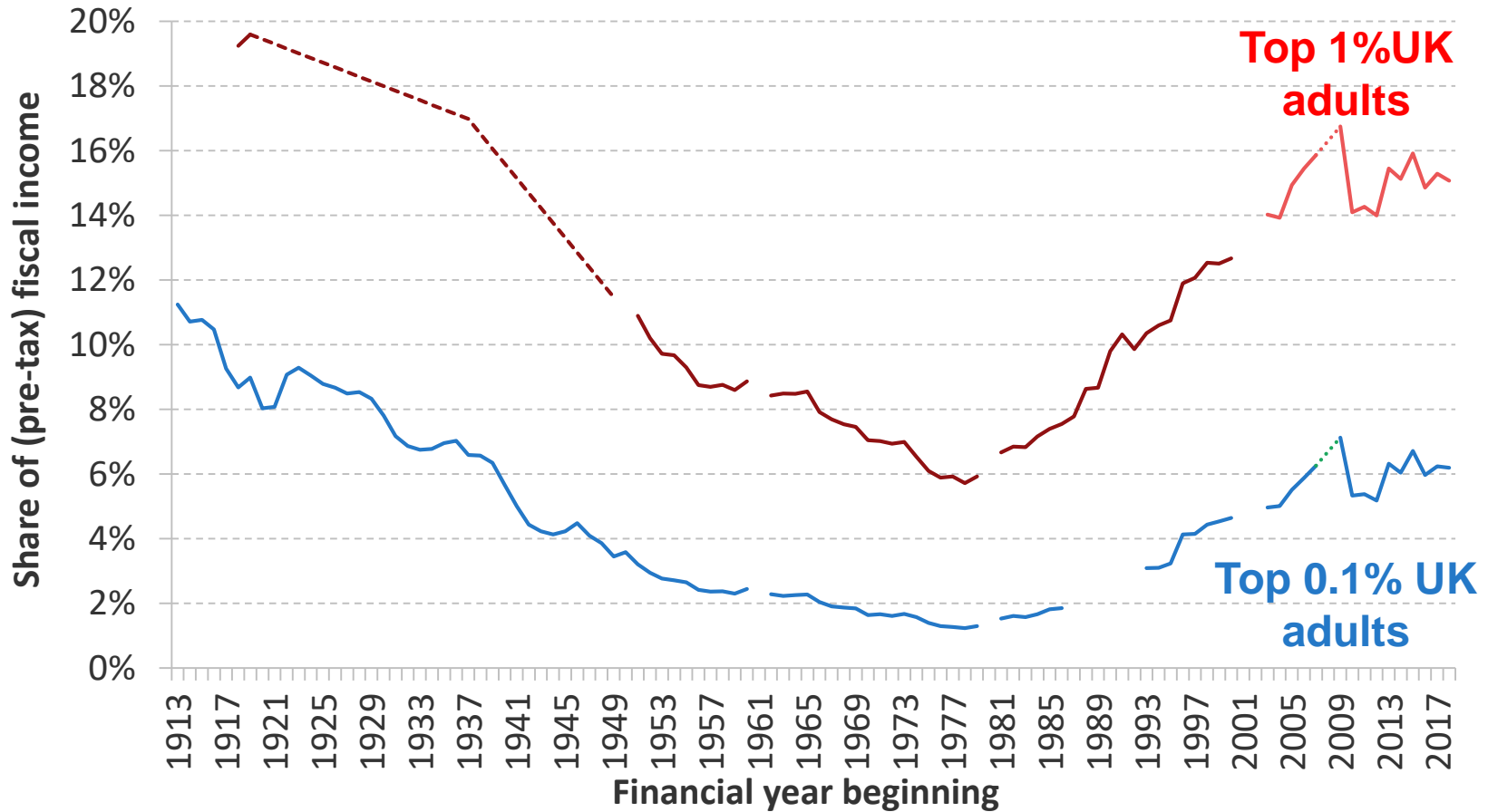


Figure 2, Delestre et al (2022)

