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Capital Losses: Why increasing CGT will deter investment, slow growth and reduce revenue

By Daniel Herring

- The Chancellor is reported to be planning an extraordinary £40 billion in tax rises and spending cuts at the forthcoming Budget, heavily weighted towards tax rises. While there have been a range of reports about her specific plans, it has been widely anticipated that capital gains tax (CGT) will be increased.

- This analysis examines the rationale for such an increase, to show that raising CGT is likely to be counterproductive – damaging investment, economic growth and revenue.

- CGT is a minor tax, raising just £17 billion, or 1.5% of all revenue. It was introduced in 1965 at a rate of 30%, and has been altered multiple times since then.

- It is also a relatively complicated tax, with rates ranging from 10% to 28% depending on the asset. It is also paid by a small number of taxpayers: just 369,000 in 2022-23.

- Internationally, the UK is relatively competitive when it comes to taxing capital gains. But this could rapidly change. Recent modelling by the Centre for Policy Studies and the Tax Foundation found that raising the CGT rate to 33%, 39% or 45% would lead to the UK falling from 30th in the OECD for overall tax competitiveness to 32nd, 33rd or 34th.

- The argument for a higher rate of CGT – besides the Chancellor's desire to raise revenue – is on the basis of fairness. It is unfair, the argument goes, for people to pay a lower rate of tax by taking gains instead of income. The tax system should also endeavour to equalise tax income on labour and capital.

- But this is too simplistic. CGT is often a form of double taxation, taxing investment that has already been subject to other tax (such as income tax). It is economically damaging, pushing people to hold on to assets unnecessarily. And it discourages entrepreneurship.

- It is also highly unclear how much revenue will be raised. HM Treasury's own calculations show that hiking CGT by 10 points would *lower* revenue by £2 billion after three years. This is supported by other studies into real-world increases in CGT in other countries.

- Given that just 38,000 people account for 80% of CGT payments, even a small behavioural response could impact revenue. An increase to CGT risks being little more than an attack on investment and entrepreneurship – on top of other damaging changes to the tax system, such as the abolition of non-dom status.

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Capital gains tax in the UK

History

Capital gains tax (CGT) was introduced in 1965, at a rate of 30%. In 1988, Nigel Lawson brought CGT into line with income tax, meaning that (after a deduction of an annual allowance) capital gains were combined with income and taxed at the appropriate rate. Importantly, any gains were indexed to inflation, so that you were not taxed for a rise in value that was only nominal.

In 1998, Gordon Brown introduced taper relief on capital gains and removed the indexation allowance. The taper relief meant that you paid a lower tax rate on a capital gain the longer it was held for. In 2008 this was removed, and gains were taxed at 18%. George Osbourne introduced a higher rate of 28% in 2010, before cutting the higher rate to 20% in 2016 and the lower rate to 10%.[1]

Capital gains tax today

CGT is applied to the difference between the price you bought an asset for and the price you sell it for. Every person gets a tax-free allowance, known as an annual exempt amount (AEA), which in 2024-25 is £3,000. There is no adjustment for inflation and CGT does not apply to corporations.

The rate of CGT varies by asset and whether the taxpayer is an individual or a trustee. The rates are (as of 2024-25):[2]

- 10% and 20% for individuals (not including residential property gains and carried interest gains).
- 18% and 24% for individuals for residential property gains. However, you do not need to pay CGT on the sale of your home, with some exceptions.[3]
- 18% and 28% for individuals for carried interest gains (in its manifesto Labour pledged to close this 'loophole' by aligning the rate with income tax rates).
- 20% for trustees (not including residential property gains).
- 24% for trustees for residential property gains.
- 20% for personal representatives of someone who has died (not including residential property gains and carried interest gains).
- 24% for personal representatives of someone who has died for residential property gains.
- 28% for personal representatives of someone who has died for carried interest gains.
- 10% for gains qualifying for Business Asset Disposal Relief (this is for people selling their business and the lower rate is meant to incentivise entrepreneurship. It replaced Entrepreneur's Relief).[4]

