

## The long term tax reforms that we need

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*This is the final part of [my series on UK tax reforms](#) (at least, for now). I would stress, I do not think this list of reforms complete :*

There is a crisis in our tax system that has to be addressed, and the recommendations to this point do just that. However, short-term reforms are not, by themselves, sufficient to deliver the progressive and fair tax system that the UK needs if it is to become a more equal, prosperous and thriving economy. This section focuses on the reforms that are essential to deliver tax justice in the UK.

### **\* *Taxing investment income at the same level as earned income***

There is an extraordinary anomaly in the UK tax system that means that investment income is taxed at much lower rates than income that is earned by people who have to go to work for a living. This anomaly is created by our National Insurance system, which, when both the employee's and employer's parts are considered, can create marginal tax liabilities on income earned from employment that exceed 25% if a person enjoys UK average earnings. There is no equivalent charge of any sort on investment income, which is much lower taxed as a result.

This anomaly has created two outcomes. The first is that those who are already wealthy can accumulate more wealth much more quickly than those who are trying to save out of their earned income, and increasing inequality has been the result.

The second consequence has been a massive boost to the tax avoidance industry, where very large numbers of people have been encouraged into what are, on occasions, false self-employments that are managed through limited companies that do not pay their directors and shareholders a salary, but which do instead pay them dividends, which mean that no National Insurance is paid on these people's earnings from work. It is possible as a consequence for two people sitting next to each other, one on PAYE, and one working as a consultant, to pay substantially different rates of tax as a result. This is a long way from tax justice.

There is a straightforward mechanism for addressing this problem. The UK had, until

the 1980s, what was called an investment income surcharge that was payable by all those who received interest, dividends, rents and other unearned income sources above a set limit. Historically this surcharge was set at a rate of 15%. This is still less than the amount of National Insurance due in combination between an employee and employer on most salary payments in the UK.

We believe that the time has come to reintroduce this investment income surcharge to create social justice between people so that whatever a person's income they should be charged an equivalent rate of tax.

For administrative reasons it would, very obviously, be undesirable that this tax charge to be applied to low levels of income and an allowance of, say, £3000 a year might be made available before the surcharge was applied. To ensure that pensioners were not unreasonably penalised if they had not saved through formal pension arrangements a much higher allowance would be due in their case, but for those pensioners with income that might make them higher rate taxpayers it would be appropriate for such an investment income surcharge to be applied.

#### \* ***Taxing wealth***

Wealth taxes have had a poor tax record around the world, but there has been one very good reason for that, which has been the opportunity for people to evade such charges by hiding their wealth in tax havens. Under new automatic information exchange arrangements now being entered into with tax havens it will become very much harder for people to hide their wealth from taxation in this way, and the consequence is that wealth taxation will very soon, for the first time, become a viable option for any country that wishes to reduce inequality whilst more fairly apportioning the tax burden in their country to those best able to make payment.

The UK's only current wealth tax is inheritance tax, which is riddled with loopholes, and easily avoided by those with the greatest wealth. As such it largely fails in the objective of reallocating wealth in the UK.

A new wealth tax, with progressive rates, payable annually and charged on those with wealth in excess of £1 million in a year would provide a much more effective mechanism for tackling wealth inequality.

#### \* ***A financial transaction tax***

It is now apparent that the excesses of the City of London have caused harm to many of the companies that are based there, to their shareholders and most obviously, to the reputation of the UK. The excessive growth of the City may have also harmed our economy at large because the UK's financial services sector has squeezed out so much other economic activity that could have been gainfully undertaken in this country.

The UK has a competitive strength in financial services, and the world needs such

services, and as a result they should be encouraged, but we do not need the abuses that have become a commonplace part of banking, in particular, with many of those abuses resulting from excessive trading for the benefit of those who work in banks, and not for the benefit of anybody else.

To tackle the problems of excessive trading, and to provide a mechanism to create financial stability, the UK needs a financial transactions tax to be charged on speculative activity. This would help address the current, widely acknowledged, problem that the banking sector is under taxed in the UK. It would, if aggressive tax rates were applied, with the rate dependent upon the volume of transactions undertaken, help slow down markets at times of instability, which is usually to their benefit, and it would force those who are investing to take a longer term approach to their activities.

Such a tax would also raise revenue, but that is not its primary purpose. Banking is a benefit, but excessive trading is not, and a financial transactions tax should seek to reduce the risk to an economy as a whole from the activities of the banking sector, which risk is very apparent in the aftermath of 2008.

**\* *Council tax reform and land value taxation***

One of the most unjust taxes in the UK is Council Tax. This tax is deeply regressive because it does not take ability to pay into serious account whilst all properties over a relatively limited value are taxed as if of equal worth, which means that the vast majority of expensive properties in UK are seriously under taxed when compared to the average house or flat.

Ultimately it would be wise for the UK to move towards land value taxation, which charges tax on the undeveloped value of land on which a property sits, but there is no doubt that this would take time to implement. Whilst it is strongly recommended that plans for the introduction of such a tax should be advanced by any new government it is also necessary to take steps in the short term to address the deficiencies in council tax, and this could best be done by introducing a number of new higher rate for this tax, and by reducing the current tax charges on lower value properties and on those who are on benefits.

**\* *Corporate taxation reform***

Much of the attention given to taxation in recent years has focused upon the affairs of large, multinational companies. That is appropriate given that they have been at the forefront of the tax avoidance activity and are now receiving international attention, but the fact is that no reform of corporation tax yet proposed will tackle the fundamental problem with the international system of corporation tax that is currently in existence.

This problem arises from the fact that at present it is accepted that each company within a multinational group should be taxed in its own right and the existence of the

group is very largely ignored for taxation purposes. This makes no sense at all. Multinational groups of companies only exist because they can make more profit by grouping companies together than could be earned by each of those companies undertaking separate trades. In that case it makes no sense at all to tax them as if they are separate when it is very obviously the case that this is not what is actually going on. No solution to the problem of international taxation will ever be effective until this fundamental problem is addressed.

The ability to address this problem does now exist. Because of the endorsement of country-by-country reporting for tax purposes by the OECD, which will be introduced in the UK from 2016, the data needed to determine where a multinational group of companies really undertakes its activities will now be available to all tax authorities. In that case the profits of a multinational group could be apportioned to states on the basis of a formula with equal weighting given to where the customers of the group are located, where it hires its employees and where it locates its real physical assets. If this were to be done taxable profits would be apportioned to countries on the basis of where they were most lightly to arise and all the abuses of companies like Google, Amazon, Starbucks and many others, could be overcome.

Whilst it is important that, in the short term, the UK adopts the OECD's proposals for tackling international tax abuse by multinational companies, it should also commit itself to reforming the basis of international taxation by adopting a unitary taxation basis for the companies that are located in the UK should work with other countries to ensure that this approach is adopted internationally to prevent multinational company tax abuse.