# 3 decade trend came to end with financial crisis

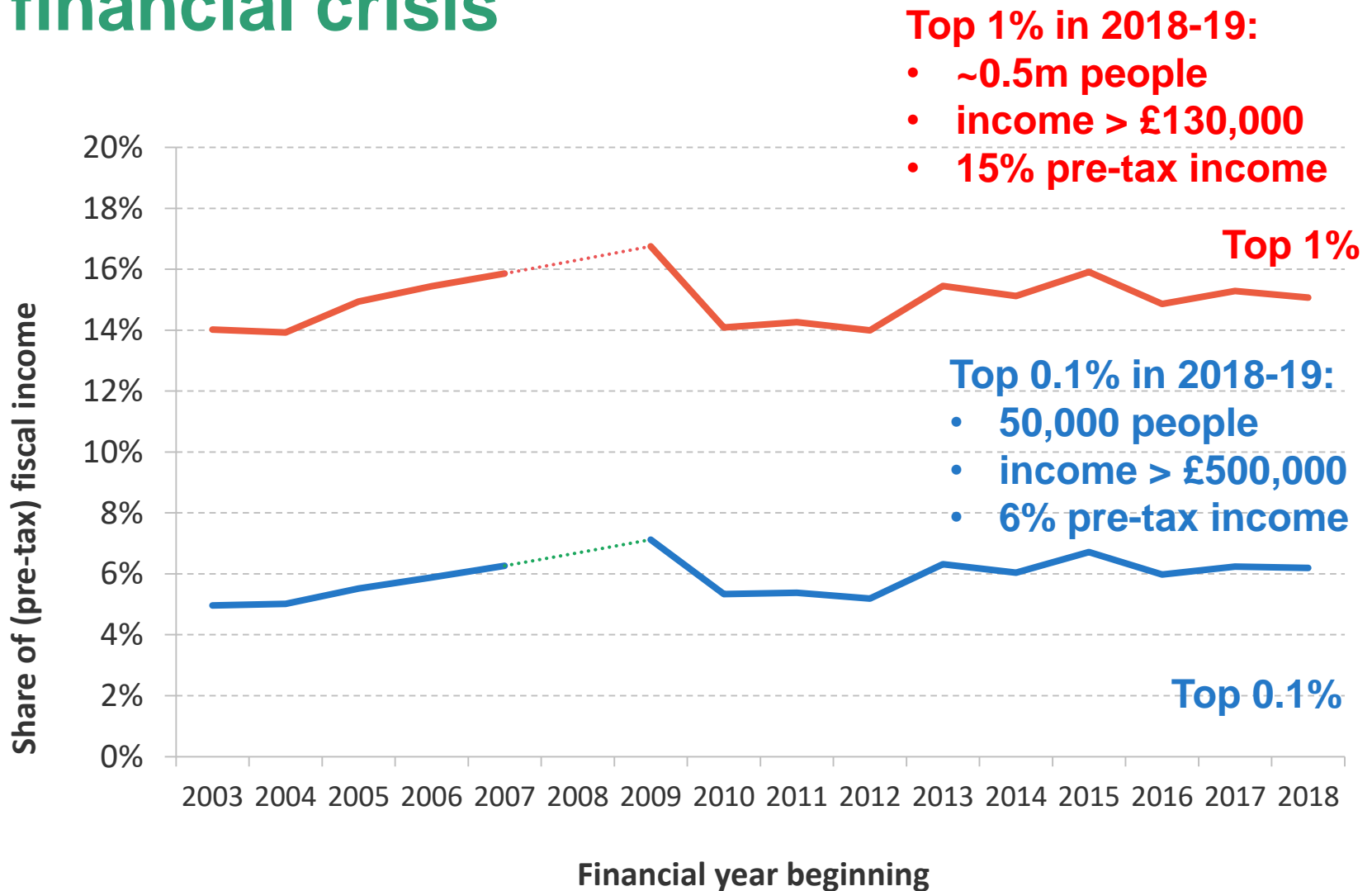


Figure 2, Delestre et al (2022)

- *Fiscal Income* - from HMRC tax records - captures income from:
  - **employment** (inc taxable employment benefits, net of tax-deductible employment-related expenses); **profits from sole trading** (net of capital allowances and losses); **partnership income**; **dividends** from UK companies; **property**; **investments** (inc from interest, trusts, settlements and estates); and **private pensions**.

