Play fair:

Equalising the taxation of earned and unearned income

Alec Haglund, Intergenerational Foundation

The Intergenerational Foundation (**www.if.org.uk**) is an independent, non-party-political charity that exists to protect the rights of younger and future generations in British policy-making. While increasing longevity is to be welcomed, our changing national demographic and expectations of entitlement are placing increasingly heavy burdens on younger and future generations. From housing, health and education, to employment, taxation, pensions, voting, spending and environmental degradation, younger generations are under increasing pressure to maintain the intergenerational compact while losing out disproportionately to older, wealthier cohorts. IF questions this status quo, calling instead for sustainable long-term policies that are fair to all – the old, the young, and those to come.

For further information on IF's work please contact Liz Emerson:

Intergenerational Foundation

19 Half Moon Lane, London, SE24 9JU

0044 (0)7971 228823

liz@if.org.uk

Alec Haglund is an IF researcher. He holds a degree from UCL in Arts & Sciences and an MA in Global Political Economy from Goldsmiths.

This work is licensed under a Creative Commons Attribution-ShareAlike 3.0 Unported License.

Front cover image courtesy of **Hassan Pasha** on Unsplash

Contents

	Page number
Executive summary	**4**
1. Introduction	**6**
2. Background	**8**
3. Why is the current tax system intergenerationally unjust?	**13**
4. All forms of unearned income should be incorporated into a unified Income Tax schedule	**17**
5. NICS and a unified Income Tax schedule	**20**
6. How much tax could be raised?	**23**
7. Arguments for and against	**28**
8. Policy recommendations	**32**
Appendix	**34**

Executive summary

- The current UK tax regime strongly favours unearned income over earned income. This has led to a tax system that is both unfair and inefficient. It also means that the young and those people who receive their income from employment pay much higher tax rates than those who receive unearned income

- In practice, because most private assets in the UK are held by older generations (mostly housing and pension wealth), the current tax system is intergenerationally out of step and represents an intergenerational injustice

- By equalising the taxation of all forms of income into a unified fiscally-neutral Income Tax schedule the tax system would become more efficient, transparent, and fair both intra-generationally and inter-generationally

- There are no social or economic justifications for skewing taxation towards earned income

- Due to the welcome but challenging increase in longevity, the proportion of national income that must be spent on health, social care, and the state pension will continue to grow. Where that tax revenue comes from is increasingly an intergenerational fairness issue

Abolishing the system of National Insurance Contributions (NICs) and instead incorporating the equivalent rates into a unified Income Tax schedule, alongside equalising the taxation levels on all forms of income, would lead to additional annual tax revenue of £30 billion

- The tax system is significantly fairer in most European countries – in France and Germany the tax rates on capital gains are 30% and 26% compared to the UK's 10-20%.

Currently, a person with an income of £60,000 a year in the form of capital gains or dividends pays less tax than a person (under 65 years) earning £35,000 through employment. Earned income, in such cases, is taxed 2 – 4 times more heavily than unearned income.

Put simply, anyone with an annual income of £60,000 drawn from unearned income has a lower effective tax rate than someone (under 65 years) earning £35,000 through employment.

A graduate in employment earning £35,000 a year pays almost double the effective tax rate of someone with a rental income of £35,000 a year.

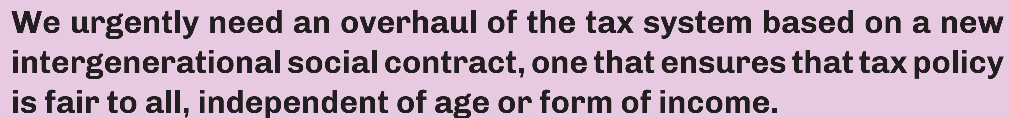
The revenue raised from equalising the taxation of earned and unearned income could be used to reduce the taxation burden on the lowest earners by increasing the personal allowance to £13,800. It would also allow for tax rates at each level to be lowered by at least 1.25 percentage points.

1. Introduction

The Intergenerational Foundation exists to advocate for the rights of younger and future generations in all areas of policy-making. This paper seeks to explain why the current UK tax regime is intergenerationally unjust. A far higher tax burden is now falling on the young and on income from work rather than on those people who receive unearned income such as from rents, shares, dividends, and property. The current tax system is also failing to rise to the fiscal challenges of the future and to cater to the needs of all citizens – the old, the young, and those to come. The UK tax system unfairly privileges unearned income over earned income. This incentivises manipulation and avoidance, leading to distortions where those on the highest incomes often have lower effective tax rates than those on average wages. An overhaul of the tax system is required, and using the lens of intergenerational fairness can help to make it fair, efficient, and fit for the future.

Governments choose where the sources of tax revenues come from in order to support the public services the nation needs. Crafting a functional, fair, transparent, and progressive tax system is as much an art as it is a science since no policy will be deemed perfect by everyone. Any reforms to tax policy will always lead to some being worse off as a result, even if those reforms would create a tax system that is better for society as a whole. Tax policy also casts long historical and political shadows, and the decisions of today (or the lack thereof) will have impacts for decades to come. The current tax system is failing, and brave decisions are required to avoid the cost of delaying important policy changes.

For tax policy to be as fair and effective as possible, it must be progressive, transparent, sustainable, and efficient, while minimising distortions, avoidance and loopholes. We live in an ageing society characterised by increasing wealth inequality on the one hand and a need for increased funding for our public services on the other. While we may be living through a turbulent period, policy-makers should not be excused from putting off reforming the tax system to ensure that tax policy is fit for purpose both for the present and the future. If avoided or pushed into the long grass, younger generations will be burdened by: ever-increasing taxes on their already low incomes; a continued increase in wealth inequality; public services suffering from insufficient funding and investment; while those who need care, support, and attention in old age will not be able to receive the support they need.



We urgently need an overhaul of the tax system based on a new intergenerational social contract, one that ensures that tax policy is fair to all, independent of age or form of income.

This paper proposes a tax reform that can be understood as largely fiscally neutral but which addresses the most damaging and unfair incongruence in the system: the unequal taxation of different sources of income. Therefore, this paper proposes that income from all sources, earned or unearned, be taxed at the same level. This would create a tax system that is intergenerationally just, progressive, effective, sustainable, and transparent, leading to a healthier and less unequal economy by age as well as by class.

2. Background

The UK tax regime treats different forms of income unequally by creating privileges for those who are fortunate enough to benefit from unearned income. These privileges come at the expense of the young and those on low- and middle-incomes who have to bear a larger part of the tax burden instead. Sadly, policy-makers have been unwilling, or unable, to undertake the radical reforms required to put the system right.

Although it is understandable that older generations have had the time to generate wealth, by benefitting from windfall gains in various asset classes, the current tax system has been set up in a way that exarcebates intergenerational inequalities by privileging this unearned income generation with exemptions, extra allowances, and lower tax rates. Meanwhile, the current tax system is increasingly punitive towards young people and income from employment.

Throughout this paper, when discussing earned income, this refers to income that is received from employment or labour. Unearned income refers to income that is received through wealth or ownership of capital, in the form of capital gains, dividends or rents. In public economics, unearned income is sometimes also referred to as "capital income" while earned income can be referred to as "labour income". This paper does not include a discussion on taxes on wealth itself but focuses on income that is generated through ownership of wealth or property.

Although various reviews have been undertaken on how to reform the UK tax system, the most holistic and extensive is "The Mirrlees Review", published in 2010, which consisted of an assessment of the current tax regime accompanied by an analysis of how the system can be reformed to reflect the necessities of the current economy.[1] The second part of the review presented a clear view on how to design a tax system for the UK that would fulfil the goals of being progressive and neutral, while simultaneously able to raise the revenue necessary to enable the distributional and spending ambitions of present and future governments.[2] The Mirrlees Review showed the desirability of reforming the UK tax system, and why removing the disparities in the taxation of earned and unearned income must be at the heart of such a reform.

The authors argued that removing the arbitrarily differential taxation rates for different people and economic activity is necessary to create an effective, progressive, fair, and coherent tax system.

[1] Adam, S. et al. (2010) Dimensions of Tax Design: The Mirrlees Review. Institute for Fiscal Studies. Oxford: Oxford University Press

[2] Adam, S. et al. (2011) Tax by Design: The Mirrlees Review. Institute for Fiscal Studies. Oxford: Oxford University Press

It also argued that all forms of income should be taxed according to the same tax schedule and that National Insurance contributions (NICs) should be integrated into the Income Tax rate schedule in order to improve fairness and avoid distortions such as privileging some forms of income over others. Incidentally or not, the current taxation system privileges wealthier and older people by taxing unearned income at much lower rates than earned income. According to the Mirrlees Review, this was not compatible with a tax system that is neutral, transparent, fair, and progressive. We are now 13 years on from the Mirrlees Review, and young people's tax rates on work remain much higher than those on unearned income, as can be seen in Figure 1.

