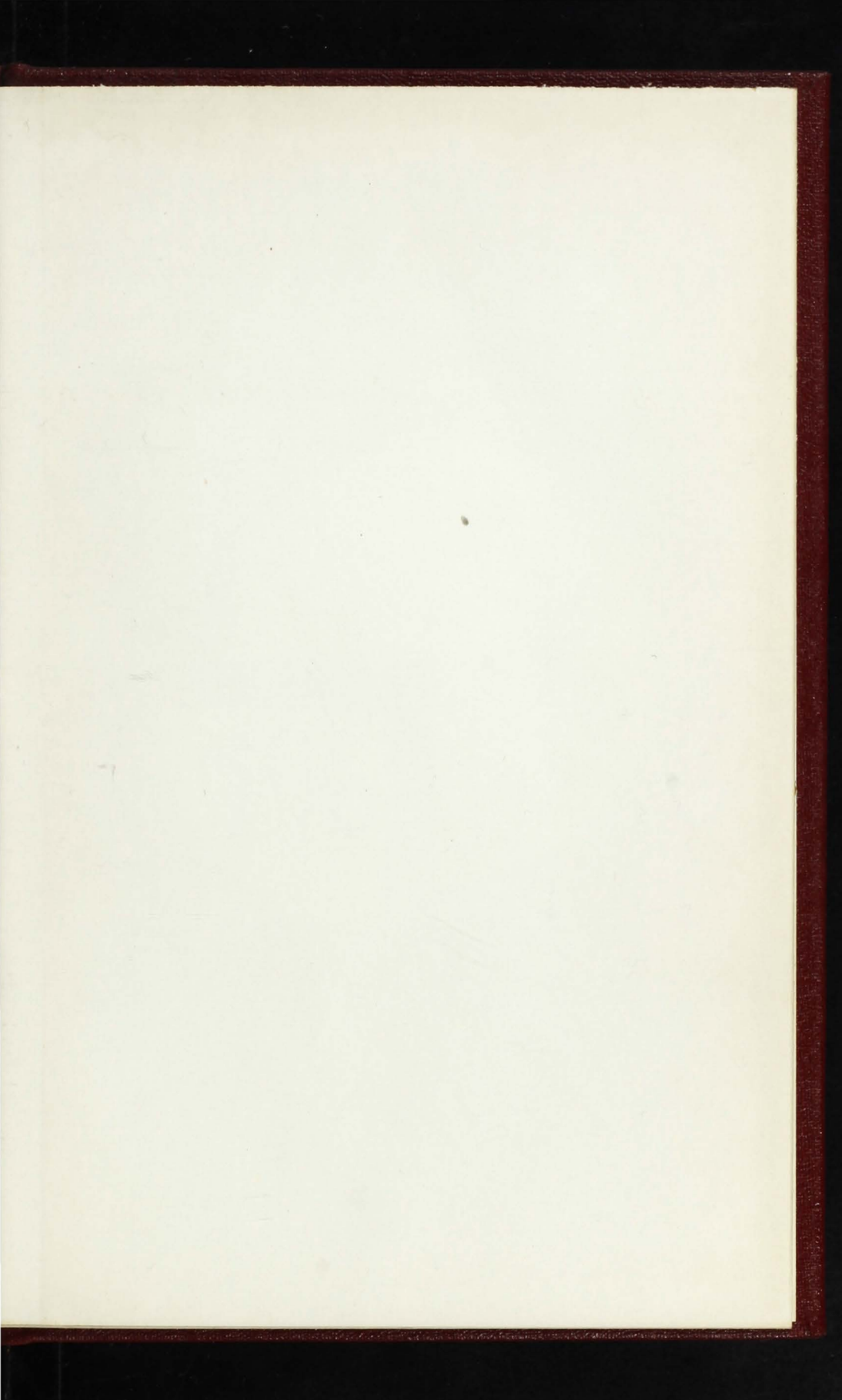
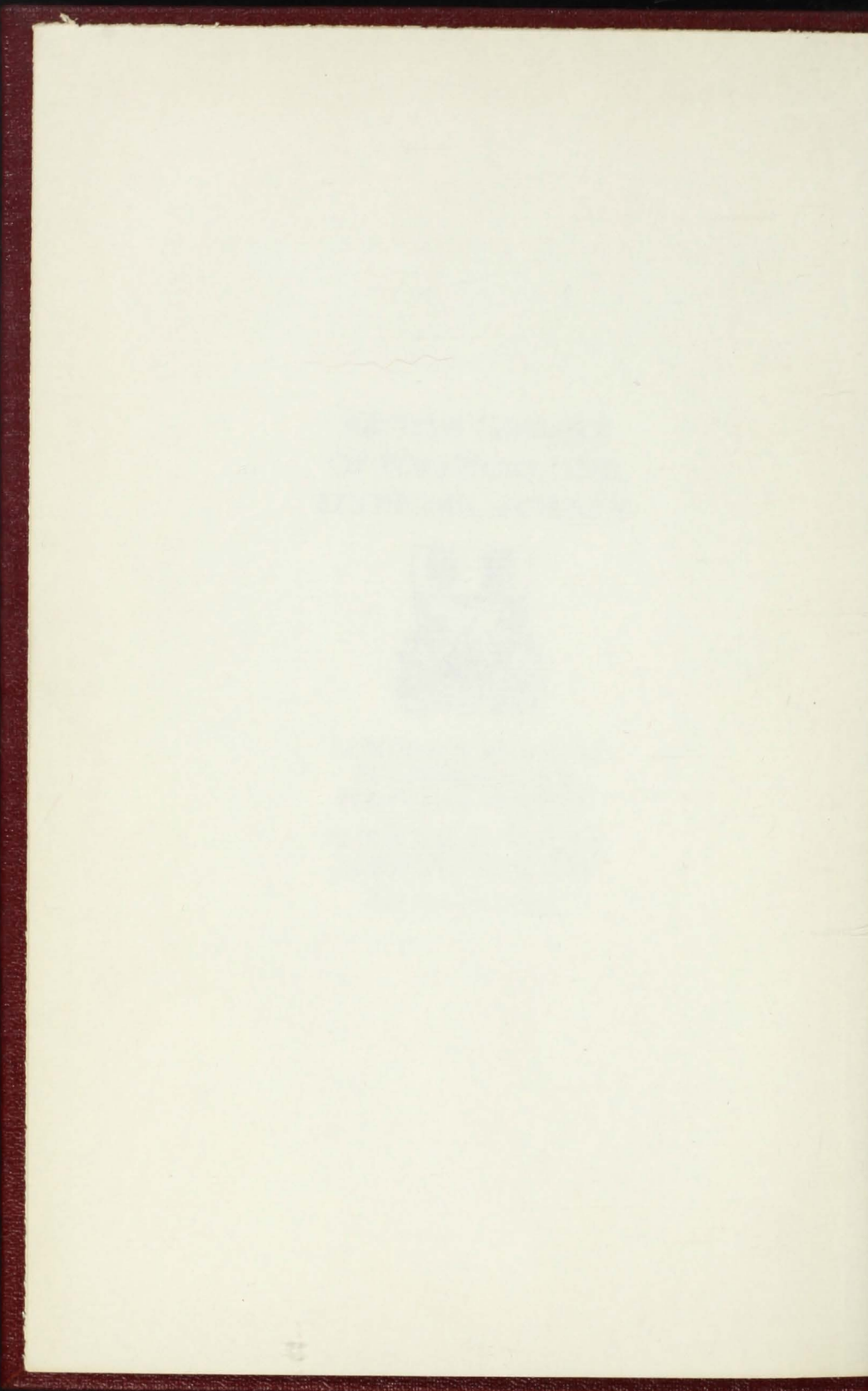


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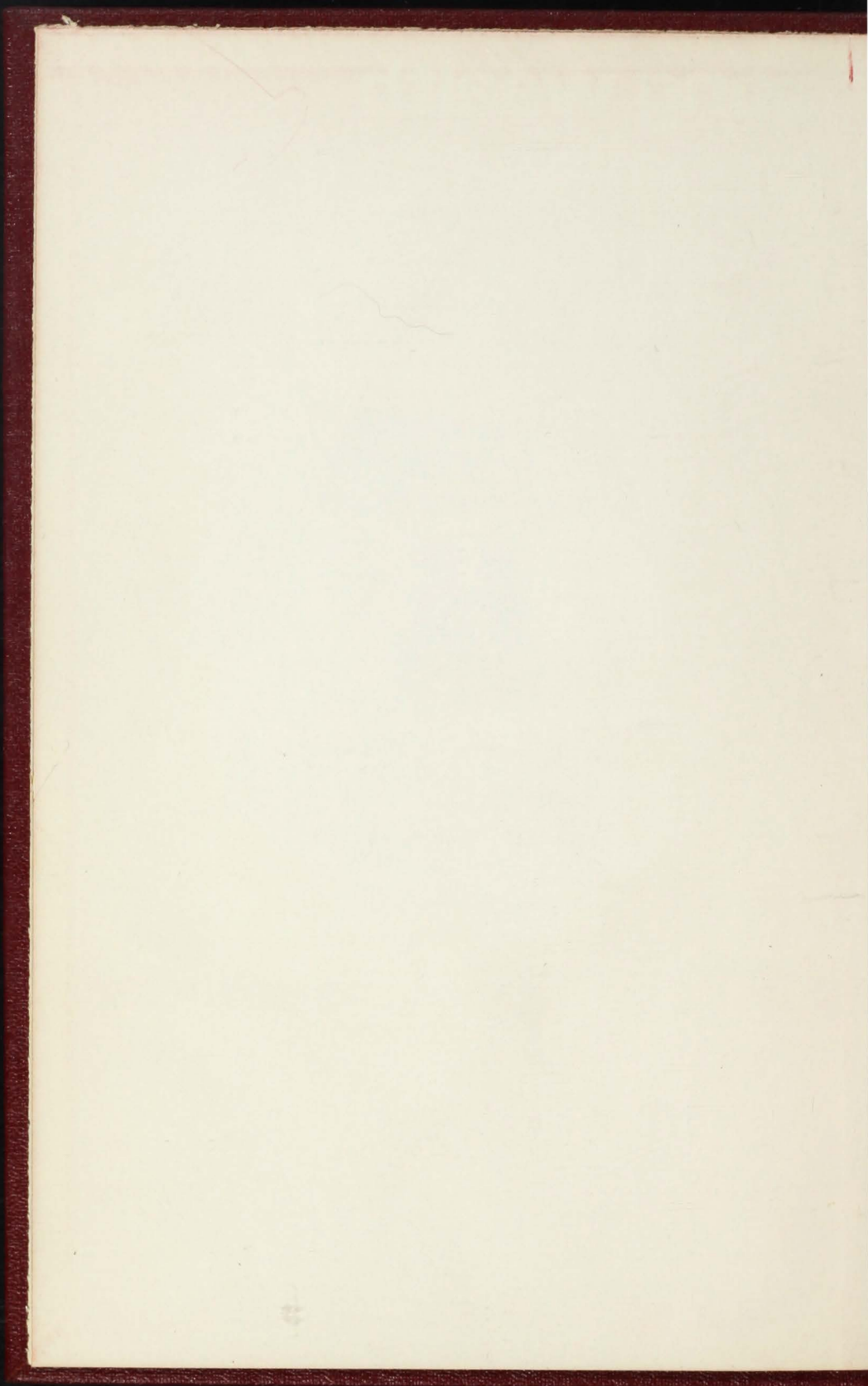


Taxing wealth inequalities

by Lord L. Burghes, B. Smith

Public Affairs 456 65p





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C Pond, L Burghes, B Smith
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1. introduction

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Few of the divisions in British society are deeper than that associated with the unequal distribution of wealth ownership. The richest one per cent of the population owns a quarter of Britain's personal wealth; the top ten per cent owns two-thirds. The ownership of wealth brings with it more than a comfortable standard of living; in our society, property also confers power, prestige and influence—the power not only to control one's life, but those of others as well. Inequalities in wealth and inequalities in power go hand in hand. Despite the growth of home ownership in recent years the concentration of wealth remains extreme: one per cent of the population has control over almost three-quarters of all wealth held as land, stocks and shares and government securities.

It is for this reason that the last Labour government committed itself to achieve an "irreversible shift" in the distribution of wealth and power in favour of working people and their families. One of the main instruments for achieving such a shift is the tax system, and the Labour government, on coming to power, stated categorically "We shall introduce an annual wealth tax on the rich". Despite this early determination to tackle wealth inequalities, such a tax was never introduced (for reasons which were not wholly without merit and which are discussed in chapter 4). The inequalities remain. Indeed, the distribution of wealth holdings became somewhat more unequal during the period of Labour's stewardship.

The approach of the present Conservative administration, as we might expect, is wholly different. One of their first acts was to abolish the Royal Commission established by their predecessors "to help secure a fairer distribution". Sir Geoffrey Howe, the Chancellor, has recently reaffirmed his commitment for early action to lighten "the destructive burden" of capital taxes. Lord Cockfield has been undertaking an investigation of the changes that should be implemented.

The aim of this pamphlet is to examine the level and effects of wealth taxation in the light of wealth inequalities. In chap-

ter 2 we review the evidence available on the extent of those inequalities and consider how they have changed over the years. We also examine the types of wealth held, and their concentration, and consider the explanations which have been put forward for the extreme inequalities that persist.

Against this background we consider, in chapter 3, the way in which wealth in Britain is taxed. To what extent can the current types and level of capital taxes be expected to affect the inequality in wealth holdings? And is Sir Geoffrey's assessment that they represent a "destructive burden" realistic? We therefore examine the contribution of capital taxes to total tax receipts and see how that contribution has changed over the years. We also report recent evidence on the burden of wealth taxes in Britain, in comparison with those of other advanced industrial nations.

Finally, in chapter 4, we consider how wealth should be taxed to fulfil the objectives of economic efficiency and equity while helping to tackle the inequalities in its distribution. Would the Labour government's proposals for a wealth tax have been a major step forward in achieving these objectives, or are there more effective ways of achieving them? We present a package of possible reforms which would help to achieve a fairer distribution of wealth while at the same time improving the equity of the tax system and improving economic efficiency. We will argue that what is required is not a smaller contribution by Britain's wealth holders to the total tax burden, as this Government proposes, but an increased contribution, albeit levied with greater equity.

