IPPR Commission on Economic Justice

A Wealth of Difference

Reforming the taxation of wealth

Discussion Paper

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The IPPR Commission on Economic Justice

The IPPR Commission on Economic Justice is a landmark initiative to rethink economic policy for post-Brexit Britain.

Launched in November 2016, the Commission brings together leading figures from across society – from business and trade unions, civil society organisations and academia – to examine the challenges facing the UK economy and make practical recommendations for reform.

The Commission is undertaking a wide-ranging programme of research and policy consultation on issues including industrial strategy, macroeconomic policy, taxation, work and labour markets, wealth and ownership, sub-national economic policy and technological change. Through a major programme of communications, events and stakeholder engagement it aims to contribute to both public debate and public policy on the economy. Non-partisan, it has been welcomed by both government and opposition parties.

The Commission's Interim Report, *Time for Change: A New Vision for the British Economy*, was published in September 2017. Its Final Report was published in autumn 2018.

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Summary

60 SECOND SUMMARY

The UK is a wealthy nation but that wealth is very unevenly distributed. This has negative implications for both economic prosperity and justice. These issues are set to become more important as technological change, stagnating wages and rising house prices increase the income and gains that can be made from wealth.

The UK's system of wealth taxation currently fails to tackle these issues. In fact, it frequently exacerbates them by creating opportunities for avoidance, distorting investment decisions, poorly capturing wealth transfers and undertaxing income from assets, particularly housing. This is unjust. In this paper we make five recommendations which together amount to a transformation of the tax treatment of wealth in the UK. We recommend that all income from wealth is taxed under the income tax schedule; that inheritance tax is abolished and replaced with a lifetime donee-based gift tax; and that that non-domiciled status is removed and trusts are reformed to be more transparent. We also propose the reform of property taxes through the replacement of council tax with an annual property tax, and the replacement of business rates with a land value tax.

EXECUTIVE SUMMARY

The UK is a wealthy nation but that wealth is very unevenly distributed. Wealth is twice as unequally distributed as income, with the top 10 per cent of households owning 44 per cent of the wealth and the bottom 50 per cent owning just 9 per cent (ONS 2018a).

Current levels of wealth inequality are unjust. High levels of wealth inequality impede equality of opportunity, allowing the wealthy – including those born into wealthy families – to augment that wealth with less effort than those relying on income from work. Wealth provides opportunity, enabling business creation and better life chances. But high levels of wealth inequality are also economically inefficient. Wealthier households are less likely than poorer households to consume any extra income they receive. This might not be a problem if it was instead invested in the productive economy, but increasingly the investment undertaken by the wealthiest in society is used for speculation on property or existing equities, generating high returns for the wealthy rather than supporting productive growth.

Wealth inequality is set to grow as returns to capital exceed the rate of economic growth. Rising house prices and declining home ownership have created inequality *between* generations today, but that will become *within* generation inequality as those with wealthy, home-owning parents inherit. Technological change risks increasing proportions of national income accruing to those with capital, and stagnant wages are making it harder for people without capital to save

There are a number of ways to address wealth inequality, including boosting and spreading asset ownership and increasing employment incomes to enable people to save. Alongside these mechanisms, taxing wealth or income from wealth, and using the revenue for progressive or universal policies, is a powerful means to reduce wealth inequality.

There are several key problems with the way that wealth taxes are currently designed. First, there are significant opportunities for avoidance, particularly

by the wealthy. Second, wealth taxes in the UK fail to raise a large amount of revenue, in part but not purely due to avoidance. Third, differential rates of tax on different assets create economic distortions and encourage the direction of investment towards speculation over existing assets rather than the expansion of the economy's capital base. Finally, by undertaxing income from wealth relative to income from labour, our tax system is regressive. As a result, these taxes have failed to reduce wealth inequality in the UK, and in certain cases have exacerbated it. The current tax system is also unsustainable: as a greater proportion of national income goes to capital owners, taxes on that income will need to increase to maintain existing levels of spending as a proportion of GDP.

In this paper, we argue for fundamental reform of the system of wealth taxation in the UK to increase tax revenues, reduce wealth inequality, and promote both prosperity and justice. We propose the following measures:

Tax all income from wealth under the income tax schedule
Having lower rates of tax on income from capital, which is disproportionately received by the wealthy, than on labour income, which is earned by almost everyone at some point in their lives, is regressive and creates opportunities for avoidance. We argue that capital gains tax and separate rates of tax for dividends should be abolished, and income from dividends and capital gains should be incorporated into the income tax schedule. This reform would involve removing most exemptions, allowances, and reliefs that currently exist for both capital gains tax and dividend taxes. We propose that the exemption on primary residences is retained, and that they are instead taxed with a property tax (see below).

Abolish inheritance tax and introduce a lifetime donee-based gift tax
The current system of inheritance tax is easy to avoid and favours the 'wealthy, healthy and well-advised'. Wealth transfers confer an unearned advantage to the recipient, and should be taxed more effectively to promote equality of opportunity. We propose that inheritance tax is abolished, and a new gift tax levied on the gifts received by an individual above a lifetime allowance of £125,000. When this lifetime limit is reached, any income from gifts would be taxed annually at the same rate as income from labour under the income tax schedule. Gifts between spouses would be exempt from the tax, and gifts below a certain lower limit would not have to be declared. To implement this policy, the UK's tax infrastructure would need to be improved. We believe this is made possible by digital technologies which make the tracking of asset transfers and self-reporting of income easier to achieve than in the past.

Abolish non-domiciled status and reform the transparency of trusts
Recent progress in introducing registers of beneficial ownership for corporations is welcome, but the current system is still not transparent enough. To reduce avoidance, the tax system must become more simple and transparent. Non-domiciled status should be removed entirely. It is regressive, has little economic justification, and can be used to avoid tax. Alongside this, a public register of beneficial ownership should be created for interest in possession trusts, to prevent these entities from being used to avoid tax. The legal treatment of trusts should also be reformed to ensure that a trust cannot be transferred without creating a new legal beneficial owner. This will prevent the emergence of 'ownerless assets' that can be used to avoid tax.

Introduce an annual property tax to replace council tax and eventually stamp duty
We argue that council tax should be abolished, and replaced with a property tax which is proportional to the present-day value of homes. Such a tax would be far more progressive than council tax and would effectively capture increases in house prices in a way in which the current system does not. The new tax we propose would therefore act as both a property tax and a tax on consumption.

A property tax of 0.5 per cent of property value would raise £1.6 billion more per year across the UK compared with the current system.[1] The vast majority of households would benefit from the tax change, and for those in the bottom half of the income distribution, incomes would rise. Over time we would anticipate the percentage charge to be gradually increased to allow reductions in the level of stamp duty land tax (SDLT), potentially phasing it out altogether. The reform would include a mechanism to allow the deferral of payment by households that are cash-poor but asset-rich. It would be accompanied by regular revaluations and could include discretion at the local level to vary the levy within certain parameters.

Introduce a land value tax to replace business rates

A land value tax (LVT) on business land would, we believe, be the most economically efficient means of taxing commercial land. It would support, rather than deter, productive investment; it would capture some of the unearned windfalls from the ownership of land; and it would reduce incentives for further speculation. It would help rebalance the economy geographically, making disadvantaged regions with lower land values more attractive locations in which to do business. The value of the land would be calculated on the basis of its 'optimum use' under existing planning permission, not its current use. To replace business rates on a revenue neutral basis it is estimated that an annual rate of approximately 4 per cent levied on land value would need to be charged. Any implementation should be incremental, for example, an initial charge of around 1 per cent of land value could be levied and rising each year by the same amount, whilst phasing out business rates at the same time.

Together, these measures will make the UK's tax system both more just and more economically efficient – both reducing wealth inequality, and helping us to build a tax system fit for the 21st century.

1 Resolution Foundation estimate.

1. Introduction

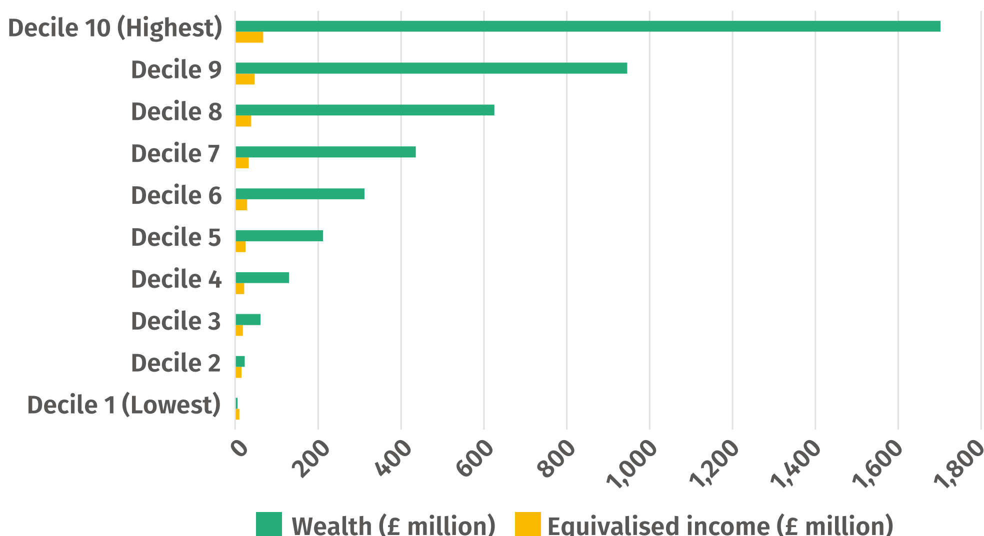
WEALTH INEQUALITY IN THE UK

The latest Wealth and Assets Survey estimates household net wealth in Great Britain to stand at £12.8 trillion. The wealthiest 10 per cent own 44 per cent of this wealth, whilst the least wealthy half own just 9 per cent (ONS 2018a)[2]. Wealth is twice as unevenly distributed as income in the UK; the Gini coefficient for wealth in the UK (2014-2016) is 0.62, while the Gini coefficient for all households' disposable income in the financial year to 2016 was 0.32 (ibid; ONS 2017). Median wealth in the bottom decile is £5,400, while in the top decile it is £1,701,600 (see figure 1).