Don't capture:

- *Capital gains*: taxable gains skewed to the top; untaxed gains more evenly spread
- *Inheritances*: increase the share of lifetime income received by the top 20%.
- *Foreign income*: no data
- *Tax evasion*: back-of-the-envelope calculation – top 1% share could be 1ppt higher if accounting for income flowing to offshore assets

# Business income is more important at the top

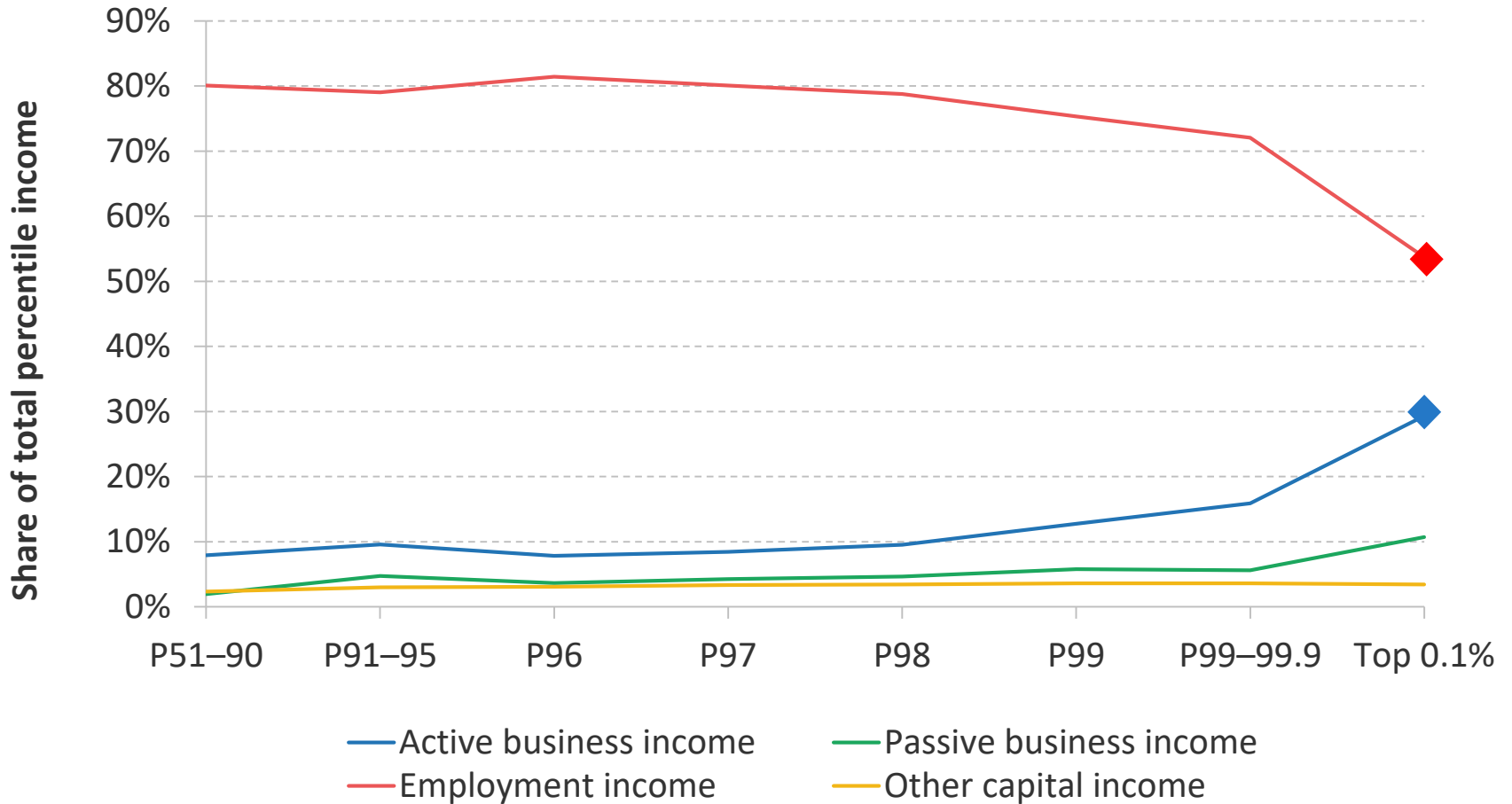


Figure 3, Delestre et al (2022)

