The current policy mix: Inconsistent and inequitable?

John Hills

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Inherent conflicts?

- Wealth is a key part of people's economic resources, and therefore might naturally be expected to be part of the tax base in some way, on grounds of horizontal equity
- Given the scale of the inequalities in wealth we have seen, and the potential impact of these on inequalities in life chances, egalitarian principles point to relatively high taxation of larger wealth holdings
- But we may want to encourage use of wealth as life cycle smoothing (both to minimise regrets from myopia and to reduce calls for support)
- If assets do have effects on life chances, we may want to help people build them up
- Administratively, there are constraints from the way in which some forms of wealth do not generate a flow of cash that is easy to capture

Taxes on capital (£ billion at 2010-11 prices)

	Inheritance tax	Capital gains tax	Stamp duties	Total	*Total as % GDP*
1948-49	5.0	-	1.6	6.7	*2.0*
1958-59	3.5	-	1.2	4.7	*1.1*
1968-69	5.2	0.6	1.7	7.5	*1.3*
1978-79	1.6	1.6	1.9	5.1	*0.7*
1988-89	2.1	4.6	4.5	11.3	*1.2*
1998-99	2.4	2.7	6.2	11.3	*1.0*
2007-08	4.1	5.7	15.1	25.0	*1.7*
2010-11	2.7	3.6	8.9	15.2	*1.1*

Other taxes on assets

- Investment income contributes to income tax base. At *average* tax rates of recipients would account for £17 billion in 2010-11
- Council Tax raised £26 billion in 2010-11, more than other capital taxes
- But it is only partly linked to capital values – part front door tax; part poll tax; part income tax. Maybe half as tax on housing?
- If so, takes taxes on capital to £45 billion, less than 1% of personal assets at the time (so tax rate of less than 30% on a 3-3.5% return)
- But CT charged to occupiers, not owners. Mirrlees argument that best seen as partial offset to VAT-exemption on *consumption* flow, not as tax on *income* flow to owners?

