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25 March 2025

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Taxation & entrepreneurship



Economic
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ANALYSIS OF
PUBLIC POLICY

Tax & entrepreneurship

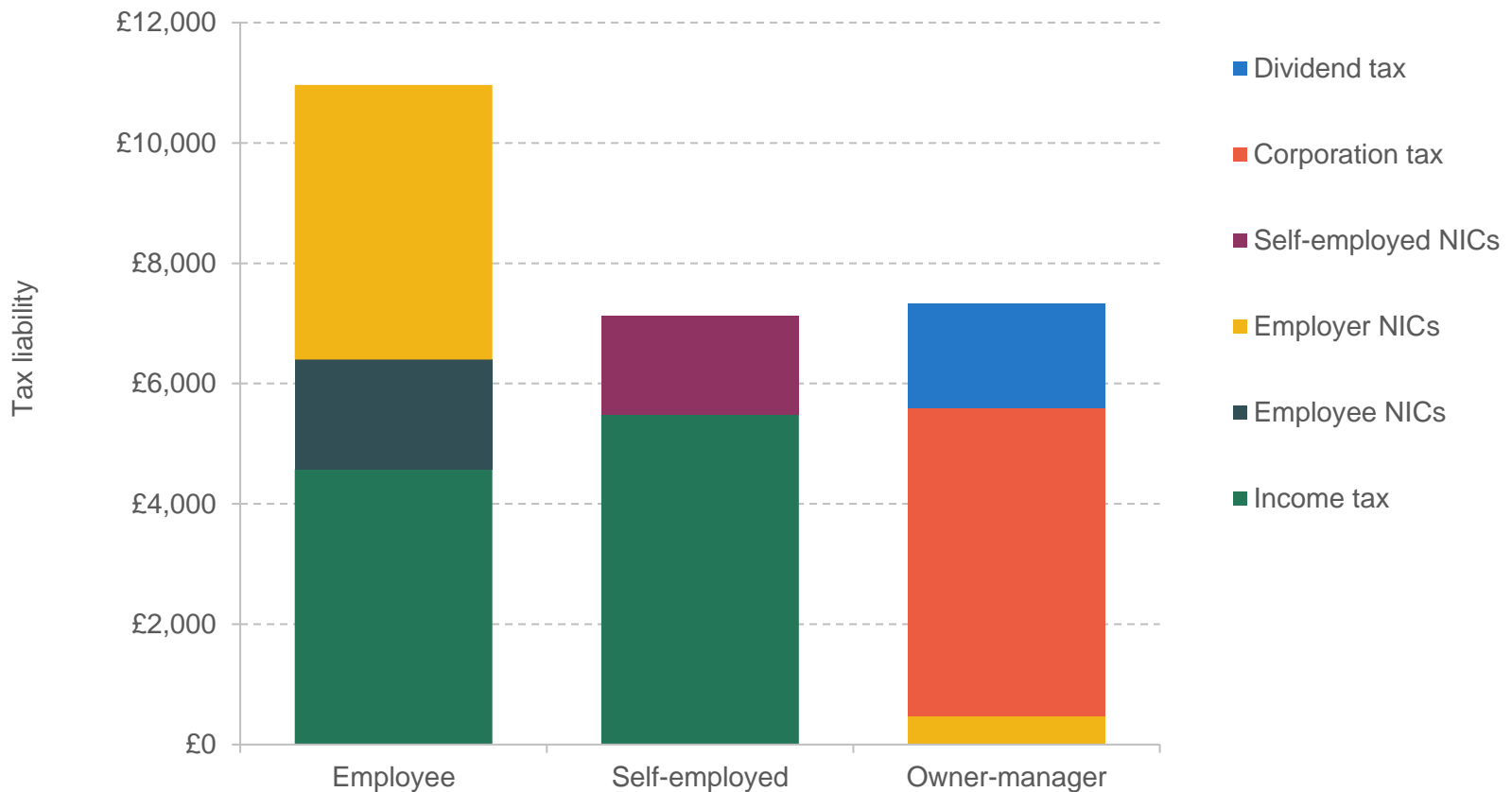
- Entrepreneurship important contributor to productivity
- We may see less of it than is socially optimal
 - Positive externalities, credit constraints, etc.
- Potential role for tax in influencing work decisions