FIGURE 1.1

Wealth is much less equally distributed than income

Median household net equivalised income and median total net wealth (£) by decile, Great Britain, July 2014 to June 2016



Source: ONS (2018a)

Private wealth is held in different types of assets: property, including primary residences (36 per cent of all wealth); financial wealth, such as savings accounts and stocks and shares (13 per cent), private pensions wealth (42 per cent); and physical wealth, which predominantly consists of vehicles (10 per cent) (ONS 2018a). Of these, financial wealth is the most unequally distributed form of wealth, with a Gini coefficient of 0.91, followed by private pension wealth (0.72), and property wealth (0.67) (ibid). The top 10 per cent of households own 60 per cent of all financial wealth (ibid).

Wealth inequality in the UK declined after the first world war from a very high peak and fell throughout most of the 20th century. This was largely due to the destruction and mobilisation of the assets of wealthy households during the two world wars and the Great Depression, along with the redistributive

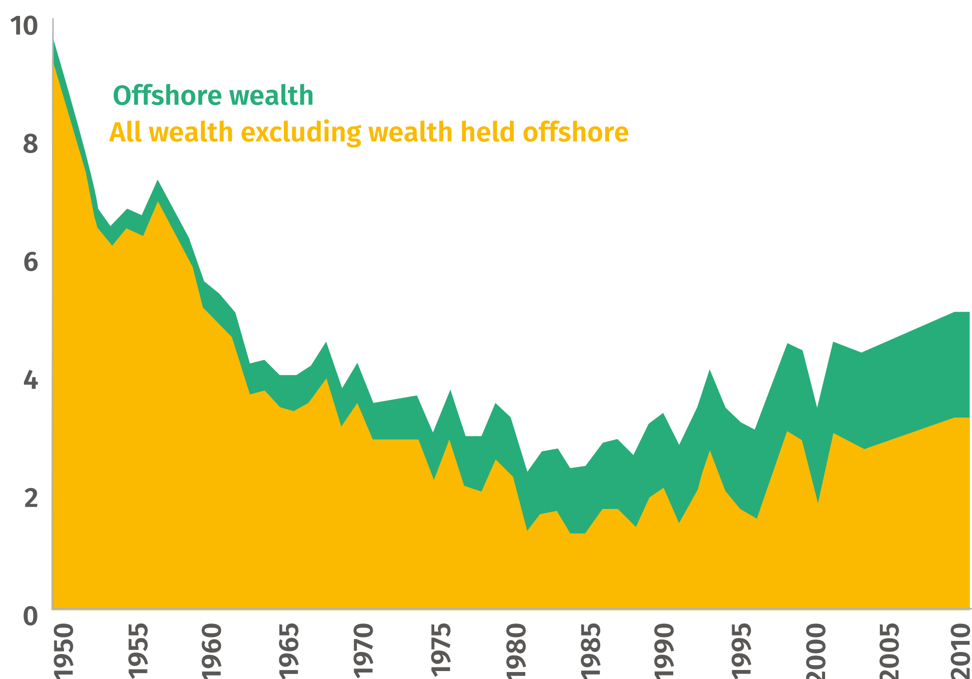
2 All figures from the Wealth and Assets Survey (WAS) (ONS 2018a) refer to Great Britain. We use these as representative of the United Kingdom, as the WAS is the best source of data available.

post-war settlement and a dramatic expansion in home ownership. Since the 1980s, however, the share of wealth owned by the richest 10 per cent, 1 per cent and 0.1 per cent of households has been increasing. Data sources beyond the Wealth and Assets Survey, particularly those that include offshore wealth, place the share of the wealthiest even higher: Alvaredo et al (2016) estimate that the share of total wealth of the top 10 per cent has risen from 46.7 per cent in 1984, to 51.9 per cent in 2013. When offshore wealth is included, the top 0.01% of households have doubled their share of wealth since 1980 to around 5 per cent, 30–40 per cent of which is now held offshore enabling the avoidance of tax (Alstadsæter et al 2017) (see figure 1.2).

The wealthiest 10 per cent of households increased their wealth in aggregate by 21 per cent between 2010–2012 and 2012–2014, compared to an increase of 7 per cent for the least wealthy 50 per cent of households (in nominal terms). This is equivalent to over half of the increase in Great Britain's wealth over that time period going to the top 10 per cent of households (ONS 2015).

FIGURE 1.2

A substantial proportion of the wealth of the very richest is held offshore
Share of net total household wealth of the top 0.01 per cent of households in the UK, including offshore wealth (%)



Source: Alstadsæter, Johannesen and Zucman 2017

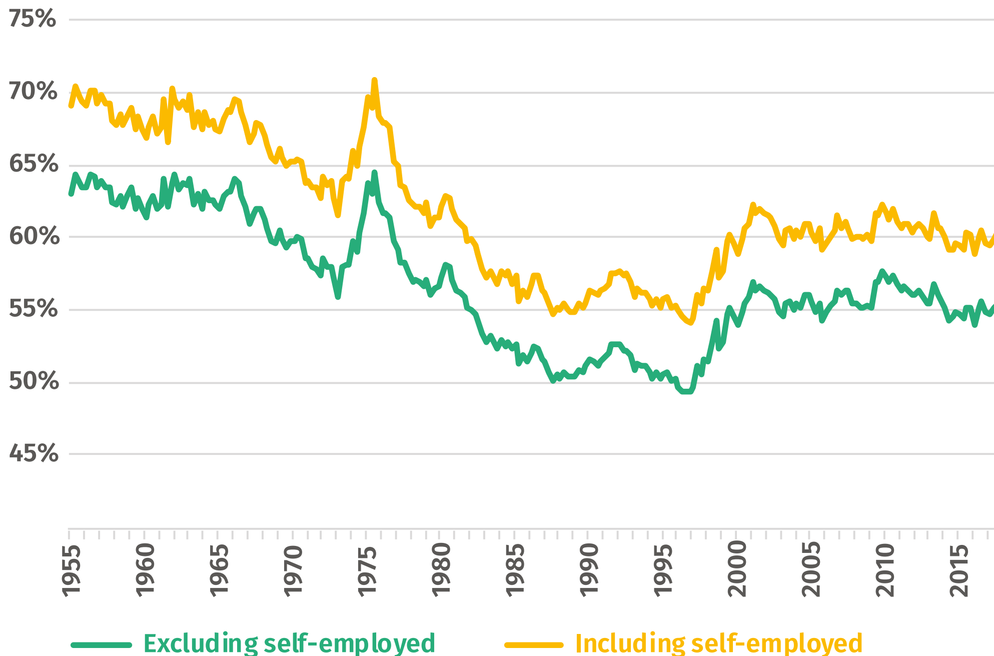
WEALTH INEQUALITY IS DRIVEN BY INCREASING RETURNS TO CAPITAL OVER LABOUR

In developed countries, the share of national income going to wages has fallen substantially since its peak in the late 1970s. In the UK, the labour share fell by 10 percentage points from over 70 per cent in 1975 to almost 54 per cent in 1996. It has since recovered somewhat, but is currently stable at around 59–60 per cent, ten percentage points lower than its peak and long-term average in the mid-twentieth century (ONS 2018b).

FIGURE 1.3

The share of national income accruing to labour has declined over the long-term

Labour share of national income as a proportion of GVA (%), 1955–2017



Source: ONS 2018b

Note: 'Excluding self-employed' series is equal to compensation of employees as a proportion of GVA. 'Including self-employed' series is equal to compensation of employees plus proportion of mixed income using ONS factor share, as a proportion of GVA (see ONS 2018b).

One factor in the share of national income accruing to capital is the rate of return to capital. When the rate of return on capital after tax is higher than the rate of economic growth, wealth inequality is likely to rise, as those with capital accumulate wealth from capital income faster than those relying more on labour income are able to save (Piketty 2014). In the 21st century the rate of returns to capital, including housing and equity, has returned to its pre-first world war trend of exceeding the rate of growth of the economy as a whole. If capital was owned equally throughout the income distribution, the increasing returns to capital – and the appreciation of assets – would not cause rising inequality. However, as seen above, different individuals and households hold different assets and liabilities, which generate differing rates of return and increase in value at differing rates. Many households have very little wealth at all, or negative wealth (meaning they owe more than they own). The tax system therefore has heavy lifting to do to equalise rates of return on capital and labour.

Several factors have historically driven the high rate of return on capital relative to economic growth. There are also a number of reasons to think the share of national income returning to capital is likely to increase.

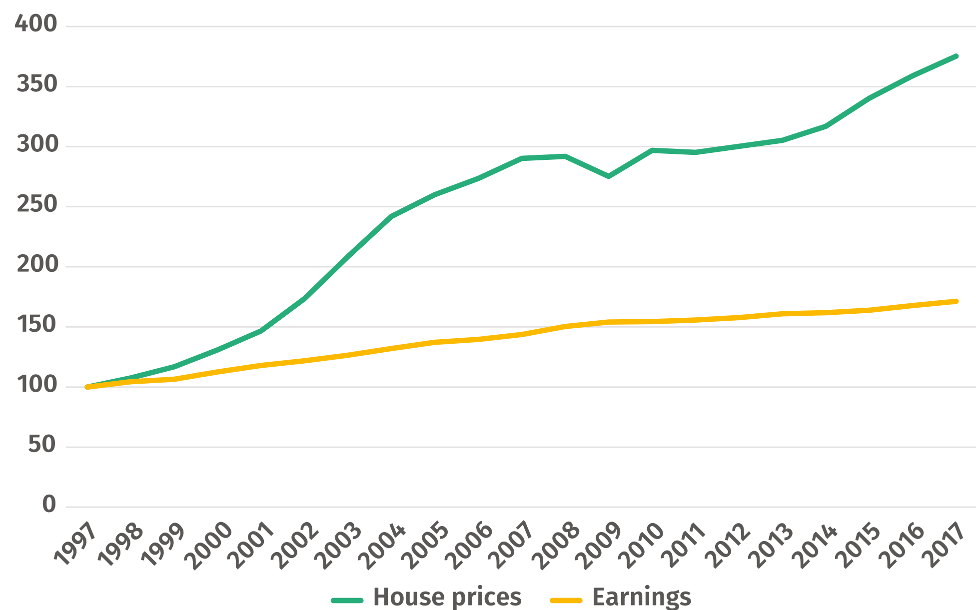
House price inflation and falling home ownership rates

Rising home ownership once helped to compress wealth inequality, but rising prices and rents alongside falling home ownership are now exacerbating it, as those with housing assets see their wealth and income grow, and those without are locked out and paying increasingly high rent to asset owners (D'Arcy and Gardiner 2017). House prices have increased tenfold since the 1980s, compared with five times

for consumer prices (Blakeley 2018a). And since 1997, average house prices have increased four times faster than average full-time earnings (IPPR analysis using ONS 2018b, see figure 1.4). This has been driven by a combination of high levels of mortgage lending due to a loosening of credit conditions, and a long-term failure to build enough homes.

