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Capital Gains Tax: A round-table discussion on one of the big but poorly thought-out tax changes planned by the UK Government. Richard Baron (IoD), John Wright (Federation of Small Businesses) and Vince Cable (Lib-Dem Shadow Chancellor) held on Wednesday, March 26, 2008 12:30-2:15pm.

The sudden and unexpected reform to the Capital Gains tax, followed by a drawn-out consultation and ultimate reform was one of the most shambolic political episodes of last year. To recap the Government replaced a 40% tax with a taper down to 10% with a flat 18% rate. After protests it introduced a lower rate of 10% for gains up to £1m. The first speaker said it had run contrary to the normal idea of raising the possibility of a change, putting it out to consultation and then either implementing it or abandoning it. In this case the water was muddied by the political necessity to both react to Conservative tax plans and prepare for a general election.

The Treasury clearly aimed to achieve a number of things. Firstly it needed to raise some money to pay for other measures. Secondly it was pursuing a simplicity agenda propounded by Alistair Darling when he took over as Chancellor. To be fair the new system was much simpler – albeit at a cost to those had enjoyed a 10% rate. Thirdly by announcing the move and saying it would take effect in six months' time it gave people time to put their tax arrangements in order.

The second speaker agreed the move had come out of the blue and broke with a tradition of giving businesses some notice. He quickly realised the majority of the 211,000 members of the FSB and the UK's 4.5m small businesses (of whom 90% employed less than 10 people) would be affected. He said he had never had such a reaction from the membership. The reason was undoubtedly that entrepreneurs tended to sacrifice pension provision and built their businesses in an expectation of being able to use the sale of their company as a pension pot. The four main business organisations – CBI, IoD, BCC and FSB – showed a united front and effectively criticised the Government for on the one hand hailing entrepreneurs as the lifeblood of the economy yet on the other hitting them with this tax rise. While the Government did relent, the delay had caused huge uncertainty for small businesses and put those thinking of selling in a weak position.

The third speaker said it was ironic that the original political motive for the CGT move – stopping private equity bosses paying less tax than their cleaner colleagues – had failed. Abolishing taper relief was actually a good idea as the old system was

incredibly complex. The Government simply miscalculated both the election timing and the implications of the reforms. In particular while they had left PE bosses untouched they had angered entrepreneurs and united the business lobby. It had also failed to tackle the long-term distortion of taxing capital at 18% and income at 40% and all the incentives for tax avoidance that creates. As one member pointed out, one of the more unfortunate consequences was that someone who has spent a lifetime building a business will pay the same as someone simply sitting on some property. The speaker suggested a return to the mid-1980s Lawson reforms that equalised capital and income taxes at 40%.

The first speaker doubted a return to the past was possible. It would be better to spend energy of getting the rate down. At its new level it will put some entrepreneurs off, he said. The second speaker said small business owners would get on with life but would be braced for further tax rises, probably with an environmental purpose. The third speaker doubted it would have a major impact, especially as 40% tax in the 1980s had not killed off entrepreneurialism. However he acknowledged that after the tax-and-spend years of Labour there was a sea-change in favour of reducing tax.

Asked about simplification, the third speaker advocated reforming corporate and income tax in both cases by eliminating allowances and relief and cutting the basic rate. One member said the problem was that Gordon Brown was wedded to the idea of tax as social engineering, which would not lead to simplification. Another member said that there was a tension between simplicity and fairness and that one should be wary of simple tax systems - as been shown by the CGT reform. Several members pointed out that the UK's system was both complex and unfair. One member said a flat tax was the most simple, yet was politically unacceptable. Another advocated combining income tax and National Insurance into one system.

The second speaker said that businesses wanted a static system and some element of stability. One member revived the old phrase attributed to Peter Ustinov: "Don't just do something, stand there!" In a perfect world, tax measures would appear to be common sense, he said. Perhaps there could be a sunset clause on tax legislation, another said. The third speaker cast a downbeat tone, saying that tax reform was a political nightmare especially for Opposition parties as it always created losers. The refusal to reform Council Tax was a good example. One member said it took real political initiative to impose tax reform. If that was not likely, as in the current political cycle, then businesses are stuck with the current system. On that depressing note, the roundtable wrapped up.