BUT

- Targeting market failures easier said than done
- Business creation a poor proxy
- Risk of waste or (worse) inducing *less* productive activity

Tax by legal form, an example

Tax due on a job generating £40,000, 2024-25



Tax support for business-owners

Tax-advantages not limited to income-tax and NICs, e.g.:

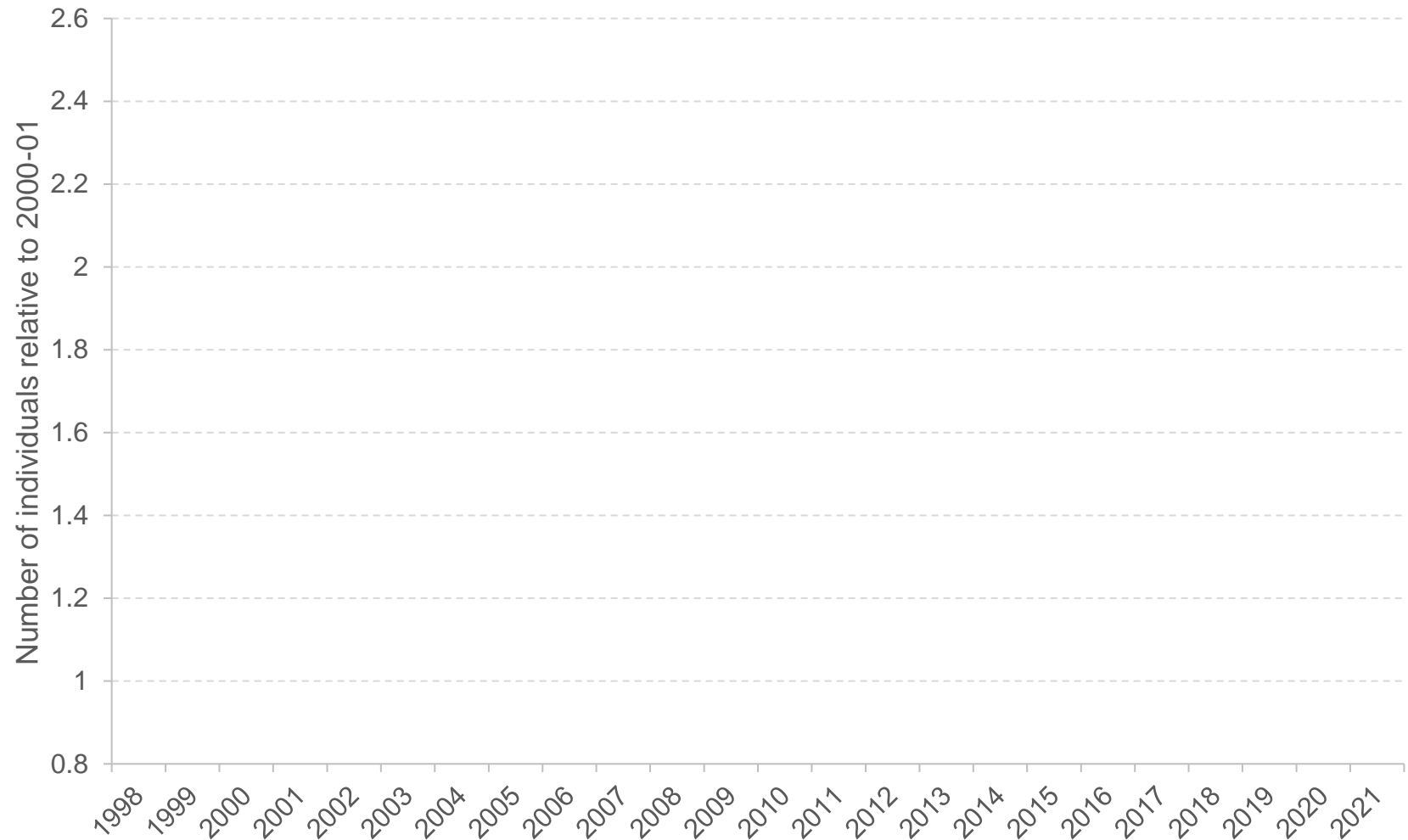
- Business Asset Disposal Relief: 10% CGT (£1 million lifetime limit)
- Business Relief from inheritance tax
- EIS/SEIS: CGT and income tax relief for investors in small firms

BUT...