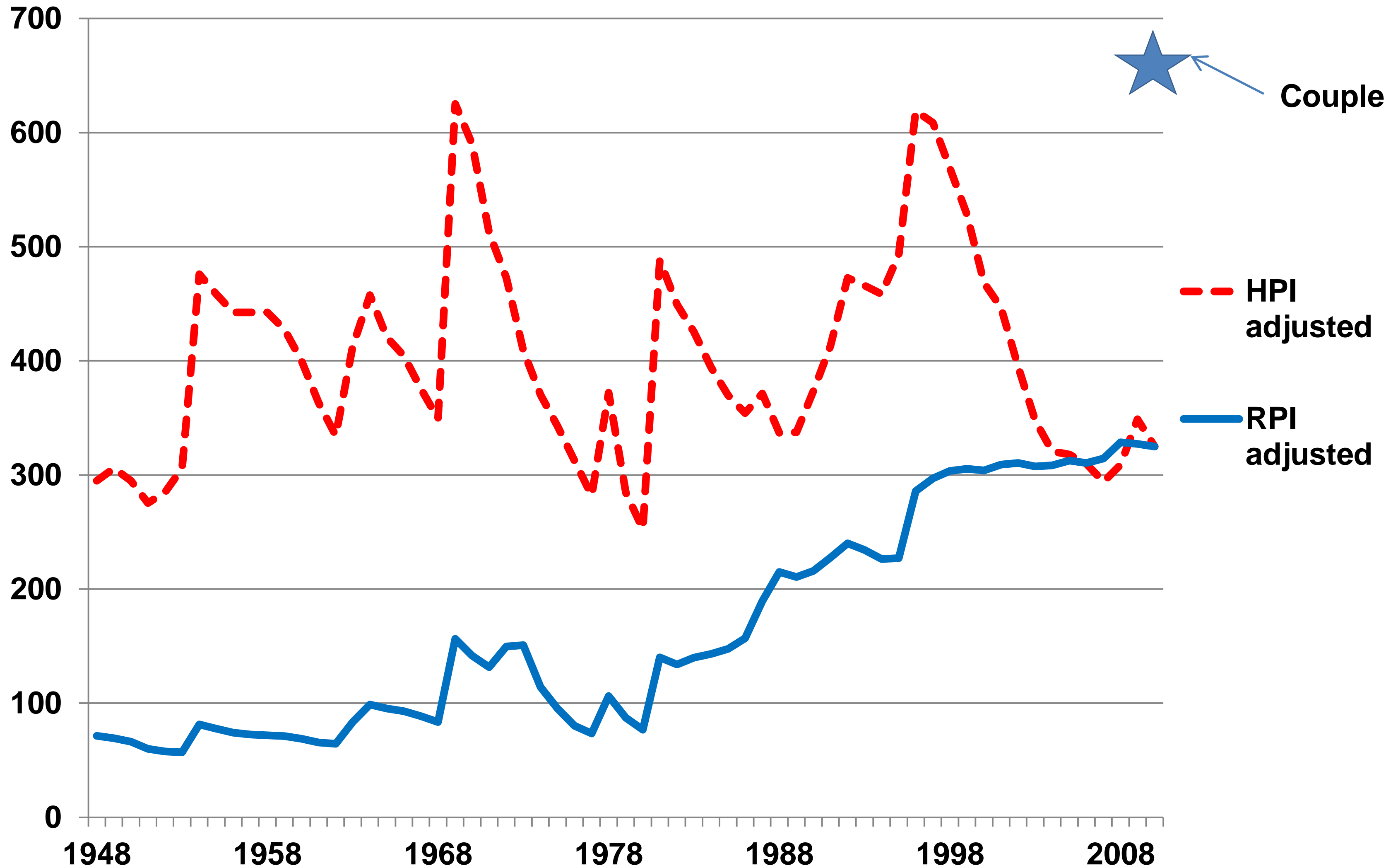
Taxation of investment returns

- Better than tax-free: saving in a pension
- Tax-free: ISAs, some national savings
- Almost tax-free: owner-occupation (no tax on imputed rent or capital gains, but periodic stamp duty – total varying between 0.1-0.2% of value of residential property)
- Partly taxed: direct share-holding through income and capital gains tax (Wakefield: effective rates on real returns of 7-10% for basic rate payers; 33-35% for higher rate payers)
- Varying rates: private landlords (income tax on net rent plus capital gains tax on *nominal* returns, but can deduct nominal interest payments)
- Taxed on nominal returns: ordinary interest-bearing accounts

Inheritance Tax

- Based on estates (and gifts just before death), not receipts
- Yield fell from 1.5% of GDP in 1948 to 0.2% by 2010-11
- 2007-08 yield just 0.06% of net household wealth, and since then reduced – compared to 0.4-0.6% in 1920s to 1960s
- Yield could be seen as lower: forgiveness of capital gains tax on death
- Thresholds follow saw-tooth pattern with house prices – now explicitly linked