# More self-employed and company owner-managers at the top

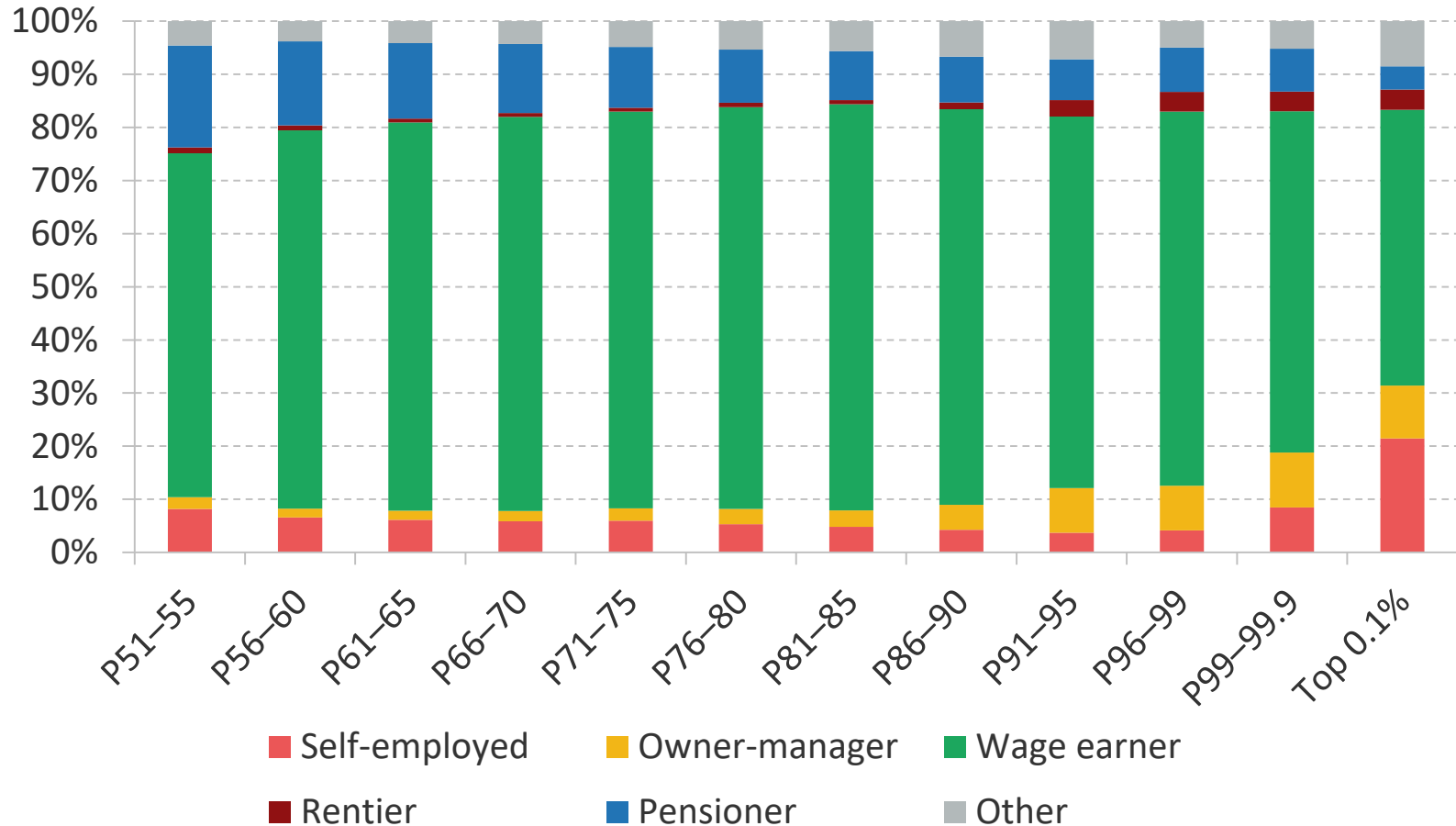


Figure 4a, Delestre et al (2022)