Design of tax base can push against investment & risk-taking, e.g.:

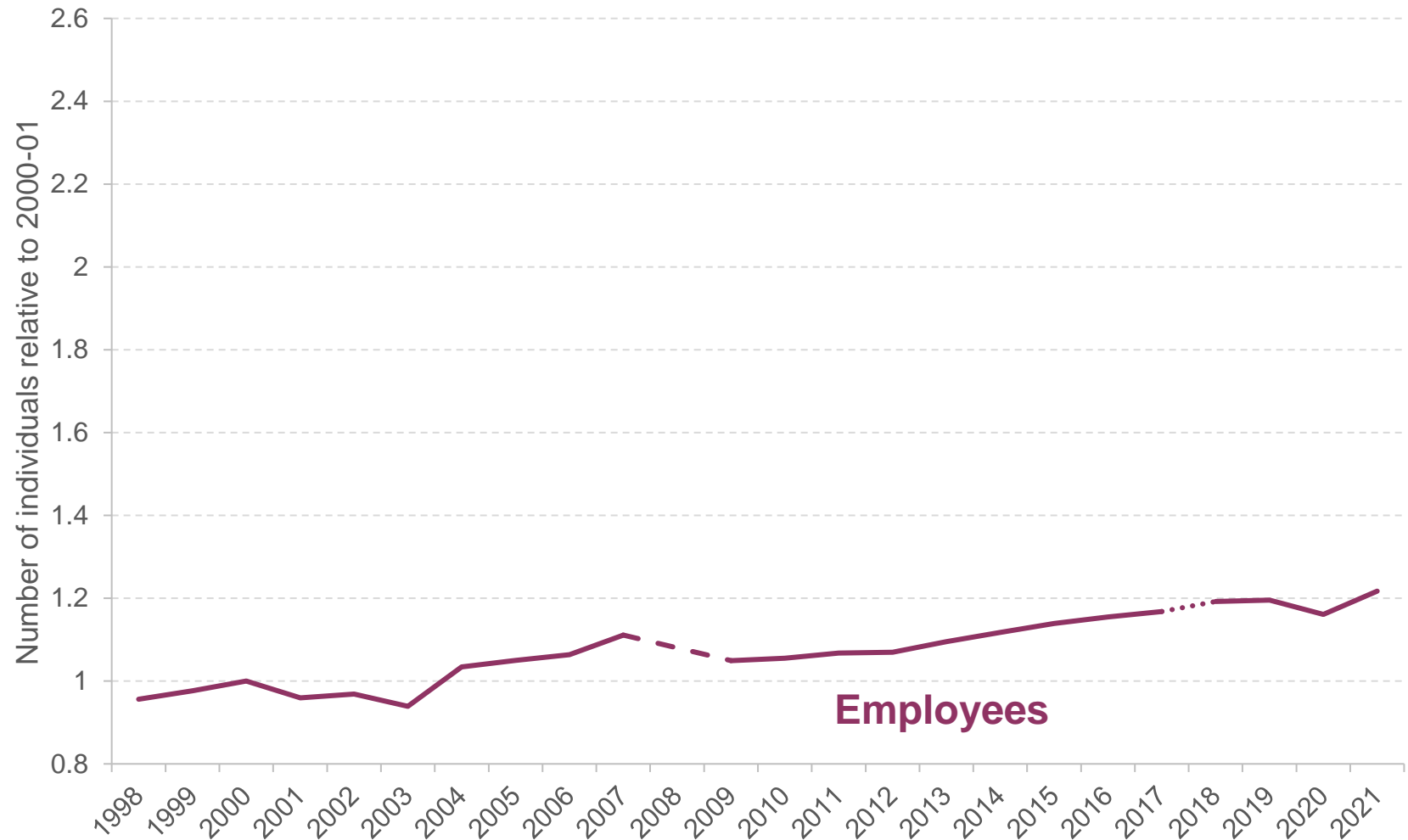
- Disincentives to invest new equity
- Incomplete capital allowances (taxation of the normal rate of return)
- Imperfect loss offsets