Figure 1

Taxation rates in 2023/24 for different forms of income when including NICs				
Form of income	**Additional tax-free allowance**	**Basic rate**	**Higher rate**	**Additional rate**
From employment	-	32%	42%	47%
From dividends	£1,000	8.75%	33.75%	39.35%
From capital gains (non-residential)	£6,000	10%	20%	-
From capital gains (residential)	£6,000	18%	28%	-
From rent	£1,000	20%	40%	45%

The Office of Tax Simplification (OTS) has also argued that the tax system would be better designed if the rate schedules of Capital Gains Tax (CGT) and Income Tax were more closely aligned.[3] OTS further suggested that the government's current plans of lowering the Annual Exempt Amount (AEA) for capital gains should be undertaken in conjunction with reducing the disparities between CGT and Income Tax.

Having large disparities between the taxation of earned and unearned income leads to distortions and arbitrage, and since there are limitations to how efficiently the government can determine what ought to be characterised as earned income or not, this creates an unnecessary complexity in the tax system.[4] Further research into the benefits of removing the disparities between taxation of earned and unearned income include: Nanda and Parkes (IPPR)[5]; Robinson and Shorthouse (Bright Blue)[6]; Advani (University of Warwick)[7]; and Summers (London School of Economics)[8], among others.

There is a growing consensus on the benefits of either reducing or abolishing the inconsistencies of how earned and unearned income is taxed, both within and outside of governmental institutions and across the political spectrum. Whether one argues that the purpose would be to raise additional tax revenue, reward work more fairly, create a more efficient tax system, or improve intergenerational fairness, it is clear that moving towards a tax system that treats all forms of income equally has support from economists, researchers, activists and the public alike.[9] There is some historical precedent for a policy not dissimilar to the one proposed here. Conservative Chancellor, Nigel Lawson, set the taxation rates of CGT at the same level as Income Tax in 1988, arguing that: "In principle, there is little economic difference between [earned] income and capital gains ... And in so far as there is a difference, it is by no means clear why one should be taxed more heavily than the other."[10]

Wealth inequality has been rising year by year in the UK and globally, mirrored by a rise in unearned income. For tax design purposes it is therefore becoming increasingly important to account for growing and intergenerationally inequitable unearned income.

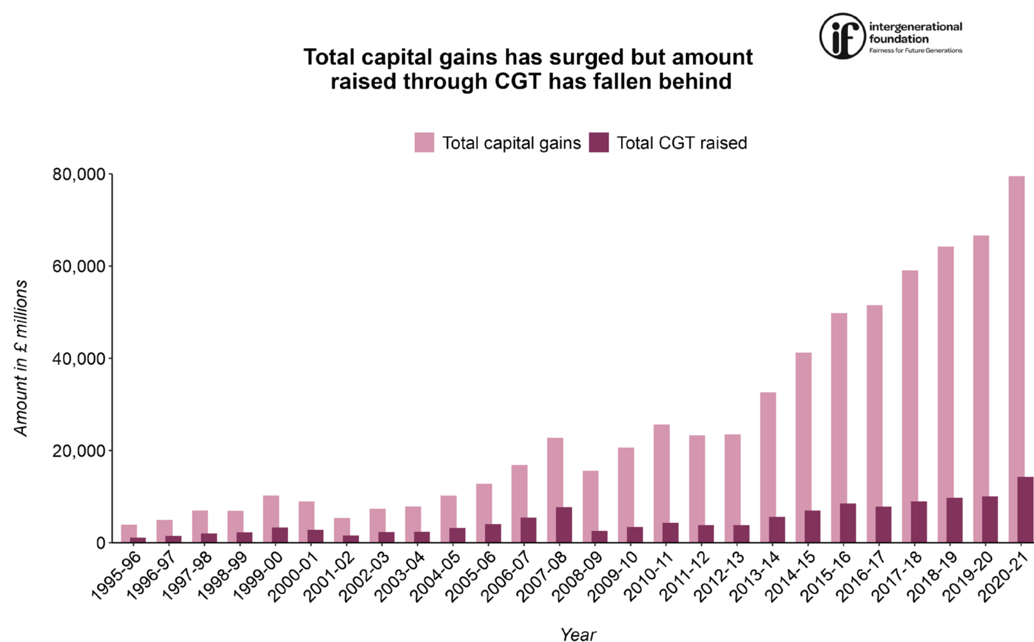
---

[3] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design.
[4] Stiglitz, J. E. (2018) Pareto Efficient Taxation and Expenditures: Pre- and Re-distribution. Working Paper 23892. Massachusetts: National Bureau of Economic Research
[5] Nanda, S., Parkes, H. (2019) Just Tax: Reforming the taxation of income from wealth and work. London: IPPR
[6] Robinson, S., Shorthouse, R. (2022) Rightfully Rewarded: Reforming taxes on work and wealth. London: Bright Blue
[7] For example Advani, A. (2021) The taxation of capital gains: principles, practice, and direction for reform. CAGE Working Paper No. 589. Warwick: University of Warwick
[8] For example Advani, A., Summers, A. (2020) Capital gains and UK inequality: New evidence from tax microdata. CAGE Policy Briefing No. 19. Warwick: University of Warwick
[9] Ansell, B. (2023) A puzzling inheritance. https://benansell.substack.com/p/a-puzzling-inheritance
[10] Budget Statement (1988) Available from: https://api.parliament.uk/historic-hansard/commons/1988/mar/15/taxes-on-capital

The current tax regime allows some individuals to characterise income from labour as unearned income for tax purposes, in essence amounting to a legal form of tax avoidance.[11] One in six of all individuals reporting capital gains do so just below the AEA, with the true number of those able to plan their realisation of gains to fall just below the AEA likely being much higher.[12] This is because in most cases capital gains below the AEA do not require reporting, and demonstrates how the system is being gamed by wealthier individuals.

Figure 2 shows how realised capital gains reported to HMRC has rapidly grown, particularly in the last decade, but that tax receipts collected by HMRC through CGT has not grown nearly as fast.

Figure 2



Capital gains, an example of unearned income, has seen a large increase over the past two decades, and this growth largely comes from income from labour that has been characterised as unearned income for tax purposes.[13]

[11] Freedman, J. (2003) Treatment of Capital Gains and Losses. In: Essers, P., Rijkers, A. (Eds.) The Notion of Income from Capital. EALTP Congress
[12] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design. Annex F
[13] Advani, A., Summers, A., (2020) Capital Gains and UK Inequality. CAGE Working Paper No. 465. Warwick: University of Warwick

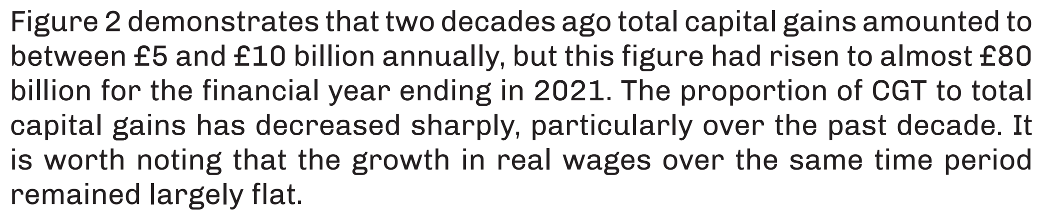


Figure 2 demonstrates that two decades ago total capital gains amounted to between £5 and £10 billion annually, but this figure had risen to almost £80 billion for the financial year ending in 2021. The proportion of CGT to total capital gains has decreased sharply, particularly over the past decade. It is worth noting that the growth in real wages over the same time period remained largely flat.

The amounts received in unearned income are often large and therefore should be taxed in an appropriate and fair manner. For example, in the financial year ending in 2018, as many as 260,000 people had taxable capital gains, with average gains of £210,000 per individual.[14] Those who benefit from unearned income are almost exclusively found at the top of the income and wealth distribution, meaning that it is the wealthiest who benefit the most from the current tax system.

The wealthy obtain two main advantages from the current system not available to most of the population: first, a large lump of tax-exempt capital gains; secondly, a maximum tax of 20%, which is less than half the top rate of Income Tax. Those who can manipulate the tax system in their favour tend to be those with high incomes or high levels of wealth, leaving a larger tax burden on younger people and those on lower incomes, further perpetuating inequalities between and within generations.

[14] Corlett, A., Advani, A., Summers, A. (2020) Who gains? The importance of accounting for capital gains. London: Resolution Foundation

3. Why is the current tax system intergenerationally unjust?

The way earnings are taxed in the UK is highly unequal, with income from work taxed at much higher rates than earnings from wealth, such as capital gains and dividends. The UK is already among the most unequal countries in the developed world in terms of income and wealth inequality. This inequality can be witnessed in many forms, but in recent years it has become increasingly visible in its generational divides.

Without a reform of the unfair tax regime, inequality between generations – intergenerational unfairness – is set to increase further. Most young people earn their income through work, while older generations are much more likely to own capital and to benefit from unearned income. If not taxed fairly, the wealth accumulation of returns on capital exacerbates already existing inequalities by benefitting older and wealthier individuals at the expense of those whose income from work is over-taxed, limiting their abilities to become financially secure. For example, not taxing capital gains from property in a progressive and equitable manner will incentivise further financialisation of the housing market, which further increases housing costs for all who are not fortunate enough to own their own property, many of whom are young.