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[1] A helpful overview is here: A. Seely, 'Capital gains tax: recent developments', House of Commons Library (8 September 2020). Link
[2] Gov.uk, 'Capital Gains Tax rates and allowances', (6 April 2024). Link
[3] Gov.uk, 'Tax when you sell your home', (accessed 16 September 2024). Link
[4] Gov.uk, 'Business Asset Disposal Relief', (accessed 16 September 2024). Link

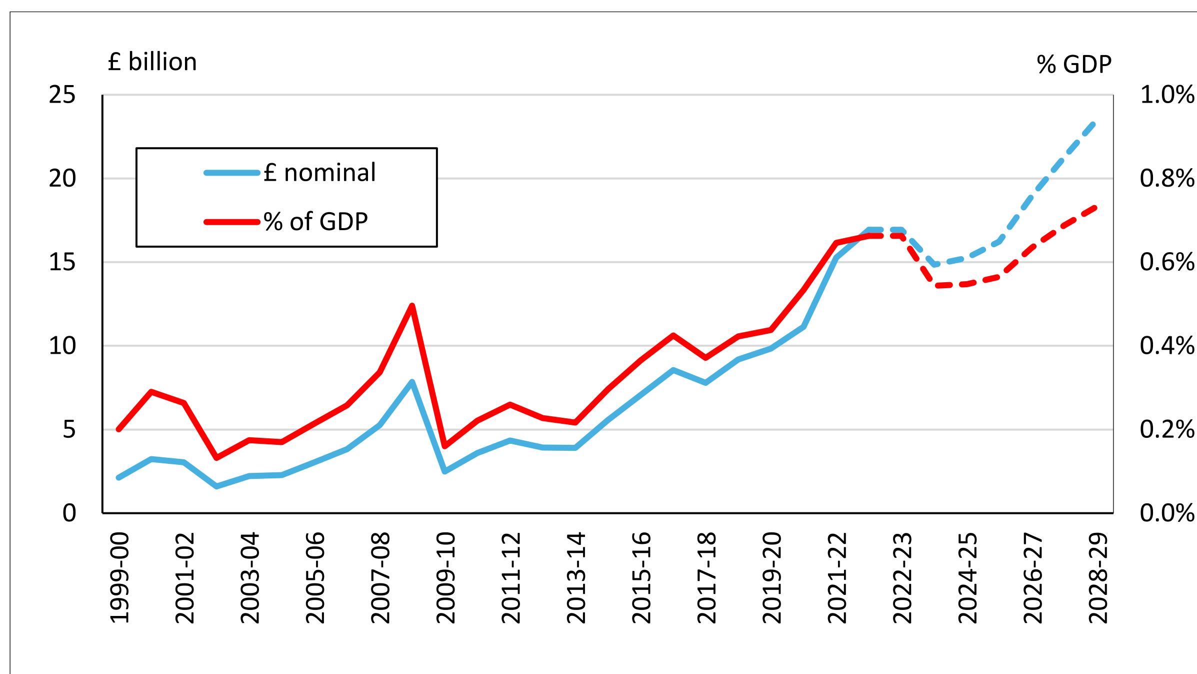
The lower rate is paid by taxpayers who pay the basic rate of income tax. The higher rate is paid by taxpayers who pay a higher rate of income tax. The various rates for different asset types and taxpayers makes the CGT regime self-evidently complex.

How much does capital gains raise?

CGT is not a major source of revenue. In 2022-23, it raised just £17 billion (1.6% of all government revenue), much less than income tax (£250 billion), National Insurance (£177 billion), and VAT (£162 billion).[5]

However, as the graph below shows, the amount it contributes has grown, both nominally and as a percentage of GDP, from £2.1 billion in 1999-2000 to £16.9 billion in 2022-23.