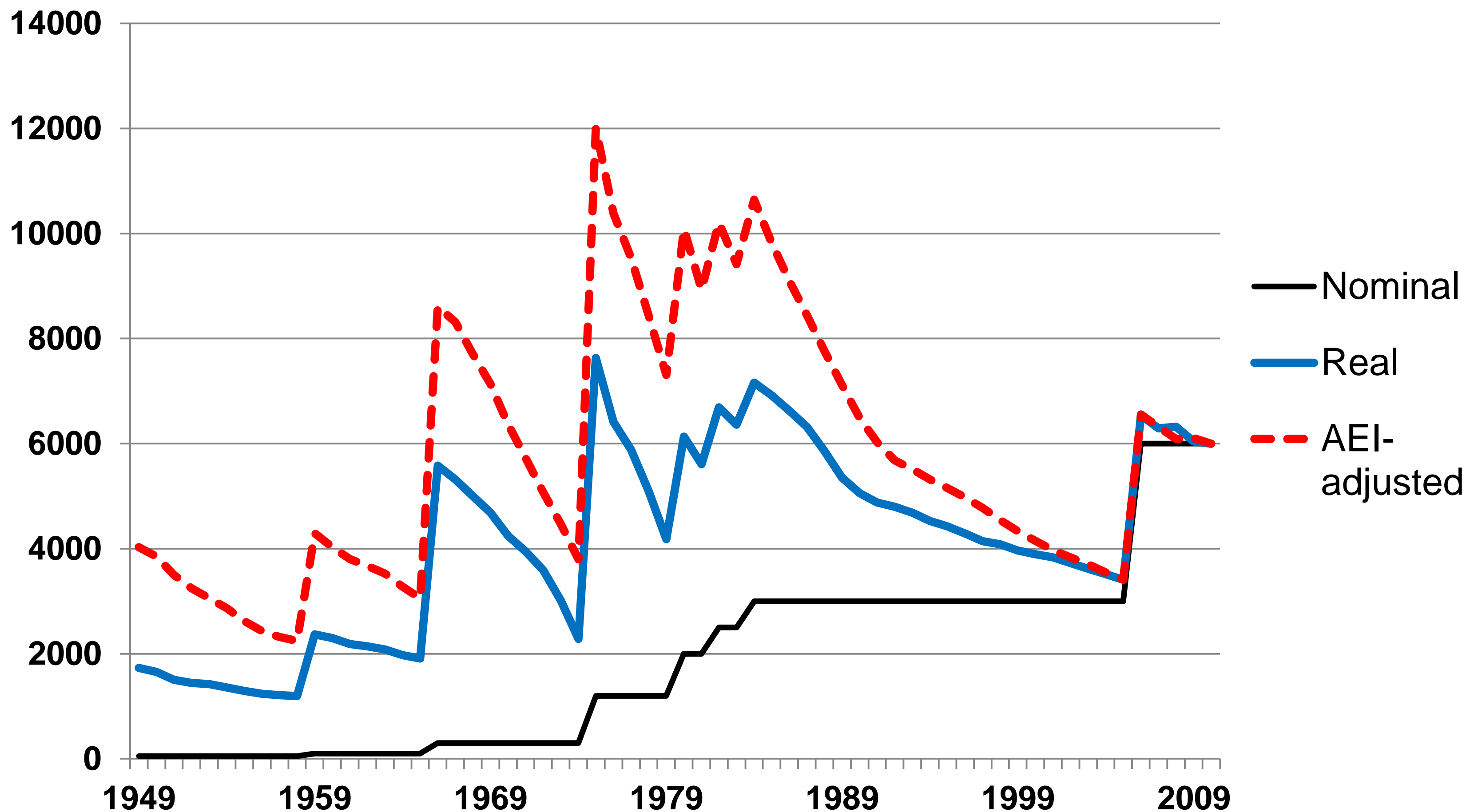
Inheritance Tax thresholds (2010-11 £000s adjusted by RPI and HPI)



Pensions taxation

- Contributions deductible for income tax (up to some limits) and employer NICs (hence LSE's 'salary sacrifice' scheme)
- Contributions also deductible in calculating tax credits and *half*-deductible for HB and CTC
- Fund investment income tax-free (but no credit for Corporation Tax on dividends)
- Up to a quarter can be paid out as tax-free lump sum
- Pension receipts taxed at income tax rate in retirement, but not NICs
- "EET" treatment could be equivalent to ISA "TEE" treatment – but pensions combination of EEE and EET, so better than tax-free
- Receipts affect means-tested benefits in retirement – but net return only low if HB in retirement but not when contributing

Income Support lower capital limit (2010-11 £s adjusted by RPI and AEI)