The purpose of this pamphlet is therefore two-fold. It was first submitted to Lord Cockfield to help in his examination of the reform of capital taxation in November 1979. We hope that the Government will pay particular attention to chapters 3 and 4 which detail the failure of the present system and present proposals for rational reform. But we also hope it will read carefully chapter 2 where it

will find evidence of the urgent need for reform if the Conservative Party are serious about their declared intention of spreading wealth ownership more widely.

The second aim of the pamphlet is longer term. If the Labour movement is to tackle decisively the inequalities that we document in this pamphlet it must be properly prepared, next time Labour takes office, with a coherent and well planned fiscal strategy. This will require debate within the movement as to what should be achieved and how we should go about it. We hope that this pamphlet will make some contribution to stimulating that debate.

2. inequalities in wealth

The ownership of wealth can confer many privileges. It extends a person's freedom, independence and security. It provides influence, power and prestige. For the wealthy there is more choice and more opportunity. For some, wealth means increased income without forfeited leisure. But the assets generally included in a definition of wealth do not all bring such advantages. Wealth includes not only stocks and shares, land and antiques, but national savings and savings in building societies, owner occupied housing, household goods and cash in the bank. The importance of wealth, then, is not only how much is owned, but what is owned.

Given the benefits of wealth, it is not surprising that those who have it wish to keep it. Calls for a more equal distribution are often criticised as mere displays of envy. But it would also be surprising, given the advantages of wealth ownership, if those with little or no wealth were not interested in seeing it a little more equally divided.

the distribution of wealth : the last fifty years

Those who criticise the unequal distribution of wealth are often told either that the data overemphasise the inequality of wealth ownership or that it is only a temporary problem: the distribution is rapidly moving towards equality. In this section we look at the distribution of wealth and how it has changed over time. We also look at those factors which might account for changes in the distribution as well as its stability.

It is generally believed that the distribution of wealth has become considerably more equal during the last fifty years and that this trend will continue. But while it is true that the very wealthiest—the richest one per cent of the population—do own a smaller proportion of wealth now than they did fifty years ago, wealth remains very unequally distributed. The wealthiest fifth of the population—the top 20 per cent—still own 85 per cent of Britain's wealth, almost as much as they did half a century ago. It seems unlikely that we are witnessing a persistent move towards equality in wealth ownership.

This conclusion does not accord with the belief that the post-war period has seen a dramatic decline in inequality. Why have the changes that have taken place in the distribution of wealth been over-emphasised? A major cause has been inadequate information. Until recently changes in the distribution of wealth over time could only be analysed by combining information on the distribution from different sources, often calculated on different assumptions and covering different populations.

Only recently have we been provided with more consistent statistics on the distribution of wealth over a considerable period of time. This has been calculated by Atkinson and Harrison for the period 1923 to 1972 (A B Atkinson and A J Harrison, *Distribution of Personal Wealth in Britain*, Cambridge University Press, 1978). Their results, summarised in the table below, though more consistent than previous estimates, are still subject to certain discontinuities. The

DISTRIBUTION OF WEALTH 1923-1972*

	% share of total wealth					
	1923	1938	1960	1964	1970	1972
top 1 per cent	60.9	55	33.9	34.5	29.7	31.7
top 2.5 per cent	21.1	21.9	25.5	24.1	23.9	24.3
top 6-10 per cent	7.1	8.1	12.1	12.8	15.1	14.4
top 11-20 per cent	5.1	6.2	11.6	12.9	15.8	14.5
top 20 per cent	94.2	91.2	83.1	84.3	84.5	84.9

*Economically independent population, England and Wales. The estimates for 1923 and 1938 are not wholly comparable with those for 1960 and later.

Source: A B Atkinson and A J Harrison, *Distribution of Personal Wealth in Britain*, CUP, 1978.

precise figures should be treated with caution. But the estimates suggest that, while the share of wealth owned by the top 1 per cent had nearly halved, the share of the remaining wealthiest fifth of the population had increased. The top 2.5 per cent had increased their share marginally, while the next richest five per cent more than doubled theirs and the next richest 10 per cent almost trebled their share. It appears that the share of the wealthiest 20 per cent of the population as a whole therefore declined from 94.2 per cent to 84.9 per cent. This is hardly a dramatic decline over a period of 50 years. Moreover, there appears to have been a considerable structural shift between 1959 and 1960 which accounts for much of the decline in the shares of the richest groups observed over the period. By the beginning of the 1970s, the poorest four-fifths of the population owned just 15 per cent of all personal wealth.

As Atkinson had commented in an earlier work, "careful examination of these figures shows that the redistribution taking place has been of a rather special sort . . . what redistribution there has been is not between the rich and the poor, but between the very rich and the rich" (A B Atkinson, *Unequal Shares*, Penguin, 1972). The decline in the share of the very richest wealth-holders, which is almost wholly balanced by an increase in those only slightly lower down, can be explained in part by the reordering of the affairs of the wealthiest families to avoid capital taxation (see chapter 3).

What is also important about these figures, is the suggestion that while the share of the top 1 per cent had been falling it had been doing so at a slower rate than earlier inconsistent long run series had suggested. "Overall, allowing for once-for-all jumps in the figures, the share of the top 1 per cent has, on average, been falling at a rate of 4 percentage points per decade. This compares with a decline of about 7 percentage points a decade shown by the Royal Commission's figures." (A B Atkinson, "The wealthy and the wealth

tax", *New Society*, 9 February 1978). If the share of the top 1 per cent was still declining, it was doing so more slowly than had previously been supposed. But as Atkinson went on to say "a fall of 4 percentage points is still quite considerable." Can we predict a continuing decline in the share of the top wealth holders? More recent data suggests not. While the data summarised above suggest that the redistribution had virtually come to a halt by 1960, the latest figures in fact show that the distribution of wealth has become more unequal since the early 1970s.

wealth inequalities in the 1970s

The most recent figures are taken from a new set of wealth data produced by the Inland Revenue since 1971. This new series (like that of Atkinson and Harrison) overcomes many of the criticisms levelled at previous wealth data (especially by the Institute of Economic Affairs). Some commentators had speculated that more adequate data would show much less inequality in the distribution of wealth. The main criticism was the Inland Revenue's assumption, in the absence of adequate data, that half the population owned no wealth at all.

The new data produced by the Inland Revenue overcomes these problems and allows us to estimate the distribution of wealth among the total adult population in the United Kingdom. It was assumed that the new series would show a much more equal distribution of wealth than the previous series. It did not. Below, we compare one of the earlier series, which assumed that persons not covered in the Inland Revenue Statistics have no wealth (Series B) with the new data which includes both the wealth and the individuals missing from the statistics (Series C).

Because the Inland Revenue changed the geographical coverage of their wealth data in 1974, no direct comparison between the two sets of figures can be made. However, what is striking is

DISTRIBUTION OF WEALTH 1971*

shares in total personal wealth (%)	Old	New
	(B) series (GB)	(C) series (UK)
top 1 per cent	28.2	30.5
2 per cent	37.4	38.7
5 per cent	52.4	51.8
10 per cent	67.5	65.1
25 per cent	91.1	86.5
50 per cent	100.0	97.2
bottom 50 per cent	0	2.8

*Adult population (over 18).

Source: Inland Revenue Statistics 1979.

the lack of improvement in the share holding of the bottom half of the population. Because of the inadequacy of the data, the older Series has had to assume that half of the population owned no wealth at all. The new Series still suggests that the share of the least wealthy half of the population is negligible. Whatever changes there have been in the distribution of wealth over the past fifty years or more, it remains remarkably unequal.

The latest figures in the table below show that the inequality has increased in recent years. We now turn to look at the reasons for the persistent inequality in the distribution of wealth and the causes of its increasing inequality in recent years.

causes and explanations of the distribution of wealth

While some have argued that Britain's unequal distribution of wealth was merely a reflection of our inadequacy in measuring it, others have argued that an unequal

distribution of wealth is inevitable. It is, they argue, the result of our being born without assets and acquiring wealth with age, for example, through savings. "Quite obviously in the most egalitarian of societies one would not expect the new born babe and the man on the point of retirement to have identical savings, or even the 50 year old and the 60 year old, and there must therefore be a concentration of wealth in a minority of hands in any society one can conceive of. Where inheritance is not allowed, only the old can be rich" (*The Times*, September 1968 quoted in Atkinson, *Unequal Shares, op cit*). This "life cycle theory" of wealth ownership cannot be tested merely by analysing the distribution of wealth holdings by age, although this has often been done. Estimates of the distribution of wealth by age use data which, the Royal Commission have pointed out, distort the value of the wealth holdings of some age groups, particularly the young.

An alternative way of testing the life cycle theory is to estimate how much wealth people might be able to save out of their earnings during their lifetime. In their fifth report, the Royal Commission on the Distribution of Income and Wealth (RCDIW) compared estimates of that sort with the Inland Revenue's estimates of the actual distribution of wealth. These results, and those of two independent experts, are given in the table on page 6.

The results vary according to the assumptions made but they suggest that in 1974 accumulated savings out of earnings would lead us to expect the top one per

DISTRIBUTION OF PERSONAL WEALTH NEW SERIES (C)*

% of adult population	shares in personal wealth (%)				
	1971	1974	1975	1976	1977
most wealthy 1	30.5	22.5	23.5	23.7	24.0
2	38.7	29.6	30.5	31.5	32.2
5	51.8	43.1	43.8	46.1	46.4
10	65.1	57.5	58.0	61.4	61.1
25	86.5	83.6	83.3	84.2	83.9
50	97.2	92.9	93.3	95.4	95.0

*Adult population (over 18) UK

Source: Inland Revenue Statistics 1979.

DISTRIBUTION OF ACCUMULATED SAVINGS OUT OF EARNINGS FROM EMPLOYMENT AND THE DISTRIBUTION OF TOTAL WEALTH

	Distribution of Accumulated Savings			Actual
	(1)	(2)	(3)	Distribution
	Atkinson	Flemming	RCDIW	of Wealth
Top 1 per cent	3.0	5.5	6.9	(4) 22.5
Top 2-5 per cent	11.2	11.0	16.6	20.6
Top 6-10 per cent	12.9	na	14.7	14.4
Top 11-20 per cent	na	na	21.3	18.8
Bottom 80 per cent	na	na	40.5	23.7

Notes:

- (1) Atkinson—assumes realistic lifetime earnings with 4½% interest.
 - (2) Flemming—allows for different earnings streams.
 - (3) RCDIW—by age, sex and two social class groups, assumes compound interest of 4%.
 - (4) Inland Revenue (C) Series 1974.
- na not available.

Source: Royal Commission on the Distribution of Income and Wealth (RCDIW) Report No 5, 1977, and Report No 7, 1979.

cent to own between 3 per cent and 7 per cent of personal wealth. This compares with their actual share of 22.5 per cent. The majority of the wealth owned by the top wealth owners cannot, therefore, be explained from savings out of earnings. The same is true for the top 2-5 per cent of wealth owners. The savings models might explain holdings of between 11 per cent and 17 per cent for this group, compared to an estimated actual wealth holding of 21 per cent. The wealthiest 6-10 per cent are the one group who, according to the assumptions of the models, could have accumulated their wealth from earnings. But if the savings models were correct, then the wealthiest 11-20 per cent of wealth owners and the bottom 80 per cent, would both own more wealth than they do. The Royal Commission models suggest that the holding of the bottom 80 per cent would be almost double their estimated actual wealth holding of just under 24 per cent. Clearly, extreme inequalities of wealth cannot be explained by savings out of earnings.

inherited wealth

If the distribution of wealth cannot be totally explained from savings out of earnings, at least a part of wealth owner-

ship must be accounted for by transmitted or inherited wealth. The Royal Commission calculated the proportion of total wealth owned by different wealth groups that could be attributed to transmitted wealth—including entrepreneurial fortunes, financial windfalls and wealth from accumulated investment income derived from inheritances. The results, shown in the table below, suggest that while the majority of the wealth holding of the wealthiest can be accounted for by transmitted wealth, transmitted or inherited wealth is of no relevance to the least wealthy.

Other evidence has pointed to similar conclusions. Work by Professor Harbury

TRANSMITTED WEALTH AS A PROPORTION OF TOTAL PERSONAL WEALTH

	%
top 1 per cent	75
2-5 per cent	52
6-10 per cent	37
11-20 per cent	25
bottom 80 per cent	nil
overall	40

Source: Royal Commission on the Distribution of Income and Wealth, RCDIW, Report No. 5, 1977.

% ASSET COMPOSITION OF PERSONAL WEALTH BY RANGE OF NET WEALTH; 1976*

Asset/Liability	range of net wealth (lower limit)							total
	nil	£5,000	£10,000	£20,000	£50,000	£100,000	£200,000	
<i>physical assets:</i>								
dwellings	28.7	50.2	56.7	41.5	30.4	21.2	13.1	41.0
land	0.2	0.5	1.0	3.1	5.2	7.1	20.0	3.8
other buildings	0.2	0.4	0.8	1.3	2.2	2.6	1.3	1.1
household goods	7.3	4.5	3.5	3.3	3.3	3.7	4.5	4.0
trade assets	0.7	1.3	1.3	3.9	5.1	4.9	2.8	2.6
<i>financial assets:</i>								
listed ordinary shares (including unit trust)	1.1	0.9	1.5	5.8	15.3	21.7	21.8	6.9
other company securities	0.4	0.2	0.6	2.4	8.1	11.8	14.3	3.6
life policies	26.9	20.4	17.6	15.7	7.2	4.3	2.7	15.1
building society deposits	11.7	9.2	9.0	11.5	8.2	4.8	1.2	8.9
listed UK government securities	1.2	0.5	0.4	1.5	2.7	4.4	6.4	1.8
cash and bank deposits	12.0	6.1	4.9	5.9	7.9	10.0	8.5	6.9
national savings	10.3	5.0	3.7	2.7	1.5	0.8	0.3	3.5
other financial assets	21.3	14.4	9.1	9.8	8.4	8.2	8.6	10.9
<i>liabilities:</i>								
personal debts	-8.7	-3.2	-2.5	-3.6	-3.8	-4.7	-4.9	-3.9
property debts	-13.3	-10.4	-7.6	-4.8	-1.7	-0.8	-0.6	-6.2
<i>net wealth</i>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*This table relates only to the population and types of wealth covered by the unadjusted estate multiplier estimates, that is all those individuals whose estates would require probate, or be liable to Capital Transfer Tax (formerly estate duty) in the event of their death.