It is morally problematic that those with the broadest shoulders and highest incomes should be taxed at lower rates than low- and middle-income individuals, whatever their age. From the perspective of sensible policymaking, it is also intergenerationally unfair that younger people who primarily earn their income from work face a larger tax burden than older and wealthier individuals who are more likely to benefit from lower rates of taxation on unearned income. Given that we live in an ageing society with increased longevity, we can expect that a larger proportion of national income each year must go towards services such as health, social care, and state pensions. This context implies that it is desirable to ensure that the tax system is suitable for the socio-economic context in which we live, so that public services are sustainably funded both in the present and for generations to come. It would be unfair for young people to have to bear a disproportionate part of this burden, which should instead be shared across generations through progressive taxation. For example, under-45s currently earn 41% of total income but are responsible for paying 53% of NICs.[15]

Although overall wealth has increased rapidly in recent years, real wages have been declining for over a decade, falling at record levels since the worst of the cost-of-living crisis began.

[15] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: University of Warwick

Household wealth as a proportion of GDP has continued to grow, but the increase in wealth has almost exclusively gone towards the already wealthy in society, with most wealth stored in pensions and property.

Young people have not been able to benefit from the growth in wealth, in fact, the boom in wealth has in some ways made life more difficult for young people as housing costs surge and building wealth through work becomes increasingly impossible for the majority.[16] For example, it will become increasingly difficult for young people and low-income workers to buy a house if their incomes are taxed more heavily than the incomes of older and wealthier people. The status quo improves the already stronger financial position of wealthier and older generations to compete for scarce resources, such as houses, in relation to the increasingly precarious position of the young. Young people face a difficult financial situation, and they were forced to spend a larger proportion of expenditure on essentials than any other age group already before COVID-19 and the recent cost-of-living crisis.[17]

Thus, taxing earned and unearned income equally would be beneficial for young people and low- and middle-income earners, since it would allow for the tax burden to be shared more progressively within the economy, ensuring that those with large amounts of unearned income do not pay much lower rates of tax than people on average wages. Additionally, equalising the taxation rates of all forms of income would also contribute to stopping the intergenerational wealth rift opening up between generations. The current tax system is an intergenerational injustice that encourages and supports the continued accumulation of wealth by those who already have it at the expense of everyone else, with most young people falling further and further behind.

Equalising CGT rates with Income Tax has support across the political spectrum, with 62.2% overall support, and 50% support even among Conservative voters. Equalising tax rates would also be financially beneficial for all workers below state pension age as it would allow for lower rates of taxation on income from work, and/or a higher personal allowance. Thus, while improving intergenerational fairness, equalising the taxation of different forms of income into a unified schedule would improve fairness and horizontal equity in the tax system as people with similar levels of income would be taxed in a similar way.

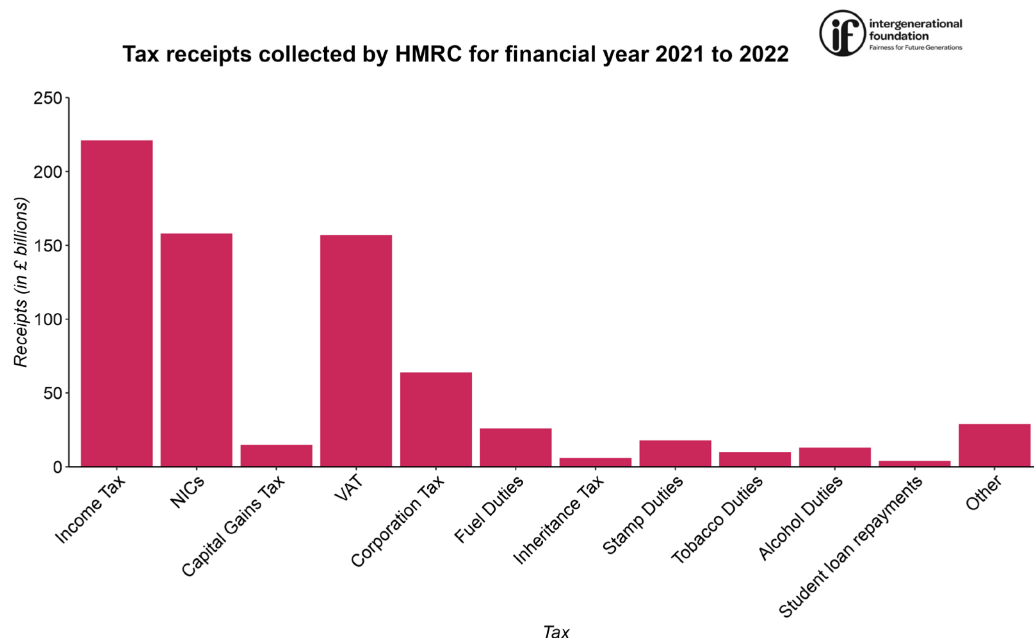
Figure 3 reveals total tax receipts collected by HMRC from different sources for the financial year 2021 to 2022. It demonstrates that taxes on work form the vast majority of HMRC tax receipts.

[16] Haglund, A. (2022) The Savings Squeeze: Young people locked out from the benefits of saving. London: Intergenerational Foundation https://www.if.org.uk/research-posts/the-savings-squeeze-young-people-locked-out-from-the-benefits-of-saving

[17] Kingman, D. (2019) All Consuming Pressures: The cost-of-living crisis facing younger generations. London: The Intergenerational Foundation https://www.if.org.uk/research-posts/all-consuming-pressures-the-cost-of-living-crisis-facing-younger-generations

Student loan repayments effectively function as a graduate tax and are therefore included in the graph despite not being tax receipts collected by HMRC.

Figure 3



Since wealth is much more unequally distributed in society than income, it implies that the divide between those who can benefit from unearned income streams and those who cannot is widening. Previous research by IF showed how the inequality in levels of saving and wealth between young people and older generations has drastically increased in the past decade.[18] Tax policy that privileges unearned income and income from wealth affects younger people negatively by entrenching wealth inequalities between generations.

Part of the goal of tax design is to ensure that such situations do not arise as a result of taxation, but the current system falls short of that goal. The tax privileges granted to those with unearned income in the UK are also over-generous by European standards. For example, in Germany the Annual Exempt Allowance is only €1,000 and all capital gains are taxed at 26.38%, while in France unearned income is taxed at 30-34%.[19]

[18] Haglund, A. (2022) The Savings Squeeze: Young people locked out from the benefits of saving. London: Intergenerational Foundation https://www.if.org.uk/research-posts/the-savings-squeeze-young-people-locked-out-from-the-benefits-of-saving
[19] PwC (2022) Worldwide Tax Summaries https://taxsummaries.pwc.com

The current system of taxing earned and unearned income differently is intergenerationally unjust because:

- Young people have low, and falling, levels of ownership of assets able to generate unearned income, meaning that the privileges of the current system are disproportionally enjoyed by older and wealthier generations
- National Insurance is effectively a tax on employment, and the majority of young people only receive income through employment and are therefore disproportionally heavily taxed
- National Insurance discriminates by age as the over-65s are exempt from paying NICs
- National Insurance is a regressive system where those on the highest incomes, who tend to be older, pay lower effective NICs rates than people on or close to average wages
- Taxing unearned income at lower rates leads to distortions in the economy where those with the highest incomes can plan to receive their income in the form of capital gains, leaving a higher tax burden for those in employment
- An ageing society requires that an increasing proportion of national income is spent on health and social care, but without reforming the current tax system this will only lead to younger people and those in employment having to shoulder an increasingly large part of the burden as society ages
- The current system concentrates wealth accumulation amongst a very small proportion of society, meaning that it is increasingly difficult for young people to compete for resources such as buying a house, leading to more and more young people being stuck in the unaffordable private rental market
- Older people are more likely to: require health and social care services; benefit from capital gains; and have higher total incomes than young people. In comparison, young people pay a proportionally larger proportion of NICs despite using health and social care services the least and having lower incomes and less assets than older people. The social contract expects the young to support the old, but it also expects that people contribute according to their ability to do so, and current tax policy fails on this account

4. All forms of unearned income should be incorporated into a unified Income Tax schedule

Figure 4 shows how earned income is taxed more heavily than unearned income, such as earnings from capital gains, dividends, or rent. The figure shows the effective tax rate (the percentage of total income collected in taxes) for annual incomes of £35,000 and £60,000, assuming all income is in the same form. The figure includes Income Tax as well as NICs and student loan repayments for the example of a graduate in employment. The tax brackets used are those for the financial year from 2023 to 2024.