Returns on capital assumed for Income Support, 1948-2008

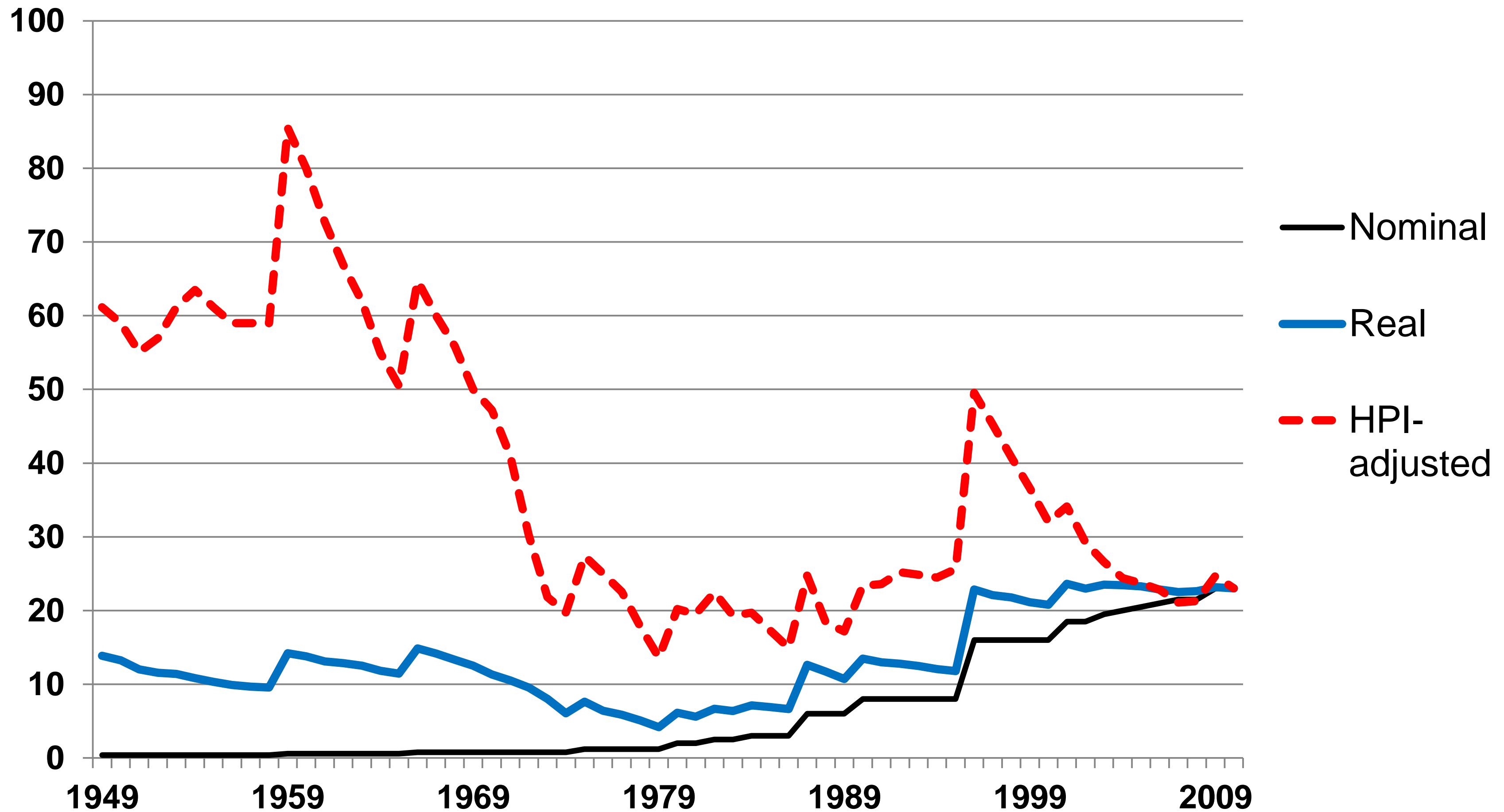
	Assumed rate of return	Actual interest rates	Shortfall
1948	5.2	2.0	3.2
1958	5.2	5.3	-0.1
1968	25.0	7.4	17.6
1978	26.1	9.3	16.8
1988	20.9	10.1	10.8
1998	20.9	7.2	13.7
2008	20.9	4.6	16.3