Source: Royal Commission on the Distribution of Income and Wealth, Report No 7.

matching the estates of the wealthiest in 1956-57 and in 1965 with the estates of the previous generation showed a strong correlation between the wealth of sons and the size of the estates of their fathers. His results proved similar to those of Wedgwood some thirty years earlier (1924-26). Professor Harbury's

work led him to the conclusion that "on the evidence available, the role of inheritance in influencing the distribution of wealth at the top end of the scale is substantial and there has been no marked change in the pattern of inheritance, at least up to the mid-1960s" (RCDIW, Report No 7, *op cit.*)

DISTRIBUTION OF THE TOTAL VALUE OF HOLDINGS OF INDIVIDUAL ASSETS BY RANGE OF NET WEALTH 1976.

proportioned total value of each assets owned by those of net wealth of

	£50,000	£100,000	£200,000
<i>physical assets:</i>			
dwellings	13.7	5.9	2.5
other buildings	46.1	24.3	9.0
land	69.8	54.5	42.1
household goods	23.9	15.0	8.9
trade assets	41.4	20.4	8.3
<i>financial assets:</i>			
listed ordinary shares	70.2	45.8	25.0
other company securities	76.9	52.4	31.0
life policies	8.5	3.3	1.4
building society	14.7	4.6	1.1
UK govt securities	62.0	44.9	28.7
cash and bank deposits	32.0	19.4	9.8
national savings	7.0	2.3	0.7
other financial assets	19.4	11.0	6.2
<i>total net wealth</i>	<i>25.4</i>	<i>14.5</i>	<i>7.9</i>

Note: 2.5% of wealth holders own £50,000; 0.7% own £100,000; 0.2% own £200,000.

Source: RCDIW, Report No 7, *op cit*.

Further work by the RCDIW supported this conclusion for later years. A study of estates in England and Wales in 1973 showed that in general the largest proportion of estates were left to relatives and that this share increased the smaller the estates. The Commission's conclusion from this study supports the earlier conclusion by Atkinson about changes in the distribution of wealth. "The fragmentation of large wealth holdings at death reduces the share of the top 1 per cent, but to the benefit of the groups immediately below as a number of beneficiaries each receives a sizeable bequest . . ." (RCDIW, Report No 7). At the same time, the concentration at the top is reinforced through marriage. From a study of women, wealth and inheritance (1973) Harbury concluded that marriage had the effect of increasing rather than diminishing concentration at the top of the wealth distribution and suggested that inheritance will continue to play an important role in shaping the distribution of wealth (*ibid*).

of wealth. Another influence on the distribution is the way in which wealth is held. In recent years it has become clear that the assets which people hold, the proportions in which they are held, who they are held by and how their relative values change are crucial determinants of the distribution of wealth. There have been changes in the proportion of total wealth accounted for by different types of assets. The greatest changes have been in shares and home ownership. Shares were a much smaller proportion of total wealth by 1976 than they had been in 1960, although they showed some recovery towards the end of the period. The most dramatic change was in the increase in the proportion of personal wealth accounted for by dwellings (while mortgage liability remained fairly steady). How these changes in the asset composition of wealth affect the distribution depends not only on the quantity of each asset owned but on their relative prices and their distribution among wealth owners.

the importance of assets

Inheritance is one, if not the major cause, of the inequality in the distribution

who owns what ?

The table on page 7 shows how the assets people own vary depending on the

amount of wealth accrued. For those with the smallest wealth holdings, dwellings were by far the most important form of physical assets, while the main forms of financial assets were life policies, cash and bank deposits and building society deposits as well as national savings. The holdings of stocks, shares and land by the groups are minimal. At the other end of the wealth scale, for those with over £100,000, stocks and shares are the most important component of their wealth accounting for over a third. Land and dwellings together account for another third. Cash and bank deposits, building society deposits, household goods, life policies and national savings are of little interest to the very wealthy.

While dwellings formed a considerable proportion of the wealth of both the least wealthy and the wealthiest, they are of greatest importance to those in the middle of the wealth range. For those with between £5,000 and £20,000 housing accounts for at least a half of their total wealth with the proportion declining for both the more wealthy and the less wealthy.

Different groups hold their wealth in very different forms, and we should be aware that, when we talk of "wealth" we are referring to a wide range of assets. The houses, bank deposits and national savings which form the bulk of the wealth of the less prosperous are matched by the land, stocks and shares and government securities held by the most wealthy. In the table below we show the distribution of these different forms of assets between different groups. The data is only available, as in the table above, for wealth-holders (excluding half the adult population who, according to the Inland Revenue statistics, have no wealth at all).

The concentration of wealth holdings which we have already documented is greater still when we consider particular assets. Only 2.5 per cent of wealth holders (just over one per cent of the adult population) owned wealth with a net value of £50,000 or more. This group owned over a quarter of all personal wealth (25.4 per cent). But this average disguises wide

variations between different types of assets. This same group owned almost half the buildings (other than dwellings). They owned almost 70 per cent of the land, and approaching three quarters of the listed ordinary shares (including unit trusts) and other company securities. They also owned almost two thirds of the listed UK government securities and a third of all cash and bank deposits. The concentration is more remarkable still if we consider ownership by those whose assets (minus liabilities) are worth more than £200,000. Only a fifth of one per cent of wealth holders (perhaps one in a thousand of the adult population) found themselves amongst this tiny elite. But this small number of people held no less than 42 per cent of all personal wealth holdings in the form of land, a quarter of the ordinary shares, and a third of other company securities and listed UK government securities. This group even held a tenth of the cash and bank deposits.

Some forms of wealth are heavily concentrated in the hands of the few. But others are more evenly distributed than the overall distribution figures would suggest. The important factor is that the concentration is greatest in those forms of wealth which confer social and political, as well as economic, power. The greatest dispersion of wealth appears to have been in those forms which allow for greater consumption and improved living standards without the additional attributes of power and influence. The differential ownership of different types of assets also has an effect on changes in the distribution of wealth in addition to the effects of quantity and price changes, which we consider as the final part of this section.

changes in asset prices and quantity

Housing. While housing is the largest part of the wealth holdings of those in the middle wealth ranges, the largest wealthholders are of course most likely to own their own houses while those at the bottom are least likely to do so. Only 6 per cent of those owning wealth with

a total value of less than £1,000 own their own house compared with nearly 90 per cent of those with more than £50,000. Moreover, the value of houses increases as total wealth increases.

But it is in the middle wealth ranges that home ownership has had the greatest impact in the last fifteen years and it is this change that has had some equalising effect on the distribution of wealth. Since 1961, the number of owner occupied homes has increased by nearly half from 6.9 million to 10.9 million, increasing as a proportion of all dwellings from just over 42 per cent to just under 54 per cent. And as the amount of owner occupied housing has increased so has its price. Between 1960 and 1976 there was an almost six fold increase in the price of housing, with a large part of the rise occurring between 1971 and 1973. No other asset has increased by such a substantial amount. Not surprisingly, the proportion of wealth owners owning their own homes has risen from just under 26 per cent in 1960 to 48 per cent in 1977 and the value of dwellings as a proportion of all personal wealth has doubled from 17.7 per cent in 1960 to 35.5 per cent in 1976. These changes combined are thought to have reduced the share of wealth of the top one per cent by about 6 percentage points between 1960 and 1972, (RCDIW, Report No 7, *op cit*).

Stocks and Shares. Although stocks and shares only form a small proportion of all personal wealth (about 10.5 per cent in 1976) changes in their relative price and quantity effects the overall distribution of wealth because of their concentration among the very wealthiest. The top 1 per cent of wealth owners own 17 per cent of all personal wealth but more than 54 per cent of all company securities. The top 5 per cent, more than 80 per cent.

Since 1960, changes in share prices have had a considerable effect on the distribution of wealth. While for the greater part of the period, share prices generally rose in line with the Retail Price Index reaching a peak in 1972, they fell sharply up to 1974. Since that time they have been increasing once more. The distribution of

wealth has reflected these changes. The changes are most clearly seen in the table on page 5. For example, between 1971 and 1974, the share of the top 1 per cent of the population fell from 30.5 per cent to 22.5 per cent, but it has since recovered to 24 per cent in 1977.

Land. Like stocks and shares, land forms only a small proportion of total personal wealth but its ownership is highly concentrated. In 1976, land accounted for only about 5 per cent of all personal wealth although its value is known to be considerably understated because of technical problems of valuation. The top 5 per cent of wealth owners own almost three quarters of all personally held land, just less than the proportion of all personally owned stocks and shares at 80 per cent. But, unlike stocks and shares, land has held its value since 1960 increasing faster than the RPI between 1960 and 1972 and rising steeply between 1972 and 1977.

changes in the distribution of wealth 1960 to 1977

As we have seen from the table on page 3, there has been very little redistribution since the early nineteen sixties. The main factors accounting for the change that did occur in the distribution since 1960 have been the fall and then the increase in the value of stocks and shares and the increase in both the value and ownership of owner occupied housing. The changing fortunes of the stock market were reflected in a declining, and now increasing, share of wealth of the top wealth holders. The increased amount of owner occupied housing and its rising value has increased the wealth holding of the middle range of wealthier holders. An additional factor, particularly at the beginning of the period, was the increased holding of cash assets—mostly savings including national savings, Building Society deposits and life assurance policies. Since these assets are of most importance to those at the bottom of the wealth distribution, an increase in the holdings of these assets may have had some equalising effect.

But the equalising effects of changes in

the distribution of wealth during this period are neither irrevocable nor dramatic. Share prices have increased since 1974 and the share of the top 50 per cent has climbed steadily. The continuing upward trend in home ownership and the value of dwellings has continued to increase the share of middle wealth owners. The share of the bottom 50 per cent has been declining since 1974 and, as important, we do not know how badly those at the very bottom have fared compared to those nearer the middle. While savings—the cash assets—have been increasing over the last few years in an assumed response to inflation and the fear of unemployment, the return on such savings is considerably less than on other assets.

Although there have been exceptional periods, it is generally true that the most wealthy are well placed to put their savings and inheritance into those assets which provide the best hedge against inflation. They tend to be the assets that come in large, expensive and indivisible lots, require specialised knowledge and for which purchase may require hefty fees. They are shares, antiques, housing and land. Housing is the only one of these assets which is important to the "middling rich" as well as the very rich. Unfortunately even that requires the sort of secure and settled future which many manual and lower grade clerical workers do not enjoy. For those who have neither large lump sums nor sufficient credit standing, savings and investment are in the form of bank and building society deposits, and life assurance policies. In general they have proved less lucrative forms of savings. Nor do such forms of wealth confer the economic and political power associated with land, stocks or shares.

The conclusion must be that wealth shares are highly sensitive to short term changes in asset prices. Since 1960 there have been periods in which the price of assets most important either to the richest or poorest wealth holders has changed rapidly. A fall in share prices that brings about a decline in the value of the top wealth holdings cannot, however, be

treated as a redistribution in any real sense. The poor certainly gain nothing even if the rich lose. Moreover, these short term changes, together with the longer term increase in home ownership have done little to alter the concentration of wealth as a whole. Power conferring assets remain highly concentrated in the hands of the few, while even increased owner occupation has been of benefit only to those in the top half of the distribution.

3. wealth taxes in Britain

We have seen that extreme inequalities in the distribution of wealth persisted in the Britain of the late 1970s. This means more than wide disparities in the living standards or consumption possibilities of different social groups. The ownership of wealth confers prestige, status and influence over and above the income it provides—the ability to influence not only one's own life, but that of others. Indeed, the greatest concentrations persist in those forms of wealth—land, government securities and company shareholdings—whose ownership carries with it social and political, as well as economic, power.

why tax wealth at all?

One of the most important instruments available to a government committed to a reduction of such inequalities is the tax system. Before considering how wealth is taxed in Britain, we need to ask why wealth should be taxed at all. For those concerned with the extreme inequalities in wealth holding described in the first section this question may seem redundant. But a clear understanding of the reasons for capital (or wealth) taxation is essential if we are to make an assessment of the current tax system in this respect. It is even more essential if we are to make a judgement about the type of wealth taxation we would like to see.

tackling inequalities

First let us examine capital taxes as a means of reducing inequalities in the distribution of wealth. This objective has clearly played an important part in the Labour Party's approach to capital taxation, as witnessed in Denis Healey's foreword to the Wealth Tax Green Paper published in August 1974: "The Government is committed to use the taxation system to promote greater social and economic equality. This requires a redistribution of wealth as well as income. Thoroughgoing reforms are needed in the taxation of capital" (Cmnd 5704, HMSO).

The tax system can be used in a number of ways to bring about a fairer distribution of wealth. First there is the income

tax system itself. Income and wealth inequalities tend to go hand in hand (although the connection is far from perfect). Those with large holdings of capital are usually able to derive an, at least comfortable, income from it in the form of rents, dividends, interest or capital gains. At the same time, high income earners have the opportunity to accumulate property through their savings. The income tax system might reduce inequalities in wealth by slowing down this process of accumulation and by reducing the net income derived from wealth.

But if governments are really serious about breaking down the concentration of wealth and power in the hands of the few, the income tax system will not take them very far. As noted in the previous section, the heaviest concentration of wealth can be attributed not to accumulations out of savings, but to inheritance. Moreover, many of the top wealth-holders are in forms that yield relatively little income in a taxable form (largely, no doubt, in order to avoid the ravages of the income tax system).

If wealth inequalities spring primarily from inheritance, it follows that a tax on gifts or bequests is likely to be more successful than a tax on the income derived from such wealth. But such an approach demands a patience which many may feel unjustified given existing wealth inequalities. The achievement of equality may take several generations even with an effective inheritance tax.

Such inadequacies have led many within the Labour movement to advocate the use of an annual wealth tax as a means of redistributing wealth from rich to poor as an immediate objective. We will return to consider whether such a tax could be expected to achieve its redistributive objective in the following section.

fairness in taxation

The Conservative Party has expressed the belief that: "The main pressure for heavy capital taxes has always been accompanied by a disproportionate increase in the contribution of wage and

tical—in part mere egalitarian envy, in part a mistaken belief that some significant redistribution of wealth could thus be achieved to the advantage of the poor” (A Maude (Ed), *The Right Approach to the Economy*, Conservative Central Office, 1976).

