

JUST TAX

REFORMING THE TAXATION OF INCOME FROM WEALTH AND WORK

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SUMMARY

Taxation is the means by which governments raise revenue and fund the welfare and public services on which a civilised society depends. The IPPR Commission on Economic Justice identified a need to move to a higher tax, higher spend economy – with future public spending challenges likely to increase over time. We also seek a tax system that is more progressive – so that those with the greatest ability to pay contribute the most – as well as more transparent and efficient. The UK is one of the most unequal countries in the developed world, and income inequality could be set to worsen as capital and property ownership become more important sources of income generation. Redistribution is essential for economic justice.

This briefing paper focusses on two sets of proposals designed to make the taxation of income simpler, more progressive and better able to raise public money. The proposals are united by the principle that income, regardless of source, should be taxed equally across individuals. It is profoundly unjust that those who work for their incomes are taxed more highly than those whose income is derived from wealth. This situation is all the worse when we consider that the wealthiest are less likely to generate their income from labour than the rest of us. Among the richest 1 per cent, over one-quarter of total income is generated from dividends and partnership income alone. Economic justice demands change.

First, we propose that **income from wealth should be taxed the same as income from work**. Capital gains should be taxed at the same rates as income from employment, and the separate reliefs applied to capital gains tax (CGT) should be abolished. A similar policy was last implemented by Conservative chancellor Nigel Lawson. Capital gains tax rates are substantially lower than they were pre-2008, and are currently taxed at much lower rates than income from work. Lower tax rates for the wealthy than for ordinary earners are fundamentally unfair; they also distort economic behaviour and create opportunities for tax avoidance. We estimate that these changes could raise up to £120 billion of additional revenue over five years, falling to £90 billion when accounting for potential behavioural effects. Removing the exemption of capital gains upon death could raise up to an additional £25 billion over the same time period, falling to £15 billion with behavioural effects. There are inevitably large uncertainties around these estimates, but even if the behavioural effects were larger, or we introduce an indexation or rate of return allowance (RRA), we would still expect these changes to raise significant sums. Our proposal would substantially increase revenues, while making the tax system fairer.

Second, we propose a **fundamental reform of the income tax system, taxing all sources of income (earnings, dividends and savings) together and equally under a single tax schedule, with a gradually rising marginal tax rate as income rises**. The current system of tax band dates from the pre-computer age and is no longer fit for purpose; we believe it is time to follow other countries such as Germany which already use this fairer approach. We argue that, among other advantages, this system would be significantly more transparent, would eliminate the ‘tax cliffs’ endemic in the current system, and would have the potential to raise significant revenue in a progressive manner. Our illustrative modelling shows a schedule that would be tax neutral while enabling an increase in take-home pay for around 80 per cent of taxpayers, as well as further schedules that could raise substantial sums while avoiding the pitfalls of alternate proposals – such as very high marginal rates of income tax, or expecting those in the poorest households to contribute more.

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Nanda S and Parkes H (2019) *Just tax: Reforming the taxation of income from wealth and work*, IPPR.

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