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Bill Dodwell
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Sent by email to ots@ots.gov.uk

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Dear Bill

Capital gains tax (CGT) consultation – stage 1

Thank you for the opportunity to comment on the reform of capital gains tax as a result of your consultation on this issue[1]. This submissions provides high-level comments on the principles of CGT, as requested by you. A second submission providing more detailed comments on the technical detail and practical operation of CGT might be submitted in due course.

Background information

This submission is being made jointly by Prof Richard Murphy FCA, the director of Tax Research LLP and Prof Andrew Baker of the University of Sheffield.

Tax Research LLP runs the Tax Research UK think tank, which is directed by Prof Richard Murphy FCA. Since 2006 Tax Research UK has been extensively engaged in research on a wide range of UK and international tax related issues. Richard Murphy co-founded the Tax Justice Network in 2003 and the Fair Tax Mark in 2013. He was also a co-author of the

[1] https://www.gov.uk/government/consultations/ots-capital-gains-tax-review-call-for-evidence-and-survey

original Green New Deal in 2008. He created the concept of country-by-country reporting, which was adopted in 2015 by the OECD as a mechanism to tackle international tax abuse.

Richard is widely published on issues relating to tax abuse and the tax gap and co-authored one of the leading books on tax havens and the abuse that they have facilitated. He comments here based on experience obtained from this research and the resulting interactions with regulatory agencies and others on such subjects. Richard Murphy is currently Visiting Professor of Practice in International Political Economy, City, University of London, Visiting Professor of Accounting at Sheffield University Management School and Visiting Professor of Sustainability at Anglia Ruskin University. He also retains a practicing certificate from the Institute of Chartered Accountants in England and Wales and works on tax investigation cases.

Andrew Baker is professor of political economy at the University of Sheffield[2]. He works in the fields of International and Comparative Political Economy and has written on various aspects of economic and financial governance, authoring several books and over fifty peer reviewed articles. He has carried out work for numerous International Organizations including the Bank for International Settlements, the Islamic Development Bank and the Global Initiative for Fiscal Transparency. He is the former lead editor of the British Journal of Politics and International Relations, and a current editor of New Political Economy one of the world's highest ranked political economy journals.

Richard Murphy and Andrew Baker have pioneered research on qualitative tax spillover analysis, initially at the invitation of the All Party Parliamentary group on Inclusive Growth[3] and then in a series of academic articles[4]. The analysis offered here is based on tax spillover methodology.

Background to this submission – tax spillovers

We note that the consultation document you have issued says:

> Respondents are encouraged to think broadly but asked particularly to consider the themes identified in the Chancellor's letter including:

[2] https://www.sheffield.ac.uk/politics/people/academic-staff/andrew-baker

[3] See appendix 3

[4] See appendix 3

- Allowances, including the annual exempt amount its level and the extent to which it distorts decision making;
- Exemptions and reliefs, including how they fit together and the extent to which they incentivise some decisions over others;
- The treatment of losses within CGT, including the extent to which they can be used and whether the loss regime distorts decisions about when to buy or sell assets; and
- The interactions of how gains are taxed compared to other types of income, including how the boundary between what is taxed as gains rather than income works. Should there be different regimes for short-term gains, compared to long-term gains?

> Many of these themes are also partly explored in the main body of the call for evidence so respondents may also wish to consider those elements that relate to structural issues, interactions with other taxes, and issues that affect business decision when responding to this section.

This submission is framed in that context. It relies in particular on the approach to tax risk assessment that is described as tax spillover assessment.

Tax spillovers have been understood as the effects one country's tax rules and practices have on others. They were thought to be caused by and confined to reductions in corporation tax, primarily arising between different countries (IMF, 2014). Our research showed (Baker and Murphy 2019a) that spillovers, consisting of tax policies and practices that do harm to, or undermine tax bases and the functioning of tax systems overall (often unintentionally), were a much broader and diverse phenomenon than had been previously thought ((IMF, 2014). The work showed how harmful spillover effects went beyond corporation tax and could arise from the interactions between different areas of tax policy and administration within the same country, and so could be domestic as well as international. We created a framework for qualitatively assessing a country's overall tax spillovers, that both diagnosed existing spillovers and identified potential policy remedies and reforms, as a way to make tax systems less internally inconsistent and secure tax bases.