Figure 4

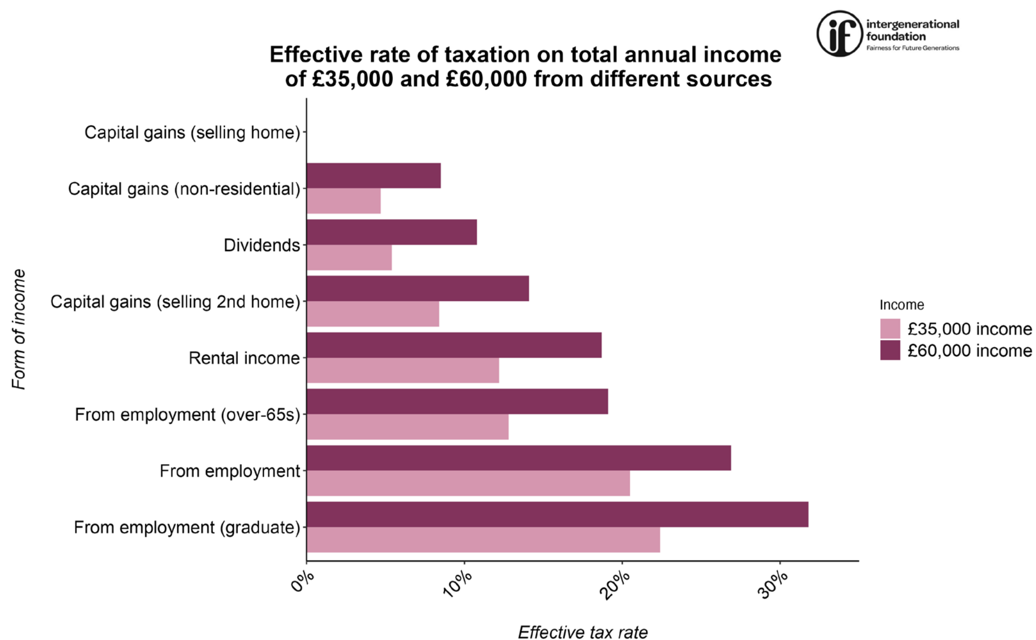


Figure 4 makes plain the full scale of the tax privileges granted to those with sources of unearned income, while those who receive their income through employment face much higher effective tax rates. For those with an annual income of £35,000, the highest effective tax rates are for graduates in employment (22.5%), those in employment without student loan repayments (20.5%), followed by over-65s in employment (12.8%), who are exempt from NICs. The lowest effective tax rates with an annual income of £35,000 are for capital gains from selling a primary residence (0%), from non-residential capital gains (4.7%) and from dividends (5.4%).

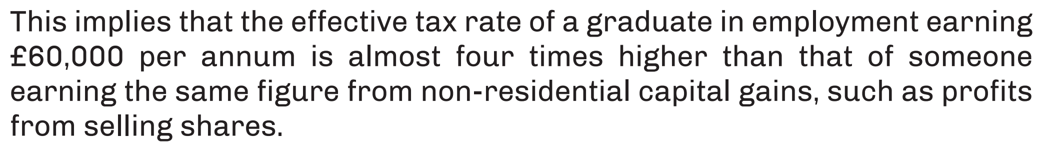
All capital gains receive an additional £6,000 Annual Exempt Allowance on top of the personal tax allowance of £12,570, and taxation of non-residential capital gains is only 10% at the basic rate. Income from dividends also receives an additional tax-free allowance of £1,000 and is only taxed at 8.75% at the basic rate. Those with an annual income of £35,000 in capital gains from selling a second home pay 8.4%, while those with the same income from rent pay 12.2% as rental income is exempt from NICs and also has an additional tax-free allowance of £1,000 on top of the personal allowance.

All those with an annual income of £60,000 not drawn from employment have a lower effective tax rate than those (under 65 years) earning £35,000 from employment. An annual income of £60,000 from non-residential capital gains has an effective tax rate of only 8.5%, while the same income from dividends has an effective tax rate of only 10.8%, and the effective tax rate of capital gains from selling a second home is 14.1%. The effective tax rate for an income of £60,000 from rent is 18.7%, while the effective tax rate of the same income from employment is 26.9% and 31.8% for graduates.

Figure 5

Effective rates of taxation on different forms of income in table format

Form of income	Effective rate of taxation on £35,000 annual income	Effective rate of taxation on £60,000 annual income
Capital gains (selling home)	0	0
Capital gains (non-residential)	4.7	8.5
Dividends	5.4	10.8
Capital gains (selling 2nd home)	8.4	14.1
Rental income	12.2	18.7
From employment (over-65s)	12.8	19.1
From employment	20.5	26.9
From employment (graduate)	22.5	31.8



This implies that the effective tax rate of a graduate in employment earning £60,000 per annum is almost four times higher than that of someone earning the same figure from non-residential capital gains, such as profits from selling shares.

Similarly, the effective tax rate of someone earning £35,000 from dividends is almost four times lower than that of someone earning the same amount through employment, even before taking into account possible student loan repayments.

Research has shown that a majority of capital gains go to owners of businesses, and that a large proportion of capital gains are often a substitution for employment income, favoured by many due to its tax advantages.[20] Capital gains have become increasingly concentrated amongst the wealthiest individuals, who also tend to have the highest incomes. The top 1% receive approximately 14% of national income when measured using only employment income statistics. When including capital gains, the top 1% receives 17% of national income, and includes more people above the age of 60.[21] It is difficult to assess the full picture of capital gains, since those who have income from capital gains which falls below the annual capital gains tax-free allowance are generally excluded from HMRC data. However, in the tax year ending in 2018, as many as 50,000 people reported gains just below the tax-free capital gains threshold.[22]

Equalising the taxation of unearned income into a unified Income Tax schedule would abolish the unfairness of taxing different forms of income unequally, and it would remove the distortion that encourages individuals to collect their income in the form of capital gains or dividends even if such income was generated through a process that would be classified as labour.

---

[20] Advani, A., Summers, A. (2020) Capital gains and UK inequality: New evidence from tax microdata. CAGE Policy Briefing No. 19. Warwick: University of Warwick

[21] Advani, A., Summers, A. (2020) Capital gains and UK inequality: New evidence from tax microdata. CAGE Policy Briefing No. 19. Warwick: University of Warwick

[22] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design.

5. NICs and a unified Income Tax schedule

When National Insurance was introduced, there was a direct link between the amount paid into the system and the benefits one would be entitled to as a result. This contributory element does not exist anymore, and National Insurance effectively functions in the same way as Income Tax for the purpose of government expenditure. Whenever shortfalls in revenues received through National Insurance contributions (NICs) occur, funding from general taxation is used to fill the gap, and vice versa. The only differences that remain are that it is more regressive, not levied on unearned income received through rent, capital gains or dividends, and not applied to workers above the State Pension Age (SPA). The policy decision of having NICs and Income Tax as two separate systems makes the tax system opaque, regressive, and overly complex.

The reason the rate at which NICs are paid is regressive is because annual income from employment, at the higher tax threshold of £50,270, only incurs NICs of 2%, while NICs must be paid at 12% on income between £12,570 and £50,270. People earning between £20,000 and £50,000 per annum make up approximately 42% of total income, but they contribute half of all revenue raised through NICs.[23]

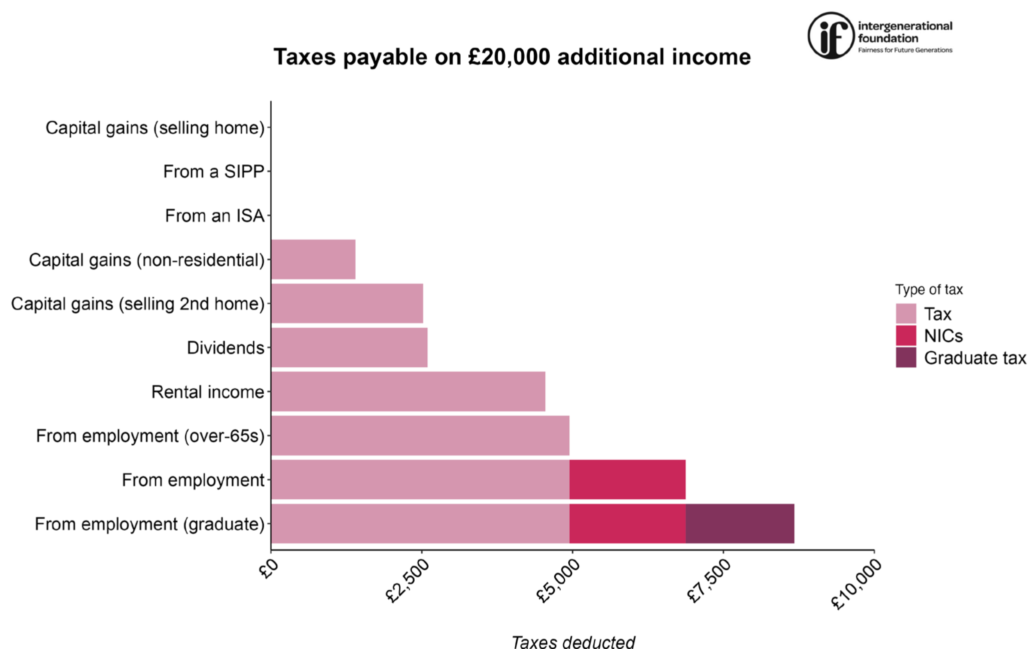
Figure 6 explains how unfairly different forms of income are treated in the current tax system, by penalising the young and those receiving their income from employment, while privileging those receiving unearned incomes. Figure 6 shows the amount that would be deducted in taxes of an additional £20,000 in income in different forms, after having already earned £35,000 through employment.

It is clear from Figure 6 that there are unfair tax privileges granted to forms of unearned income over income earned through employment, as those receiving an additional income of £20,000 through capital gains, dividends or rental income do not pay NICs on such income and also enjoy lower rates of taxation even before the application of NICs and possible student loan repayments. Earning an additional income of £20,000 through employment (after already having earned £35,000 through employment) means Income Taxes payable on the additional income amount to £4,946 and £1,927 in NICs, a total of £6,873 or 34.4% of the total additional income. For those with student loans, the total sum payable in taxes on the additional income would be £8,673, or 43.4% of the total additional income.