FIGURE 1.4

House price inflation has significantly outstripped wage growth for two decades
Median full-time earnings and median house prices in England and Wales, 1997–2017 (Index: 1997=100)



Source: ONS (2018b)

Financial asset price inflation and shareholder primacy

Financial assets such as equities, bonds, and derivatives are the most unequally distributed form of wealth (ONS 2018a). One of the most significant factors driving wealth inequality in the UK since 2010 has been the increase in both the prices of and return on equities (Domanski et al 2016). In the long-term this has been driven by the major trend towards excessive short-termism and the primacy of shareholder returns, as well as the rise of intermediaries such as investment funds that have captured large proportions of value created in the economy (Stirling and King 2017). Monetary policy has exacerbated inequality of financial wealth since the financial crisis, as the Bank of England's quantitative easing policy has driven up asset prices through a portfolio rebalancing effect (Stirling 2018). Looking forward, asset price inflation is likely to continue to increase, due to the propensity of financial systems towards instability. Based on recent experiences of high returns, leveraged investment in existing assets is likely to rise, pushing up asset prices further.

Automation

An estimated 50 per cent of the fall in the labour share since the late 1970s has been driven by technological change (Dao et al 2017). The automation of production substitutes labour for capital, and though employment has in aggregate risen, if the new jobs being created are low-paid, if workers are not paid their share of increased product, or if capital-intensive firms do well relative to labour-intensive firms,

the share of national income accruing to capital increases (Lawrence et al 2017). As automation increases with the adoption of artificial intelligence and growing dominance of 'superstar' technology firms, returns to labour are likely to decrease relative to returns to capital, increasing wealth inequality further (ibid).

Low-paid work and weak labour bargaining power

Poor rates of wage growth make it harder for households to accumulate wealth. Real average wages remain 2-3 per cent below their pre-recession peak, and are not forecast to rise until the middle of the next decade (Cribb et al 2018; D'Arcy 2018). Around 3.4 million people are now estimated to be in insecure work, which often comes with fewer employment benefits such as generous employee pensions. This type of work is particularly prevalent among younger workers. In combination with low pay, insecure work is likely to inhibit the capacity of many people to accumulate wealth over time (Roberts and Lawrence 2017).

Stagnant wages result from a combination of poor productivity performance and weak labour bargaining power, meaning that wages do not keep up with rising prices. The decline of manufacturing in the UK has shifted work to less productive, and less unionised, industries. Over the last 40 years, union density has fallen from one in two workers to fewer than one in four (Dromey 2018). At the same time, capital mobility and globalisation have put workers around the world in competition with each other, and strengthened the power of capital owners in setting wages and determining how returns are split between profit and wages (Onaran and Guschanski 2017). To take a specific but highly symbolic example, Jeff Bezos, CEO of Amazon, has become the richest man in the world while Amazon faces charges of minimum wage underpayment and Victorian working conditions (Bloodworth 2018).

2. Wealth taxation in the UK

In chapter 1 we outlined the underlying causes of the UK's high and rising wealth inequality. Addressing these root causes requires a restructuring of our economy, such that it generates better-paying jobs, higher investment in productive industries, and stronger bargaining power for workers, as well as a rethink of our macroeconomic policy frameworks to help reduce asset price volatility (Jacobs et al 2017; Dromey 2018; Blakeley 2018a).

There are also a number of specific measures to change the way that wealth accumulates in the economy, such that wealth inequality is reduced *before* redistributive taxes and benefits. These include policies to broaden asset ownership, by building affordable housing, and spreading ownership of capital through employee ownership or a Citizens' Wealth Fund. IPPR has proposed these policies in previous papers for the Commission on Economic Justice (Murphy 2018; Roberts and Lawrence 2018; Lawrence and Mason 2017).

But alongside these measures that aim to hardwire greater equality into the UK's economic model, we need to rethink the way the tax system impacts on the distribution of wealth. Ultimately, wealth inequality is determined by *post-tax* returns to capital relative to economic growth and *post-tax* returns to labour. Designed well, taxes can reduce the relative returns to capital versus labour. Taxing either wealth (a stock) or income from wealth (a flow), and using the revenue for progressive or universal policies, is therefore a powerful means at the government's disposal to reduce wealth inequality. Further, the design of wealth taxation has a powerful market shaping effect, as it changes the returns on investments for different groups of people, and for different types of asset, and consequently who accumulates wealth and where in the economy.

Historically, wealth taxes – in the form of estate taxes and other property taxes - were a much more substantial portion of tax revenue in the UK than they are today. Income taxation was only introduced at the turn of the 18th century. In the 1930s, the largest estates were taxed at rates of up to 40 per cent; by 1945, this had risen to 65 per cent, and by 1949, 75 per cent (Glennerster 2012). Today, however, taxes on income and consumption have become the dominant source of revenue in the UK and around the world (Lawton and Reed 2013). Together, these forms of taxation make up 60 per cent of government revenues, whilst the main wealth taxes - capital gains tax (CGT) inheritance tax (IHT), dividend income taxation, and the two stamp duties - brought in just 4 per cent of tax revenues in 2017/18 (OBR 2018a). These wealth taxes, as well as council tax and business rates which brought in £59.6 billion in 2017/18, are the focus of this paper (ibid; ONS2018b).

There are several key problems with the way that wealth taxes are currently designed. First, there are significant opportunities for avoidance, particularly by the wealthy. Second, wealth taxes in the UK fail to raise a large amount of revenue, in part but not purely due to avoidance. Third, differential rates of tax on different assets create economic distortions and encourage the direction of investment towards speculation over existing assets rather than the expansion of the economy's capital base. Finally, by undertaxing income from wealth relative to income from labour, our tax system is regressive. As a result, these taxes have failed to reduce wealth inequality in the UK, and in certain cases have exacerbated it.

THE TAXATION OF FINANCIAL WEALTH

As we note above, financial wealth is the most unequally distributed form of wealth in the UK. It is composed of financial assets such as equities, bonds, and associated derivatives. The value of these assets can fluctuate dramatically, and therefore they are generally held by specialist investors who trade them for a profit. These investors often receive large windfall gains from the ownership of financial assets. Currently, the UK's tax system fails to capture many of these windfall gains and introduces several other distortions that reduce revenues and create opportunities for avoidance.

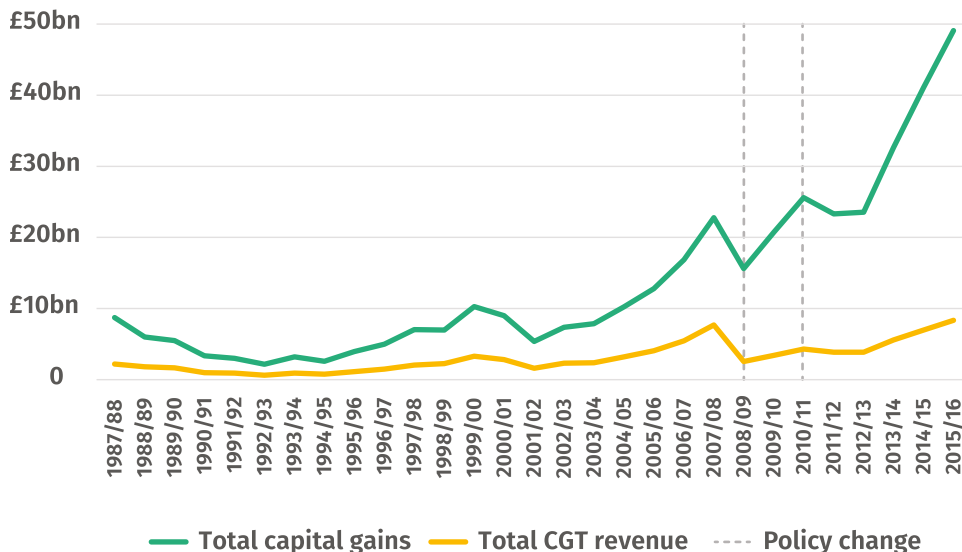
Capital gains tax

Capital gains tax (CGT) is paid on capital gains made upon the 'disposal' of an asset[3], primarily physical, property or financial wealth, above the exempt amount, which in 2018/19 is £11,700. The capital gain is defined as the difference between the value of the asset at the time of disposal and the cost of acquiring the asset. Individuals incurring capital gains below the upper limit of the basic rate of income tax are charged 10 per cent on their capital gains, and those above charged 20 per cent; these rates were reduced from 18 and 28 per cent in 2016. The higher rates still apply to residential property that is not a primary residence. There are a number of reliefs and exemptions that may reduce or remove the CGT liability – entrepreneurs' relief, for example, which qualifies certain business assets to be charged CGT at the lower rate of 10 per cent. CGT currently brings in £7.9 billion for the Treasury, around 1.1 per cent of tax revenues (HMRC 2018a; OBR 2018b). As shown in figure 2.1, while the value of capital gains in the UK has risen dramatically over the last 10 years, revenues from CGT have only recently returned to their 2007/08 levels.

FIGURE 2.1

While capital gains have risen since 2001, capital gains tax revenues have not kept pace

Total capital gains and total revenues from CGT (£, millions)



Source: HMRC (2018b) Table 14.1. Notes: Figures from 2011 onwards are provisional.

3 The disposal of an asset includes any occasion when the beneficial ownership (relates to the person who enjoys the benefits of the asset) of part or all of an asset is transferred from one person to another.

Taxing capital gains at a lower rate than income from work results in higher post-tax rates of return to capital than to labour, enabling wider inequalities of income and consequently wealth between those with capital and those without. It also creates substantial opportunities for avoidance: a lower rate of tax on capital income compared to labour income incentivises business-owning individuals and executives to disguise personal income as investment income. This both reduces tax revenue and is unfair on those who pay income tax rates. This issue has been exacerbated by much lower levels of corporation tax, which further weight the scales in favour of classifying income as investment income (Blakeley 2018b).