Many taxes have a defensive purpose, acting as a mechanism for reinforcing tax systems as a whole. The qualitative evaluation framework we created assesses the relationship between taxes within and between tax jurisdictions, as well as a number of administrative and political features of tax systems. It delivers a broad sense of the risks and vulnerabilities particular regimes generate and face in their entirety. The framework evaluates whether one aspect of tax policy and practice reinforces, or undermines another aspect of tax policy and practice through the creation of a scoring system.

There are a number of reasons for governments and their agencies to assess spillovers in this way. Firstly, they might be seeking to raise additional tax revenue without increasing tax rates, or extending the tax base. Second, they may be seeking to uphold the rule of law. Third, they may be trying to improve fiscal management of the economy. Fourth, they may be seeking to ensure that the incentives and other arrangements to encourage particular behaviours built into the tax system work to best effect. Fifth, they might be seeking to promote economic and social justice by making sure that everyone pays their share of the taxes owing, creating a level-playing field. Sixth, governments may be concerned about the investment they are making in tax authorities and wondering whether those funds are being used to best effect. Finally, they may be concerned about their international tax relations and the way international tax competition might erode their tax base and limit their fiscal autonomy. In short, spillover assessment can present an aerial picture of how capital gains tax and its administration, interact with other parts of the tax system and with what consequences. Reviewing the spillovers caused by the practice of capital gains tax, would therefore be highly relevant to the review the OTS is currently undertaking. As part of the review you should consider assessing the harmful spillovers engendered by the UK's capital gains tax regime. The current respondents have already used the methodology they devised to undertake such a review and would be happy to provide further advice on how this might be done.

We attach as Appendix 1 to this letter a note on our tax spillover methodology and as Appendix 2 the extracts relating to capital gains tax from a tax spillover assessment for the UK that we have undertaken and which inform the comments in this submission.

Capital Gains Tax as a defensive, anti-avoidance measure

Capital gains tax (CGT) is primarily a defensive tax. Its original objective in the UK was to protect the income tax system by preventing leakage from that tax base. It so happens that some additional tax bases come within the scope of tax as a result of the rate being a capital gains tax, but this is an incidental benefit.

The budget speech of the late Rt Hon Jim Callaghan, then Chancellor of the Exchequer, on 6 April 1965, when introducing capital gains tax, confirms this view[5]. He stated:

> First, I begin with tax reform. The failure to tax capital gains is widely regarded, outside as well as inside the Labour Party, as the greatest blot on our existing system of direct taxation. There is little dispute nowadays that capital gains confer much the same kind of benefit on the recipient as taxed earnings more hardly won. Yet

[5] https://www.theyworkforyou.com/debates/?id=1965-04-06a.245.0

> earnings pay tax in full while capital gains go free. This is unfair to the wage and salary earner. It has in the past been one of the barriers to the progress of an effective incomes policy, but now my right hon. Friend the First Secretary of State has carried this policy forward to a point which many did not believe was possible six months ago. This new tax will provide a background of equity and fair play for his work.
>
> Moreover, there is no doubt that the present immunity from tax of capital gains has given a powerful incentive to the skillful manipulator of which he has taken full advantage to avoid tax by various devices which turn what is really taxable income into tax-free capital gains. We shall only make headway against avoidance of this sort when capital gains are also taxed.

Five implications are present in the statement as the original rationale for CGT:

- First, capital gains contribute to income as much as does the reward from work;
- Second, it is wrong that this source of income be untaxed;
- Third, it is unfair to the wage earner that capital gains be subject to a lower tax rate than work;
- Fourth, CGT was intended to deliver tax justice through a level playing field;
- Fifth, CGT was necessary to beat avoidance of income tax.