Growth in business owners



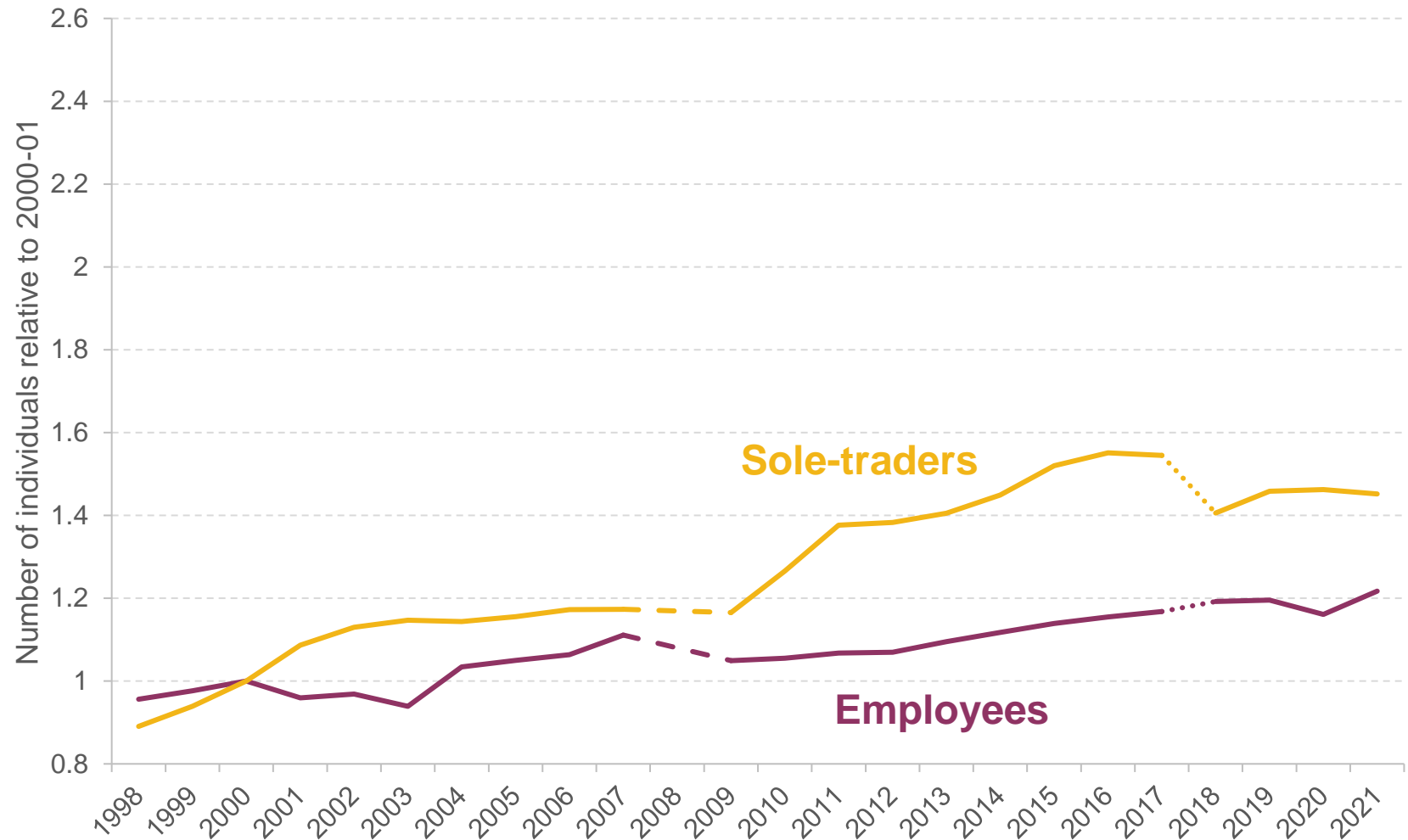
Source: SPI public use tape

Growth in business owners