Second, the significant number of reliefs and exemptions that are applied to CGT have also reduced the base, reducing revenues and increasing the opportunities for tax avoidance through careful planning, for example by reclassifying investments. The most significant exemptions are for first homes, entrepreneur's relief, and a relief on all capital gains realised at death, which reduced revenues by almost £700 million in 2010/11. The asset-price inflation of the last 30 years combined with a tax system ill-equipped to deal with these changes means that the exemption for first homes has created significant inter-generational inequities and distorted investment decisions in favour of investment in property (Green 2017). Entrepreneur's relief was extended to cover £10 million of gains in 2011. As argued by Johnson (2014), this increase has effectively allowed 'some people to be charged tax at just 10 per cent on what is effectively a return to their labour'.

Third, levying CGT on the increase in the value of equities, and not on corporate bonds, encourages debt over equity financing. Combined with the tax-deductibility of corporate interest (which we have previously recommended reforming), this amounts to a significant distortion (Blakeley 2018b). Debt financing, which has to be repaid regardless of the firm's performance, is much less flexible than equity financing, which is effectively a promise of a share of the firm's future earnings.

Dividend income taxation

Dividend income is taxed using the same bands as income tax, but the rates applied are lower. There is a zero per cent rate of tax up to £5,000 called the dividend allowance, set to reduce to £2,000 in 2018/19, which is separate from the personal income tax allowance. For any income above £5,000, dividend income is added to other income to determine the taxpayer's tax band: basic rate taxpayers pay an 'ordinary rate' of 7.5 per cent, higher rate taxpayers pay the 'upper rate' of 32.5 per cent, and additional rate taxpayers pay 38.1 per cent – this compares to the main income tax rates of 20, 40 and 45 per cent. Overall, dividend taxes raised just £11.1 billion for the Exchequer in 2017/18, representing 1.6 per cent of total tax revenues (OBR 2018a; HMRC 2018c).

Dividend income is taxed progressively (in the sense that larger gains are taxed more heavily), but considered alongside the income tax schedule, it advantages wealthier earners over those with minimal income from wealth. Individuals receiving income from dividends are concentrated at the top end of the income spectrum. People paying dividend taxes generally fall into the higher or additional rate tax bands, but a significant proportion of dividends are taxed at the ordinary rate or not at all due to the separate allowance. Those with wealth held in shares are therefore able to receive income from their wealth that is taxed more lightly than income from labour. As well as being unfair, this also creates opportunities for tax avoidance through individuals incorporating and paying themselves through dividends (Blakeley 2018b).

The tax system incentivises corporations to pay employees, especially senior management, through dividends. As outlined in IPPR's paper on corporate governance, this has exacerbated short-termism amongst most large organisations

(Lawrence 2017). Executives have an incentive to increase dividend payments now in order to maximise their incomes, rather than undertaking investments to raise their productivity out of retained earnings. This stifles investment and inhibits the performance of companies.

Stamp Duty Reserve Tax

SDRT is levied on all purchases of and interests in UK and some foreign shares. SDRT is levied at a flat rate of 0.5 per cent based on the amount paid for the shares being purchased. The majority of SDRT is levied on electronic transactions of shares, and is captured through an electronic settlement and registration system. 'Off-market' transactions are settled by stockbrokers rather than through the Certificateless Registry for Electronic Share Transfer (CREST). In 2017/18 SDRT raised £3.5 billion, or 0.5 per cent of total revenues (HMRC 2018a).

There are good reasons to implement transaction taxes on financial assets in order to promote financial stability and capture economic rents (Stirling and King 2017). SDRT is, however, a blunt mechanism in this regard. It only applies to equities and exempts 'market makers': the asset managers and hedge funds that generate liquidity in equity markets by deliberately contributing to increased share turnover. Historically, this type of activity accounted for around 15 per cent of transactions, but the growth in the intermediation chain now means that 40–50 per cent of share turnover is eligible for exemption (ibid). In a previous report, we proposed that incentives for excess trading should be reduced by replacing the 100 per cent relief on SDRT for intermediaries with a new rate of 0.2 per cent, which would reduce turnover generated by intermediaries by around 60 per cent, and overall turnover in equity markets by about a quarter to a third, as well as raising around £1.2 billion by the 2020s (Stirling and King 2017).

THE TAXATION OF WEALTH TRANSFERS

Wealth transfers, such as inheritances, confer opportunity on the recipient. Taxing and redistributing transfers, either to individuals or through investment in collective services, therefore promotes equality of opportunity. This issue has become particularly salient as property prices have increased and ownership of property has become more unevenly distributed, creating a stark inter-generational divide. This inter-generational problem will become an intra-generational wealth inequality problem when this wealth is transferred to younger generations. Put simply: it is not that no one in younger generations will own property, but that the gap in wealth between those with wealthy parents and those without will become wider.

Inheritance tax

Inheritance tax (IHT) is the primary tax on wealth transfers. It is levied on the net assets of a deceased person upon their death, and any gifts made within seven years of the deceased's death. IHT is levied on the assets of a deceased person in excess of £325,000, and is charged at a rate of 40 per cent. Transfers between spouses or civil partners are exempt, as are unused tax-free allowances, meaning that the tax-free allowance for IHT for a married couple is now £650,000. IHT raised £5.2 billion for the exchequer in 2017/18, 0.7 per cent of revenues (HMRC 2018a; OBR 2018a).

There are several exemptions for gifts to charities and businesses, and for unquoted shares and agricultural property. Exemptions set against assets[4] were valued at £20 billion in 2014/15. Main residences have an additional nil-rate band, rising to £175,000 in 2020/21, meaning that a property worth up to £1 million could

4 For reliefs and exemptions set against assets, the amount recorded is the full value of the relief set against assets in the estate, rather than the reduction in an estate's tax liability.

be passed on by a married couple without any inheritance tax paid, by using both partners' tax free allowance and additional nil-rate bands for primary residences.

Even though many people pay no inheritance tax – it only affects 7 per cent of estates – the tax is incredibly unpopular (Rowlingson et al 2015). This is largely because it conflicts with the widely-held belief that parents should be able to pass on assets they have accrued over their lifetime to their children. This is partly due to the way in which the tax is levied: inheritance tax is not actually a tax on inheritances, it is a tax on estates. It is calculated based on the estate of the deceased, rather than the inheritance of the individual who receives the inheritance. This makes it easier to class inheritance tax as a politically unpopular 'death tax', rather than a social mobility enhancing 'accessions tax' or 'gift tax' (Dolphin 2010).

The current structure of inheritance tax also creates significant opportunities for avoidance, that can be manipulated by those with more resources (ibid). Exemptions for agricultural land and unquoted business assets reduce the tax base without any economic justification, and many households are able to minimise their tax burden by transferring assets before the seven-year pre-death period kicks in (Johnson 2014). As argued by Kay and King (1990), IHT benefits the 'healthy, the wealthy, and the well-advised'.

Trusts

A trust is a type of legal relationship which allows one person to transfer their assets to one or more individuals, or companies. These individuals or companies are then made legally responsible for the assets and hold the assets on behalf of the beneficiary. When a trust is created, it involves three parties: the settlor, the trustee, and one or more beneficiaries. A trust can hold a variety of assets, including property and shares, which may produce income or capital gains. The way in which these are taxed will vary depending on the type of trust.

For UK tax purposes, there are two main types of trust – interest in possession (IIP) trusts and discretionary trusts. There were around 50,000 IIP trusts and 90,000 discretionary trusts in the UK in 2015/16 (ONS 2018e). The main difference between these two types of trust is who is considered the beneficial owner for tax purposes. The beneficiary of an IIP trust is entitled to any income from the trust as it arises, and is considered the beneficial owner for tax purposes, notably for inheritance tax. A discretionary trust, on the other hand, is one in which the trustees have discretion over how the trust's income and capital is used, while the assets within it are not considered the property of any one beneficiary. Other types of trust also exist but in much smaller numbers and will be excluded from the analysis that follows.

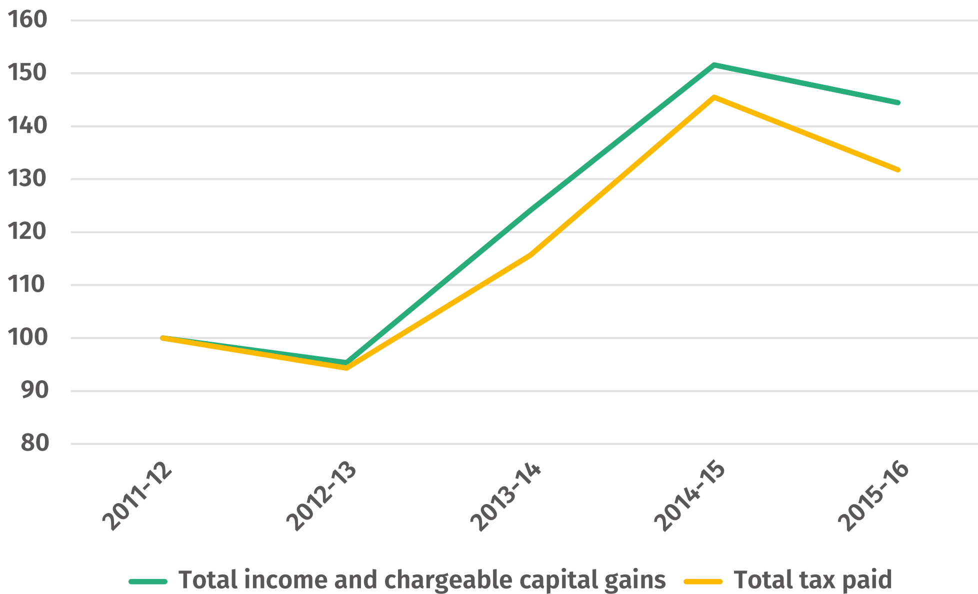
Discretionary trustees are responsible for paying tax for income accumulated by the trust. Dividend income is taxed at 7.5 per cent, and non-dividend income at 20 per cent, for all income up to £1,000. For income above £1,000, dividend income is taxed at 38.1 per cent and non-dividend income at 45 per cent. Trustees of IIP trusts are also responsible for paying tax on any non-distributed income, at a rate of 7.5 per cent for dividend income and 20 per cent on non-dividend income. Distributed income is taxed at the beneficiary's marginal rate of income tax. If assets are disposed of, the trust will also have to pay capital gains tax at standard rate of 20 per cent (on most assets) above the exempt amount.

While trusts have seen their income and capital gains rise in recent years, the total tax paid on these trusts has remained broadly unchanged (see figure 2.2).