CGT was not created as a tax on wealth. It was originally introduced to be a tax on the income from wealth, or on income that has been disguised as an increase in wealth. That rationale remains valid. It is unfortunate that this is not always recognised today. A recent Financial Times article[6] suggested that CGT reform was part of a review of wealth taxation when that is not the case. The clarity of understanding and purpose in Callaghan's speech regarding the purpose of CGT has been lost over time and could usefully be restored. This objective should be central to the current review. Complications built into CGT since it was first introduced, potentially undermine its original defensive, reinforcing purpose. We propose identifying and remedying those complications and inconsistencies to restore the original purpose of capital gains tax could be aided by a spillover assessment and should be a core focus of the current review.

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[6] https://www.ft.com/content/734e63db-6bf6-4c97-b1a8-2d284b8979d7?segmentId=3f81fe28-ba5d-8a93-616e-4859191fabd8

Detailed observations

In addition to the above noted primary observation we make the following additional observations based upon our work summarised in Appendix 2. The spillover assessment conducted in that work identified the following major weaknesses within UK CGT:

1. That the UK CGT system potentially undermines other parts of the UK tax base because it provides considerable incentive for income to be re-categorised as capital gains, largely because of the disparity in rates between the income tax and capital gains tax systems.

2. That the provision of generous allowances for offset against CGT, including the equivalent of an additional annual personal allowance (that is effectively transferable between spouses) to that provided for income tax, means that awareness of CGT amongst many taxpayers is quite low and the risk of non-disclosure, even if inadvertent, is high, and this undermines the credibility of the tax as well as its yield while permitting CGT to seriously undermine the income tax system.

3. The CGT base is undermined because many asset sales are not subject to automatic information exchange from those who manage them on behalf of vendors, resulting in potential widespread under declaration.

4. The exemptions and reliefs within the CGT system distort behaviour. So, for example, there is little doubt that corporate behaviour has been distorted by a bias towards generating gains for shareholders rather than dividend returns while UK housing is over-valued as a result of primary residences not being subject to CGT and the management of mergers and acquisitions is significantly distorted by CGT allowances and reliefs.

5. The UK CGT system is undermined by generous capital gains allowances within UK corporation tax that mean most merger and acquisition activity within such companies is exempt from a UK capital gains charge.

6. The CGT system is also undermined by the ease of incorporation in the UK and the laxness of both company law regulation and the corporation tax system, where there is evidence of substantial non-submission of corporation tax returns each year[7]. This makes it relatively easy to evade a capital gains tax liability by having it recorded in the name of a corporate entity that is then struck from the Register if Companies without disclosure taking place of tax being paid.

7. The use of tax havens remains a threat to capital gains tax. Research into tax haven

[7] http://www.taxresearch.org.uk/Documents/Intheshade.pdf

activity by accountants shows how insubstantial are the activities of many accounting firms in those places. They frequently act only as 'booking locations'[8]. Due to the low number of staff employed in such places[9] it is likely that most of tax planning relating to their use takes place onshore, which is from where automatic information exchange from those engaged in that process is required as a result.

This means that if the UK capital gains tax system is to resume its defensive role within the UK tax system and deliver the back up to the income tax system that it was intended to, creating equity in taxation between income derived from work and investment activity, and preventing artificial tax avoidance within the income tax system, the following reforms are required:

1. Tax rates should be aligned between the income tax and capital gains tax systems even if a modest indexation allowance is provided to allow for this;

2. The annual allowance for CGT should be reduced significantly to prevent leakage from the tax system by those able to engineer persistent gains as a source of income;

3. The ability to effectively transfer CGT allowances between spouses by making tax free transfers of the ownership of assets prior to sale should be restricted to prevent tax avoidance;

4. Capital gains within closely held limited companies should by subject to close company rules, requiring that they be subject to tax as if earned by the shareholders in those entities, the only exception being in the case of reinvestment in the trade of the entity making the gain;

5. All limited companies should, without exception, be required to file a corporation tax return each year, with personal liability for any taxes owing falling upon those persons with responsibility for making such returns and who fail to make them;

6. Automatic information exchange from banks and other agents within the financial services sector should be required each year requiring disclosure by those agents with regard to those persons (natural or legal) whom they are aware have:

[8] See 'Tax havens: How globalization really works' R Palan, R Murphy, C Chavagneux. 2010. Cornell University Press.