[23] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick

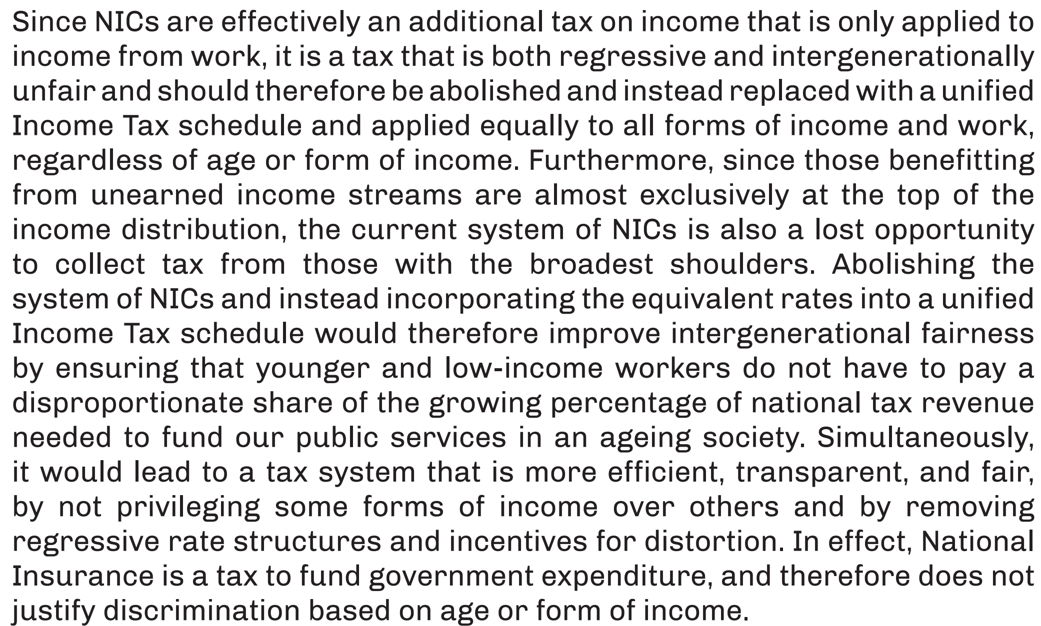
Over-65s earning an additional income of £20,000 only pay £4,946 in taxes, or 24.7% of the additional income, since they are exempt from paying NICs.

Figure 6



Notes: Assuming that each individual has already earned £35,000 from employment. The first 25% from a SIPP is tax-free.
© Intergenerational Foundation 2023 www.if.org.uk

All forms of unearned income are exempt from paying NICs. Rental income also benefits from the tax privilege of a tax-free allowance of £1,000 in addition to the personal allowance, meaning that tax payable on additional income of £20,000 from rent is only £4,546, or 22.7% of the additional income. An additional income of £20,000 from dividends means taxes payable would be £2,595, or 13% of the additional income. The same income from capital gains of selling a second home would incur tax of £2,520, or 12.6% of the additional income. Additional income of £20,000 from the capital gains of non-residential assets only incurs a tax of £1,400, or 7%, as it benefits from both the additional capital gains AEA and the low rates at which capital gains are taxed. Additional income of £20,000 from selling a primary residence would not incur any tax liability. The first 25% of income from a Self-Invested Personal Pension (SIPP) does not incur any tax liability and income from an Individual Savings Account (ISA) is also exempt from tax, although paid out of post-tax income.



Since NICs are effectively an additional tax on income that is only applied to income from work, it is a tax that is both regressive and intergenerationally unfair and should therefore be abolished and instead replaced with a unified Income Tax schedule and applied equally to all forms of income and work, regardless of age or form of income. Furthermore, since those benefitting from unearned income streams are almost exclusively at the top of the income distribution, the current system of NICs is also a lost opportunity to collect tax from those with the broadest shoulders. Abolishing the system of NICs and instead incorporating the equivalent rates into a unified Income Tax schedule would therefore improve intergenerational fairness by ensuring that younger and low-income workers do not have to pay a disproportionate share of the growing percentage of national tax revenue needed to fund our public services in an ageing society. Simultaneously, it would lead to a tax system that is more efficient, transparent, and fair, by not privileging some forms of income over others and by removing regressive rate structures and incentives for distortion. In effect, National Insurance is a tax to fund government expenditure, and therefore does not justify discrimination based on age or form of income.

6. How much tax could be raised?

Unifying the taxation schedules of earned and unearned income would raise a significant amount of revenue. This could be used either for public spending, or to allow for increasing the personal tax-free allowance significantly and/or lowering tax rates in a fiscally neutral way. However, just how much could be raised through this tax reform is difficult to calculate and estimates among researchers vary.

The primary reason it is difficult to estimate exactly is due to the sheer scale of the reform. Additionally, the nature of the reform would lead to behavioural changes, and while such changes can be estimated to some extent, they are difficult to account for with precise figures. Further, due to the existence of tax-free allowances for capital gains and dividends, it is not clear how many individuals currently plan their unearned incomes to be just below the tax-free threshold every year.

Research undertaken by Advani and Summers shows that equalising the rate of taxation of capital gains with Income Tax would raise approximately £15 billion annually.[24] This estimate is largely corroborated by Office of Tax Simplification (OTS) analysis of 2018-19 HMRC data, suggesting that aligning CGT rates with Income Tax would raise £14 billion annually, or £16 billion if combined with removing the AEA for capital gains.[25] This aligns with the estimates of the National Audit Office, which estimated the value of the AEA relief at £2.9 billion in the financial year ending in 2013.[26] However, research suggests it is now considerably higher, at approximately £4.6 billion for the financial year ending 2022.[27]

Calculations by Nanda and Parkes reveal a similar figure, showing that equalising earned and unearned income (but not NICs) into a unified tax schedule would raise £120 billion over five years in a static analysis, or £90 billion when taking into account behavioural effects.[28] This would imply additional tax receipts of approximately £18 billion per year which is broadly in line with other calculations. The total estimated additional tax revenue from equalising earned and unearned income and removing reliefs and allowances for unearned income arrived to by Palmer, Turner and Hebden comes to £25 billion annually.[29] Removing CGT relief on death would itself raise approximately £1.2 billion in 2018 figures.[30]

[24] Advani, A., Summers, A. (2020) Capital gains and UK inequality: New evidence from tax microdata. CAGE Policy Briefing No. 19. Warwick: University of Warwick, and Advani, A., Summers, A. (2020) How much tax do the rich really pay? New evidence from tax microdata in the UK. CAGE Policy Briefing No. 27. Warwick: University of Warwick

[25] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design. Annex F

[26] National Audit Office (2014) Report: Tax reliefs

[27] Nanda, S., Parkes, H. (2019) Just Tax: Reforming the taxation of income from wealth and work. London: IPPR

[28] Nanda, S., Parkes, H. (2019) Just Tax: Reforming the taxation of income from wealth and work. London: IPPR

[29] Palmer, R., Turner, G., Hebden, P. (2019) A Manifesto for tax equality. London: Tax Justice UK

[30] Corlett, A. (2018) Passing On: Options for reforming inheritance taxation. London: Resolution Foundation

Additionally, such reform would remove inefficiencies in the economy, as individuals may hold onto investment properties to avoid CGT which contributes to the housing stock being under-used.

However, all these estimates assume that the exemption for the sale of a primary residence will continue to apply. It is difficult to estimate the cost of exempting the sale of a primary residence from capital gains tax since behaviour would likely drastically alter as a result of removing such a policy, but the government estimated the tax exemption to be worth £37.3 billion during the financial year from 2021 to 2022.[31]

The estimates cited do not include collapsing NIC rates into a unified Income Tax schedule. Calculating the impacts of NICs separately, the Institute for Fiscal Studies (IFS) shows that abolishing the National Insurance exemption for over-65s in employment would raise approximately £1.1 billion annually.[32] Advani estimates that applying NIC rates for over-65s would raise £1.6 billion annually, or £3.6 billion if combined with applying NIC rates to unearned income.[33] HMRC estimates that the lower rate of NICs paid by the self-employed relative to those in employment was estimated to be worth £4.7 billion in the financial year from 2021 to 2022.[34]

Although pension income is liable for Income Tax, it is currently exempt from NICs. Estimates from 2018 suggest that for every percentage point that NICs (or an equalised tax schedule) were levied on pension income approximately £650 million would be raised, and 60% of this from the wealthiest 20% of pensioners.[35] Limiting the tax-free lump sum that can be taken from a pension pot to a maximum of £42,000 would raise £2 billion annually.[36]

According to research by Advani et al., extending NICs to unearned income in the same fashion it currently applies to income from employment would raise approximately £8.6 billion annually, rising to £11.8 billion if combined with removing the exemption for over-65s.[37] Furthermore, Advani's calculations show that equalising the rate on high earnings for NICs would raise an additional £20 billion annually.[38]