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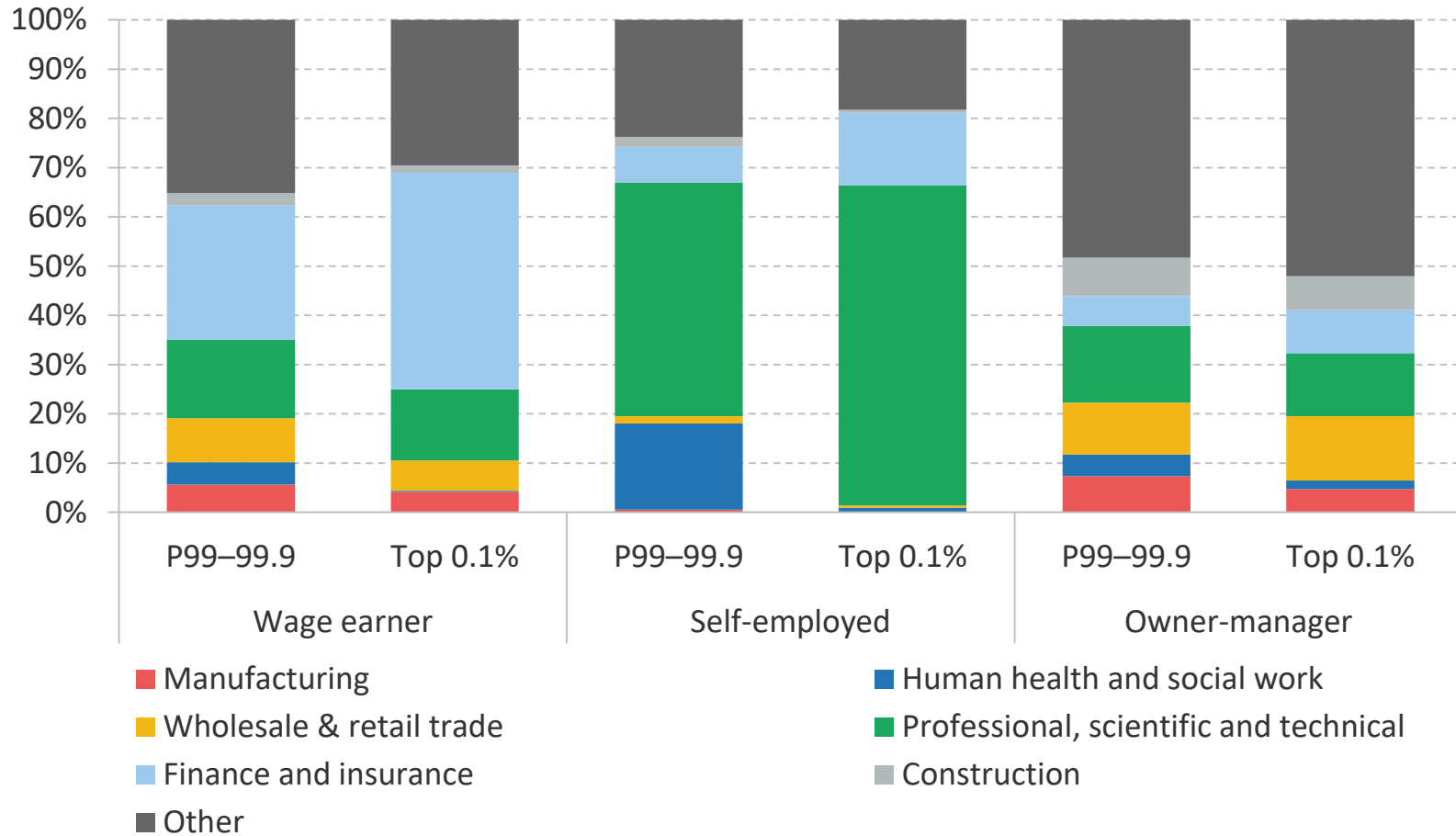


Figure 4b, Delestre et al (2022)

# 1. Income taxes are progressive

- Average tax rates, including income tax and NICs:
  - Top 0.1%: 43% (47% inc employer NICs)
  - Top 1%: 41% (46% inc employer NICs)
  - p91-95: 24% (30% inc employer NICs)



## 2. Top taxes have been rising...

- New **'additional rate'** of **income** tax above £150,000 in 2010
  - Initially 50%; 45% from 2013-14
  - Includes new higher rate on dividends: 25% to 30.56%
- All dividend rates increased in 2016. Top rate to 38.1%