Capital gains revenue



Source: Office for Budget Responsibility, 'Tax by tax, spend by spend'. Link

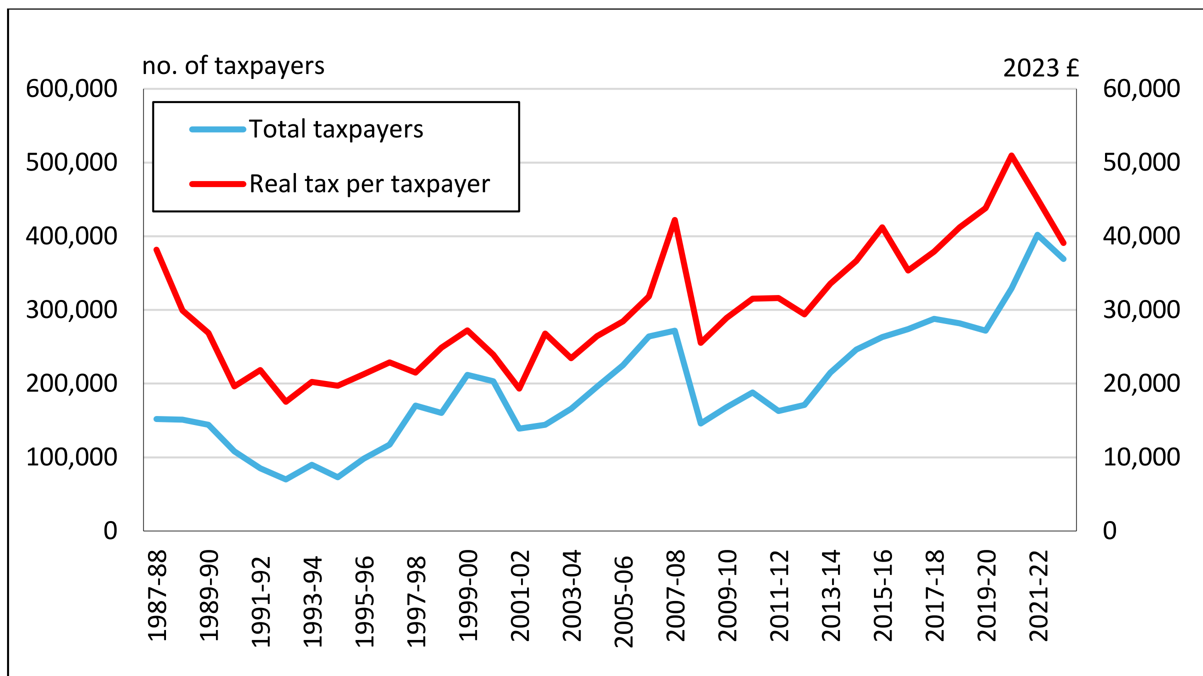
[5] Office for Budget Responsibility, 'Tax by tax, spend by spend'. Link

Who pays capital gains tax?

Unlike the big three taxes (income tax, NICs, VAT), CGT is paid by a small number of taxpayers. According to HMRC, in 2022-23 369,000 taxpayers paid £14.4 billion on £80.6 billion of realised gains. Most gains go to individuals, rather than trusts (in 2022-23, individuals paid 94% of all CGT).[6]

The total number of taxpayers and the amount paid per taxpayer have both grown since the 1990s. In 1987-88, 150,000 taxpayers paid, on average, £38,000 in CGT each in today's money. This fell in the 1990s: in 1992-93, 70,000 people paid £17,500 each. But by 2022-23, 370,000 taxpayers were paying £39,100 each.

Total CGT payers and amount paid per taxpayer (includes trusts & individuals)



Source: HMRC, 'Capital Gains Tax statistics' (1 August 2024) 'Table 1: Estimated number of taxpayers, amounts of gains and tax liabilities by year of disposal'. Link

In truth, however, most CGT is in fact paid by a very small number of people who have very large gains. In the most recent figures, just 6,000 taxpayers – less than 2% of those who pay CGT – had gains of over £2 million apiece and accounted for half of the total CGT paid. Just over 10% of those paying CGT, 38,000 taxpayers, had gains over £250,000 and accounted for 80% of gains.

