The UK domicile rule costs £4.3 billion in lost tax a year

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Background

I was challenged when recording Hecklers for Radio 4 recently to estimate the tax lost as a result of the UK's domicile rule. And I admit I guessed. I said as much must be lost as was paid by those officially registered as having that status.

Data

According to Jane Kennedy at the Treasury, that's about £3 billion a year. She says that the 112,000 registered non-domiciled people have an average income of about £87,500 a year and pay about £26,800 each in tax, a sum which almost coincides with a simple calculation of the liability due by anyone on that income.

This information did not, of course, suggest anything about tax lost, only about tax paid, so I thought some more calculations might be in order. So I went to table 2.5 of the HMRC statistics for 2006-07, the last year for which there is real data.

Assumptions

Using data solely in that table I could work out the average income of people in the various income bands it refers to and the average tax they paid. In the income band from £50,000 to £100,000 the average income is £66,452 and the average tax paid is £16,581. This income is obviously a lot less than that of the average non-domiciled person. But they do fall into this band as a whole, on average. That locates them for the purpose of this analysis.

Claiming non-domicile status is, of course, of no benefit if you have no income or gains arising out of the UK. So, it logically follows that those who claim this status

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must have higher income than that which they declare in the UK. The data disclosed by Jane Kennedy clearly refers to the income these people declare in the UK. Since their average income is already £87,500 it's reasonable to assume two things.

The first is that their real income is going to be, on average, in excess of £100,000.

The second is that because of their ability to use the domicile rule they don't on average appear in the data relating to those falling into this income bracket as published by HMRC in their table 2.5. In other words, statistically they do not significantly distort the data for those who declare income in that band and above and as such it is statistically acceptable to base an analysis on that data set and to extrapolate it to calculate tax lost without having to allow for the presence of non-domiciled people in that data set.

I stress these are important assumptions. I also stress that I think that they are fair.

Calculations

There were 507,000 people in the UK who declared income above £100,000 in 2006 - 07. Data on them might look like this based on Table 2.5:

Band start point £	Mid point £	Average £	Tax each £	Tax rate	Number '000	Weighted Average £
100,000	150,000	133,693	41,509	31.0%	371	97,830
200,000	350,000	287,273	98,182	34.2%	110	62,327
500,000	750,000	689,474	244,737	35.5%	19	25,838
1,000,000		2,242,857	807,143	36.0%	7	30,966
					507	216,963

The average tax rate in this group is about 33%. To be more precise is to add spurious accuracy. The weighted average of their income is £216,963. So, the average tax payable might be £71,598. If UK tax rates were applied as set out in law the tax payable would be more: I'll live with the compromise and assume tax reliefs and planning takes place as the figure I use implies, and as would be likely in practice.

Given that all 112,000 people who are non-domiciled should on the basis of the assumptions made fall into this income bracket, but do not at present, we can extrapolate this liability to suggest that if those non-domiciled people did declare their likely average worldwide incomes here (assuming they are distributed in the same way as those of UK domiciled people, which seems if anything an assumption likely to underestimate their actual liability) then their total tax liability would be £8.019 billion a year. But we have been told that the tax paid by non-domiciled people in the UK is just £3 billion. This suggests there is just over £5 billion of tax unpaid as a result. Logically this has to be true.

Allowing for those who'd leave

But logic is not, of course everything. It's been argued that some non-domiciled people will leave if the domicile rule goes. However, since many work in the City of London that's unlikely. There's nowhere else for these people to go to get the experience they want assuming they can't or don't want to go the States. They'll stay. So will all US citizens now here. They pay US tax on their worldwide income anyway. And all those who are not domiciled here but who are in the UK because it's a great place to do business stay. As will all those who would pay more tax if they lived just about anywhere else in the world that charges resident people to tax on their worldwide income and also provides a decent environment in which a sane person would want to live (which excludes most tax havens, for starters). But, let's say 20% of all non-domiciled people decide to go as a result of a rule change to allow for the argument of those who say this would happen. Then the total tax paid by this group would go down to £6.4 billion. That still leaves an apparent gain of £3.4 billion from getting rid of the domicile rule.

Inheritance Tax and Capital Gains Tax

But there are two further taxes that must be considered. One is Inheritance Tax. Non-domicile people are older than average when they make their claim for this status. And they do die. Those that do will, if the domicile rule is abolished, fall within the net of this tax. Most do not now. Suppose just 2,000 non-doms a year will die here. Their estates are highly likely to be chargeable. 37,000 estates are chargeable on average a year now. If these estates just paid the same as each of these on average the tax yield would go up by £215 million. A much higher yield is likely.

And also consider capital gains tax. In 2006-07 the total yield from this tax was £3.8 billion. This would have been very largely paid by people earning more than £100,000 a year: they have the cash to invest in assets that result in chargeable gains. If the population chargeable to this tax went up by 80% of 112,000 then the yield would increase by 17.7%, or about £670 million. In combination with Inheritance Tax that is £785 million extra tax a year.

The non-declared non-doms

Add to that the fact that 112,000 is the number currently claiming to be non-domicile. As has become clear as a result of the recent UK 'tax amnesty' quite a number of those who have not declared their offshore income have not done so assuming they were non-domiciled but without having told the Revenue of that fact. 60,000 people have so far come forward under that scheme. Suppose 20% of them use this defence then 12,000 extra people will fall into the net if the domicile rule goes. To be cautious suppose they aren't as wealthy as those who have declared their non-domiciled status and only, on average, have extra tax of £20,000 of income a year to declare (I gather that this is not uncommon amongst those making declaration). That's £8,000 of tax each. That's £96 million extra income tax. And another £90 million of potential capital gains too, which is reasonable because non-domiciled people find these very easy to avoid at present.

£4.3 billion

So now we have (within reasonable grounds of estimation) almost £1 billion of extra tax to compensate for the losses from those who leave. That brings the extra income arising from the abolition of this rule to a sum in excess of £4.3 billion calculated with caution throughout.

Can the UK afford to ignore this extra income? I doubt it.

Will it work?

Will it lose anything by the change? Candidly, no. The City will still handle the same people's money. Non-domiciled people will be able to remit all their income and gains here without restriction: the VAT yield will likely go up as a result. And will business go? No, of course it won't. Business locates where there is profit to be made and the UK provides ample opportunity for that.

Political will

The gain is there to be had. It will just take political will to claim it.