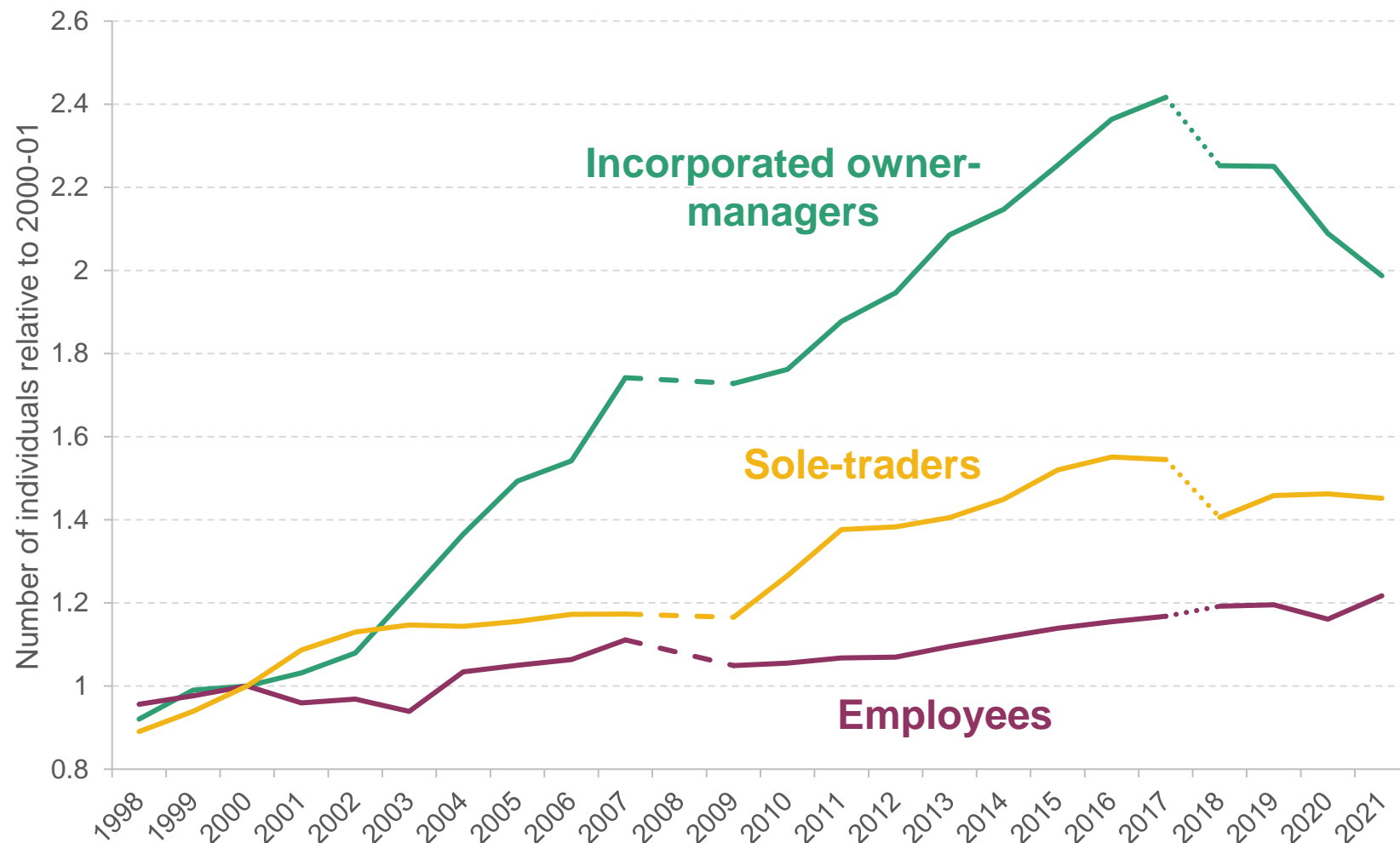
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Growth in business owners