Current "tariff income" rule assumes return of £1 per week per £250 of savings above lower limit (half that for Pension Credit age and above)

Contributing to long-term care

- Assets and income not taken into account for NHS care, but 1948 National Assistance Act carried over modified Poor Law rules, so those with capital expected to contribute.
- As home-ownership has spread and house prices have risen, more (single) people find ‘family home’ taken into account
- Contributions expected (in England) on capital between £14,250 and £23,250 (fixed to April 2015). Tariff income equivalent to 5% of excess. Full fees above cliff-edge of £23,250
- In Scotland, ‘personal and nursing’ care are free (up to limits), but accommodation paid in full if capital above £24,750 (with some contribution above £15,250)

Upper capital limit for residential care (2010-11 £s adjusted by RPI and HPI)



Encouraging asset ownership

- The Right to Buy: discounts of up to 60-70%, averaging 40% at peak. Current value of equity from discounts £150-200 billion – 3-4 per cent of household wealth. Maximum discount raised recently to £75,000.
- Child Trust Funds: £250 voucher for children born 1 September 2002 to 2 January 2011, doubled if on low income. Top up at age 7 in 2009-10. Cost of £0.5 billion by 2009 with top-ups – total state contribution about £2.5 billion. Abolished.
- Savings Gateway: pilots of matched savings schemes for people with low incomes. Was to roll out nationally (with 50p match for £1 saved) from July 2010….

Also in the picture:

- Student loans and fees. Income-contingent repayments, but will constrain people's ability to borrow, and classed as debt in wealth statistics. £20 billion outstanding to SLC at end 2010-11.

The Lucky family

- Professional couple working for large companies providing good occupational pensions – state adds to savings
- Buy own home, with very little tax on owner-occupation apart from occasional stamp duty (and with mortgage relief earlier)
- Further savings via tax-free PEPs/TESSAs/ISAs
- Do not need significant long-term care
- Can leave up to £650,000 without Inheritance Tax (plus lifetime transfers) without need for trusts, etc.

State has <u>added</u> substantially to their savings rather than charging net tax

The Unlucky family

- Low-income couple working for companies not providing occupational pension (may change with Automatic Enrolment from October onwards)
- Saved when they could through standard building society account, taxed on nominal return – more recently via an ISA
- Build up nest egg of £30,000
- As above £16,000 limit ruled out of Pension Credit, HB and CTB
- And when one needs long-term care, expected to run savings down to £23,250 (and then assumed to contribute at 5% of excess over £14,250)

State has taxed their savings and reduced their rights to means-tested benefits and care because of their savings

The Not-so-unlucky family

- In this case they were council tenants and bought their home at a discount (now with current value of £75,000), paying for rest from savings and low mortgage payments
- Housing assets do not rule them out from Pension Credit or CTB
- Nor does their house get taken into account when first of them needs long-term care

State has given them a large share of a capital asset in a form that does not reduce rights to means-tested benefits or care (for first partner)

Where do we go from here?

- Easy to see ways in which current policy mix is unfair, over-complex and economically inefficient (Mirrlees, etc.)
- Strong equity case for making overall system progressive

But:

- Continuing failure to revalue property for Council Tax, let alone introduce proportional rate structure (see fate of 'mansion tax'
- Promise to raise IHT threshold to £1 million politically decisive
- By contrast CTFs and promised SG roll-out first casualties of 2010 election
- Sensible long-term care reforms can be branded as 'death tax' or 'granny tax'
- Are interests involved <u>so</u> powerful that even simple reforms are impossible?