FIGURE 2.2

Tax paid on trusts has not kept up with increases in trust income and capital gains

Total income and chargeable gains for all trusts and estates making a self-assessment return, and total income and capital gains tax paid (Index 2011-12 = 100)



Source: IPPR analysis using ONS (2018d)

The tax treatment of trusts for inheritance tax purposes is notoriously complicated. Rather than inheritance tax being payable on trust assets on a death, it is levied on creation (charged at 20 per cent to the extent that the assets exceed the settlor's available 'nil rate band', currently £325,000), every ten years from the trust's creation (up to 6 per cent) and on when assets are added to or transferred out of the trust. The exact tax treatment will depend on the type of trust and the circumstances of its creation.

THE TAXATION OF PROPERTY

Taxes on property and land have been around for centuries and remain a significant source of overall taxation revenue (Mirrlees et al 2011). Taxes on land have long been favoured by economists. Fixed in supply and hard to avoid, land – and the economic rents it earns – can be taxed without distorting behaviour (ibid).

In the UK the main taxes on property and land are council tax, the national non-domestic rate (business rates) and stamp duty land tax (SDLT). These taxes combined raised £72.6 billion in 2017/18, representing 10.4 per cent of overall tax receipts.[5]

Council tax

For the purposes of council tax, properties are placed into one of eight bands (nine in Wales) based on their 1991 values. Each local authority is responsible for setting the rate charged for homes in Band D in their area and all of the other

5 IPPR analysis using OBR (2018a) and OBR (2018b)

bands are set as a ratio of Band D based on a system of ninths[6] which is set by national government. The tax raised £32.2 billion in 2017/18 (OBR 2018a).

Council tax is widely recognised to be in need of fundamental reform. The central criticism of council tax is that it is highly regressive in relation to its tax base, which arises from three central flaws with its design and operation (Mirrlees et al 2011; Murphy et al 2018; Corlett and Gardiner 2018).

First, the amount paid in council tax is based, for properties in England and Scotland, on values from April 1991 (in Wales it is 2003). As a consequence, those areas with low house price growth since 1991 are effectively taxed more heavily than those located in areas where prices have risen the most – an inherently unfair result (Murphy et al 2018).

Second, council tax is unique amongst current taxes in being deliberately regressive in its design, as the effective tax rate on lower-value properties is higher than that on higher-value properties (Murphy et al 2018; Johnson 2014). The highest value property in Band H (the highest band), no matter its value, will attract a maximum of three times the tax on the lowest value homes. Recent research by the Resolution Foundation found that those living in £100,000 homes pay around five times the tax rate of those living in £1 million mansions as a proportion of property value (Corlett and Gardiner 2018). Moreover, due to the fact that individual bands are quite wide and cover a broad range of property values, a property at the bottom of a band pays a higher effective tax rate than one at the top (ibid).

Third, there is a distinct spatial unfairness with significant variations across regions due to the geographical distribution of high value properties (Corlett and Gardiner 2018; Murphy et al 2018). In high value areas, a higher proportion of properties fall into the higher bands, which allows local authorities to charge lower rates overall – and vice versa in low value areas. Poorer areas are therefore effectively hit twice by the tax: tax rates are more punitive simply because of how property values have changed, and then they are made higher still by the local authorities' need to raise revenue (ibid).

As first homes are exempt from CGT, council tax is the main property tax that could be used to capture the value of rising house prices. There is no reason in principle why the capital gains on a residential property shouldn't be taxed like any other investment. But as a consequence of its design and operation, council tax fails to capture unearned windfalls that accrue to homeowners. Moreover, council tax incentivises the over-consumption of housing because it is undertaxed relative to other investments, and larger or additional homes are treated favourably (Mirlees et al 2011).

There is also a distinct generational aspect with the regressivity of the current system falling hardest on the current generation of young adults. This is because this cohort is more likely to live in the lowest, and most regressive, council tax bands (Corlett and Gardiner 2018).

In addition, an effective property tax closely linked to property values could help to dampen house prices, by reducing demand for homes and encouraging a more efficient use of the housing stock – but currently council tax fails to do this (Barker 2004).

6 Band D is equivalent to one, the lowest band is Band A which is 6/9 of Band D and the highest is Band H which is two times Band D. For example, if a local council sets the Band D council rate at £1,000, Band A would be 6/9 of that value at £666.66 and Band H would be £2,000. The ratio between the lowest band and the highest is capped at a multiple of three times, regardless of the value of the properties.

The national non-domestic rate (NNDR or business rates)

The national non-domestic rate (NNDR) or business rates are levied as a percentage of the estimated rental value, the so called 'rateable value', of non-residential property with valuations held every five years.[7] It raised £27.4 billion in 2017/18 (ONS 2018d). Business rates are administered locally and, following reforms in 2013, half of the revenues are retained locally and the rest are pooled nationally according to an agreed formula.

It is widely accepted that business rates are not well-designed (Mirrlees et al 2011). As Johnson argues (2014), economists regard business rates as a 'combination of one of the worst taxes – a tax on the value of business property – with one of the best – a tax on land values'. Its most fundamental flaw is that it distorts firm behaviour by taxing an input to the productive process of a company (the business property) disadvantaging it vis-a-vis other forms of physical capital (Mirrlees et al 2011). As argued in the Mirlees Review, 'it is an important principle of the economics of taxation that an efficient tax system should not distort choices firms make about inputs into the production process, and hence that intermediate goods – those used in the production process – should not be taxed' (ibid).

As a consequence of business rates, property intensive businesses are at a disadvantage relative to other businesses in the UK. They are also at a disadvantage relative to international business competitors - for example, business rates are routinely cited as a cause for the lack of competitiveness in the UK steel industry (Boxall 2017; Pickard and Pooler 2016).

The other crucial flaw of business rates is the way unused and undeveloped land is treated (Mirrlees et al 2011).The fact that the charge is either reduced or levied at zero on this type of land creates significant distortions in the incentives to hold and develop land, and encourages its inefficient use. Business rates also discriminate against certain kinds of business – agricultural land is exempt, for example – and this creates additional perverse incentives to use land inefficiently (ibid). Finally, there are inconsistencies between council tax and business rates, the consequence of which is that there is a clear incentive for the use of land for housing at the expense of commercial use (Wingham 2017).

Moreover, and importantly for wealth distribution, business rates fail to adequately capture the economic rents which accrue to landowners from rising land values. This is due to the large number of exemptions as outlined above, the fact that tax revenues are linked to inflation rather than the value of the property and the fact that it is levied on the property as a whole rather than the space that lies underneath.

Stamp duty land tax

Stamp duty is levied on the land transactions of residential properties and is paid by the purchaser. Stamp duty rates for 2017/18 are set out in table 2.1. In 2017/18, stamp duty and its devolved equivalents raised £13.1 billion in revenue (OBR 2018a).

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7 A new three-year cycle will be introduced following the next valuation in 2022.

TABLE 2.1
Standard stamp duty land tax rates and thresholds, 2017/18

Property or lease premium or transfer value	Stamp Duty Land Tax rate
Up to £125,000	0%
The next £125,000 (the portion from £125,001 to £250,000)	2%
The next £675,000 (the portion from £250,001 to £925,000)	5%
The next £575,000 (the portion from £925,001 to £1.5 million)	10%
The remaining amount (the portion above £1.5 million)	12%

Source: Replicated from https://www.gov.uk/stamp-duty-land-tax/residential-property-rates

Other arrangements exist for various categories of buyers, including relief for first-time buyers, higher rates for those buying additional properties and those purchasing through a corporate body.

As argued by the IFS and the LSE, amongst others, SDLT is an example of a 'bad tax'. There is no good economic argument for taxing housing that is traded more frequently, as SDLT does (Mirrlees et al 2011). Moreover, SDLT actively discourages mutually beneficial transactions, it restricts ownership of residential property by those who value it most (first-time buyers), reduces incentives for people to move home, and it means some people are encouraged to live in an area or size of home they otherwise wouldn't have (ibid).

3. Reforming the system of wealth taxation in the UK

THE CASE FOR REFORM

There are strong positive returns to wealth, meaning that, left untaxed, those who own capital are likely to experience exponential increases in their wealth (ibid). For example, in 2015 the wealthiest hedge fund manager in the UK made a 54 per cent return on the assets invested in his private fund – which were primarily his own assets and those of his friends and family – last year, up from a 50 per cent return in 2016 (Kumar and Marsh 2018). Whilst this level of return is the exception rather than the rule, the generalised asset price inflation of the last 30 years has created a large 'wealth effect' for owners of capital (Roberts and Lawrence 2017).

However, under the UK's current tax system, income from labour is often taxed much more heavily than income from wealth. It is intuitively unfair that those who were lucky enough to own capital before a period of asset price inflation should be getting wealthier whilst those who are forced to work for a living are struggling to make ends meet. Real average weekly earnings are still lower than what they were before the financial crisis; this represents the worst decade for wage growth in two centuries (D'Arcy 2018). However house prices have continued to rise since the crisis. In this context, home ownership is increasingly out of reach of most people: a recent report found that it would take the average working family 19 years to be able to save for a deposit, up from three years in the 1990s (Judge and Tomlinson 2018). In contrast, those who have received huge windfall gains from the last 40 years of asset price inflation will be able to pass this wealth on to their children, who will be able to afford to purchase a home simply due to the good fortune of being born to wealthy parents.

Current levels of wealth inequality are not just unfair, they are also limiting economic growth. At present, wealth gets 'stuck' at the top of the income spectrum rather than being recycled back into the economy. The idea that the wealth of those at the top 'trickles down' to everyone else through their spending and investment is a familiar defence of wealth inequality (see Bourne and Snowdon 2016), but there is limited evidence that this effect holds. In fact, the higher one's wealth, the less likely one is to consume any increases in income (Carroll et al 2014). Instead, income is likely to be reinvested in the accumulation of extra wealth, compounding the positive returns outlined above (Alvarez-Cuadrado and Vilalta 2013). This lower marginal propensity to consume amongst those at the higher end of the income spectrum means that high levels of inequality are often associated with lower levels of economic growth (Cingano 2014).