[9] See 'A Tax Map of Global Professional Service Firms: Where Expert Services are Located and Why' R Murphy, L Seabrooke, SN Stausholm. Copenhagen Business School 2019

a. Been in receipt of capital sums resulting from the sale of assets that might be subject to a capital gains charge, with basic information on the transaction to be supplied;
b. Managed, directed, controlled or had a stake of more than 10% in a limited company or similar entity;
c. Been a settlor, trustee or beneficiary of a trust;
d. Had an interest in a financial arrangement outside the UK to which a capital gain might have accrued;

7. The special favour provided to capital gains arising within companies in the UK should be reviewed and eliminated to the greatest possible degree.

These steps would help reinstate the purpose for which capital gains tax was created.

We shall be pleased to provide elaboration if you require it.

Yours sincerely

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and
Visiting Professor of Practice in International Political Economy, City, University of London
Visiting Professor of Accounting, University of Sheffield Management School
Visiting Professor, Anglia Ruskin University Global Sustainability Institute

For himself and Professor Andrew Baker of the University of Sheffield.

Appendix 1
Tax spillover methodology

We note here the approach that we have developed towards qualitative tax spillover assessments that underpin the comments we make in this submission and the analysis of UK capital gains tax in Appendix 2.

Our qualitative evaluation framework seeks to assesses the relationship between four direct taxes within and between tax jurisdictions to a get broader sense of the risks and vulnerabilities particular regimes generate and face in their entirety. These are: personal income tax (PIT); corporate income tax (CIT); capital gains tax (CGT); and social security contributions (national insurance) (SCR). Value added tax (VAT) and excise duties are both indirect taxes and not the subject of overt tax competition, so are not considered here. We also assess four endogenous features of tax systems: tax politics; tax administration; company and trust administration; and international agreements.

The qualitative evaluation framework we have developed is a toolkit for conducting spillover assessments. Assessors do this by answering a series of questions about how tax policies and practices in the jurisdiction concerned have implications for other areas. In every case they do so normatively, making just one simple assumption, which is that no part of the tax system should undermine another part of that system, or of another tax system.

To help in this exercise we have created an extensive questionnaire for each area of concern, which indicates the areas and issues that should be considered in informing the allocation of scores on a 1 to 5 scale. In reaching judgements, professional assessors can cross reference a range of information sources, - interviews with stakeholders, the administration of questionnaires, analysis of legal documentation and legislation, available and applicable quantitative data, to create a picture of behaviours and processes. Written notes talking back to the questionnaire can detail the information used to answer questions and inform scores, creating the basis for a longer discursive qualitative report within a common structured framework, that sets out spillover risks and vulnerabilities in each jurisdiction. It is this longer qualitative report that we present here for the UK as a prototype country level spillover evaluation.

Figure 1

Country X	Issue impacting upon										
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax competition	Tax Politics	Company and trust administration	International agreements	Total	Sub totals
Issue being considered	Income tax										
	Corporation tax										
	Capital gain tax										
	Social security										
	Tax Politics										
	Tax administration										
	Company and trust administration										
	International agreements										
	Total										

Assessors complete three appraisal grids that each resemble figure 1, and for each square on the grid the assessor awards a grade on a 1 to 5 scale. For the domestic grid (which is that which is primarily of concern in this submission) they begin in the top left corner, working across horizontally to consider how the tax or policy area listed in the rows, starting with income tax (top of y axis), is impacted upon by the areas listed in the columns (x axis). For example, for the second box on the first row, the assessor asks 'is this country's income tax base undermined by its corporation tax system?' If they think it does then the score is either 5 or 4, depending upon the severity of that threat. Alternatively, if they think that corporation tax reinforces the income tax base, then the appropriate score is 1 or 2. Where there is no impact either way the score is 3. A domestic spillover assessment provides a reading of the degree to which a tax system is balanced, asking whether different elements support, or undermine each other.