## 2. Top taxes have been rising & reduced post-tax income shares

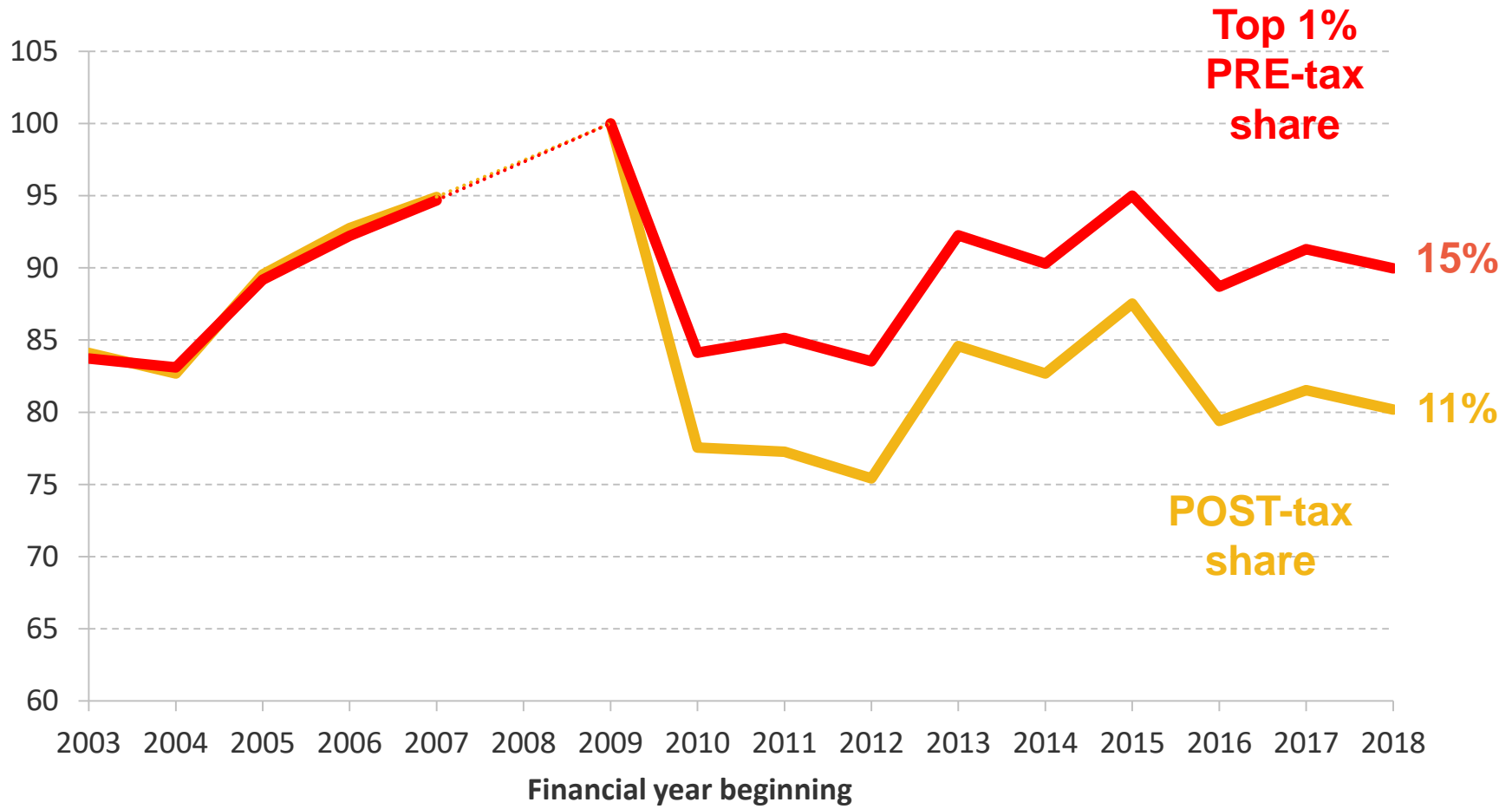


Figure 10, Delestre et al (2022)

# 3. Taxes vary by income source

Mean average tax rate by type of individual within the top 1% of UK adults, 2018–19

