Where next for capital gains tax?
Two compelling ideas

1. “Tax all income the same”
2. “Don’t discourage saving, investment and entrepreneurship”

- These are in apparent conflict
  - Tax capital income & gains as much as earnings (1) or not at all (2)?

- Result: reduced, but not zero, tax rates on capital income and gains
  - Compromise doesn’t achieve either objective satisfactorily
  - Tax rates yo-yo as emphasis changes

- But we can have our cake and eat it
  - Set tax \textit{rates} the same for all sources of income
  - Adjust the tax \textit{base} to avoid undesirable disincentive effects
Reduced tax rate is biggest giveaway to those making highest returns. High returns could be:

- **Predictable**: Those investments will be worthwhile regardless of tax – focus instead on investments that are borderline worthwhile
- **Lucky**: Why further reward the fortunate?
- **Result of effort and skill**: Why tax working to generate income more heavily than working to increase asset values?

Give deductions for desired activity, not for returns to the activity

More generous deduction for amount invested

- e.g. deduct purchase cost immediately, not when dispose of the asset
- or index the purchase price for a (risk-free) interest rate
- Tax any returns above that in full
- Investments that are worthwhile before tax still worthwhile after tax
CGT and risk-taking

- Risk-taking is discouraged when upside is taxed more than downside is cushioned

- Currently, gains are taxed, but losses can’t always be deducted

- So make capital loss offsets as flexible as possible
  - e.g. allow to offset against income (rather than gains) more widely
CGT and death

- Gains unrealised at death are written off
  - Deceased’s estate not liable for CGT on rise in value before death
  - Inheritor deemed to acquire for value at death, not original price

- Big incentive to hold onto assets that have risen in value until death

- Incentive would be even worse if CGT rates higher
  - Better to end uplift at death before increasing rates
  - Could be done in conjunction with other reforms (IHT? Social care?)
Summary

- The tax base needs reform
  - More generous treatment of purchase cost
  - More flexible loss offsets
  - Abolish uplift at death
  - Merge annual exempt amount with income tax personal allowance

- If tax base fixed, increasing CGT rates would be a fair way to raise revenue from the well-off with little damage to incentives
  - Aim to align overall tax rates across all sources of income / gains
  - Start by getting rid of business asset disposal (BAD) relief