If this wealth was invested productively, then this might not be such a problem. However, an increasing portion of wealth at the top of the income distribution is both derived from and generates economic rents rather than profits in the traditional sense (Mihályi and Szelényi 2016). An economic rent is the difference between the returns gained from ownership of an asset and the amount the asset costs to supply (Ricardo 1817). In other words, anything over the amount that someone would need to be paid to convince them to sell or rent out a particular asset. Economic rents can be contrasted with normal returns from investment, which should in a competitive economy be equal to the supply cost of a particular asset. Land rents are the clearest case in point, and extremely important to tackle, but there are multiple different types of economic rent. For example, income from

financial assets over and above the amount required to compensate the investor for the risk associated with lending their capital constitutes an economic rent (Mirrlees et al 2011).

Investment to realise rents frequently does not support productive economic activity, and pushes up prices of those assets. Hedge funds and mutual funds tend to invest in existing equities, debt instruments, and associated derivatives: 25 per cent of hedge fund strategies are based on long or short positions on equities, and a further 17 per cent invest in fixed income securities (Bank of England 2017). Meanwhile, money flowing into existing property has increased as lending has grown: real-estate loans to business and individuals account for over 78 per cent of all loans to non-financial UK residents (ibid). Purchasing existing assets like equities or real estate is not productive economic activity, and does not increase economic output in any real sense. Instead, increasing levels of investment in existing assets have served to drive up the prices of these assets, leading to increasing returns to capital, particularly when it comes to real estate (Blakeley 2018a). In the fourth quarter of 2017, UK house prices were almost 10 times their value in the fourth quarter of 1979 (Shabani et al 2014). Similar patterns have held in equity markets: the FTSE100 rose from under 100 points before 1980 to almost 3,500 in 2007 (ibid).

In this sense, wealth does not 'trickle down' to the rest of the population either through the consumption or the investment activity of the wealthy. Instead, much of this wealth is reinvested in existing assets in the hope of realising economic rents. Epstein (2005) has analysed the growth of the 'rentier share' in wealthy economies around the world in the run up to the financial crisis. This measures the income accruing to individuals 'whose main income comes from the interest on assets' (Hashimzade et al 2017). In the UK, Epstein finds that the share of national income accruing to rentiers has increased substantially since the 1980s: from around 1 per cent in 1986 to almost 10 per cent in 2000 (Epstein 2005).

We should tax economic rents because they represent non-productive gains that increase inequality without expanding the productive potential of the economy. They are gained, rather than 'earned' in any commonly understood meaning of the term; this principle at the heart of our economic system is at odds with political rhetoric and opinion of just reward for hard work, and undermines the popular foundations of how our economy functions. Failing to tax economic rents also poses a fundamental threat to economic stability.

In terms of the practical implications of taxing economic rents, so long as the owner of an asset derives some income from it, over and above the opportunity cost for the particular use of an asset, they are unlikely to withdraw the asset from the market (Mirrlees et al 2011). This is borne out by the empirical evidence, which shows that 'the prospect of paying CGT has virtually no impact on people's decisions about the acquisition of assets' (Seely 2016).

DIRECTIONS FOR REFORM

It is clear that the current system of wealth taxation is failing to arrest increases in wealth inequality. In this section, we outline the ways in which the system should be reformed to make it fairer and more effective.

The taxation of income from labour should be harmonised with the taxation of income from capital

In theory, wealth taxation should be designed so as to capture the entirety of the 'excess return' generated by an asset, leaving the investor with the normal returns (see for example Mirrlees et al 2011). In practice, the actual value of an economic rent is quite difficult to measure, because the 'supply cost' of an asset is in many cases impossible to determine. In the absence of such a precise way of measuring

excess returns, there are strong arguments from both a fairness and an efficiency perspective for taxing income derived from wealth at the same level as income derived from labour. Such a system would reduce the tax advantage on rents, alongside being more transparent, simple and less distortionary (ibid). As such, we argue that income from capital should be taxed as part of the income tax system. Such a system would have further positive effects.

First, taxing income derived from wealth, such as interest and economic rent which often requires little or no ‘work’ to obtain, at a lower rate than income derived from labour, which requires significant exertion on the part of the worker, is intuitively unfair. Having lower rates of tax on income from capital, which is disproportionately received by the wealthy, than on labour income, which is earned by almost everyone at some point in their lives, is regressive (Lawton and Reed 2013). It also disincentives labour market participation by the wealthy, which contrasts with the incentives and expectations of those lower down the income spectrum (Anderson 2018).

Second, simplifying the system and increasing the effective rate of tax levied on capital will raise more revenue, and more progressively than the current system. Many – if not most – of the reliefs and allowances currently available to those declaring income from capital are not justified by economic theory, and they allow the very wealthiest in society to reduce their tax liabilities (Murphy, Christensen and Kimmis 2005).

Third, simplifying the tax system in this way will reduce opportunities for avoidance (ibid). Harmonising the taxation of income from capital with the taxation of income from labour would remove the incentive for individuals to disguise their labour income as capital income (ibid). This type of avoidance happens a great deal in the current system, eroding the base for income tax and reducing government revenues (Blakeley 2018b).

Fourth, this change would shift the balance of taxation away from labour, and towards economic rents, which is a necessary development if the tax system is to continue to raise sufficient revenue in a context of swift technological change. Automation is likely to increase the capital income share (Lawrence, Roberts and King 2017). Without a commensurate increase in revenues from the taxation of capital income, this will reduce the amount that the chancellor receives in income taxes, putting the public finances on an unsustainable footing while allowing wealth inequality to rise. Greater taxation of capital, when combined with sound redistributive mechanisms aiming to spread or collectivise asset ownership, should help to ameliorate these effects and promote equitable economic growth (Lawrence and Mason 2017).

Wealth transfers must be taxed more effectively to promote equality of opportunity

Aside from taxing the flows of income from wealth, there are also strong arguments for taxing wealth transfers because they confer an unearned advantage to the recipient (White 2018). Studies controlling for background factors have shown an ‘asset effect’ on life chances. Having some wealth at age 22 is associated with positive impacts at age 33, including participation in work, higher wages, good health, absence of depression and greater political agency (McKnight 2011; Bynner and Paxton 2001). Those with assets are better able to take risks and invest in new ventures: among successful entrepreneurs, the most commonly shared trait is not personality but access to financial capital, often through gifts and inheritance (Bahaj et al 2016; Blanchflower and Oswald 1998). Entrepreneurs with access to more collateral create larger firms and more value-added, and are more likely to survive, even in the long run (Schmalz et al 2017). As such, failing to tax wealth transfers sufficiently perpetuates economic injustice, and negatively impacts social mobility, while also constraining economic growth. Importantly, the value of wealth

transferred between generations is set to double over the next 20 years, which will increase the absolute difference in wealth between those who inherit and those who don't (Gardiner 2017). In turn, that will make it harder for younger individuals to earn their way to being wealthy: luck of birth is set to become more important. This makes reform of taxes on wealth transfers more urgent.

Some argue that it is unfair to tax wealth transfers because of the issue of 'double taxation' (see Clougherty 2011). The taxpaying individual will have already paid tax on the income used to acquire the asset being transferred and may have also paid tax on the capital gains associated with the increase in its value. However, so-called 'double taxation' is a central part of any normal tax system. People pay income tax and are then taxed again when they purchase goods and services through VAT, as well as a wide variety of other consumption taxes. As argued in the Mirrlees review, 'double taxation is a natural feature of any taxation of wealth holdings or wealth transfers and, if justified in its own right, does not provide a rationale for not fully taxing the income (or capital gain) received by donors' (Broadway et al 2010). Further, not all wealth taxes imply double taxation: if the recipient of an inheritance or gift is taxed on gains made by the donor, there are no grounds for claiming that they have been taxed twice (McLean 2018).

The tax system should be as simple and transparent as possible

The more complicated a tax system, the easier it is to avoid paying tax. Complicated reliefs, allowances, and exemptions are often open to abuse by those who abide by the letter but not the spirit of the law (National Audit Office 2013). Tax reliefs don't just reduce tax revenues, they also have administration costs, potential unintended consequences and they increase the risk that revenue will be lost through error, tax avoidance and fraud (ibid).

It is also important to consider the impact of one tax on the base of another. Corporation tax, for example, plays an important role in the tax system as a backstop to income taxation – without a corporate income tax, there would be a greater incentive for individuals to incorporate and pay themselves through dividends (Mirrlees et al 2011). Our current system of separate rates and allowances for different types of asset and taxes, with housing particularly undertaxed, creates opportunities for avoidance and distorts decisions around which assets to invest in.

Currently, the base for a number of taxes is reduced substantially due to the large number of reliefs and allowances that are applied to it (Corlett 2018; Mirrlees et al 2011). When it comes to inheritance tax, the seven-year rule – which restricts inheritance tax to transfers made within seven years of a donor's death – means that those who are able to plan ahead can avoid paying inheritance tax altogether (ibid). Capital gains tax has some very large reliefs – like the relief at death and the relief for first homes – which erode the base substantially, as well as smaller ones – like the absence of a tax on capital gains for corporate bonds – that distort behaviour. The personal allowance for dividend income means that some recipients of dividend income pay no tax on that income at all.

There are few economic justifications for most of these reliefs and exemptions. Encouraging certain behaviours that have positive externalities is a good justification, but the way in which these taxes are designed is, however, important in determining their effectiveness. If they are set too high, or are made too complex, then they will erode the tax base without countervailing positive economic effects. There are often other ways to support economically beneficial behaviour, such as spending measures, which do not involve complicating the tax system. We have previously argued that there should be a preference towards spending measures over tax reliefs in future (Blakeley 2018b).

The effectiveness of the tax system is further reduced by a lack of transparency. As Oxfam (2015) and Eurodad (2017) argue in recent reports, the UK lags behind other countries when it comes to ownership transparency. While the implementation of the Public Beneficial Ownership Register (PBOR) and the UK's commitment to implement country-by-country reporting have been welcome steps in the right direction, serious concerns remain about both. The PBOR relies on self-reporting and is only required for individuals who own more than 25 per cent of a particular company. Furthermore, it does not cover the crown dependencies and overseas territories where much illicit activity is believed to take place. A proposal to call for six overseas territories to implement such a public register as part of the Sanctions and Anti-Money Laundering Bill was rejected by the House of Lords earlier this year. Moreover, the country-by-country reporting that the UK is introducing as part of base erosion and profit shifting (BEPS) will only cover multinationals with a consolidated turnover of €750 million or more, and the information gained from this will not be available publicly.