For the international risk grid, the assessor evaluates the potential risks the issue being considered - (rows on the y axis,) generate for the various taxes and policy areas of other countries listed in the columns (on the x axis). This reverses the pattern of asking how the policy area (rows on the y axis) under consideration is affected by areas in the columns, as in the case of the domestic and international vulnerabilities grids. The rows effectively act as the dependent variable in domestic and international vulnerability grids, but become the independent variable on the international risk grid. These different forms of assessment are necessary because states can be both aggressors and generators of risk, but also vulnerable to spillover risk, to varying degrees. The framework provides a comprehensive reading of the diverse elements of spillover as a multi-faceted and multi-directional phenomenon.

The following five-point scale is used for both the domestic spillover and international vulnerability grid, with a score of 5 indicating the highest risk/ vulnerability and threat of a harmful spillover effect.

5.The tax base or policy area being considered is heavily undermined by and vulnerable to the area it is being compared with.
4. The tax base or policy area being considered is to some extent undermined by and vulnerable to the area it is being compared with
3. The tax base or policy area being considered is neither undermined nor reinforced by the area it is being compared with and has limited vulnerability
2. The tax base or policy area being considered is to some extent reinforced by the area it is being compared, and has little vulnerability
1. The tax base or policy area being considered is significantly reinforced by the area it is being compared with and is secure.

For international risks generated the following scoring system is used.

5. The area being considered undermines this element of the tax system in other countries to a considerable extent.
4. Some features of the area being considered undermine elements of this aspect of the tax system of other countries to some extent.
3. Some features of the area being considered can have detrimental effects on this area of the tax system in other countries, but this is limited.
2. The area being considered has limited impact on this element of the tax system in other countries, with few signs of harm.
1. The area being considered poses no threats or risks to this element of the tax system in other countries.

For all of the grids, higher scores are generally indicative of poor performance, - either high degree of vulnerability to harmful spillover risk, or the aggressive generation of spillover risks for others.

Appendix 2
Tax spillover appraisal on UK capital gains tax (CGT)

The following is an extract from a pilot domestic tax spillover analysis for the UK undertaken by the authors in late 2018 and published in 2019 (Baker and Murphy 2019(b), see Appendix 3 for details). It is not suggested that the work is definitive, but it does indicate the issues that the existing structure of the UK's capital gains tax gives rise to which need to be remedied now and informs the recommendations made in this submission. The 'squares' referred to are explained in the methodology note in Appendix 1.

This appraisal has been sued to inform the comments made in this submission.

Domestic spillovers effecting capital gains tax		
Marked against:	Mark	Reasons for mark:
Does income tax undermine or reinforce capital gains tax? Square 3.1	Score 3 Capital gains tax is neither undermined nor reinforced by income tax and has little vulnerability to income tax	• The UK income tax does, in itself, pose little threat to the UK's capital gains tax base, even if the reverse is not true. Nor, does it reinforce it, however.
Does corporation tax undermine or reinforce capital gains tax? Square 3.2	Score 4 Capital gains is to some extent undermined by corporation tax and has some vulnerability to corporation tax	• The UK capital gains tax base is undermined by UK corporation tax because gains arising on merger and acquisition activity by companies that involve more than 10% of the capital of a subsidiary are exempt from all capital gains charges within corporations. This can encourage incorporation. • Failings in the corporation tax system, and in particular the ease with which it is possible to avoid a requirement to file corporation tax return, undermines the effectiveness of the UK capital gains tax system. The ease of incorporation that exists in the UK, matched by the laxness of the tax