But the arguments for taxing wealth go beyond those of equality. Indeed, the capital taxes that exist both here and in other advanced industrial countries, have little to do with equality. Most are more concerned with “equity” within the tax system. A basic principle of the British income tax system is that investment income should be taxed more heavily than earned income. Many conservatives regard this as yet another example of egalitarianism. Yet as the influential (and hardly leftist) Meade Committee on tax reform explained “Capital produces an income which, unlike earning capacity, does not decline with age and is not gained at the expense of leisure” (J. E. Meade (chairman), *The Structure and Reform of Direct Taxation*, Institute for Fiscal Studies/George Allen and Unwin, 1977). As a result, many countries (including the UK) apply a surcharge to investment income or allow special relief to earned incomes; others discriminate against investment income through the use of an annual wealth tax.

The logic does not end at taxing unearned income more heavily. As we have noted, much wealth yields no income at all in a readily taxable form. It by no means follows that the “taxable capacity” of such wealth holders is zero. An employee with earnings of £10,000 whose great aunt has left him a Rembrandt (or even a Lowry) is clearly better off than his colleague who earns the same but only has wallpaper on his walls. Yet under an income tax system they both pay the same amount of tax.

This argument for taxing wealth is often dismissed by those on the left as an intricacy of the tax system which is of interest only to tax economists and accountants. For instance, Jeremy Bray, in his draft report on the wealth tax for the Select Committee, considered this

aspect of the problem under the heading “Equity among the rich”. But this is to overlook the important linkages between the workings of the tax system and inequality. The Green Paper on the Wealth Tax made this clear: “The ownership of wealth, whether it produces income or not, adds to the economic resources of a taxpayer so that a person who has wealth as well as income of a given size necessarily has a greater taxable capacity than one who only has income of that size. Because our tax system takes no account of this fact, although we have a highly progressive system of income tax (sic), the bulk of privately owned wealth is still concentrated in relatively few hands” (*Wealth Tax*, Foreword by the Chancellor of the Exchequer, *ibid*). Hence, if wealth is not subject to taxation it becomes a vehicle for circumventing the income tax system. Moreover, since wealth confers benefits over and above the income yielded, it should be subjected not only to tax in the same way as income, but to a heavier burden of taxation.

economic efficiency

Many of the arguments against taxing wealth are couched in terms of the “economic costs” of doing so. While there are important economic effects of certain types of wealth taxation (though not always clear cut) yet it is difficult to see how such arguments can be used to justify taxing wealth, or the income derived from it, less heavily than income from employment. Indeed, since wealth taxes are related to past rather than present effort, the disincentive effect may be less than with an income of the same yield.

For some the desire to accumulate savings—for a spending spree, retirement or to pass on to their heirs—may be a driving force to work harder. On the other hand, the knowledge that these ends can be achieved with more ease (in the absence of wealth taxation) may cause widespread laurel-resting. Two things are clear. First that the postwar period has seen a decline in the contribution of wealth holders to the total tax burden

salary earnings. If we are worried about incentives, we had better shift the burden back again—quickly. Second, we know that some of the largest property holdings are not accumulated because of the monetary return they yield, but because of the other advantages conferred by wealth. To that extent the taxation of wealth is unlikely to discourage accumulation. We may add that it is even less likely to discourage inheritance!

how is wealth taxed?

The present Conservative administration has committed itself to reductions in capital taxation. In this section we consider the way in which capital or wealth is now taxed in Britain. We also consider what has happened to the burden of capital taxes as a whole in recent years.

Wealth can be taxed in a number of ways: on its income, its capital value (annually or on transfer) or on any increase in its value. The British capital tax system is an amalgam of these three approaches: the investment income surcharge, the capital transfer tax and the capital gains tax are usually considered to be the three principal wealth taxes, and it is these three on which we concentrate here. Local authority rates and stamp duties might also be included within the definition. But the first is usually treated in official accounting exercises more as a form of (highly regressive) local income tax or an expenditure tax on housing consumption, while the second are applied to a variety of property transactions and—although important in revenue terms—cannot be treated as “part of the fabric of the system of capital taxation.” (C T Sandford, *Taxing Personal Wealth*, George Allen and Unwin, 1971).

We note that the Conservative Party include Stamp Duties in their list of capital taxes (although they include no proposals for their reform) (*The Right Approach to the Economy*, *op cit*). As we show, their inclusion makes little difference to our conclusions about the burden of capital taxation. The Party also consider the Development Land Tax as a form of tax on capital and propose to reduce its

impact. Since it raised only £13 million in 1978/79 out of a total direct tax revenue of £24,000 million, there seems little that the Government can do to make it less effective. Again its inclusion would not change our conclusions.

taxing wealth transfers— voluntary taxation

The main form of wealth tax in Britain, death duties, are related to the actual value of wealth. In that sense they are more akin to an annual wealth tax, but instead of being assessed each year they are levied only when wealth changes hands. Estate Duty, replaced in 1974 by the Capital Transfer Tax, was payable on the value of property changing hands at death.

Such taxes have a long history. The Estate Duty was introduced by Harcourt in 1894 and remained substantially unchanged until it was converted into Capital Transfer Tax 80 years later. Harcourt's budget was framed against a background of “the entirely novel idea that taxation might not only supply the wants of the State but actually become a means to redress social inequalities”. In his view, the guiding principle of taxation is that liability should be imposed where it shall be the least heavily felt”, a principle which led him to introduce the tax subject to a progressive scale of rates (B E V Sabine “Influences on the Development of Direct Taxation in Britain”, in T D Lynch (ed), *Direct Taxation in the United Kingdom*, Institute of Chartered Accountants of Scotland, 1968). The Government were warned that the new tax would lead to large scale evasion (a prediction which proved correct) and that it would bring about the demise of English landlords and the virtual extinction of English farming (on which the critics were wrong) (C T Sandford, *Taxing Personal Wealth*, *op cit*).

Harcourt's progressive tax was set at 1 per cent on estates between £100 and £500 rising to 8 per cent on those valued at over £1 million, rates which one MP described as sufficient to “throw into shade everything that had ever been done in the way of highway robbery” (quoted in

A B Atkinson, *Unequal Shares, op cit.* Nevertheless, the top rate was raised to 20 per cent by Lloyd George in 1912, to 40 per cent by Chamberlain and to 50 per cent by Snowden in 1930. The post-war period saw an even greater degree of progression in the rates. Both Dalton (1946) and Stafford Cripps (in 1949) saw death duties as a means of reducing wealth inequalities, and they raised the top rates to 75 per cent and 80 per cent respectively (Sandford, *ibid*, A B Atkinson, *Unequal Shares, op cit.*)

Over its 80 year life, the top marginal rate of Estate Duty was therefore subject to a ten fold increase. With such dramatic increases in the rates we may have expected a powerful redistributive effect of the tax. But if we return again to chapter 2 we are reminded that over recent years the decline in shares of wealth at the highest levels was modest, and was to some extent offset by an increasing share of those who were only slightly less rich. As Atkinson has argued, this may reflect not so much a redistribution of wealth in any true sense, but rather a reordering of the affairs of the wealthiest families, passing on their wealth earlier to avoid Estate Duty—

“the redistribution has been very much a “family affair” (*ibid.*)

The failure of Estate Duty to redistribute wealth, despite the dramatic increase in its nominal rates, is reflected in a somewhat surprising decline in the revenue raised by the tax. The table below shows the contribution of Estate Duty (plus Capital Transfer Tax after 1975/76) as it has changed over the past 70 years.

In the year following their introduction (in 1895/96), death duties raised an impressive £14 million, equivalent to over a third (35 per cent) of all Inland Revenue taxes. By 1908, they raised £18 million, although this now represented only 20 per cent of Inland Revenue receipts. With the very substantial rise in income tax during the First World War, the relative contribution of death duties again fell. Nevertheless, they remained a powerful source of revenue: “In their hey-day as a revenue-yielder, just before the First World War, the death duties were contributing over 16 per cent of central government revenue from taxation. In those years, they played an important part in financing the beginnings of the welfare state” (C. T. Sandford, J. R. M. Willis and D. J. Ironside, *An Accessions Tax*,

REVENUE FROM ESTATE DUTY/CAPITAL TRANSFER TAX, 1908-1978

	Income Tax and Surtax (£m)	Estate Duty/CTR (£m)	Total Inland Revenue Receipts (£m)	Estate Duty revenue as % of total (%)
1908/09	34	18	96	18.8
1918/19	294	31	624	5.0
1928/29	293	81	407	19.9
1938/39	399	77	521	14.8
1948/49	1460	178	2055	8.7
1958/59	2484	187	3012	6.2
1968/69	4574	382	6546	5.8
1969/70	5162	365	7492	4.9
1970/71	5978	357	8180	4.4
1971/72	6780	451	9110	5.0
1972/73	6818	459	9248	5.0
1973/74	7444	412	10634	3.9
1974/75	10457	339	14236	2.4
1975/76	15150	330	18143	1.8
1976/77	17076	383	20711	1.8
1977/78	17450	398	21914	1.8
1978/79	18784	369	24075	1.5

Source: Inland Revenue Statistics 1974, HMSO, 1979.

Institute for Fiscal Studies, September 1973). Estate Duty maintained its contributions at around this level until the eve of the Second World War, at which time it still yielded £1 for every £5 raised in income tax. The real decline came in the post-war period. Despite the substantial increases in the rates of duty imposed by Dalton and Cripps, Estate Duty raised only 9 per cent of Inland Revenue receipts in 1948/49 and only 6 per cent ten years later. By the time of its replacement with Capital Transfer Tax in 1974, Estate Duty contributed only 2.4 per cent of all receipts.

Given that the nominal rates of tax were subjected to very substantial increases over this period, which might have been exacerbated by the effects of inflation and rising property prices, this steady decline in revenue requires some explanation. One such explanation might be that the top wealth holdings had declined substantially in value. But in 1927, when the top nominal rate stood at about 30 per cent, death duties represented just 0.42 per cent of all personal wealth holdings (Atkinson, *op cit*). By 1976 our own calculations suggest that Estate Duty and Capital Transfer Tax together contributed only 0.2 per cent of total personal wealth. The impact of the duty in either period on the distribution of wealth can hardly have been dramatic.

a voluntary tax

A more plausible explanation is that Estate Duty over the years had increasingly become a "voluntary tax" paid only by eccentrics and "by those who dislike the Revenue less than they dislike their heirs" (quoted in Sandford, *Taxing Personal Wealth, op cit*). The tax gained itself this reputation through the ease with which it could be avoided, principally through life-time gifts, the setting up of trusts or investment in assets which were wholly or partially exempt from the tax. The principal way of avoiding the duty was to pass on the wealth before "passing on" oneself, since the tax was applied only to property changing hands on the death of the owner. In an attempt to

tighten this loophole the length of time allowed before death in which gifts could be made tax-free was increased from 3 months to 7 years over the life-time of the tax. But as Kay and King have remarked, "the healthy, wealthy and well-advised" were well able to order their affairs in such a way as to avoid the duty completely (J. A. Kay and M. A. King, *The British Tax System*, Oxford University Press, 1977).

An alternative, for those finding the prospect of prematurely giving away their wealth altogether too harsh, was to set up a trust which was wholly or partially exempt from tax. By the late 1960s, it was estimated, 95 per cent of all discretionary and accumulation trusts had been created solely as tax-saving devices. Finally, there was the option of converting wealth into exempt or partially exempt forms such as agriculture or forestry, private businesses or works of art. As Kay and King have warned, the result of such concessions to agriculture and woodlands have had the somewhat perverse effect of making life more difficult for the working farmer. The concessions turned farms into highly desirable forms of wealth-holding, forcing up the price of agricultural land and making it still more difficult for small farmers to set up or stay in business (Kay and King, *op cit*).

These various loopholes in the Estate Duty legislation ensured that the tax was easily avoided. Atkinson estimated that by 1966, life-time gifts and discretionary trusts alone accounted for £160 million in lost revenue from estate duty. This represented more than half the total amount of revenue raised by the duty in that year. An indication of the wider spectrum of avoidance is given by the relationship between the yield of estate duties and the rates in force. Given the very substantial increase in rates over this century, and in the absence of any substantial decline in the wealth holding of the top groups, we would have expected a very much larger revenue than actually exists. A large part of the shortfall may be attributed to avoidance. Atkinson has used this reasoning to estimate the overall level

of avoidance: "We can estimate that had the 1966 rates of duty been in force in 1911 (with the exemption level and the tax brackets the same percentage of average wealth) the revenue payable would have been 1.5 per cent of total personal wealth. This is nearly four times the actual percentage collected in 1966, and would have implied a revenue in 1966 of some £1,200 million rather than the actual revenue of £300 million" (Atkinson, *Unequal Shares, op cit*). Using the same approach (and assuming that the revenue payable maintained the same relationship to total personal wealth) we can estimate that in 1977/78 the expected revenue would have been over £3,000 million. The actual revenue from estate duty in 1974/75 was £398 million—one eighth as much as these calculations would predict.

We should note at this point that revenue and the ability of a tax to reduce wealth inequalities need not exactly coincide. There is one type of avoidance about which socialists should not be unduly concerned. Suppose, for instance, that a tax actually encouraged wealth holders to give their property away to a number of individuals in order to minimise the tax paid on the transfer. Revenue would be reduced but redistribution would nevertheless take place. The process would bypass the government sector, and may therefore be more haphazard, but inequality would nonetheless be reduced.

Unfortunately the Estate Duty, and its successor, the Capital Transfer Tax, contain no such incentive for the dispersion of wealth holdings. The tax is assessed on the person who gives it away (or on his estate) regardless of the way in which the estate is subsequently distributed. Whether the estate is split into a hundred parts, or whether it is passed on in one lump, the tax payable is the same. This point was not lost on Parliamentarians when Harcourt's new Estate Duty was introduced: "I understand the advantage of taxing a man at an increased ratio in proportion to his wealth: I do not understand the advantage of taxing a man exceptionally, not according to his own wealth, but according to his father's wealth", puzzled

Balfour. He advised the Government to "graduate property in proportion to the amount enjoyed, and not in proportion to the amount left by those who can no longer enjoy it" (quoted in C. T. Sandford, *Taxing Personal Wealth, op cit*, see also A. B. Atkinson, *Unequal Shares, op cit*).

The use of an estate duty of this type, as opposed to an inheritance tax assessed on the wealth of the recipient, is particularly inequitable. In many cases the tax is in effect *paid* by the recipient, even though it is *assessed* on the donor's circumstances (unless the donor is so determined to pass on a given amount that he "grosses up" the amount left to take account of the tax). So the owner of a supermarket chain who inherits a million will be subject to the same tax, in effect, as would be paid by one of his shop-workers inheriting the same amount.