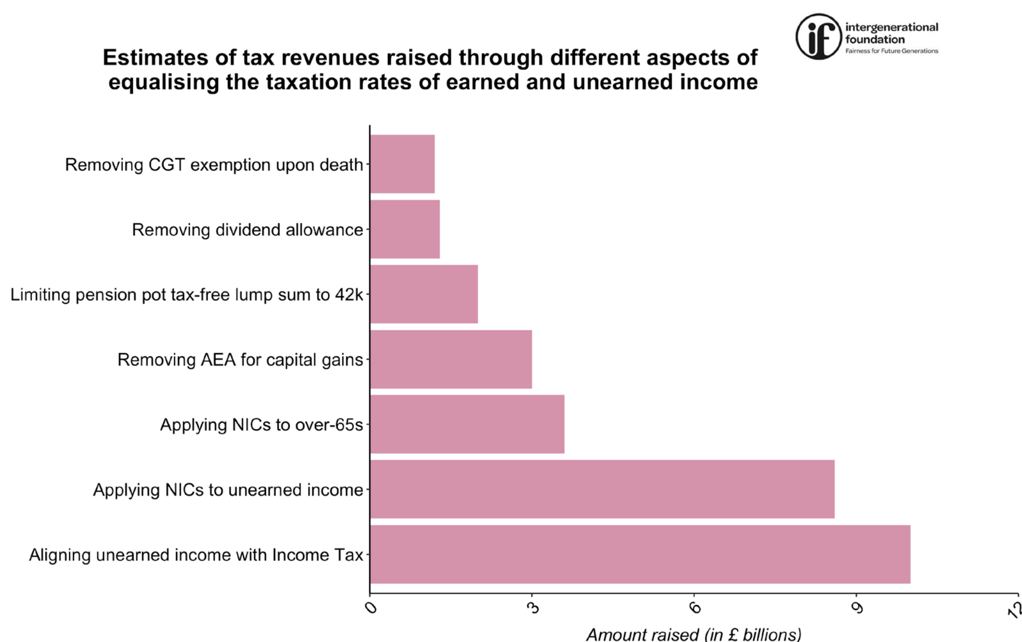
Analysing the revenues that could be raised from dividends separately, without taking into account structural exemptions or income via Individual Savings Accounts (ISAs), HMRC estimated that the personal dividend allowance in the financial year 2021 to 2022 was worth £720 million, when

[31] HMRC (2023) Non-structural tax relief statistics (January 2023)
[32] Adam, S., Waters, T. (2018) Options for raising taxes. London: The Institute for Fiscal Studies
[33] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick
[34] HMRC (2021) Tax relief statistics (December 2021) Updated January 2023
[35] Adam, S., Waters, T. (2018) Options for raising taxes. London: The Institute for Fiscal Studies
[36] Resolution Foundation (2018) A new generational contract: The final report of the Intergenerational Commission
[37] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick
[38] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick

the dividend allowance was £2,000.[39] However, other research suggests that abolishing the dividend allowance and rolling it into the personal allowance would raise £1.3 billion annually.[40]

Figure 7 uses the estimates cited to visualise how much could be raised through each of the measures that form part of the wider policy to unify earned and unearned income under one Income Tax schedule. The figures used are on the conservative side rather than using the most optimistic calculations. This figure uses a combination of the estimates as calculated by Advani et al., Corlett, Nanda & Parkes, IFS and OTS as cited in this chapter. An explanation of the figures that have been used is provided in the Appendix. This data includes indexation, that is allowing for rate of returns at the rate of inflation to be non-taxable for capital gains.

Figure 7



Although the figures used contain uncertainties due to the scale of the policy reform, Figure 7 demonstrates that large amounts could be raised in tax receipts by unifying earned and unearned income into one Income Tax schedule. Behavioural effects are taken into account for aligning unearned income with Income Tax and for removing the AEA, while the other figures were estimated using a static analysis. The figure showing that applying (the equivalent of) NICs to over-65s also assumed that the equivalent of NICs is applied on unearned income.

[39] HMRC (2021) Tax relief statistics (December 2021) Updated January 2023

[40] Palmer, R., Turner, G., Hebden, P. (2019) A Manifesto for tax equality. London: Tax Justice UK

In total, the amounts raised would amount to almost £30 billion annually. Even if the figures contain large amounts of uncertainty, the total sum that could be raised would nonetheless be a substantial amount. Additionally, if not allowing for a normal rate of return to be non-taxable, the amount raised would drastically increase, or if applying Income Tax to the sale of a primary residence then the amount raised would likely double.

The real revenue raised would depend on how each policy is implemented in practice. However, it is worth noting that the estimate of £30 billion is more conservative than it is optimistic. The data used in Figure 7 is skewed towards more conservative estimates, suggesting that a larger increase in the tax take is possible. Additionally, since some of the data is a few years old, the nominal amount raised would be higher due to inflation and asset growth in recent years. How the policies would be implemented in practice also depends on how the concept of equalising taxation of all forms of income is interpreted by policy-makers. For example, if the lower NIC rate for high earners was removed when abolishing the NIC system and incorporating the equivalent rates into a unified Income Tax schedule, then an additional £20 billion would be raised.[41] Analysis of how trusts interact with the tax system is too complex to address in this report but would also be a source of additional tax revenue if a version of these reforms were implemented once the complexities of trust law are unpicked.

By abolishing the system of NICs and instead applying the equivalent rates to all income within a unified Income Tax schedule, the tax rate would be 32% at the basic rate, 42% at the higher rate, and 47% at the additional rate for all forms of income. However, it would be possible to use the proceeds from the additional tax revenue to either raise the personal tax allowance and/or lower taxation rates.

HMRC estimates that increasing all main allowances, starting and basic rate limits by 10% would cost approximately £14 billion annually in lost tax revenue.[42] Additional analysis by HMRC estimates that increasing the personal allowance by 10% (to approximately £13,800) would lead to annual losses in tax revenue of between £8.6 billion and £10 billion in the next three years.[43]

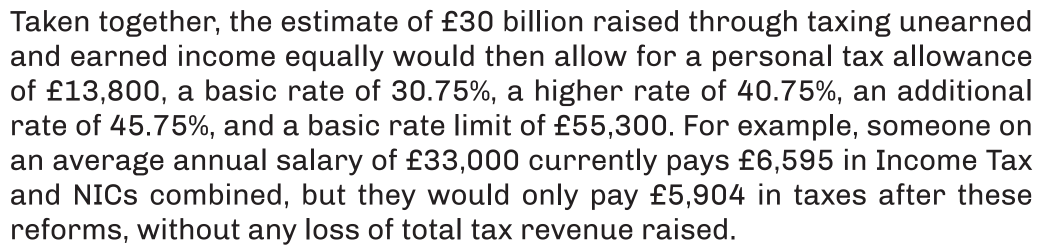
It would be possible to increase the personal allowance to £13,800 and increase the basic rate limit to £55,300 at a cost of approximately £14 billion annually, or less than half of the savings made from equalising the taxation of earned and unearned income. It would also be possible to lower each tax rate by 1.25 percentage points at a cost of approximately £16 billion annually.[44]

[41] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick

[42] HMRC (2013) Direct effects of illustrative tax changes. Updated January 2023

[43] HMRC (2013) Direct effects of illustrative tax changes. Updated January 2023

[44] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. 33. Warwick: The University of Warwick



Taken together, the estimate of £30 billion raised through taxing unearned and earned income equally would then allow for a personal tax allowance of £13,800, a basic rate of 30.75%, a higher rate of 40.75%, an additional rate of 45.75%, and a basic rate limit of £55,300. For example, someone on an average annual salary of £33,000 currently pays £6,595 in Income Tax and NICs combined, but they would only pay £5,904 in taxes after these reforms, without any loss of total tax revenue raised.

Of course, these are mere illustrations of the possibilities. The government might prioritise raising the personal tax allowance even higher rather than lowering tax rates or vice versa, or committing a portion of the proceeds to public investment or public services. Furthermore, if a more extensive version of the policies proposed here were introduced, such as not allowing for indexation of gains, then the taxation burden on low- and middle-income workers could be lowered significantly more.

7. Arguments for and against

A large reform of the tax system is never without opposition. Other than the sheer scale of the task, there exist arguments both for and against the policy proposal of equalising taxation of earned and unearned income that are worth mentioning.

7.1 Arguments against

One argument against this policy is that which concerns the risk taken by investors, and that this risk should be rewarded in the form of lower rates of taxation. This argument, however, assumes that risk is something unique to investors, and not something that those in employment face. While the risk is different in character, those who receive their income from employment may face risks such as injury, displacement, or ill health due to their work, among other risks. Without making a subjective value judgment on different forms of risk inherent to any economic activity, a neutral stance from a tax perspective would not favour one form of risk over another, and therefore treat both forms of income equally. Aligning the taxation rates of earned and unearned income under the same schedule may also serve to improve public discourse around tax, since unifying the rates has the benefit of appealing to a sense of common and shared social responsibility, making it easier to lower or raise taxation rates without complexity or distortions appearing. While there exist arguments for using tax incentives to encourage investment in specific industries, such as renewable energy, such incentives can instead be provided through direct public investment rather than through tax privileges. Most importantly, when tax policy diverges from neutrality on different sources of income it incentivises distorting behaviour, such as the characterising of income from labour as capital gains.[45]

It can also be argued that unearned income is generated from savings which have already been taxed, and that they should therefore not be taxed again. Some forms of savings and investments, such as capital gains from ISAs, already operate in this manner, the justification of which is that the population should be encouraged to save to fund their own old ages. However, the fundamental problem with the double-taxation argument is that it conflates taxing the profit with taxing the principal, and it is only the profit which would be taxed. Thus, double taxation does not occur, but rather only the taxation of the additional income that has been generated by using the capital which had previously been taxed. Furthermore, in many cases the ownership of capital or wealth which generates income has not been acquired through earnings from employment, for instance in the case of inheritance.