		system when it comes to demanding and enforcing the obligation to submit corporation tax returns makes it possible for an asset disposal to be declared in the name of a company, without the resulting taxation liability being disclosed, when it should actually be declared on the tax return of the individual who benefited from the transaction.
Does capital gains tax legislation and practice undermine the capital gains tax base? Square 3.3	Score 5 Capital gains tax legislation and practices significantly undermines the capital gains tax base	• The UK capital gains tax systems undermines the prospect of capital gains tax being paid in a number of critical ways; • The UK capital gains tax system does not always require automatic information exchange from those who assist persons to make gains e.g. those who facilitate trades in shares and securities or in land; • The exemption of some assets from the charge, including residential homes, distorts the tax base. The exemptions for let property distort the housing market and reduces the potential tax base, as well as removing progressivity from it; • The number of exemptions and allowances available within the system encourages non-reporting. In particular, the annual exemption for the tax is high and potentially creates distortions within the tax system as a whole. Exemptions for personal chattels can also be open to abuse; • Some allowances, such as Entrepreneur's Relief , continue to be hard to justify on the basis of any economic rationale; • Few justifications for capital gains tax exemptions, reliefs and allowances have been published and as such few have been rationally explained, and none appear to be subject to periodic review to appraise their continuing suitability; • The operation of a capital gains tax charge on gifts is rarely appropriately understood, and gives rise to significant potential underpayment of tax.

Does social security undermine or reinforce capital gains tax? Square 3.4	Score 3 Capital gains tax is neither reinforced or undermine by social security and has little vulnerability to social security	• The UK social security system does, in itself, pose little threat to the UK's capital gains tax base. Nor however, does it reinforce it;
Does tax politics undermine or reinforces capital gains tax? Square 3.5	Score 5 Capital gains tax is heavily undermine by and is vulnerable to tax politics	• The risk in this is case is broadly similar to that noted for income tax, but with a significant twist that capital gains is seen as a tax on virtuous savings and investment activity, and on wealth. There is little evidence of political appetite in the UK to tax such activities. Limited willingness to promote and control disclosure means that mechanisms for ensuring fair, effective and proportionate capital gains tax is paid are underdeveloped. • The issues noted with regard to income tax referred to in the preceding paragraph were as follows: • The UK's tax politics advocates low rates of tax on investment income; low capital gains and corporation tax rates; and supports a tax system that lacks serious progressivity at its higher end. This undermines the effectiveness of the tax system, opens it to risk from tax abuse and creates the political risk that many taxpayers might be alienated by the apparent injustice within the tax system, which might encourage them to evade their responsibility to pay the taxes that they owe; • The UK's tax politics also appear biased towards those who are self-employed. Value is attached to risk taking and entrepreneurial spirit. Limited resources are expended on detecting abuses that self-employed persons can perpetuate because they have sources of income that are not automatically notified to HMRC. There has been

		considerable reluctance to create systems of automatic information exchange from UK banks to tax authorities on the income streams of those persons who appear to have random patterns of bank deposits that might indicate the existence of self-employed arrangements. There has also been a reluctance to tackle prevalent tax evasion amongst those who trade at a relatively small scale through internet platforms. These combined acts of reticence all act to undermine income tax receipts. This risk might apply equally to capital gains made by the self-employed; • There is evidence that UK politicians treat the tax authority, HM Revenue & Customs, as a cost centre within the civil service and that it has a duty to minimise expenditure. Its revenue generating potential is not fully supported with additional resources. While this misunderstanding of the role of HMRC persists UK tax politics undermine the effectiveness of the capital gains tax. • UK politicians, from leading parties, have made strong statements against international tax abuse. But to date there has been a lack of political will to abolish the UK's domicile rule. These arrangements make it an attractive jurisdiction for wealthy itinerant international individuals whose aim it is to pay little or no tax in any country in which they reside. This means that the UK is collecting less capital gains tax than it might. • There is persistent evidence, arising over many years, that substantial sums of UK capital gains tax has been lost as a result of abuse undertaken through tax haven structures. This would suggest that UK tax politics should be vehemently opposed to the use of tax havens, but despite this the UK has maintained a network of tax havens under its international protection. These havens include Jersey, Guernsey, the Isle of Man, the Cayman Islands, the British Virgin Islands, Bermuda, Gibraltar and other locations.