Despite these drawbacks, measured against the yardsticks of both equity and equality, it was not an inheritance tax with which the Labour Government replaced Estate Duty in 1974 but another donor-based tax—the Capital Transfer Tax (CTT). Nevertheless, a major improvement of CTT over the old Estate Duty was that it attempted to close the loophole of life-time gifts. As the White Paper announcing the tax explained "the new tax on capital transfer would apply, subject to certain exemptions for small amounts, to all transmissions of wealth, whether made by gift during a person's life-time or by way of property passing on his death . . . the charge would be at progressive rates charged on the cumulative total of gifts made during a person's life-time with the further final cumulation of property passing on his death" (Capital Transfer Tax, Cmnd 5705, HMSO August 1974).

The new tax should have been a powerful revenue raiser and might have been expected to have more effect than estate duty on wealth inequalities. But what the Government taketh away, the Government (in this case) giveth. Loopholes were replaced with generous exemptions and lower rates than Estate Duty. One of the most important effects of the change

must have been to reduce the costs of accountants' fees to the wealthy. Taking first the change in the rates, an estate valued at under £15,000 was still exempt. But that valued at between £15,000 and £20,000 was subject to a rate of 10 per cent instead of 25 per cent under Estate Duty; an estate worth £40,000 to £50,000 was subject to a rate of 30 per cent instead of 40 per cent; and the top rate of 75 per cent which was payable under Estate Duty on estates worth over $\frac{1}{2}$ million was now only payable on those over £2 million. These were the rates when the tax was introduced. The current rates of CTR, on life-time transfers made at death, are set out below.

Although gifts were now included in the tax base the rate of tax chargeable on gifts of less than £100,000 are only half the rates payable on death (provided the property passed hands at least three years before death). Transfers (whether by gift or inheritance) between husband and wife are exempt from tax altogether. This was a major concession in comparison to Estate Duty, to which the Royal Commission on the Distribution of Income and Wealth attributed "the recent decline in the annual yield of capital transfer tax" (RCDIW, *Report No 8, CMND 7679, HMSO, 1979*). The exemption level at

RATES OF CAPITAL TRANSFER TAX FROM OCTOBER 1977

value of transfer (£)	transfers at death	lifetime transfer
0-25	0	0
25-30	10	5
30-35	15	7.5
35-40	20	10
40-50	25	12.5
50-60	30	15
60-70	35	17.5
70-90	40	20
90-110	45	22.5
110-130	50	27.5
130-160	55	35
160-510	60	42.5-60
510-1010	65	65
1010-2010	70	70
over 2010	75	75

Source: Inland Revenue Statistics 1979.

£25,000 is considerably higher in real terms than in 1894 and in effect is higher still when viewed over the life-time. An individual can give away £2,000 tax free, a married couple £4,000 each year. "Over a 10 year period a couple could pass on more than £100,000 without paying a penny in tax." In addition gifts of up to £5,000 "in consideration of marriage" are exempt (Kay and King, *The British Tax System, op cit*).

The effects of these various concessions, but still excluding the impact of the favourable treatment of life-time gifts, are shown in the table below. The table shows the nominal rates of tax payable on estates of differing size passing at death. It is these rates to which most people refer when considering the harshness of capital transfer tax. But the table also shows the effective rates actually paid on estates of this size, and that is a rather different story.

The effective rates of tax are hardly "confiscatory". No tax is payable on estates of less than £25,000. An estate of this value is subject to tax at a nominal rate of 10 per cent (20 per cent before October, 1977) but the actual tax paid on estates of this size is less than half that amount. Even estates of £100,000 with a nominal tax rate of 45 per cent (and 50 per cent before October 1977) only paid tax equivalent to one quarter their value. Only estates worth over £2 million paid tax equal to half their value, even though the top nominal rate on such estates was 75 per cent.

Special additional concessions are provided for certain business assets. These concessions can be formidable. The Royal Commission on the Distribution of Income and Wealth has calculated that business relief reduce the effective rate of tax on an estate by almost three quarters. (RCDIW *Report No 8, Cmnd 7679, HMSO, October, 1979*).

We have seen that, as a result of these substantial concessions, Capital Transfer Tax raised even less revenue than Estate Duty—the voluntary tax. In the table below we show the amounts of revenue raised in Estate Duty in 1974/75 and in

NOMINAL AND EFFECTIVE RATES OF CAPITAL TRANSFER TAX ON ESTATES PASSING AT DEATH, 1977/78.

value of estate (£)	nominal rate of tax paid (%)		effective rate of tax paid (%) 1977-78
	before Oct 1977	after Oct 1977	
25,000	20	10	4.5
50,000	35	30	14.8
100,000	50	45	25.7
150,000	60	55	29.9
200,000	60	60	34.4
500,000	65	60	41.8
1,000,000	70	65	46.1
2,000,000	75	70-75	53.4

Source: Inland Revenue Statistics 1979, HMSO, 1979.

Estate Duty plus CTT in each of the three following years. These are expressed as a proportion of all Inland Revenue Taxes and as a proportion of estimated total personal net wealth.

The real value of estate duty/CTT revenue fell substantially over the period. The contribution of capital transfer taxes to total revenue was less than 2 per cent in 1977/78 (compared with 35 per cent in 1895/96!) At the same time the revenue accounted for less than a fifth of one per cent of estimated total personal wealth. The ability of the tax to redistribute wealth can hardly have been significant.

taxing the income from wealth

Many of our European neighbours have annual wealth taxes dating back to the first World War. Britain, meanwhile,

attempted to achieve the same effect by introducing a heavier tax on property incomes. (C T Sandford, J R M Willis and D J Ironside, *An Annual Wealth Tax*, Heinemann Educational Books, Institute for Fiscal Studies, 1975). Until 1973 this differentiation between earned and investment income was achieved by providing an earned income relief, superseded by a special surcharge on investment incomes thereafter. The current level of the investment income surcharge is an addition of 15 per cent to the tax rates applied to earned incomes. While the maximum rate of tax on earned incomes is therefore 60p in the £, that on unearned income is 75p. As we noted above, the rationale for such discrimination against investment incomes is that they are subject less to the uncertainties of age and health than are earned incomes, and they received without the sacrifice of leisure. Moreover, there are

REVENUE RAISED BY ESTATE DUTY AND CTT AS A PROPORTION OF ALL INLAND REVENUE RECEIPTS AND TOTAL NET PERSONAL WEALTH UK, 1974/75 to 1977/78

	revenue from Estate Duty and CTT £ million	total net personal wealth* £ million	revenue as proportion of all Inland Revenue taxes	total personal wealth %
1974/75	339	159,911	2.4	0.21
1975/76	330	190,290	1.8	0.17
1976/77	383	203,821	1.8	0.19
1977/78	398	209,772	1.8	0.19

*Estimates based on personal sector balance sheets. These figures apply to calendar years and may overstate the revenue as a proportion of wealth.

Source: Inland Revenue Statistics 1979.

certain costs associated with employment incomes, such as travel to work.

Unfortunately, the investment income surcharge is not very effective as a means of differentiating in favour of earned incomes. While the rate of surcharge is 15 per cent, this applies only to investment incomes in excess of £5,000 a year. These rates apply only to taxable income, after deduction of tax-free personal allowances and a motley collection of other reliefs. Although the numbers subject to the surcharge increased substantially in the first four years after its introduction, the high-water mark was reached in 1976/77—the year that will perhaps go down in history as the turning point in the Labour government's attack on inequality. Subsequently the numbers fell until they reached an estimated 300,000 people in 1979/80—almost a third the number subject to the surcharge four years earlier (Board of Inland Revenue, *Inland Revenue Statistics*, HMSO, 1979).

The partial elimination of the surcharge in effect is not the only problem with this "proxy" for a wealth tax. That unearned income should be taxed more heavily than that from employment remains sacrosanct only in principle; in practice the reverse is often true. As the Meade Committee have argued "role of the earned income relief and investment surcharge as providing such discrimination has been undermined progressively over the last half century or so as a result of the development of a national insurance system financed by compulsory contributions imposed on earnings" (Meade, *op cit*). The Committee argued that national insurance contributions, payable only on employment incomes, represented in effect an "earned income surcharge." At current rates, earnings are subject to national insurance contributions of 6½ per cent payable by the employee and 13.5 per cent payable by the employer on all earnings up to £135 a week. (Both are soon to rise by ¼ per cent). Together these account for a tax on labour income of 20 per cent, in addition to the income tax. This more than cancels out the investment income surcharge except in

the case of higher earned incomes which are above the £135 contribution ceiling. Moreover, since the surcharge is not payable on small investment incomes at all, low earned incomes are considerably more heavily taxed than low investment incomes. In the case of lower incomes (below the ceiling on national insurance contributions) the differentiation is completely reversed in favour of income from wealth. This is important when considering firms' decisions on whether to use more labour or more capital. And since the employers' contribution may be paid out of lower wages as well as higher prices, the surcharge on wage-earners is clear.

The investment income surcharge is not only an inequitable means of taxing "wealth", it is also highly inefficient. By definition, only wealth that yields money income is taxed at all by the surcharge, while wealth that yields less income is more favourably treated than that which yields more. This has two rather detrimental effects. First we have a situation in which two people with wealth of equal value are taxed differently. One may hold his wealth in the form of investments on which he will be subject to tax. Meanwhile the other may decide to hold his wealth in a form that produces no money income, such as yachts, cars or houses. Since he has no money income from his wealth, he pays no tax on it. But his command over economic resources is clearly the same, since he could at any time sell this playboy paraphernalia and invest the proceeds to obtain an income. Indeed economists would say that he must derive an income "in kind" from the possession of these items or he would make good his losses by switching his wealth into more "productive" forms. Again this may seem to be an argument about the unfair treatment of one wealthy person in comparison to another. But once more it has a great deal to do with wealth inequalities. For as we have seen, the existence of the investment income surcharge encourages the very wealthy to divert their resources into non income yielding forms. This wealth is untouched by taxation, but it continues to provide status, power and security to its owners.

This state of affairs not only insulates the wealthy from the rigours of taxation which might reduce inequalities. It also has a disturbing economic effect which might reduce the overall level of wealth available to share. By exempting unproductive wealth (defined as that which yields no income) the investment income surcharge distorts investment, consumption and savings amongst the very wealthy. Investment in "productive" capital is actively discouraged. The absurdity created by this situation was illustrated graphically by the Liberal Party in a discussion document on taxation. By their calculations, a Rolls Royce of a value of £30,000 would have cost just £48 per annum to buy. The basis for this calculation was that the alternative might be to invest the £30,000 in productive capital yielding an interest of 8 per cent, which would then have been subject to tax at that time) at a rate of up to 98 per cent (Liberal Party, *Incentive Taxation*; interim report to the 1977 Liberal Assembly, 1977).

The Conservative party have criticised the Investment Income Surcharge for the same reasons arguing that it "distorts capital markets by diverting private investment towards capital profit and away from income yielding securities". As a result they declare that "we are increasingly doubtful about the wisdom of retaining any kind of Investment Income Surcharge". (*The Right Approach to the Economy op cit*). While we agree with this assessment with regard to the distorting effects of the current arrangements, we should stress that the greater problem at present is the existence of an "earned income surcharge" in the form of national insurance contributions. To dispense with the surcharge on property incomes altogether would be highly inequitable, given the advantages associated with income in this form.

capital gains tax

The third form of tax considered here—the Capital Gains Tax—is not really a tax on capital at all. It is more appropriately thought of as a tax on a form of income,

the income which derives from the increased value of wealth.

Capital gains have long been considered a form of income. Almost a quarter of a century ago the Minority Report of the Royal Commission on the Taxation of Profits and Income asserted that "capital gains increase a person's taxable capacity by increasing his power to spend or save" (*Final Report*, Cmnd 9474, HMSO, 1955). A short term gains tax (on gains realised within 6 months) had been introduced in 1962, and attempts to tax gains on specific types of assets stretch back to 1909. In 1965 gains realised within 12 months of purchase were treated as income and subject to income tax and surtax. Long term gains were taxed under a special Long Term Capital Gains Tax. In the 1971 Budget, however, all capital gains were subject to the same long term rate which was considerably lower for most taxpayers.

The maximum rate of Capital Gains Tax (CGT) is 30 per cent, the same as the standard rate of income tax on earned income. Until recently the maximum rate of tax was substantially lower than that paid on earned income; it is well below the rate payable on other *unearned* income, and very much lower than the higher rates of income tax.

Against this already very low rate of tax, there are substantial concessions. Individuals' gains of up to £1,000 a year are exempt, as is the entire value of the principal private residence and private cars. Gilt edged securities are not subject to CGT on an increase in their value as long as they are held for at least a year. In addition to these exemptions relief against tax is given for gains of less than £9,500 a year. A gain of between £1,000 and £5,000 is taxable at only 15 per cent. Hence a person earning £5,000 a year (about the average male wage) would pay £1,113 income tax plus £325 national insurance contributions, equivalent to 28.8 per cent of the gross wage. But if he received the same amount, not in earnings, but in the form of capital gains, the most he would expect to pay would be £600—less than half as much. His tax bill would represent only 12 per cent of

his income. As with the investment in come surcharge, the principle that earned income should be more favourably taxed commands little respect in reality.

The cost of these exemptions and reliefs is considerable. The loss in revenue on the exemption of gains on the principal residence alone was estimated at £1,500 million for 1978/79 (sufficient to reduce the standard rate of tax by 3p in the £). Other reliefs for which the cost could be estimated increased the cost to £1,700 millions, but there were another 36 allowances or reliefs against CGT for which the cost could not be estimated. (Inland Revenue Statistics 1979, *op cit*). Since total revenue from CGT in that year was only £353 million, the reliefs involve at least five times as much revenue as the tax raised (and probably much more).

It can be argued, as it often is, that the Capital Gains Tax has been converted by inflation into a harsh wealth tax. This is because an increase in the value of an asset which does no more than maintain its value against rising prices may nevertheless come to be subject to tax. So instead of just taxing the increase in the value of the asset, the tax effectively bites into the value of the capital itself. It is this aspect of capital taxation which the Conservatives are most likely to change. There are two courses of action. Either the tax can be properly indexed to avoid the effect, or it can be abolished. We suspect the Government will adopt the latter course of action. Since the tax only raised 1½p in every £ of Inland Revenue taxes in 1979/80—and the same amount in cash terms as in 1974/75—this move would shift the burden of taxation further towards income tax payers. In the following chapter we propose the adoption of a means of taxing capital gains more equitably but at a more realistic level. We agree that the current situation is haphazard and unsatisfactory. But since the tax raises less than £400 millions, the harshness of the inequity should not be overstated.