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[6] It's worth noting that HMRC's number for the total CGT paid is less than what the OBR gives (HMRC states recent years are provisional estimates).

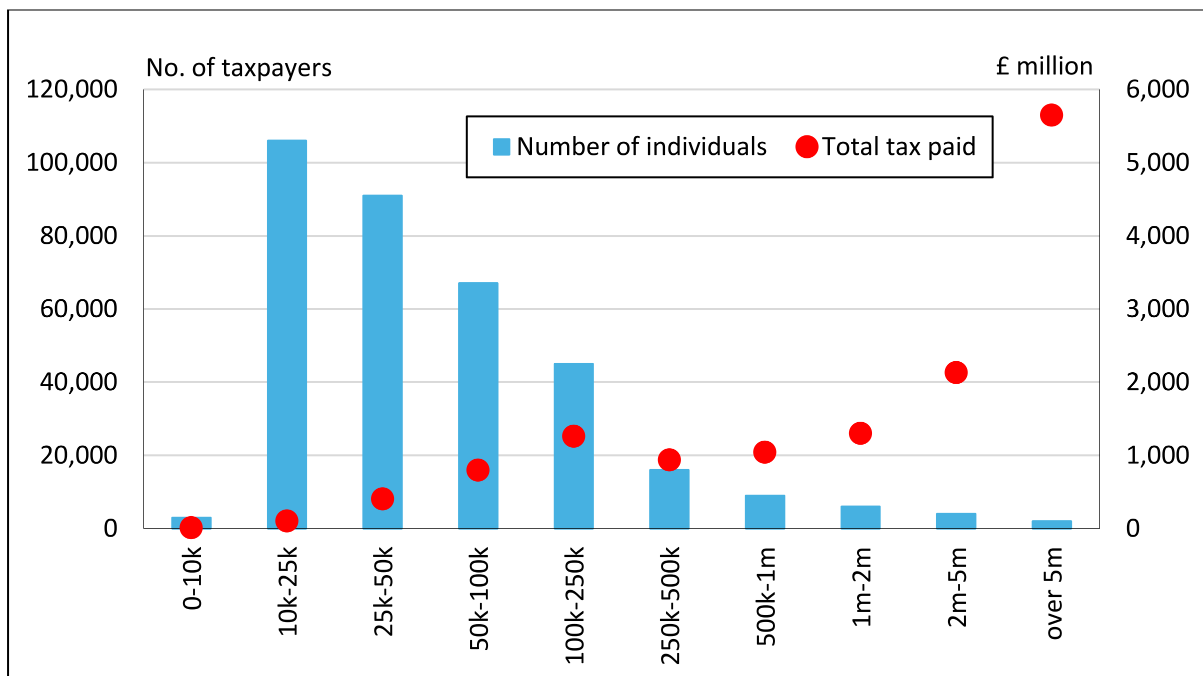
So it would only take a relatively small number of people – generally the most mobile and tax-efficient investors and entrepreneurs – to change their behaviour for CGT revenues to fall dramatically.

In the chart below, the gains from CGT are evenly split by three income groups. The first group is those on low incomes who report a large amount of gains (although these also consist of the largest number of taxpayers). These are likely to be a mix of people on low wages, not working (such as pensioners) and those who receive their income as capital gains.

The second group is those on incomes between £37,700 and £200,000.