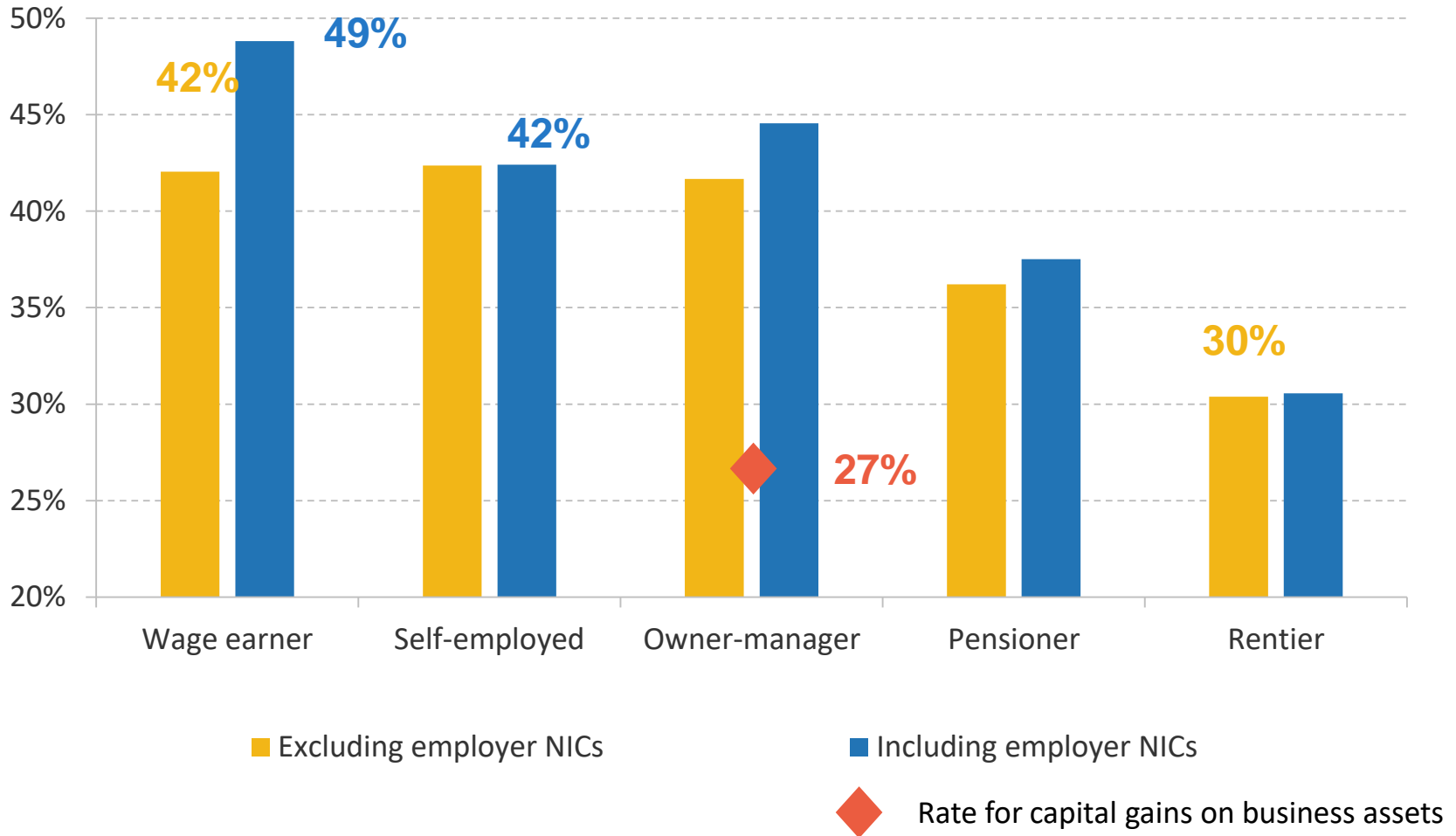


Figure 11, Delestre et al (2022),

# How high should top taxes be?

Depends on:

- Preferences for redistribution
- What is driving top shares? (e.g. effort vs market power)
- How do people respond to taxes?
  - Work effort; business start up; innovation; location
  - Avoidance; income shifting
- Official forecasts predict higher additional rate of income tax would raise little additional revenue
  - Lots of uncertainty
  - High-income people are very responsive, but much of that is avoidance

# Base reform and rate alignment

- Case to make rates on business & investment income more similar to employment income
  - Horizontally more equitable (where people doing similar work)
  - Reduce tax motivated income shifting & changes in legal form
  - Lower rates aren't well targeted at entrepreneurship
- But higher rates would discourage some saving and investment
  - Get around trade-off by **reforming the tax base** – minimise extent to which taxes discourage investment and risk taking
- With a reformed base, strong case to align overall rates (including capital gains)
  - Would allow more to be raised from the top if desired

# Summary

- Those at the top get a lot more income from working in financial services or for their own business
- Share of pre-tax income flowing to top 1% rose from 1980s; flat since 2013
  - Top 1% (0.1%) get 15% (6%) of pre-tax income
- Income taxes are progressive & higher taxes since 2010 have reduced post-tax top incomes
- Business income taxed less heavily than employment income
  - Especially low rates on capital gains