More important, in our view, is the fact that CGT has become less a tax than a tax-avoidance device. Those subject to the higher rates of income tax or invest-

ment income surcharge can reduce their tax bill substantially by converting their income into capital gains. This can be done by selling off income yielding assets and buying shares or other property likely to increase in value. Liability can thereby be reduced from a maximum 75 per cent (on investment income) to 30 per cent or even to zero if certain favoured assets are chosen. As the Meade Committee noted: "There is thus a marked incentive for the higher rate taxpayer to distort his affairs by seeking investment channels which may not be the most productive but which will produce their product in the form of a capital gain rather than of investment income" (*Structure and Reform of Direct Taxation, op cit*). As well as being highly efficient, by encouraging taxpayers to devote time and resources to converting their income from one form to another, this is highly inequitable: a taxpayer can pay up to 75 per cent if his investment income is in one form, but a maximum of 30 per cent if it is in another. It also reduces the progressiveness of the income tax system by allowing higher rate taxpayers to side step the higher rates of tax. Less than two taxpayers in every hundred are now subject to the higher rates, partly because of the effect of CGT. It follows that Capital Gains Tax has more effect in widening inequalities in income than in narrowing inequalities in wealth.

A remarkable feature of the present system is that the Government itself connives in such tax avoidance by providing special low-yielding Government Stocks. Such stocks provide little interest, which would be subject to tax of up to 75 per cent, but promise substantial capital gains which are taxed at no more than 30 per cent and will be totally exempt if disposed of after one year or more.

Kay and King have estimated that "At present, at least £3,000 million is invested in Government stocks which are clearly unattractive to anyone who is not a higher rate taxpayer". (*op cit*.) They also warn that such a state of affairs has implications stretching beyond the effects on the progressiveness of the income tax: "The tax system has, in effect pushed

private investors out of traditional 'middle-of-the-road' investments like good-quality equities, properties, and bank deposits and into fringe activities like 'performance shares', geared investments in property, and portfolio investment abroad, as well as higher rate taxpayers' stocks, which promise—but do not necessarily deliver—above average capital gains. This is part of the general mangling of the patterns of savings and investment in this country by the tax system”.

the myth of capital taxation

It is generally believed that capital taxes in Britain are severe. This is a belief shared, apparently, by the Chancellor of the Exchequer and his advisers. In his budget statement, for instance, Sir Geoffrey Howe expressed his determination “to make the taxation of capital simpler and less oppressive” He described Capital Gains Tax as “a capricious and sometimes savage levy”. Capital Transfer Tax (CTT), in the Chancellor's view, “is oppressive, harmful to business and a real deterrent to initiative and enterprise” (*Hansard*, 12 June, 1979).

Our examination of the three main forms of capital taxation has led us to rather different conclusions. We have seen that Capital Transfer Tax—far from preventing the maintenance of estates intact—

provides little incentive for the dispersion of wealth. The revenue it raises, as a proportion of all Inland Revenue taxes, represents less than a tenth the amount raised when this type of tax was introduced 80 years ago. CTT payments amounted to less than one fifth of one per cent of total net personal wealth—hardly sufficient to make a major impact on wealth inequalities. The investment income surcharge affects only 300,000 people and raises revenue of little more than £250 millions (1.2 per cent of all taxes). Moreover, when national insurance contributions are taken into account, we find that the intended differentiation in favour of earned income is converted into a bias in favour of investments. Most earned income is subject to a higher rate of tax than that paid on income from capital. This is certainly true of one form of investment income—that which comes in the form of capital gains. Because the rates of CGT are lower than those on unearned income, and lower in many circumstances than on earned income, it has become a useful device for tax avoidance. Its impact is greater in widening inequalities in income than in reducing inequalities in wealth.

It only remains for us to draw together the strands of the argument by showing the amount of revenue raised by these three main forms of capital tax compared with all other taxes.

CONTRIBUTION OF CAPITAL TAXES TO TOTAL INLAND REVENUE RECEIPTS 1973/74-1978/79.

	Estate Duty		Capital		Investment		All Capital Taxes** excluding Stamp Duties and DLT	
	£	%	£	%	£	%	£	%
1973/74	412	3.9	324	3.0	136	1.3	872	8.2
1974/75	339	2.4	382	2.7	202	1.4	923	6.5
1975/76	330	1.8	387	2.1	232	1.3	949	5.2
1976/77	383	1.8	323	1.6	265	1.3	971	4.2
1977/78	398	1.8	340	1.6	253	1.2	991	4.5
1978/79	369	1.5	353	1.6	(313)	(1.3)†	1035	4.3†

**Excluding Stamp Duties and Development Land Tax (DLT).

†Estimated on the assumption that Investment Income Surcharge continues to raise 1.3% of all Inland Revenue receipts.

Source: *Inland Revenue Statistics 1979*.

Over the past six years total receipts have increased substantially. But the contribution of wealth holders to the total has fallen dramatically from a meagre 8 per cent to 4 per cent. In just six years, wealth taxation as a proportion of total direct taxation, has halved. Even if we include Development Land Tax (DLT) and Stamp Duties (which, for reasons explained earlier are not central elements of the capital tax system) the revenue from capital taxes has increased by only £163 million. Their contributions to total revenue has fallen from 9.9 per cent even on this wider definition. This is in a period in which prices doubled and income tax revenue increased $2\frac{1}{2}$ times. Capital taxes have also declined quite sharply as a proportion of net personal wealth over the period (RCDIW, *Report No. 7, op cit*).

Considering the taxes separately, CTT/Estate Duty raised less revenue in cash terms in 1978/79, than in 1973/74 and its contribution to total revenue halved, to a mere $1\frac{1}{2}$ per cent. Capital Gains Tax contributed the same small proportion to total taxes in 1978/79 as CTT. Far from being converted into a harsh "wealth tax" by inflation CGT barely managed to maintain its cash revenue at its 1973/74 level. If inflation is taken into account, the real value of CGT receipts halved over the period, as did the proportion contributed to total revenue.

Investment Income Surcharge increased its revenue yield roughly in line with inflation over the period (assuming that our estimate for 1978/79 is broadly correct). But it was the one element of income tax for which the revenue remained constant as a proportion of total receipts: in a period when income tax receipts increased from 70 per cent of total revenue to 80 per cent that from the Investment Income Surcharge remained at approximately 1.3 per cent. It is perhaps paradoxical that these considerable reductions in the relative tax burden of wealth holders came during the period of office of a Labour government—a government, moreover, who began its period in office with a commitment to reduce wealth inequalities. Yet that same

government presided over an effective halving of the contribution of capital taxes. The prospect of achieving real reductions in wealth inequalities under a Conservative government committed to further cuts in capital taxation cannot be viewed with optimism.

A favourite past-time of Conservative administrations is to make international comparisons. A recent study carried out for the Organisation for Economic Co-operation and Development (OECD) by C T Sandford, J R M Willis and V Flegmann allows us to make tentative conclusions about Britain's treatment of wealth taxation in comparison to other advanced industrial nations. The report showed that in 1976, UK taxes on capital transfers represented 0.87 per cent of total tax revenue, compared with 2.60 per cent in 1965. Only twelve of the 21 countries raised a smaller proportion of their revenue through wealth taxes (including annual wealth taxes) in 1976, whereas the UK came third from the top of the league in 1965. If wealth taxes are expressed in relation to gross domestic product then the UK, at 0.32 per cent, again came midway in the league in 1976 (ten countries raised less as a proportion of GDP). This compared with Britain's position near the top of the league (three raised less) in 1965, when capital taxes in the United Kingdom represented 0.81 per cent of GDP (C T Sandford, J R M Willis and V Flegmann, *The Taxation of Net Wealth: Capital Transfer and Capital Gains of Individuals*, OECD 1979). In summary, we may recall that Britain's wealth holders have been called upon to contribute a steadily declining proportion of revenue for the Government's requirements over the past decade. The UK is now midway in the league of advanced industrial nations in this respect. Not only are Britain's wealth taxes poor revenue-raisers, they are also economically inefficient and inequitable. Moreover, they offer little prospect of breaking down the extreme inequalities in property ownership that divide the nation. In the final chapter we outline a framework of capital taxes which could meet these objectives both more efficiently and more equitably.

4. how should we tax wealth?

Extreme inequalities in the ownership of wealth, and therefore in the political and economic power that it represents, persist. The system of wealth taxation has failed lamentably to break down these concentrations, beyond a rearrangement of the pattern of wealth ownership within the richest families. Moreover the system has not served us well either in terms of economic efficiency or fairness between taxpayers. Sam Brittan, an economist who can hardly be accused of holding rampant egalitarian views, once asked: "Is it conceivable that if a new system were being designed for Britain that income would be taxed heavily and effectively, and capital hardly at all?" (S. Brittan, *The Treasury under the Tories*, 1951-1964, Penguin, 1964). Those words were spoken 15 years ago, when the relative burden of capital taxes was somewhat greater than it now is.

In this final chapter we consider the options for reform of capital taxation, especially an annual wealth tax. We share the concern of the Conservative government that the system of wealth taxation should be more conducive to economic efficiency than is the case with the current arrangements. But we are also concerned that capital taxes should be levied with considerably greater equity than is now the case. And, in particular, we feel that the prime objective of a system of wealth taxation should be to help break down the extreme inequalities which now exist. Once more, it seems, we are not alone in this objective. The Conservative party have stated that "it is no part of our aims to encourage the concentration of the country's assets in fewer and fewer hands" (*The Right Approach to the Economy, op cit*). Unfortunately, the policies they propose would have precisely that effect. Moreover, at the time of writing (November 1979) the Conservative government looks set to embark on these policies with vigour.

Before considering the options for reform, we should set out precisely what it is we plan to achieve. Our aim is greater equality, while at the same time improving equity and economic efficiency. We can state the basic principles which should

guide us quite briefly. First there is the principle that the income from wealth should be taxed more heavily than that from employment. The former does not involve the loss of leisure or the insecurity which attaches to many (especially manual) sources of income. Moreover there are often additional costs associated with employment incomes, including those of travel. A second main principle is that wealth should be subject to tax, whether it yields income or not. Even where no money income derives from the ownership of wealth, the additional taxable capacity is evident, and such wealth continues to confer prestige, status and power on its owner. Thirdly, inherited wealth should be taxed more heavily than that accumulated out of savings. In part this can be justified on either equity or efficiency grounds, since inherited wealth requires no effort or ability on the part of the recipient. More important, in our view, is the fact that inherited wealth is the prime source of inequality. If we are really concerned about the ability of the tax system to reduce the concentrations of property in a few hands, we must devise a means of tackling inequality at its tap root, and that is the system of inheritance.

a wealth tax

The Labour government which came into power in 1974 was committed to the redistribution of wealth and power in favour of working people and their families. As a major part of the programme to achieve that objective, the Chancellor announced his intention in the March 1974 budget to "introduce an annual wealth tax on the rich". A few months later, a Green Paper was issued proposing the implementation of a wealth tax, applied to wealth holdings in excess of £100,000.

The Green Paper also announced the setting up of a Select Committee of the House of Commons to consider "the exact shape of the tax, and the rate at which it should be introduced" (*Wealth Tax*, cmnd 5704, HMSO, 1974). It also expressed the intention of introducing the tax in the 1976 Finance Act.

Party's initiative. The Green Paper specified very little about the shape of tax which the Government then had in mind, except that it should only be payable on net wealth (excluding liabilities such as mortgages) exceeding £100,000. Above this level it only provided two illustrative schedules of rates, one rising to 2½ per cent on net wealth exceeding £5 million, the other reaching 5 per cent at that level.

The Conservative members of the Select Committee claimed that the Green Paper proposals were "unequivocally an additive tax" (Select Committee on a Wealth Tax, *Report and Proceedings of the Committee*, HC 696-1, Nov. 1975, vol. 1). A closer inspection of the "illustrative" structure of rates suggests that this statement was itself a little too "unequivocal". The starting point for liability at £100,000 would in 1974 have affected just 80,000 people—about one fifth of one per cent of the adult population. On either schedule proposed, very few wealth holders (probably less than one in a thousand) would have been subject to a rate in excess of 1 per cent. (A one per cent annual wealth tax equals a 20 per cent tax rate on income if the wealth yields a 5 per cent return, 10 per cent on that yielding 10 per cent, and so on.)

Moreover, the Green Paper indicated that the Investment Income Surcharge and the wealth tax would probably be offset, one against the other. But as John Pardoe (who was not concerned primarily with the equality objective) pointed out in his draft report, 620,000 people paid the Investment Income Surcharge in 1974/75 while only 100,000 would be affected by a wealth tax with the proposed threshold. "We are bound to say that we are not attracted to proposals for a wealth tax intended to promote horizontal equity which leave out of account more than five-sixths of eligible persons" (Select Committee on Wealth Tax, *ibid*).

The proposal to offset investment income surcharge meant, according to the calculations of one witness, that even on the higher and more progressive schedule of rates proposed in the paper, a typical tax-

payer would be better off under the wealth tax unless his net wealth exceeded £300,000. (Evidence of Dr. Barr, quoted in Select Committee on a Wealth Tax, *ibid*). As Dr. Bray commented in his draft report "At any lower rate the redistributive effects would be very slow and small . . . Any lower rate or higher threshold will scarcely be seen as a wealth tax at all" (*ibid*).

The Green Paper indicated that even this offsetting of the wealth tax against income tax did not go far enough, in the Government's view, and raised the possibility of setting a ceiling to the taxpayers total tax liability. As Jeremy Bray, once more, pointed out: "The purpose of a ceiling to the combined liability to income tax and wealth tax is to limit or even prevent any redistribution of wealth by the wealth tax . . . The argument that people cannot pay tax in excess (sic) of 100 per cent of their incomes reflects the long standing, deeply engrained, but old fashioned attitude that capital is sacrosanct and must not be touched."

The proposed threshold of £100,000 was to be applied to net wealth, after liabilities and exemptions. Owner-occupied houses were to be included in the tax base, although few would have attracted liability. Somewhat surprisingly, the Green Paper explicitly excluded the value of occupational pensions from the scope of the tax. By contrast, the Conservative draft report of the Select Committee stressed at length the value of occupational pensions to Civil Servants (noting the evidence of the Inland Revenue arguing for their exclusion) and insisted that a wealth tax, if introduced, must include such elements. Cynics might be led to suggest that the Labour Government slipped this one specific commitment into the Green Paper to avoid the clammy, dead hand of civil service resistance falling on the proposals, while the Opposition had an interest in such resistance, and were at pains to encourage it.

