Funding the Future

Tax justice - Dan Neidle style

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I mentioned Dan Neidle's proposed reform of capital gains tax yesterday. As he had previously done with investment income, he suggested that the 'normal rate of return' on investment should go untaxed when making his suggestions and that only the excess should be taxed.

As I noted yesterday, he made no suggestion that the normal rate of return on labour should be free of tax, and later yesterday morning, he made his proposals for income tax reform, most of which will, again, be of significant benefit to the wealthy, and none of which address most of the real problems with that tax.

I thought an example of what Dan is proposing on capital gains and the taxation of investment income might be of benefit.

Firstly, suppose a person made an investment of £1,054,000 in a business in 1990.

Secondly, assume that the normal rate of return is 4 per cent.

Thirdly, assume that in 2024, 35 years later, they sold the investment for £4 million.

If I was now setting an exam question, I would ask you to calculate the tax owing using Neidle's proposed system of taxing capital gains.

I will save you that effort, though; that entire gain of £2,946,000 would be tax-free under Dan Neidle's proposal, with the rate of return being 4 per cent, compounded, throughout.

Then, I might ask a follow-up question.

Now presume that the person making this tax-free sale invested the proceeds at 4 per cent, earning £160,000 a year. Now, calculate the tax due on that using Dan Neidle's method of calculating tax due on investment income.

That 4% return would be a "normal rate of return", according to Dan, and so under his proposal, that income would be entirely tax-free.

Now let's look at the situation of a person who is paid £36,000 a year (near enough, the median wage). They have a student loan and make a very standard pension contribution. The government PAYE simulation for this year says they will pay:

Your estimated take-home pay for 2024/25

Yearly | Monthly | Weekly

£27,587.40 a year

How we calculated this

Gross income	**£36,000.00**
Personal Allowance	£12,570.00
Pension Contributions	£1,080.00
Student loan	£990.00
Taxable Income	**£22,350.00**
Income Tax at 20%	£4,468.20
National Insurance	£1,874.40
Take-home pay	**£27,587.40**

I treat the student loan repayment as tax, for the very obvious reason that it is calculated as if it is, so we are entitled to assume it is what it looks to be. In that case, the total tax paid by this person with income of £36,000 would be £7,332.

In comparison, assuming the capital gain was made at the start of the tax year in the example I have given above, that person would have an income of £2,946,000 plus £160,000 of interest, or £3,106,000 in all, and they would pay nothing in tax, at all.

This is not what tax justice looks like.

There is nothing even remotely reasonable about what Dan Neidle is proposing unless you are very wealthy, of course.

But I should add that what Dan is proposing is not his own work. He is promoting the ideas in the 2011 Mirrlees Review of taxation in the UK that was promoted and published by the Institute for Fiscal Studies. In chapter 13 of the 2011 version of this (there was a preliminary publication in 2010), it was argued:

By sacrificing consumption today, saving is a way of generating future income and, like other forms of investment, there is a case for exempting the normal return. The taxation of the normal return to savings distorts the timing of lifetime consumption and labour supply. A timing-neutral tax system would not create such distortions, and there are a number of tax systems that achieve such neutrality.

On the basis of this crass assumption, it is claimed that a person is entitled to a tax-free normal rate of return on their investment, however big it might be.

The trouble is that savings are not a way of generating future income. Banks do not lend money deposited, and almost all other savings are in the stock market casino, which does not use the funds entrusted to it to fund investment but instead uses them to fund speculation. The supposed theoretical justification for Neidle's proposal does not exist.

When it comes to gains, the argument for exempting the normal return in these is to be found in chapter 15 of the same work, where this is said:

Taxing the stock of accumulated savings is closely related to taxing the returns to savings, and raises many of the same issues. We have already argued in favour of exempting a 'normal' return to savings but taxing 'excess' returns. A tax on the stock of accumulated savings does the opposite of this.

Therefore, they say that normal returns to accumulated savings - or capital gains - should also be exempt from tax. For the same reason that they were wrong on income-related returns, they are also wrong on capital gains.

But Neidle has not noticed that any more than the supposedly objective gods of modern economics, the IFS, did.

I will quote *James Baldwin in case objections are raised. He once said, very appropriately:*

I can't believe what you say, because I see what you do.

A tax system based on utterly false economic assumptions that lead to the returns to the wealthy going untaxed in almost unlimited amounts is not even a vague approximation to tax justice: it would be a system rigged in favour of the already wealthy. And that is what Dan Neidle is suggesting, whatever he might say.