		Successive UK governments have protected the rights of these jurisdictions to maintain their own, secretive, tax and company law regimes that have directly undermined the effectiveness of the UK's income tax system.
Does tax administration undermine or reinforce capital gains tax? Square 3.6	Score 5 Capital gains tax is significantly undermined by and significant vulnerabilities resulting from tax administration	• The UK's tax administration, which is managed by HMRC, has seen its real-terms funding significantly reduced in recent years. The result is that there are fewer tax officers to administer the system. • Trade unions argue that staff at HM Revenue & Customs have been persistently underpaid over many years. Recruiting and retaining staff of the highest calibre has been difficult, at cost to the effectiveness of the income tax regime. • The number of tax investigations undertaken in the UK has reduced significantly in recent years, and those that are undertaken tend to be of those persons who have already declared their income and raise questions on points of detailed tax law rather than on the omission of income streams from taxation altogether. There is a widely perceived bias amongst tax practitioners that tax investigations are targeted at those who are, in the main, seeking to be tax compliant as opposed to being used as part of a drive to collect undeclared sources of income tax. • As a result of the closure of a great many local tax offices in recent years the number of locations where a taxpayer can seek in-person advice from a tax officer on their affairs has vastly reduced. This means that many taxpayers have to make judgements when submitting their tax returns, because they don't have access to proper technical advice from the tax authority to ensure that the disclosures that they make are appropriate. • HM Revenue & Customs are unusual amongst tax authorities worldwide for preparing an annual tax gap estimate. The effectiveness of that estimate

		has, however, been questioned due to the use of what might be inappropriate or incomplete methodologies. The cost of tax reliefs and allowances is not included in the estimate. In addition, the basis for estimating tax lost within the income tax system is the extrapolation of errors within tax returns submitted. Little or no systematic work is undertaken on estimating tax lost as a result of non-disclosure of income streams; the failure to submit tax returns or the existence of the shadow economy. • There is no evidence that the tax authority is taking any steps to ensure that automatic disclosure of data that might indicate the existence of potential capital gains, for which tax maybe due. Such administrative laxity potentially significantly undermines the capital gains tax base. • For all these reasons the UK tax authority seriously undermines the effectiveness of the UK's capital gains tax system.
Does company and trust administration undermine or reinforce capital gains tax? Square 3.7	Score 4 Capital gains tax is to some extent undermined by company and trust administration	• The ease of incorporation of companies and the low rates of tax that companies pay, plus the exemptions that are available to companies upon the sale of business assets, and the failure of the company and trust administration to ensure that adequate disclosure of data is required by all businesses, particularly at the point when they close for trading (which is precisely when gains might arise,) means that the capital gains tax system is vulnerable to weaknesses in the company and trust administration of the UK.
Do international agreements undermine or reinforce capital gains tax revenue? Square 3.8	Score 4 Capital gains tax is to some extent undermined by interpretation and implementation	• Information exchange requirements with regard to capital gains remain weak despite recent changes in those arrangements. • The ease with which some assets can be relocated offshore means that the vulnerability of the capital gains tax base to limited information exchange provisions in international arrangements is of some significance.

	of international agreements in the UK	

The following table has been created from materials from the same source document as the previous table and summarises the spillover impact of the UK's capital gains tax on other parts of the UK tax system:

Marked against:	Mark	Reasons for mark:
Does capital gains tax reinforce or undermine income tax? Square 1, 3	Score 5 Capital gains tax heavily undermines income tax and income tax is vulnerable to spillovers and flows into capital gains	• The UK's capital gains tax rates are considerably lower than those due with regard to income tax. Gains arising on land and buildings do not exceed 28%, and in some cases do not exceed 10%. Income tax rates reach 45% and many of those who might pay capital gains tax will be higher rate income taxpayers, with liabilities due at rates of at least 40%. There is, therefore, an incentive in the UK tax system to seek to record income as gains whenever possible. This is particularly true with regard to investment income, where any opportunity for income to be rolled up within a company or fund, with realisation being achieved by sale of the asset rather than by income distribution, is greatly attractive to those who save tax as a result. The consequence is, however, that the income tax is undermined, as is its progressivity. • The UK's capital gains tax system has identifiable administrative weaknesses. There is very little automatic reporting of the disposal of assets from those managing such arrangements to the UK's tax authority, HMRC. Chances of misdeclaration of an income stream that is treated as a capital gains appears to be much higher than for the equivalent stream if taxed as income. The effectiveness of income tax is undermined as a result because there is incentive for those who wish to evade tax liabilities to invest in those asset categories that