[45] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design.

Additionally, some forms of "double taxation" are natural parts of any tax regime. For example, post-tax income that is used to acquire goods or services usually incurs VAT on those purchases.

Some may argue that tax on earned income is easier to collect than tax on unearned income, whereas the administrative task of tax collection is the least complicated if the tax burden primarily falls on income from employment. Thus, policy-makers may opt for ease over equity. While this argument may be true to some extent from an administrative standpoint, it does not imply that a tax system which privileges unearned income over earned income is superior from any economic or social perspective, simply that it may be an easier system to administrate. Furthermore, if it is easier to administrate, this is only the case because our current tax system is already set up in a way that focuses on collecting taxes on earned income. The rising importance of unearned income, particularly for the wealthiest in society, means that it is increasingly desirable to properly integrate the taxation of unearned income into the tax system. Not doing so would only further encourage distortionary behaviour, and therefore increase lost opportunities from generating tax revenue from those who can afford it the most. Even if it is a difficult task to reform the tax system so that all forms of income are treated similarly, the benefits of such a system far outweigh the administrative costs and difficulties that would arise given the scale of the reform. Additionally, once the reform is successfully undertaken, the tax system will be simpler to administrate going forwards due to having fewer tax schedules, allowances, exemptions and reliefs to administer and monitor.

It can also be argued that reform would destabilise or disrupt the UK system which has been built on the privileged tax treatment of housing, property, capital gains and savings in tax-free vehicles such as ISAs. Although this argument contains some merit, it must be recognised that the current system is destabilising in itself and contributes to the state of the economy young people find themselves in, where buying a house is out of reach, and real incomes and expenditure on non-essentials is rapidly falling for the majority of young people in work. The current tax regime is partially responsible for the UK being amongst the most unequal developed economies, with some very wealthy people but more poverty.[46]

7.2. Arguments for

Equalising the rates of taxation of earned and unearned income would have benefits for the tax system by making it more effective, transparent, sustainable, coherent and progressive.

[46] Financial Times (2022) Britain and the US are poor societies with some very rich people. Financial Times, 16 Sept 2022

However, there are additional arguments about the wider socioeconomic benefits such a policy would have, and why tax design is important for achieving societal goals in an equitable way.

Demographic change in the UK will lead to the proportion of the population aged over 65 years to increase from 19.2% in 2022 to 29.1% in 2072.[47] An ageing society puts more pressure on public services, whereas we must ensure that tax revenues are put on a stable, fair, sustainable, and progressive foundation for future generations. The proportion of national income spent on health and social care will continue to rise, meaning that maintaining current levels of welfare provision implies a necessary increase in tax revenue collected as a proportion of national income if quality of provision is not to drastically fall. However, in order to ensure that tax revenue is collected in a way that is intergenerationally fair, it is necessary to ensure that the distribution of how the extra tax revenue is collected does not fall disproportionally on younger generations but that it is progressively distributed across age and income groups. Taxing all forms of income equally would improve horizontal equity in the tax system, ensuring that taxpayers with similar incomes and abilities to pay do in fact pay similar amounts in tax.

Equalising the taxation of earned and unearned income would allow for reduced Income Tax rates or an increased personal allowance. This would remove some of the disincentives to work for those on lower incomes. Of those on lower incomes, many of which are young people, marginal tax rates of up to 75% (when taking benefits into account) discourage economic activity in the form of labour.[48] Of course, the blame must partly be put on the highly complex, punitive and disintegrated system of benefits, but an increase in the personal tax-free allowance would be a welcome improvement in rewarding employment. Additionally, it would mean that those on low- and middle incomes would keep slightly more of their salary after tax.

The propensity to consume is higher for those on lower incomes, who tend not to benefit from unearned income, whereas shifting the tax burden towards income generated from wealth would lead to the majority of people having increased spending power. This would have positive impacts on economic activity and growth. For those with the most wealth, a further increase in wealth is most likely to lead to accumulation of further wealth instead of consumption.[49] A large portion of wealth accumulation in the contemporary economy occurs through the extraction of economic rents, for example through the ownership of land, natural resources or patents, rather than through investment that furthers the productive capacity of the economy.[50]

[47] Office for Budget Responsibility (2022) Fiscal Risks and Sustainability – July 2022

[48] Stirling, A. (2018) Tapering Over the Tax: Reforming taxation of income in the UK. London: IPPR

[49] Carroll, C. D. et al. (2014) The Distribution of Wealth and the MPC: Implications of New European Data. The American Economic Review. 104(5), pp. 107-111

[50] Mihalyi, P., Szeleny, I. (2016) Two different sources of inequalities: Profits and rents in advanced market economies. IEHAS Discussion Papers 2016/30

Thus, the taxation of earned income slows down the economy more than the taxation of unearned income.[51] By aligning the taxation schedules of earned and unearned income the tax base would effectively be expanded as reliefs and exemptions would be removed, which would allow for lowering the taxation burden of those in employment. Not only would this reward work, but it would also spur economic activity and stimulate economic growth and benefit the whole economy.

Equalising the taxation of earned and unearned income would be beneficial on the simple basis of equity both intra-generationally and inter-generationally. Those who benefit from unearned income streams are almost exclusively at the top of the income or wealth distribution, and it goes against the basic principle of a progressive tax system to tax the incomes of the well-off at lower rates merely because they are able to receive their income in the form of capital gains, dividends, or rents. In the long run the improved social equity between and within generations as a result of the tax reform would also have positive financial effects for those who end up paying more in taxes as a result. Since the proceeds would allow for increased public investment, improving productivity, welfare and health in the economy, the initial “losses” to those paying higher taxes would eventually be offset by the gains in productivity.[52] However, this benefit depends on using part of the proceeds for public investment and public spending instead of using all of the raised revenues to increase thresholds and lower rates.

Finally, successive governments have formed new taxes and tax reliefs on a largely ad hoc basis, which has led to a poorly designed tax system without the capacity to raise necessary revenue in a progressive and fair way. Instead of applying new taxes such as the Health and Social Care Levy to make up for the shortfall in revenue produced by the current tax regime, it would be more sustainable to reform the design of the tax system as a whole to ensure its sustainability. This would avoid the need for having to impose poorly designed taxes in the future only for them to be swiftly removed shortly after. It would be much more stabilising, benefitting workers and businesses alike, to have a tax system that is fairly and sustainably designed, without the need for drastically altering rates, reliefs, and exemptions on annual basis due to the inherent shortcomings of the design of the system itself.

---

[51] Jung, C., Nanda, S. (2021) Tax and Recovery: Beyond the Binary. Why raising some taxes this year, alongside a bold stimulus, is in line with a strong recovery. London: IPPR

[52] Stiglitz, J. E. (2018) Pareto Efficient Taxation and Expenditures: Pre- and Re-distribution. Working Paper 23892. Massachusetts: National Bureau of Economic Research

8. Policy recommendations

Although it is difficult to undertake radical changes to the tax system, the long-term costs of not doing so are far too high to justify postponing necessary change. As shown in this paper, the current way of taxing different forms of income is not only regressive and economically inefficient, but also increases both intra-generational and intergenerational inequality. Although there are other aspects of the UK tax regime that also are regressive and inefficient, one of the priorities for building a tax system fit for the future must be equalising the rates of taxation of all forms of income without discriminating on age or form of income. This would allow for raising the tax revenue necessary to support health and social care costs associated with an ageing society without leaving the young and future generations with a disproportionate part of the bill. It would also shift some of the tax burden away from young and low-income workers towards those benefitting from unearned income, creating a fairer and more progressive tax system. This would benefit the economy as a whole and allow society to prosper for generations to come.