Overall, it appears that a wealth tax, if introduced, would have done little to redistribute wealth. The only draft report of the Select Committee to advocate an

additive wealth tax was that of Jeremy Bray who received little support from other Committee Members. The primary aim of the other reports was to increase fairness between taxpayers, an objective which led them to propose substitutive taxes.

If we look carefully at the Chancellor's Foreword to the Green Paper it becomes clear that, although the wealth tax was to make some contribution to greater equality, this was to be achieved rather indirectly. Instead of reducing the top wealth holdings by allowing the tax to bite into capital, the primary aim was to close some loopholes in the income tax system: "Once the additional taxable capacity represented by ownership of wealth is adequately brought into charge, excessive inequalities of wealth will in time be eroded, and it will be possible to reduce the high rates of tax on earned income" (*Wealth Tax, op cit*, our emphasis). By making the income tax system more effective, the accumulation of wealth would be hindered (somewhat). But progress towards greater equality would be a very slow one indeed.

This is not to imply, of course, that a wealth tax could not be devised which would begin to break down such inequalities with more speed. J. S. Flemming and I. M. D. Little have, for instance, proposed a tax with marginal rates of 3 per cent on wealth of £100,000 rising to 13 per cent on £1 million and to 20 per cent on two million. Even though they proposed the abolition of the investment income surcharge, estate duty (now CTT) capital gains tax and stamp duties, the authors estimate that such a scheme would make it very difficult to accumulate wealth above £250,000. Their motivation is not primarily egalitarian: "In a progressive mixed society some clever, lucky, efficient individuals have to be allowed to become rather rich. But they do not have to be extremely rich—say, with over £250,000. Less than one person in a thousand falls within the latter class . . . Great inequality cannot be justified on the grounds that it makes it easier to collect taxes" (J. S. Flemming and I. M. D. Little, *Why We Need a Wealth Tax*,

Methuen, 1974). At the same time, the authors were concerned to ensure that the accumulation of wealth is made easier for the poorer 95 per cent of the population.

It would therefore be possible to devise a wealth tax which had a significant impact, albeit a slow one, on the current distribution of wealth. But if we are concerned primarily with inequality, we should remember that the root source of that inequality is inheritance. For this reason improvements in wealth taxation should include a reform of wealth transfer taxes and of those on investment income and capital gains.

inheritance taxes

We noted in chapter 3 that the Capital Transfer Tax (like its successor the Estate Duty) was a tax levied on the donor of the gift or inheritance. The revenue from such taxes has fallen dramatically over the post-war period. If transfer taxes were now called upon to contribute the same proportion of total revenue as they did thirty years ago, their yield would be six times its current level, and equivalent to a tenth of current income tax receipts. The rate of income tax could be reduced by up to 4p in the £ without an increase in the government borrowing requirement. Even ten years ago, transfer taxes raised proportionately four times their current revenue yield, sufficient now to reduce the standard rate of income tax by 3p in the £. A principal objective of reforms should be to raise through transfer taxation at least the same proportion of total Inland Revenue receipts as was the case a decade ago.

Since CTT revenue now accounts for less than a fifth of one per cent of total estimated personal wealth-holdings, it can hardly be expected to make a significant impact on wealth inequalities. Moreover, as we have noted, being assessed on the estate of the donor, it provides no incentive for the wider dispersion of wealth. The move from an estate tax to an "accessions tax" covering all gifts and

inheritances but payable by the recipient would be more equitable while encouraging redistribution. Such a tax could be levied at a progressive rate on the cumulative total of gifts or inheritances received by an individual (for a fuller discussion see Sandford, Willis and Ironside, *An Accession Tax*, op cit, and Atkinson *Unequal Shares*, op cit).

The Meade Committee on tax reform were in favour of an accessions tax of this type, but acknowledged that an important drawback remained: "it levies the same tax whether the wealth is held for a long or for a short period. Inherited wealth which changes hands frequently is taxed more heavily than inherited wealth which stays in the same ownership for long periods" (J. E. Meade (Chairman), *The Structure and Reform of Direct Taxation*, op cit). As a result, the incentive to pass on wealth quickly is reduced even though there is encouragement to disperse it more widely when it is passed on. To overcome this problem, the Meade Committee proposed an accessions tax combined with a wealth tax, and levied at progressive rates (PAWAT). On receiving a gift or inheritance, a progressive accessions tax would be levied. At the same time an additional tax would be payable on the wealth received levied at an annual progressive rate over the period for which the recipient was expected to hold the wealth, perhaps his or her life-expectancy. This would in effect levy a tax on the annual value of wealth to be paid in advance. If the recipient passed the wealth on sooner, part of the wealth tax element of the tax would be refunded.

Two problems arise with such a tax. First, an accessions tax is likely to reduce inequality more slowly than an annual wealth tax levied at comparable rates, since the former only applies when wealth changes hands. Secondly, an accessions tax does not, by definition, apply to wealth accumulated out of savings. While it may encourage the faster dispersion of inherited wealth, it actively discourages that of accumulated wealth. The Committee also therefore proposed the consideration of a separate progressive annual wealth tax in addition to a non-

progressive linear combined annual wealth and accession tax (LAWAT) (*ibid*). This, they argued, would provide a general discrimination against inherited wealth, leaving the annual wealth tax to tap the largest fortunes, whether inherited or saved. Although a non progressive LAWAT would be easier to administer, it would be feasible to apply such a tax progressively, together with a separate progressive annual wealth tax. If the rates of the annual wealth tax were sufficiently high, however, little would be gained from applying a PAWAT.

taxation of investment incomes

We have argued that, if the main objective is to tackle wealth inequalities, a wealth tax should be "additive". It should be levied at such a level that the largest wealth holdings were actually reduced. This would lead us to retain the separate taxation of investment incomes.

We noted in chapter 3 that the current method of taxing investment incomes was highly inefficient. The Conservative Party has argued that the tax distorts capital markets by encouraging people to convert their investment income into capital gains which are far more favourably taxed. Indeed, for many the investment income surcharge, like the Estate Duty, has become a largely voluntary tax. The approach of the Conservative Party has been to consider abandoning the Investment Income Surcharge altogether.

This is a prime example of throwing out the baby (an apt description given the revenue of the surcharge) with the bath water. Given the advantages associated with unearned incomes, it would be highly inequitable to remove the historic discrimination in favour of earnings. A more appropriate course of action would be to remove the incentive to convert income into capital gains, by taxing gains *as income*. There is little justification for treating capital gains as a separate form of receipt subject to a lower and proportional rate of tax. All gains should therefore be subject to the progressive schedule of income tax, as was the case

with shortterm gains between 1965 and 1971. Moreover, since capital gains are by definition "unearned income" they should be taxed as such, subject to the Investment Income Surcharge.

The difficulty that arises from this treatment is that capital gains are at present levied only when the asset is sold, on "realisation" of the gain. If an asset is sold, this would add substantially to the liability of its owner in that tax year, whereas the increase in value may have occurred over several years. With a progressive tax, this would mean higher tax payments than if liability were assessed year by year on the increasing value. Yet to do this would require annual valuation and the high administrative costs which would result. To overcome this problem, Atkinson has proposed that gains be taxed on realisation but with allowance for averaging the gain over a period of (say) five years (*Unequal Shares, op cit*). A similar approach was proposed by the Canadian Carter Commission on Tax Reform who also suggested that capital gains be taxed as income. Only real gains (rather than inflation-created paper gains) would of course be included. The Meade Committee has proposed a method whereby this could be achieved.

We have also shown that, in effect, the real surcharge applies to earned income, through the effect of national insurance contributions. More "tax" is payable on earnings than on investment income, a situation which runs contrary to basic principles of fairness in taxation. One obvious means of overcoming this problem would be to integrate the national insurance contributions with the income tax, rather than retaining them as a separate, regressive levy. But this would have severe implications for the new Pensions Scheme. A more straightforward approach would be to increase the level of the Investment Income Surcharge, by removing the exemption for small investment incomes (which already receive the same personal allowances as earned income) and increasing the rate. If this seems harsh, we should remember earned incomes are treated more harshly.

In these last two pages we set out some of the options for reform of wealth taxation.

conclusion

These reforms we believe would improve the ability of the system to tackle severe inequalities, increase the fairness of taxation, and improve economic efficiency. The programme of reform should include the following:

1. A combined annual wealth and accessions tax, as proposed by the Meade Committee, levied at either progressive or proportional rates. Such a transfer tax should be expected to raise revenue at the effective level of Estate Duty ten years ago. The removal and reduction of many of the (currently distortionary) exemptions and reliefs, would allow transfer taxes to make a real contribution to tax revenue.
2. The introduction of a progressive annual wealth tax with rates high enough to make it impossible to maintain the largest concentrations of wealth by drawing on income (taking account of the tax also payable on that income). If we are serious about reducing inequalities, we cannot continue treating capital as "sacrosanct".
3. The retention of an investment income surcharge and an increase in its effective rate to ensure the differentiation in favour of earnings.
4. The abolition of the separate Capital Gains Tax and the treatment of capital gains as income, again subject to the progressive schedule of rates. This would remove the current loophole provided for those who can convert their income into capital gains. Such conversions reduce the progressiveness of the income tax system and are highly wasteful in economic terms.

We do not pretend that this package of proposals is the only way in which the tax system can be used to tackle wealth inequalities. An author with whom we share common objectives and priorities,

Michael Meacher, MP, has recently proposed an alternative framework consisting of, first, a progressive accessions tax with rates reaching 100 per cent on transfers of £20,000 or more; second, an annual wealth tax at (say) 5 per cent on holdings exceeding £ $\frac{1}{2}$ million and, third, a tax on imputed incomes from wealth holdings above a threshold of (say) £20,000 (having made generous allowance for owner-occupied housing) (M. Meacher, "Wealth", in N. Bosanquet and P. Townsend (eds) *Labour and Equality*, Heinemann, 1980).

Nor, in the space allowed, have we been able to explore the administrative or economic implications of such proposals (the reader is referred to the report of the Select Committee on a Wealth Tax, to that of the Meade Committee and A. B. Atkinson's *Unequal Shares*, on which we have drawn heavily throughout). We would not wish to minimise the constraints which face a government trying to implement policies which tax more heavily those who have not been used to paying tax. Action might be necessary to avoid the flight of capital, a problem which the recent abolition of exchange controls has exacerbated. At the same time, high marginal rates of capital taxes would tend to lead the wealthy to "spend themselves out of the depression" of being taxed. Inequality in consumption might well increase while the process of reducing inequality in wealth holdings progressed. But it would have to be a special kind of consumption (excluding those goods which would be subject to tax) and might actually increase the dispersion of wealth holdings in the longer term. The economic, administrative and political difficulties of a reform of wealth taxation should not be ignored. But if the Labour Movement is really committed to a reduction in the extreme inequalities of wealth and power that persist, a decisive programme of change is now needed with some urgency.

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taxing wealth inequalities

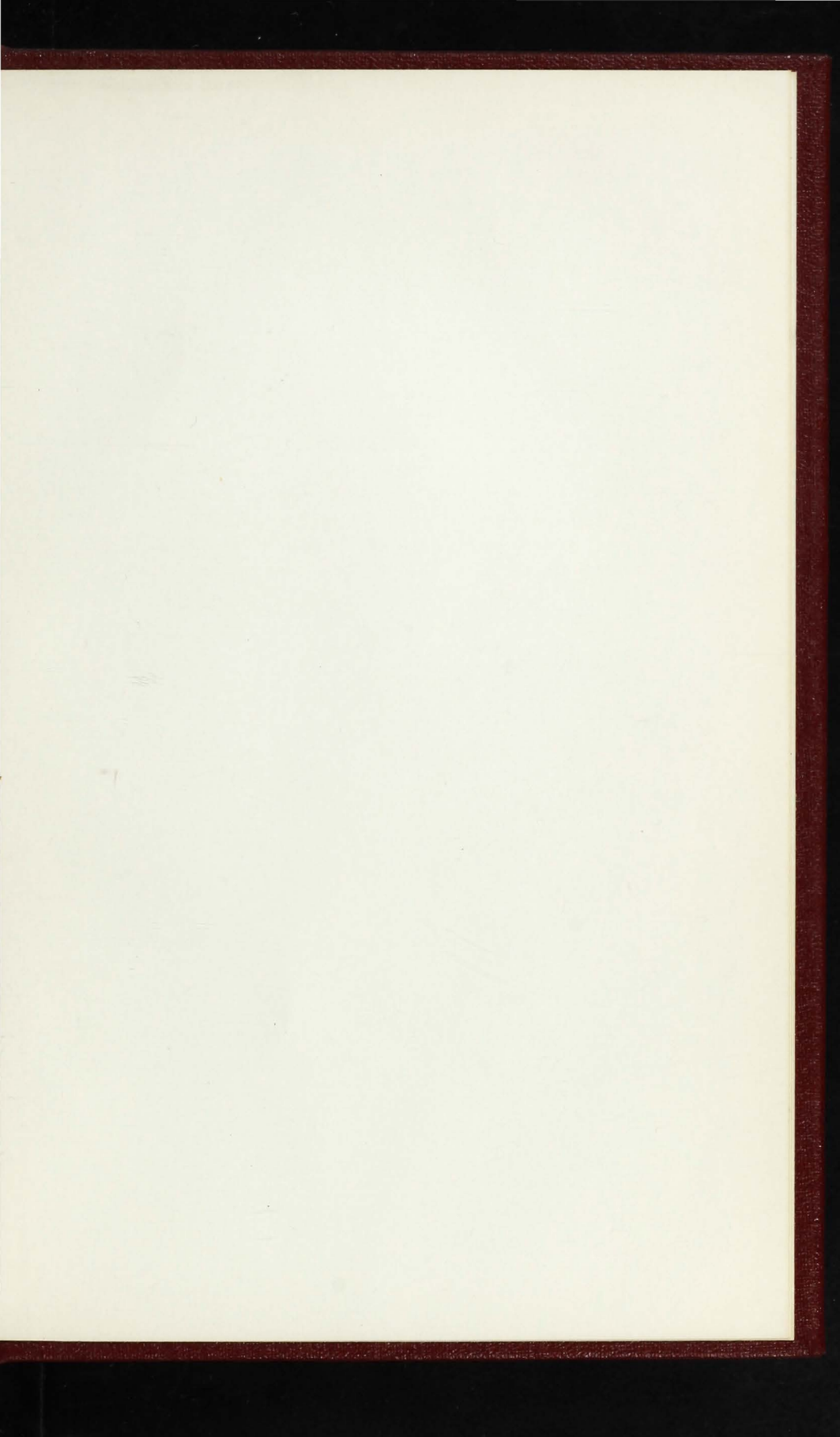
This pamphlet places capital taxes in their economic and social context. One per cent of the population owns one quarter of Britain's personal wealth, including almost threequarters of all land, stocks and shares and two thirds of all government securities. It is against this background that the Chancellor has asserted that capital taxes are "oppressive, harmful to business and a real deterrent to initiative and enterprise". The evidence as set out in this pamphlet suggests that the Chancellor is wrong. It is pointed out that the various capital taxes contribute little more than 4 pence in every £ of direct taxes raised—less than half their relative contribution when Labour last took office.

