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IFS-CIOT debate

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Where next for capital gains tax?



Economic
and Social
Research Council

Two compelling ideas

1. “Tax all income the same”
2. “Don’t discourage saving, investment and entrepreneurship”
 - These are in apparent conflict
 - Tax capital income & gains as much as earnings (1) or not at all (2)?
 - Result: reduced, but not zero, tax rates on capital income and gains
 - Compromise doesn’t achieve either objective satisfactorily
 - Tax rates yo-yo as emphasis changes
 - But we can have our cake and eat it
 - Set tax *rates* the same for all sources of income
 - Adjust the tax *base* to avoid undesirable disincentive effects

- Reduced tax rate is biggest giveaway to those making highest returns. High returns could be:
 - *Predictable*: Those investments will be worthwhile regardless of tax – focus instead on investments that are borderline worthwhile
 - *Lucky*: Why further reward the fortunate?
 - *Result of effort and skill*: Why tax working to generate income more heavily than working to increase asset values?
- Give deductions for desired activity, not for returns to the activity
- More generous deduction for amount invested
 - e.g. deduct purchase cost immediately, not when dispose of the asset
 - or index the purchase price for a (risk-free) interest rate
 - Tax any returns above that in full
 - Investments that are worthwhile before tax still worthwhile after tax

CGT and risk-taking

- Risk-taking is discouraged when upside is taxed more than downside is cushioned
- Currently, gains are taxed, but losses can't always be deducted
- So make capital loss offsets as flexible as possible
 - e.g. allow to offset against income (rather than gains) more widely

CGT and death

- Gains unrealised at death are written off
 - Deceased's estate not liable for CGT on rise in value before death
 - Inheritor deemed to acquire for value at death, not original price
- Big incentive to hold onto assets that have risen in value until death
- Incentive would be even worse if CGT rates higher
 - Better to end uplift at death before increasing rates
 - Could be done in conjunction with other reforms (IHT? Social care?)

Summary

- The tax base needs reform
 - More generous treatment of **purchase cost**
 - More flexible **loss offsets**
 - Abolish **uplift at death**
 - Merge **annual exempt amount** with income tax personal allowance
- If tax base fixed, increasing CGT rates would be a fair way to raise revenue from the well-off with little damage to incentives
 - Aim to **align overall tax rates** across all sources of income / gains
 - Start by getting rid of **business asset disposal (BAD) relief**