There are further issues regarding transparency in the UK's tax system, related to non-domiciled status. The UK has recently taken steps to remove permanent non-dom status for anyone living in Britain for at least 15 of the past 20 years. This is a welcome move, and will raise almost £1 billion extra in revenues for HMRC by 2020/21 (Houlder 2017). Inheritance tax will also be applied to UK residential property held by non-doms, raising a further £245 million by 2020/21. Non-doms are, however, still not liable to pay income tax and capital gains on assets held outside the UK, and there are a number of other valuable reliefs associated with the status, such as the remittance basis charge.

There are also serious issues remaining about the tax treatment of trusts. While inheritance tax changes mean that in practice trusts not owned by non-doms are now liable for similar tax payments as individuals, the opaque nature of the ownership arrangements made possible by trusts means that they are often used to obscure beneficial ownership (Shaxson 2012; Knobel 2017). This can take place, either because trustees are not obliged to register their beneficial owners publicly or because 'their complex control structures often confuse authorities about who really controls or benefits from the assets' (Knobel 2017). As well as this, it is possible to pass on trusts or the assets within them without creating a new beneficial owner for tax purposes. This can often lead to a situation in which a trust contains assets to which no individual has any beneficial right (ibid).

4. Recommendations

The current system of wealth taxation in the UK is unfair, fails to raise sufficient revenues, and fails to reduce wealth inequality. It requires fundamental reform. In this section, we make five recommendations which together amount to a transformation of the tax treatment of wealth in the UK. We have designed these recommendations based on the principles above: that wealth taxation should seek to reduce wealth inequality, promote equality of opportunity, and be as clear and transparent as possible.

TAX ALL INCOME FROM WEALTH UNDER THE INCOME TAX SCHEDULE

Capital gains tax and separate rates of tax for dividends should be scrapped, and income from dividends and capital gains should be incorporated into the income tax schedule. Variations on this proposal have been advocated previously by the IFS, the Fabian society, and many others (Glennerster 2016). The Australian tax system has equal rates of tax on income and capital gains, and the UK did previously under Conservative chancellor Nigel Lawson, who aligned CGT and income tax rates in 1988. There are clear arguments from both an economic efficiency and a justice perspective for harmonising the rate of tax on income from capital and labour.

As the current taxes would be scrapped, this reform would involve removing all exemptions, allowances, and reliefs that currently exist for both capital gains tax and dividend taxes, including the capital gains tax exemption on death, both increasing the effective rate of taxation and broadening the base. The economic case for all existing reliefs should therefore be reviewed as part of the design process.

Of the reliefs to be considered for abolition, there is a particularly strong case for removing the deductibility of interest, as the current system privileges debt over equity financing. We have argued previously that the UK should reduce the incentives to favour debt financing inherent in the corporation tax system (Blakeley 2018b). Here, we argue that capital gains made on bonds and other debt-based securities should be treated the same way as those made on equities, meaning they would be taxed at the standard 40 per cent rate.

There are also strong cases for removing entrepreneur's relief and agricultural relief. Both introduce excessive complexity into the tax system and reduce the base without commensurate economic benefits. There may be an economic or social case for encouraging entrepreneurialism or protecting agriculture, but these objectives could be achieved through spending measures rather than via the tax system.

Finally, we argue for the removal of the relief on capital gains upon death. Allowing the relief is regressive and has exacerbated wealth inequality and inter-generational inequality, as well as reducing the tax base.

We do, however, argue that the relief for CGT on first homes should be maintained and gains from rising property values instead captured through a residential property tax, which would be levied on an annual basis (see below). We have argued elsewhere for the introduction of a house price inflation target, implemented by the financial policy committee of the Bank of England (Blakeley 2018a). Together, these measures should serve to limit increases in house prices and prevent a repeat of the asset price inflation of the last 40 years.

And, to ensure that investment is not deterred, the case for and appropriate design of an inflation allowance and a 'normal rate of return' allowance should be considered.

Our proposal would mean that dividend income would be taxed at the same (higher) rate as labour income. One potential problem with taxing dividends – essentially corporations' distributed earnings – in this way is that it represents double taxation, as corporation tax is calculated after the wage bill, but before dividend income is distributed. If a company is paying dividends out of its post-tax profits, it may find it more tax efficient to employ its shareholders and pay them salaries and bonuses. But in decisions about whether to pay dividends, there is a consensus in the literature that tax is 'a second order concern' (Brav et al 2008). Firms pay dividends for multiple and complex reasons and whilst the structure of dividend taxation is likely to affect these decisions at the margin, it will not completely remove incentives to pay dividends. Furthermore, the smallest firms can avoid undue risk in paying employees in labour income by paying this income as a bonus rather than a wage.

Fiscal impact

It is difficult to model the impact of collapsing capital gains and dividend taxation into the income tax schedule given the complex nature of receipts under the current system, and the high level of uncertainty around the likely behavioural response, as well as price effects. However, as our proposal would represent a significant tax increase, and capital gains taxes have been shown to have a limited the fiscal impact is likely to be substantial. Removing the exemption of CGT on death alone would raise an estimated £1.2 billion, and simply restoring the pre-2016 capital gains tax rates would raise a further £800 million in 2020/21 (Corlett 2018; Corlett 2017). HMRC estimates that raising the lower and upper capital gains tax rates by just one percentage point would raise £15 and £50 million each in 2020/21, and that each £1,000 decrease in the dividend income allowance would raise an additional £315 million in that year, though these do not account for behavioural effects (HMRC 2018d).[8] These figures suggest the total fiscal impact of our reform would be large, as these represent small components of the overall package we are proposing.

ABOLISH INHERITANCE TAX AND INTRODUCE A LIFETIME DONEE-BASED GIFT TAX

A donee-based gift tax would be levied on the gifts received by an individual above a lifetime allowance of £125,000. When this lifetime limit is reached, any income from gifts would be taxed annually at the same rate as income derived from labour under the income tax schedule. Gifts between spouses would be exempt from the tax, and gifts below a certain lower limit (which we have not attempted to determine) would not have to be declared. When combined with our first proposal, this would mean that all income from capital gains, dividends, and lifetime gifts would be included in the income tax schedule, although there would be a separate personal allowance for gifts.

This is not the first time IPPR has advocated such a proposal, and we believe that the case for the reform is just as strong now as it was when we recommended it in 2010 and 2012 (Dolphin 2010). Several other groups have also advocated the introduction of such a tax including the Commission on Taxation and Citizenship and the Resolution Foundation (Fabian Society 2000; Corlett 2018). The arguments for such a gift tax are threefold.

First, the tax would help to reduce wealth inequality. Inheritances would be more likely to be distributed amongst several beneficiaries, as the tax burden for a sole beneficiary would be greater than for multiple beneficiaries, provided they hadn't already used up their lifetime allowance and that they weren't all already higher

8 We plan to carry out further work on the likely fiscal and distributional impact of these proposals.

rate taxpayers (Dolphin 2010). Another effect is that, unlike under the current flat rate structure, higher rate taxpayers would pay higher levels of inheritance tax than lower rate ones. This would both directly increase the tax burden on higher earners who receive large gifts and may also encourage gifting to less well-off beneficiaries.

Second, a gift tax would have far fewer exemptions and loopholes than the current system of inheritance tax. In particular, the perverse incentives associated with the seven-year rule would be removed entirely, and one would not be able to avoid paying inheritance tax through careful tax planning.

Finally, the tax is likely to be more popular than inheritance tax, and therefore easier to implement, as it would appeal to values of equality of opportunity and fairness. The fact that the tax is levied on recipients means that it is less likely to be labelled a 'death tax'. It is also less likely to be perceived as double taxation, as the recipient would be receiving the income for the first time (Dolphin 2010).

Implementing this recommendation would require improvement of the UK's tax infrastructure. Because it would rely upon self-reporting of gifts by individuals, there is a danger that individuals would fail to accurately report the gifts that they had received. There will also be issues associated with the valuation of non-monetary gifts and illiquid assets, and of irregular gifts incentivising the 'spreading' of gifts over a number of years to avoid tax. These are not, however, insurmountable obstacles. The value of gifts over the allowance could potentially be carried forward into future tax years. All taxes are subject to some avoidance and evasion, but tax authorities have increasingly effective tools at their disposal to tackle these behaviours. Digital technologies mean mandatory tax returns and registers of changing asset ownership are now possible and could be implemented more cheaply and easily than in the past. Ireland has a similar gift tax model and, although the administration costs are higher than for the UK's inheritance tax, they do not appear to be prohibitive and the tax has survived for more than 35 years (Broadway et al 2010). Similarly, avoidance has not prevented other European countries from implementing higher inheritance taxes than we propose here (Corlett 2018). Ensuring that HMRC would be able to enforce the gift tax would require providing it with greater resources, a proposal for which we have argued elsewhere to deal with tax avoidance (Blakeley 2018a).

The gift tax should be designed to protect genuine businesses during succession. Under the current inheritance tax system, Business Property Relief (BPR) and Agricultural Property Relief (APR) exist to ensure that viable businesses are not damaged when inherited. However, there are no stipulations about maintaining the integrity of the business after inheritance, which means a business could be sold for cash immediately after a death, which provides an unfair loophole and incentive to pass on wealth in business assets. To close loopholes while also protecting businesses, the gift tax would have conditional exemptions for business and agricultural property, analogous to the tax treatment of certain 'heritage' assets. The tax treatment of heritage assets means that families are able to retain the assets without paying inheritance tax as long as they allow a degree of public access and pay tax when the asset is sold. Under our proposal, tax could be deferred until the asset is sold or until the business ceases to be a trading entity and becomes an investment entity. This would allow families to maintain the integrity of agricultural land or business assets, but would also prevent inheritees from gaining large tax-free windfall gains.

Fiscal Impact

Resolution Foundation have modelled the introduction of a lifetime receipts tax, levied on recipients with an allowance of £125,000, based on information in the Wealth and Assets Survey (Corlett 2018). They find that taxing gifts through the income tax system, at our proposed rates, would raise £15 billion in 2020/21,

£9.2 billion more than the current inheritance tax system, and would do so more progressively (ibid). The vast majority of recipients would only be liable to pay the basic rate but having a higher top rate would help to reduce wealth inequality.

In practice, there are likely to be behavioural changes associated with the introduction of a gift tax that are very difficult to model. Changes in the way estates were divided, gifts were given, and the structure of reliefs and allowances make determining the base for the new tax difficult. However, in the absence of behavioural changes of an impossibly large magnitude, the gift tax would raise more money, more progressively, than the current inheritance tax system.