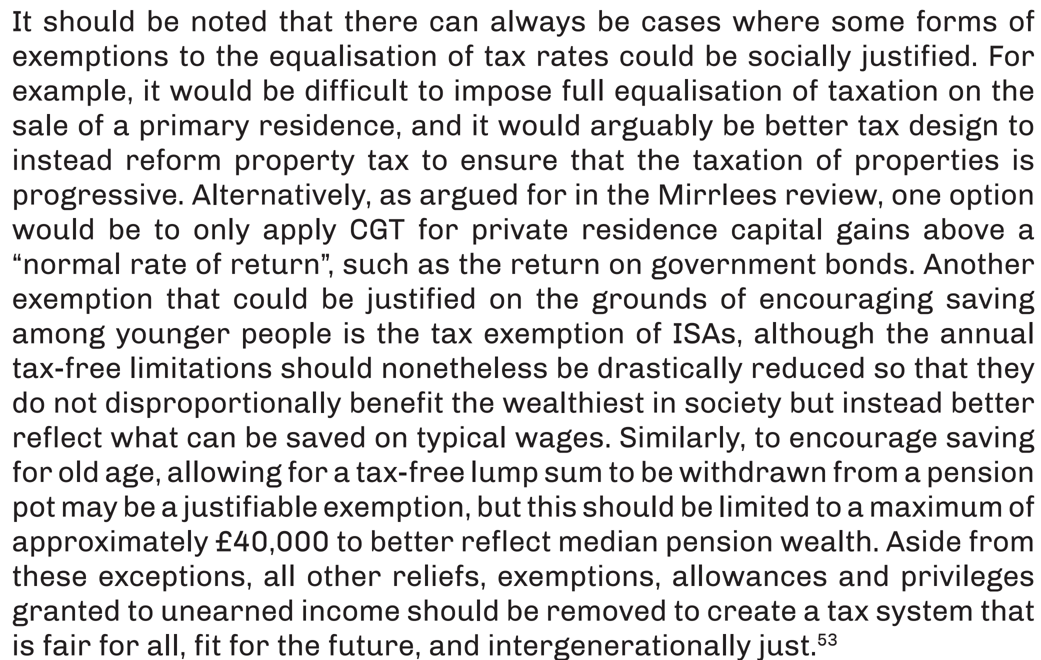
Therefore, we propose the following policy recommendations:

- **Abolish the system of NICs and instead incorporate the equivalent rates into a unified Income Tax schedule for all forms of income**

- **Abolish separate tax schedules on unearned income streams and incorporate taxation of all forms of income into a unified Income Tax schedule**

- **Remove almost all separate reliefs and allowances that exist for unearned income and remove the NIC exemption for over-65s since NICs would not exist**

- **Use the revenue raised to lower the tax burden for young people and those on low incomes, with any surplus used for public investment in building a more intergenerationally fair economy, by investing in education, renewable energy, affordable housing, and public transport.**



It should be noted that there can always be cases where some forms of exemptions to the equalisation of tax rates could be socially justified. For example, it would be difficult to impose full equalisation of taxation on the sale of a primary residence, and it would arguably be better tax design to instead reform property tax to ensure that the taxation of properties is progressive. Alternatively, as argued for in the Mirrlees review, one option would be to only apply CGT for private residence capital gains above a "normal rate of return", such as the return on government bonds. Another exemption that could be justified on the grounds of encouraging saving among younger people is the tax exemption of ISAs, although the annual tax-free limitations should nonetheless be drastically reduced so that they do not disproportionally benefit the wealthiest in society but instead better reflect what can be saved on typical wages. Similarly, to encourage saving for old age, allowing for a tax-free lump sum to be withdrawn from a pension pot may be a justifiable exemption, but this should be limited to a maximum of approximately £40,000 to better reflect median pension wealth. Aside from these exceptions, all other reliefs, exemptions, allowances and privileges granted to unearned income should be removed to create a tax system that is fair for all, fit for the future, and intergenerationally just.[53]

[53] This paper assumes that employers should continue to pay the equivalent of employers NICs.

Appendix

Various sources have been used to estimate how much would be raised through equalising the taxation of earned and unearned income. Since those researching the topic have approached the issue from different perspectives or focused on different aspects of the wider policy of equalising taxation rates, the results of various authors have been combined to arrive at a reasonable approximation of how much would be raised in total.

The £1.2 billion estimate for how much would be raised by removing the CGT exemption upon death is by Adam Corlett.[54] We understand this figure to be a conservative estimate due to inflation and growth in capital gains since 2018 when the research was undertaken.

The estimate for how much would be raised by removing the dividend allowance was retrieved from Tax Justice UK.[55] Although HMRC estimated the dividend allowance tax-relief to be worth approximately £720 million annually, they state that this figure contains large uncertainties. Research by Nanda suggested that removing the relief would raise close to £1 billion annually.[56] Thus, the £1.3 billion estimate arrived to by Palmer, Turner and Hebden seems reasonable, particularly given the general increase in unearned income.

The figure for how much would be raised by limiting the pension pot tax-free lump sum to £42,000 is derived from research by the Resolution Foundation.[57] Given the increase in pension wealth since 2018, the estimate of £2 billion raised annually is likely to be a slight underestimation in 2023/24 figures.

The estimate that removing AEA for capital gains would raise approximately £3 billion is at the lower range of estimates. OTS analysis of HMRC data suggested that it would have raised £2 billion in 2018/19.[58] The National Audit Office calculated the relief to be worth £2.9 billion in 2013, but total capital gains realised were then only about one-third of total capital gains realised today, and the AEA was higher than it is today.[59] The most recent estimate is produced by Nanda and Parkes, suggesting that removing the allowance would have raised £4.6 billion in 2021/22.[60] Thus, we believe that £3 billion is a reasonable estimate, albeit at the lower end of the range. However, since a large proportion of those who collect capital gains use it as a preferred form of income precisely due to its tax advantages, it is reasonable to be cautious and utilise an estimate at the lower end of the spectrum.

The estimate for how much would be raised by applying the equivalent rates of NICs to those above the SPA are from the IFS and Advani. Research by Advani et al. in 2021 showed that applying the equivalent rate of NICs to those over 65 years of age would raise £3.2 billion when done in conjunction with equalising the rate of taxation of all forms of income, or £1.6 billion without equalising

[54] Corlett, A. (2018) Passing On: Options for reforming inheritance taxation. London: Resolution Foundation
[55] Palmer, R., Turner, G., Hebden, P. (2019) A Manifesto for tax equality. London: Tax Justice UK
[56] Nanda, S. (2019) Reforming the taxation of dividends. London: IPPR
[57] Resolution Foundation (2018) A new generational contract: The final report of the Intergenerational Commission
[58] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design. Annex F
[59] National Audit Office (2014) Report: Tax reliefs
[60] Nanda, S., Parkes, H. (2019) Just Tax: Reforming the taxation of income from wealth and work. London: IPPR

the rates of taxation.[61] The IFS showed that imposing NIC rates on those above SPA would raise £1.1 billion annually in 2018, but this calculation does not include equalising the rate of taxation on all forms of income and uses older data.[62] Thus we believe that the most accurate figure is the estimate by Advani et al., since it is the most recent and includes equalising the rates of taxation on all forms of income. The estimate for how much would be raised by applying the equivalent rate of NICs to unearned income is from research by Advani et al., showing it would raise approximately £8.6 billion annually.[63]

Finally, the estimate for how much would be raised by equalising the rate of taxation between unearned and earned income as a separate category to other allowances, reliefs, exemptions and NIC rates is a middle-ground between figures arrived at by Advani et al., Nanda & Parkes, the OTS and Palmer, Turner & Hebden. Although Palmer et al. put the figure at £25 billion annually, this includes removing reliefs, allowances, and exemptions, while applying NIC rates to unearned income. Given the estimated values of each of the policies separately as discussed above, this suggests that the equalisation of taxation rates itself would be worth approximately £10 billion. The OTS arrived at a figure of £14 billion in 2018/19 just for equalising CGT with earned income but did not include dividends, behavioural changes or indexation of gains.[64] Advani estimated the figure for equalising rates on capital gains to have raised £15.6 billion in 2022 when allowing for indexation, although this figure also included removing CGT relief upon death.[65] The calculations by Nanda & Parkes showed that merely equalising the rate of CGT would raise approximately £9 billion per year when taking behavioural effects into account.[66] Although this figure does not include indexation, it also does not include equalising taxation of dividends. Unfortunately, there is little evidence on how much equalising the taxation of dividends with earned income would raise by itself as a separate category within the wider policy of equalising the rates of earned and unearned income. However, it is worth noting that the effect of including for dividends is likely to more than offset the effect of indexation. Additionally, since Advani arrived at a figure of £15.6 billion merely for capital gains when including indexation (albeit also including removing CGT relief upon death), it suggests that a figure of £10 billion when including both indexation and dividends is a conservative estimate. Nanda & Parkes calculated that taxing earned and unearned income equally would lead to approximately £18 billion raised annually when taking into account behavioural effects and removals of exemptions, allowances and reliefs but not applying NIC rates. Since other sources showed that applying NIC rates to unearned income and for over-65s would raise slightly over £12 billion annually, as discussed in this Appendix, if combined with the £18 billion figure by Nanda & Parkes it would amount to a total figure of £30 billion, in line with our total estimation for the wider policy. Thus, although this figure contains large uncertainties, £10 billion is a reasonable estimate at the lower end of the range for how much would be raised by equalising the taxation of earned and unearned income as a category that is separate to the values of exemptions, allowances, reliefs, and the application of NIC rates.

[61] Advani, A., et al. (2021) Fixing National Insurance: A better way to fund social care. CAGE Policy Briefing No. [33]. Warwick: The University of Warwick

[62] Adam, S., Waters, T. (2018) Options for raising taxes. London: The Institute for Fiscal Studies

[63] OpCit.

[64] Office of Tax Simplification (2020) Capital Gains Tax review – first report: Simplifying by design. Annex F

[65] Taxation of wealth calculator University of Warwick: https://arunadvani.com/taxreform.html

[66] Nanda, S., Parkes, H. (2019) Just Tax: Reforming the taxation of income from wealth and work. London: IPPR

Intergenerational Foundation
www.if.org.uk
email: info@if.org.uk

charity no: 1142230