The authors put the issue of wealth taxes firmly on the legislative agenda of a future Labour government. How should the inequalities in wealth be tackled? Do we need the sort of wealth tax to which the last Labour government was committed but which it abandoned? Should we have a more effective system of inheritance taxes? The authors argue that socialists must now begin to ask these questions and they provide an excellent basis for discussion within the Labour movement with this pamphlet.

fabian society

The Fabian Society exists to further socialist education and research. It is affiliated to the Labour Party, both nationally and locally, and embraces all shades of socialist opinion within its ranks — left, right and centre. Since 1884 the Fabian Society has enrolled thoughtful socialists who are prepared to discuss the essential questions of democratic socialism and relate them to practical plans for building socialism in a changing world. Beyond this the Society has no collective policy. It puts forward no resolutions of a political character. The Society's members are active in their Labour parties, trade unions and co-operatives. They are representative of the labour movement, practical people concerned to study and discuss problems that matter.

The Society is organised nationally and locally. The national Society, directed by an elected Executive Committee, publishes pamphlets, and holds schools and conferences of many kinds. Local Societies—there are one hundred of them—are self governing and are lively centres of discussion and also undertake research.



Living with the Government

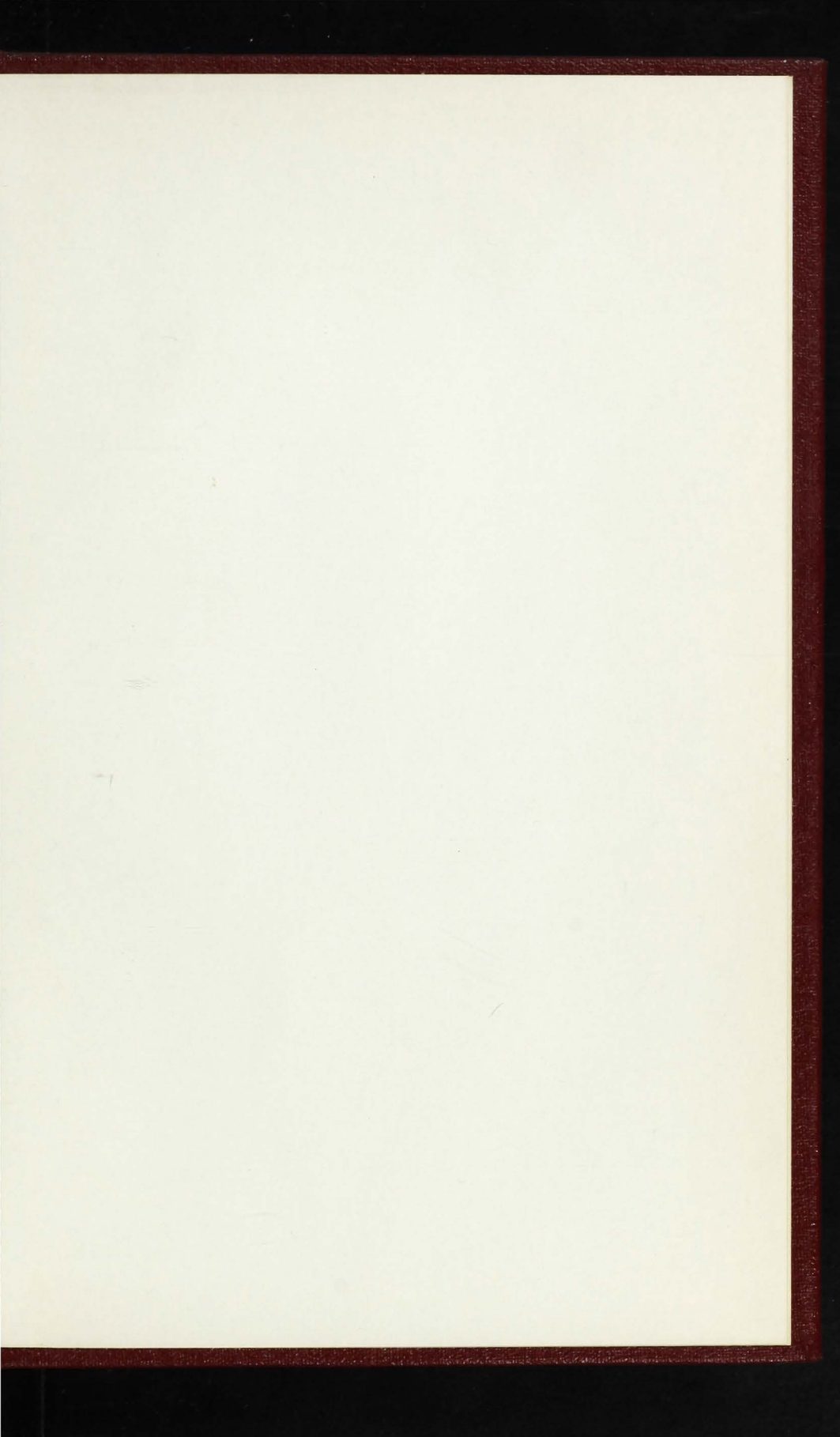
The principal theme of this book is the working and living conditions of the poor and the unemployed, and the struggle for better conditions, including the struggle for the right to work, and the struggle for the right to a minimum wage. It is a story of the hardships and the struggles of the poor and the unemployed in the United States, and a call for action to improve their conditions. The author is not only a writer but also a social worker, and his knowledge of the conditions of the poor is based on his own experience and the experience of others. He has spent many years in the slums and the tenements, and he has seen the suffering and the struggle of the poor first-hand. His book is a powerful and moving account of the life of the poor, and a call for action to improve their conditions.

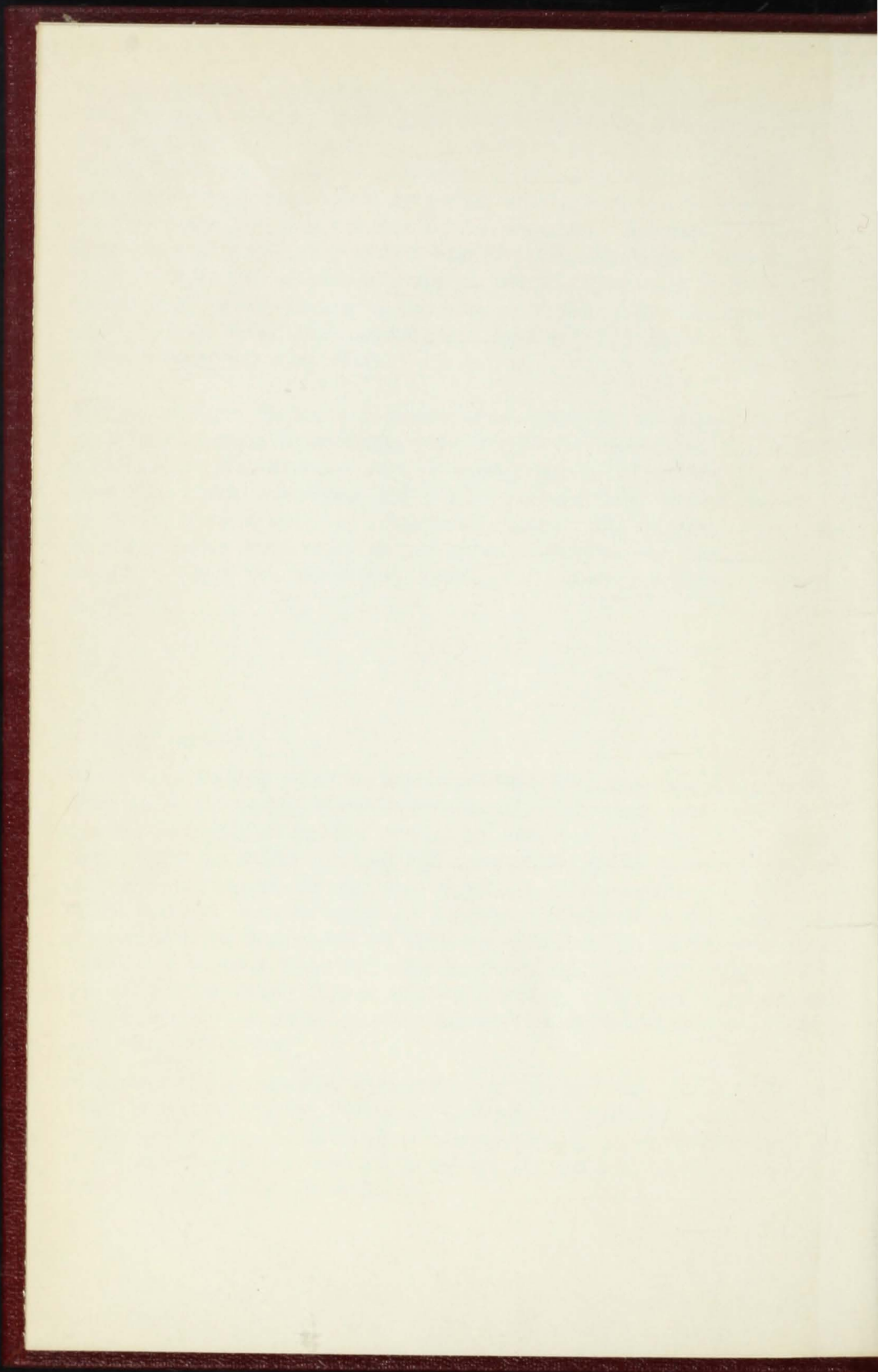
The author has the aim of making the book a living document, and a record of the life of the poor. He wants to show the conditions of the poor as they are, and to show the struggle for better conditions. He wants to show the suffering and the struggle of the poor, and to show the need for action to improve their conditions. He wants to show the life of the poor as it is, and to show the need for action to improve their conditions. He wants to show the suffering and the struggle of the poor, and to show the need for action to improve their conditions.

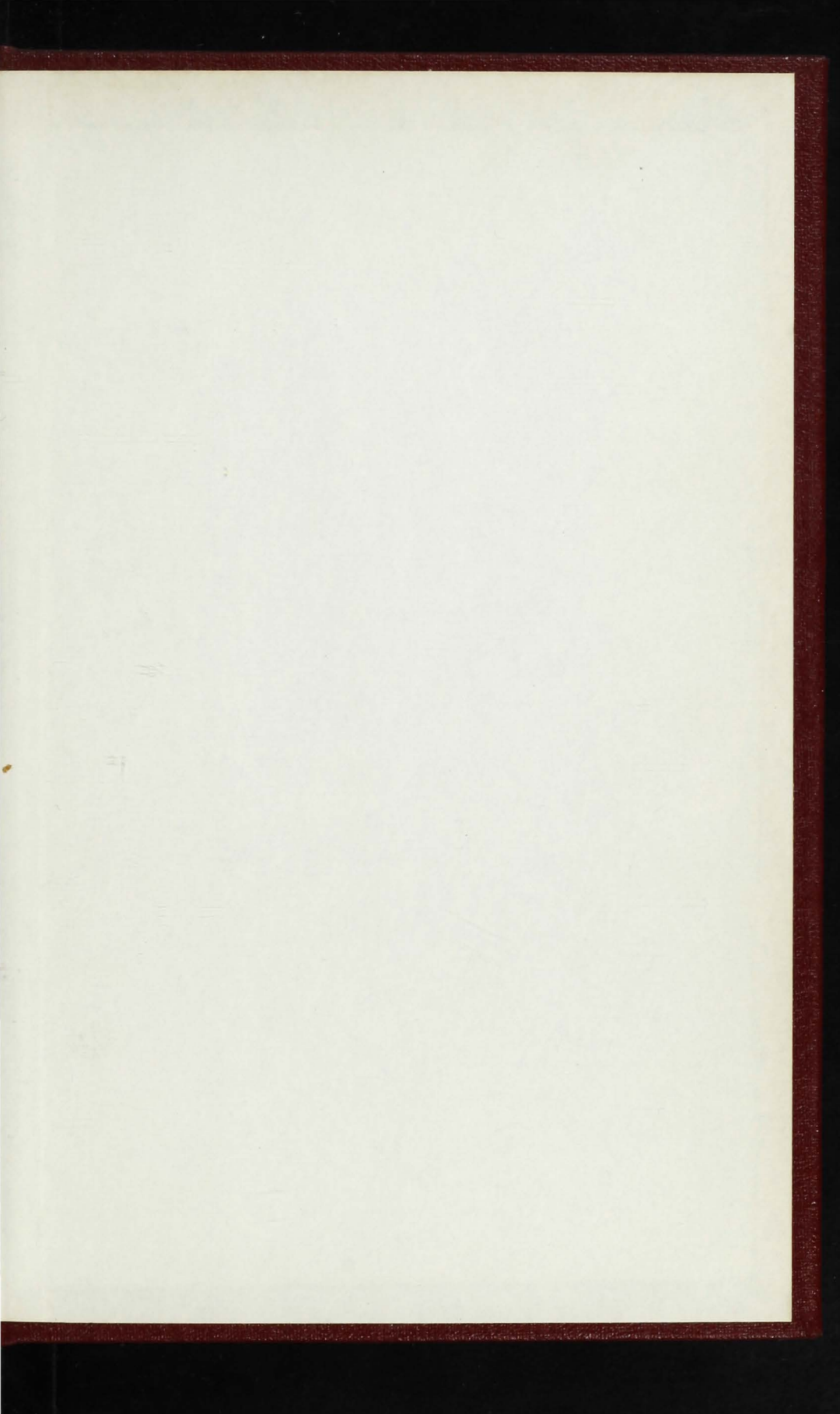
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