		are more likely to give rise to gains, which they can then not declare. • Each person resident in the UK has an annual capital gains tax allowance, which is broadly equivalent to the sum also available to each person who has an annual income tax allowance in the country. The result is that those who can generate part or their income as capital gains can enjoy the benefit of double annual allowances, and therefore an initial much lower rate of tax than that which is available to the persons who live on revenue streams that are only subject to income tax. This creates a considerable bias against income tax and reduces its effectiveness.
Does capital gains tax undermine or reinforce corporation tax? Square 2.3	Score 3 Capital gains tax neither reinforces or undermines corporation tax	• The capital gains tax system is not a direct threat to the corporation tax system in the United Kingdom and does not undermine it. • It should be added that the corporation tax system in the UK does not reinforce a proper capital gains tax base.
Does capital gains tax reinforce or undermine social security? Square 4.3	Score 3 Social security is neither undermined, nor reinforced by capital gains tax	• The UK capital gains tax system does, poses little threat to the UK's a social security base. Nor however, does it reinforce it. • By allowing the continuing diversion of some income into gains (albeit, largely as a result if undiscovered tax avoidance activity) the capital gains tax system may undermine the social security system as a result of income that should be subject to national insurance charges being miscategorised for tax purposes, but the risk is considered to be limited.
Does capital gains tax undermine or reinforce tax politics? Square 5.3	Score 3 Tax politics is neither reinforced nor undermined by capital gains tax	The UK's tax politics are not as such undermined or reinforced by the capital gains tax system. However, the reverse is not true, as tax politics has been responsible for some deficiencies in capital gains tax .

Does capital gains tax legislation practice reinforce or undermine tax administration? Square 6.3	Score 4 Tax administration is significantly undermined by capital gains tax	• The existence of a very high annual allowance for capital gains tax purposes, means it is possible for individuals to avoid making regular returns for the purposes of this tax, even if they are active traders in shares and securities. Identifying those who should be within the capital gains tax base is more limited than it might be. The UK's tax administration is impeded in identifying those who should pay this tax. • The absence of a requirement that many of those assisting taxpayers to make capital gains do not have to disclose those transactions to the tax authority, also impedes that authority's prospects of identifying those who might owe capital gains tax. An automatic information exchange system between share trading platforms of all sorts, land conveyancers, auction houses and rental agents, is one potential way of increasing the information available to tax administrators. The required disclosure would not categorically identify those with liability to pay, but it would provide a basis for further investigations by the tax authority. This would increase the potential that the tax base is identified. It would also increase the pressure on those with capital gains to make the disclosure required of them by law. • Tax legislation in general involves many exemptions and allowances with regard to capital gains. These provide opportunities for people to seek to avoid this tax. They also create confusion as to whether disclosure is required, or not. These arrangements start with ISAs (Individual Savings Accounts) which effectively extend the personal capital gains tax allowance, and embrace chattels relief on the sale of certain personal property, which cannot be categorically identified in advance. There are also many exemptions with regard to houses used as homes and rental properties. All of these exemptions reduce the prospect of high rates of tax compliance by

		taxpayers and undermine the effectiveness of the tax authority. The economic value of these reliefs is, in many cases, unknown. • The absence of a legal requirement to create an effective tax gap measure noted with regard to income tax is repeated here with regard to capital gains tax.
Does capital gains tax reinforce or undermine company and trust administration? Square 7.3	Score 4 Company and trust administration is to some extent undermined by capital gains tax	• The capital gains tax system continues to encourage the use of trusts, to some extent, and as such distracts the attention of the trust administration system, whose primary task is to provide services to those who require such structures for charitable purposes.
Does capital gains tax reinforce or undermine UK involvement in international agreements? Square 8.3	Score 5 International agreements are significantly undermined by capital gains tax practices in the UK	• The UK has a very limited basis for collecting information on those who might make gains inside the United Kingdom and as such is unlikely to collect sufficient information to exchange automatically with other states on this issue.

Appendix 3
References

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