ABOLISH NON-DOMICILED STATUS AND REFORM THE TRANSPARENCY OF TRUSTS

The UK has recently made progress in introducing registers of beneficial ownership for corporations, even extending this to the overseas territories. This progress is welcome, but that the current system is still not transparent enough. Reducing the complexity of the tax system and increasing its transparency and progressivity now requires two actions: removing non-domiciled status entirely, and ending the practice of ownerless assets and obscured ownership of trusts.

There is no economic justification for allowing residents of the UK to claim residency of another jurisdiction for tax purposes. Doing so is regressive and increases opportunities for avoidance, particularly through the use of trusts. As tax justice campaigners have argued previously, it is 'a relic from the past and continues to enable wealthy elites to shelter their wealth from tax authorities' (Sikka 2018). For this reason, we recommend that non-domiciled status is removed.

To further increase transparency in the tax system, and as we argue in our report on business taxation, registers of beneficial ownership should be extended to the crown dependencies – otherwise the increased regulation elsewhere in the UK and the overseas territories risks merely giving the crown dependencies a competitive advantage in facilitating tax avoidance (Blakeley 2018a). As well as this, public registers of beneficial ownership should be created for interest in possession trusts. There is no justification for obscuring the beneficial owners of trusts, and doing so creates opportunities for avoidance.

Finally, the ability to create 'ownerless assets' that exists under the current system should be removed. Following the Tax Justice Network, we argue that where a settlor has placed assets into a trust but they are deemed to have no beneficial owner for tax purposes, the assets should be deemed to belong to the settlor. This would mean that tax would be levied at the point of death of the settlor or when a distribution was made.

REPLACE COUNCIL TAX AND STAMP DUTY WITH AN ANNUAL PROPERTY TAX

There are a number of options for the reform or replacement of the council tax system which would ensure that the system is simpler and fairer, and which would make the housing market more efficient. These could include minor changes such as adding additional bands for high-value properties or changing the ratios between the bands. Such changes would make the system slightly more progressive and ensure that those with more valuable properties paid more than under the current system.

However, such reforms to the existing structure would leave the system reliant on out of date property values from the last century, would not completely address its regressivity, and would retain the current crude system of banding (Corlett and Gardiner 2018).

We argue that council tax should be abolished, and replaced with a property tax which is proportional to the present-day value of homes. Such a tax would be

far more progressive than council tax and would effectively capture increases in house prices in a way in which the current system does not.

Unlike a land value tax (which we recommend to replace business rates in the following section), it would also be a tax on the property. This is appropriate for domestic property because a home is effectively 'consumed' and in economic terms should be liable for a form of VAT (Mirrlees et al 2011). The new tax we propose would therefore act as both a property tax and a tax on consumption.

To bring the UK in line with its international counterparts (Whitehead and Blanc 2017), we recommend the property tax be levied on owners rather than occupiers, though we recognise that higher taxes are likely to be passed on to tenants in the form of higher rents. The simultaneous abolition of council tax – which is usually paid by the tenant – would help to ensure that the disposable income of tenant households was not negatively affected. Nevertheless, it would reduce the salience of property tax (making it less visible as a charge to the tenant) which is frequently cited as a major cause of council tax's unpopularity (Slack and Bird 2014).

A necessary component of this tax reform would be the introduction of a mechanism to allow the deferral of payment for those households that are cash-poor but asset-rich. Such a mechanism would allow payment on sale or death of the property owner. There would need to be regular revaluation, potentially on an annual basis as is practised elsewhere (Corlett and Gardiner 2018), to ensure that the tax was reflective of its tax base. Regular revaluation would ensure that the tax would better capture the increase in house prices that arose from public investment such as in new transport links, for example the new Jubilee Line, and vice versa should house prices fall.

An essential component of reforming council tax is consideration of the fact it is a key revenue stream for local government. Given the multitude of interests and complications that this provides, we are not able to consider this in detail here. However, many people still believe there is a strong link between council tax and the services provided for locally, and many see it as a charge for those services rather than a property tax (Murphy et al 2018). There is then a strong case for retaining that link and there could, for example, be discretion at the local level to vary the levy within certain parameters to allow for different local priorities and needs for public services, as well as variable tax allowances to allow for regional disparities in house prices (Corlett and Gardiner 2018).

Over time we would anticipate the percentage charge to be gradually increased to allow reductions in the level of SDLT, potentially phasing it out altogether.

Fiscal and distributional impact

Research undertaken by the Centre for Progressive Capitalism and the Resolution Foundation suggests that an annual charge of 0.5 per cent of property values would be at least revenue neutral in the case of the former (Aubrey 2016) or raise £1.6 billion more across Great Britain when compared with the current council tax system (Corlett and Gardiner 2018). A rate set slightly higher at 0.7 per cent would increase revenues by £12.7 billion (ibid).

There is the option of introducing a threshold below which properties would not have to pay the tax. For example, a 1 per cent tax rate which provided for a £100,000 tax-free allowance per property, would have meant no tax liability for the bottom 14 per cent of properties nationally in 2015/16, and progressive effective tax rates for properties above the threshold. If regional allowances were introduced instead of a national allowance, recognising the significant variation in

house prices across places, it could raise £3.8 billion in additional revenues (ibid)[9]. Adding in a higher rate of 2 per cent for properties over £500,000 and retaining the regional allowance rate would see £8.4 billion raised in additional revenues – but would hit homeowners in London and the South East particularly hard.

In all instances of reform (with the exception of 0.7 per cent levy) the vast majority of households would benefit from the introduction of a proportional property tax and for those in the bottom half of the income distribution, their incomes would rise. London and the South East would see fewer winners than other regions and therefore the regional allowances and the possibility of local discretion would be important (ibid).

INTRODUCE A LAND VALUE TAX TO REPLACE BUSINESS RATES

We argue that business rates should be replaced by a land value tax (LVT) as others have argued including the Institute for Fiscal Studies (Mirrlees et al 2011), the Centre for Progressive Capitalism (Aubrey 2016) and the Tony Blair Institute (Adler 2017). Indeed the idea of a land value tax can trace its roots to Thomas Paine and David Ricardo (McLean 2018).

A land value tax is based on two principles. It taxes the value of land, not the property standing on it. And the value of the land is calculated on the basis of its 'optimum use' under existing planning permission, not its current use (Ryan-Collins et al 2017).

These principles confer several advantages over our current business rates system. By taxing undeveloped land on the basis of its use value, it penalises those who hold land without developing it, and incentivises development. Since the value of a property is excluded from the valuation of the land, it does not penalise those businesses which improve their properties, as business rates do today.

Introducing a land value tax in the UK would not be simple. It isn't always easy to determine who owns land. Estimating the value of land without the property on it would require new techniques and institutional arrangements. There would also be significant transitional issues in shifting from one form of taxation to another. Nonetheless, land value taxation is already in place in a number of European countries, as well as in parts of the US, Australia and New Zealand, and each has found ways of overcoming the obstacles.

Introducing a land value tax would, we believe, be the most economically efficient means of taxing commercial land without the distorting effects of business rates. It would support, rather than deter, productive investment; and it would capture some of the unearned windfalls from the ownership of land, and reduce the incentive to speculate on it. It would help rebalance the economy geographically, making disadvantaged regions with lower land values more attractive locations in which to do business.

We argue therefore that business rates should be replaced by a new land value tax on all non-residential land. We recommend that it be introduced incrementally, whilst phasing out business rates at the same time. We would not anticipate national exemptions such as for agriculture, but consideration could be given to exempting the first £20,000 value per hectare which would, in effect, exempt most low value agricultural land (Muellbauer 2005). In addition, local authorities could be empowered to offer certain businesses transitional protections.

9 The Resolution Foundation, for example, make the lowest 10 per cent of properties in each region tax-free. These range (for 2015-16) from £72,000 in the North East to £160,000 in the South East and £240,000 in London (Corlett and Gardiner 2018).

Alongside the introduction of the land value tax, measures should be introduced for the registration and valuation of land for this purpose. The Office for National Statistics (ONS) recently included the separation of land value from the value of the buildings on top of it, also breaking it down into different sectors. However, detailed regional or local estimates are not provided. As part of any process of introducing a land value tax, such estimates would have to be far more detailed, learning from processes elsewhere where taxes on land value are already in operation. An annual valuation, for example, would ensure values were up to date and would reflect current market conditions. When employed elsewhere annual valuations have proved successful - in the Netherlands annual revaluations resulted in an 80 per cent reduction in appeals (Aubrey 2016).

We would see such a tax continuing to fund local government, while the rates of tax would be set nationally (as is the case for business rates), to allow for redistribution between local authorities. In due course, as regions converged, it might be possible to introduce some local variation.

Fiscal Impact

To replace business rates on a revenue neutral basis it is estimated that an annual rate of approximately 4 per cent levied on land value would need to be charged (Mirrlees et al 2011). Any implementation should be incremental, for example, an initial charge of around 1 per cent of land value could be levied and rising each year by the same amount, whilst phasing out business rates at the same time (as argued by Mirllees et al 2011).

Conclusion

Wealth inequality is severely damaging the UK's society and its economy, and our tax system is currently failing to deal with it. Reform is long overdue. The proposals we have laid out in this paper are a first step towards ensuring that the UK builds a tax system that is fit for the realities of the modern economy. Our proposals will ensure that we are raising enough money from the taxation of wealth to fund important public services in the fairest way possible, in the context of technological change and rising returns to capital. Together, our proposals make for a tax system based on the principles of both justice and prosperity.

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A Wealth of Difference

Reforming the taxation of wealth

Discussion Paper

The IPPR Commission on Economic Justice is a landmark initiative to rethink economic policy for post-Brexit Britain. The Commission brings together leading figures from across society to examine the challenges facing the UK economy and make practical recommendations for reform.

This policy paper assesses the UK's system of wealth taxation and finds that it is failing to tackle wealth inequality in the UK, which is set to grow as technological change, stagnating wages and rising house prices increase the incomes of the wealthy. The paper makes five recommendations which together amount to a transformation of the tax treatment of wealth in the UK. It recommends that all income from wealth is taxed under the income tax schedule; that inheritance tax is abolished and replaced with a lifetime donee-based gift tax; and that non-domiciled status is removed and trusts are reformed to be more transparent. It also proposes the replacement of council tax with an annual property tax, and the replacement of business rates with a land value tax.

The IPPR Commission on Economic Justice

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