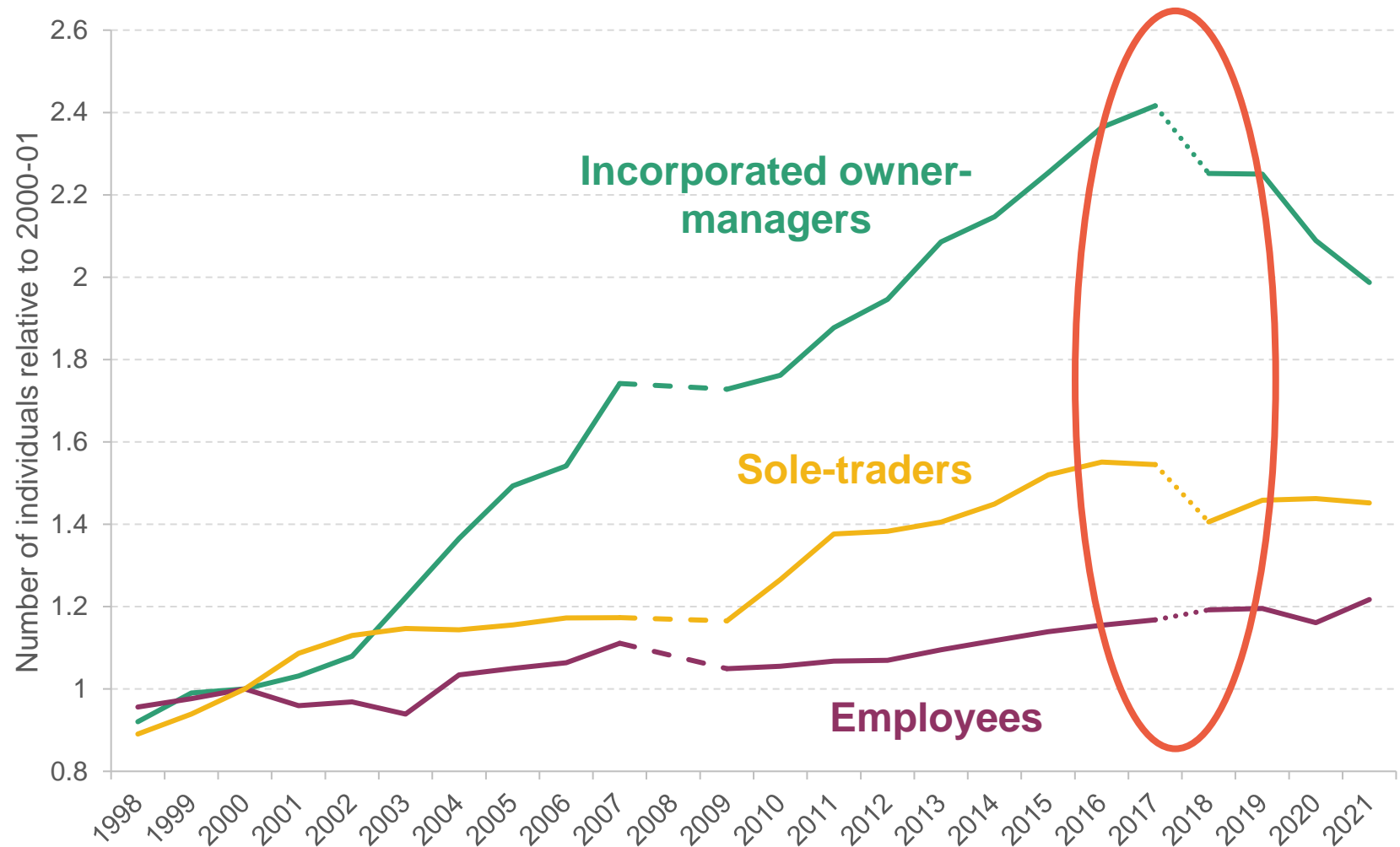
Source: SPI public use tape

Growth in business owners



Source: SPI public use tape

Growth in business owners



Source: SPI public use tape

Who are business-owners?

Increasing share of workforce are owner-managers, but...

- 75% of self-employed have zero employees
- Growth in incorporated owner-managers entirely one-director firms
- Less than 25% of sole-traders are undertaking capital investment
- Average sole-trader incomes substantially below that of employees

Better ways to target support?

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Current approach:

1. Preferential tax rates for business owners
 2. Tax penalties on investment & risk-taking
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- A better solution: Mirrlees review (2010)
 - Eliminate/reduce tax boundaries between legal forms
 - Target reform at fixing distortions to investment & risk




Steps towards a better system

- Miller & Smith 2025; [Equity and efficiency effects of capital tax reform](#)
 - Model of business owners, using data from HMRC tax records
 - Individual-company link enabling new insights
 - Can simulate counterfactual policies
- Model can compare equity/efficiency outcomes for:
 - Increase in CGT rate
 - Increase in CGT rate + base reform (of equivalent fiscal cost)





Equity vs efficiency?

	CGT rate increase only	CGT rate increase + base reform
Revenue		
Investment		
Hours worked		







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Conclusions

- By targeting legal form, the UK tax system risks encouraging work that is actually less productive
- Tackling disincentives to investment & risk-taking a better bet
- Policies on the table that could increase *both equity and efficiency*

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