Funding the Future

Tax After Coronavirus (TACs) : The need for an investme...

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The reasons why wealth needs to be subject to additional taxation has been discussed in another Tax After Coronavirus (TACs) post, with all links being supplied there and so it will not be repeated here.

What was also discussed in that post was that the necessary short term changes to wealth taxation fall into three groups. They are, firstly, to equalise tax rates on equivalent sources of income or allowances. Second, it is by reconsidering those things that should be taxed that are not but might be if the goal of greater equality is to be achieved, and vice versa. In other words, those parts of available tax bases subject to exemptions and reliefs need to be reviewed. Third, it is about creating a more progressive tax system by changing tax rates without challenging, as far as possible, the first objective.

An investment income surcharge

There is a major problem within the UK tax system as a result of the fundamentally different levels of tax paid on income from work and income from investments.

The difference results from the fact that the UK has throughout the whole post-war era had a social security system that is supposedly funded by national insurance contributions (NIC). The reality is that NIC does not fund that social security system now: NIC is now simply a tax, However, the suggestion that this is both a form of insurance and that contributions from those in employment are required as a result has persisted despite that fact. As a consequence an anomaly has been created within the UK tax system.

A detailed numerical explanation of the consequences arising from this disparity is hard to provide, precisely because the NIC system is complex, and rates vary heavily across income scales. However, for employees **broadly speaking NIC is paid at 12% on the equivalent of earnings between £9,500 and £50,000 per annum from each employment, and at 2% on earnings above that sum whilst employers pay NIC at 13.8% on the earnings of their employees over the equivalent of £8,788 per annum. Investment income suffers no such charges.**

As example of the resulting disparity, assuming £40,000 is available to pay a recipient to whom it is owed, then comparing the tax due on that sum if paid as a salary or as investment income produces the following comparison:

	Labour £	Unearned income £
Income available for payment to the person to whom it is due	40,000	40,000
Employer's national insurance	3,785	-
Pay available to the employee	36,215	40,000
Employee national insurance due	3,206	-
Tax due (assuming full basic personal allowance available for offset and the first £1,000 of investment income is tax free as provided for in UK tax allowances)	4,743	5,300
Net payment received by recipient	28,266	34,700
Effective tax rate on gross available income	29.3%	13.3%
Effective tax rate on declared taxable income	21.9%	13.3%

The example is indicative. It is also the case that if the investment income is from dividends a different tax regime applies, and the tax rates can be slightly higher, but are still less than those on labour. The point, however, is very clear, and is that earnings from employment are substantially more heavily taxed than are those from investment income.

For a very long time the UK tax system addressed this issue. Until 1973 the solution was called surtax: an additional tax rate on the wealthiest. Thereafter as the Institute for Fiscal Studies noted in 2002 (and note, this quotation has been edited to highlight the relevant points):

In 1973, the system was overhauled, integrating the surtax on high incomes, which *dated back to 1911, into the main income tax and simplifying the operation of the rate structure. During the 1973 reform, the very top rate of income tax on earnings was left at 75 per cent. In 1974, the top rate on earnings was actually increased, to 83 per cent.*

Throughout these years, the highest feasible rate on investment income was higher still. These very high tax rates became the focus for discontent over the possible disincentive effects of taxation, even though they affected very few individuals and the theoretical impact on labour supply was ambiguous.

As they noted of the investment income surcharge:

The investment income surcharge [was] an additional income tax charge on unearned income. As this had a maximum rate of 15 per cent, in the second half of the 1970s it combined with the 83 per cent top main income tax rate to give a top feasible marginal rate of 98 per cent on unearned income. Very few individuals were actually charged at this marginal rate. The investment income surcharge was abolished in 1984.

Tax rates had, of course, fallen by 1984, to a maximum 60% rate, excluding this charge.

Since 1984 the bias in favour of unearned has existed.

It could easily be corrected. If, **as data shows, those who derive their income from increases in wealth or returns from it are taxed a great deal more lightly than are those who derive all their income from work, then the reintroduction of an investment income surcharge makes a gear deal of sense.**

The way in which HMRC supplies data on income tax paid on investment income makes it very difficult to estimate how much additional tax would be due as a result of this change in rate, not least because some figures are stated net of allowances. However, for 2016-17, which is the most recent year for which much of the data is available, investment income was as follows:

3.7 Property, interest, dividend and other income, 2016-17
Taxpayers only

Range of total income (lower limit)	Net income from property			Interest from building societies and banks			Dividends			Other income			Total property, interest, dividend and other income			Distribution of amounts of total property, interest, dividend and other income
£	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	%
11,000 [(a)]	66	338	5,100	903	83	92	24	11	466	..	..	..	956	432	452	0.5
12,000	156	869	5,560	3,120	478	153	259	185	714	8	3	363	3,260	1,540	471	1.8
15,000	268	1,620	6,030	4,760	849	178	612	1,510	2,470	25	36	1,430	5,080	4,010	790	4.6
20,000	430	3,110	7,240	6,490	1,440	222	1,060	5,180	4,910	51	130	2,540	7,000	9,860	1,410	11.4
30,000	585	4,920	8,410	5,890	1,580	268	1,580	18,200	11,500	85	323	3,810	6,610	25,000	3,780	29.0
50,000	215	2,400	11,200	1,440	563	392	426	7,400	17,400	42	264	6,300	1,660	10,600	6,410	12.3
70,000	142	1,880	13,300	679	389	574	269	7,520	27,900	38	338	8,970	821	10,100	12,300	11.7
100,000	86	1,330	15,500	239	283	1,180	182	5,240	28,700	32	313	9,670	326	7,160	21,900	8.3
150,000	32	594	18,700	84	143	1,700	66	2,270	34,300	16	170	10,500	113	3,170	28,100	3.7
200,000	24	610	25,900	62	141	2,290	51	2,170	42,600	15	237	15,500	82	3,150	38,600	3.7
300,000	14	390	28,400	38	114	2,970	34	1,950	57,900	13	283	21,000	50	2,740	54,500	3.2
500,000	8	342	44,300	22	99	4,500	20	1,870	91,600	11	249	22,900	28	2,560	91,300	3.0
1,000,000	5	332	70,900	12	166	14,000	11	4,380	393,000	7	985	143,000	14	5,870	406,000	6.8
All ranges	2,030	18,700	9,230	23,700	6,330	267	4,590	57,900	12,600	345	3,330	9,660	26,000	86,300	3,320	100.0

Source: Survey of Personal Incomes (SPI) 2016-17
Table updated March 2019

Total investment income for those earning over £50,000 was £45 billion. If an investment income surcharge for all those below the age of 60 (when

retirement becomes more commonplace) of 15% on all investment income exceeding £2,000 a year was introduced a significant step towards addressing this imbalance would have been created. The yield might exceed £4 billion, but some variation is possible and would require better data before any estimate could be refined.