Funding the Future

The Institute for Fiscal Studies' proposed reform of ...

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The Institute for Fiscal Studies issued a new report on the reform of capital gains tax yesterday, some parts of which are welcome.

Firstly, they suggested that the reform of capital gains tax is important whether or not it raises additional revenue because the existing system is unfair in itself. This is a welcome development because it recognises that tax is not all about revenue raising, if it is about that at all.

Secondly, as they made clear throughout the report, there are no good reasons why capital gains tax is charged at less than income when it comes to passive sources of return on investment, i.e. those that result from saving.

Thirdly, and as importantly, they also make clear that there is no good reason why the return to work should be taxed differently if some of it gave rise to earned income and other parts gave rise to capital gains. Both, they suggest, should be taxed at the same rate to remove distortions in the tax system.

Fourthly, they propose that the exemption from capital gains tax on death should be removed, which I welcome.

Fifthly, they challenge the claim made by HM Treasury that increasing capital gains tax rates by 10% would reduce revenues. I agree with that challenge. HM Treasury has never shown its workings that support this calculation, and the assumption that it is true is just that: it is nothing more than a guess based upon the existence of the Laffer curve, and that is unjustified.

That's the good news. Then comes the almost inevitable neoliberal nonsense that shows the complete lack of understanding that organisations like the IFS have of taxation when much of what they say is based on the archly neoliberal Mirrless report of a decade or so ago, of which I was deeply critical at the time and ever since.

For example, they seem wholly unaware of the role of savings in the macroeconomy (which have a marginal contribution to macroeconomic well-being at best but are of enormous benefit to those seeking to create and reinforce inequality in society) or of the structure of most small businesses, where the amount invested in capital is generally utterly insignificant in comparison to investment in time, and through the provision of loans.

Based on their false assumptions, and despite the apparently positive points I have noted previously, the IFS suggest a number of ways of reforming CGT, including making the normal rate of return on a person's investments free of all tax, with this return being defined as the interest rate payable upon medium-term government bonds.

The benefits to the wealthy from this variable tax-free allowance, which would obviously increase as your wealth does, meaning it is the exact opposite of what is required by a progressive tax system, should be apparent. Those with wealth would be able to enjoy enormous amounts of income tax-free which would be entirely unavailable to the rest of society, of which fact the IFS appears to be completely unaware.

Alternatively, they suggest organising the tax on a cash flow basis so that deductions can be made when sums are invested in assets subject to all proceeds from sale then becoming taxable. Despite that, they still discuss the possibility of indexation allowances to allow for inflation, which makes no sense at all. Such a scheme would, of course, significantly defer the time when most capital gains tax would have to be paid because a built-in tax avoidance arrangement resulting from simply reinvesting the proceeds would then effectively be built into this tax. The fact that tax deferral rather than absolute avoidance is a significant part of tax planning appears, once more, to have evaded the attention of the IFS.

There are other proposals made, including the abolition of what was once called entrepreneur’s relief, but overall this is a typically disingenuous report from the IFS. Whilst appearing to offer a real prospect of change to capital gains tax by holding out the chance that this tax might, eventually, collect more revenue on the death of people, the superficially attractive proposals like equalising tax rates are massively outweighed by the generosity of the reliefs and allowances for the wealthy that would be built into such structures, meaning that their overall tax rates would, despite the increasing rates, almost certainly fall significantly.

This is not the capital gains tax reform that we need. For that, see the Taxing Wealth Report. The IFS proposal is, instead, what happens when you set out with the following goals:

1. To pretend you are reforming when you really are not.

2. To appease the wealthy.

3. To define fairness as being equity for those with wealth

4. To presume that making the wealthy wealthier is the goal of society, and you

disguise that fact by describing increasing inequality as growth without asking who benefits.

5. To refuse to consider the interests of anyone but those who pay capital gains when reforming that tax.

Were these the goals of the IFS? It really does look like it.