The third group are high income earners earning over £200,000. This latter group make up 8% of individual taxpayers declaring a capital gain, while in the general population, those earning over £200,000 in income make up about 1% of all taxpayers.[7]

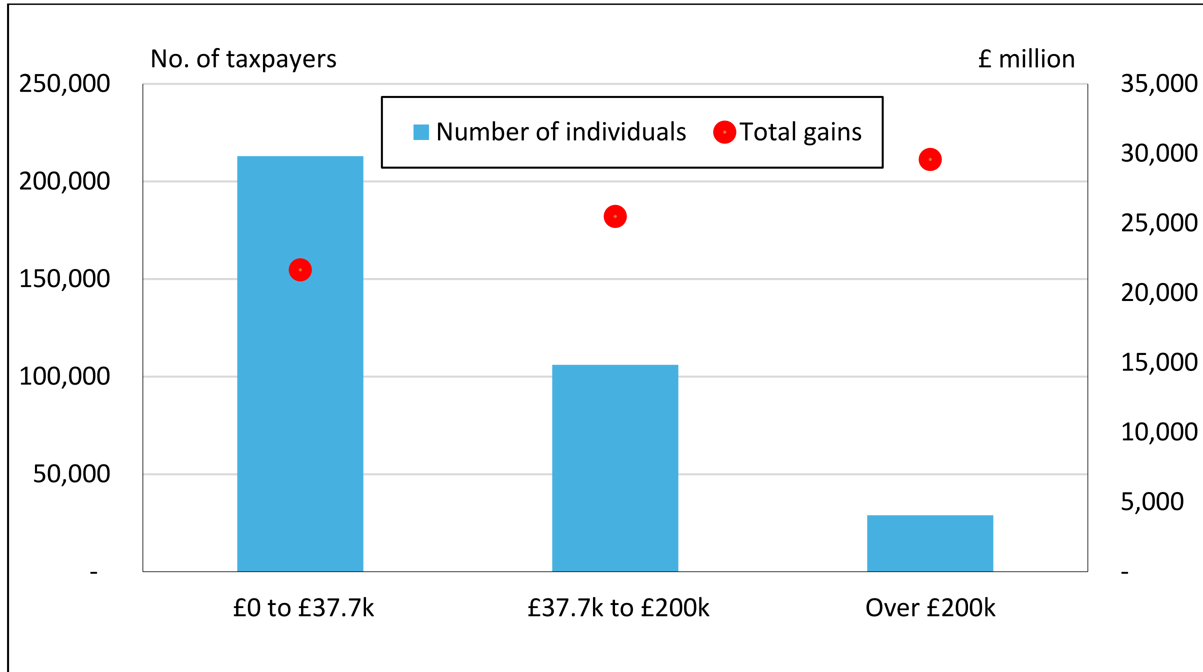
Number of taxpayers and total CGT paid, by range of capital gain (2022-23)



Source: HMRC, 'Capital Gains Tax statistics' (1 August 2024) 'Table 2.1: Estimated number of taxpayers, amounts of gains and tax liabilities by size of gain'. Link

[7] HMRC, 'Table 2.5 Income Tax liabilities by income range', (27 June 2024). Link

Number of individual taxpayers and total gains, by income (2022-23)



Source: HMRC, 'Capital Gains Tax statistics' (1 August 2024) 'Table 3: Estimated number of individual taxpayers by size of gain and taxable income'. Link

Capital gains tax internationally

The UK is currently relatively competitive when it comes to taxing capital gains. But if the top rate was raised to 39%, as was recently suggested in the media, it would be the third highest in the OECD, and at 33%, joint eighth highest.

The Tax Foundation's International Tax Competitiveness Index measures how pro-growth the tax systems of 38 OECD economies are. In the 2024 edition, the UK comes 30th. If the UK were to raise its CGT rate to 33%, 39% or 45%, then the UK's overall ranking would fall to 32nd, 33rd or 34th.[8]

[8] D Herring, 'The UK's International Tax Competitiveness: 2024 Update', Centre for Policy Studies (21 October 2024). Link

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Capital gains tax rates (with top marginal income tax rate for comparison)

Country	Capital gains tax rate[9]	Top income tax rate
Denmark	42%	56%
Chile	40%	40%
Norway	38%	46%
Netherlands	36%	51%
Canada	36%	54%
Finland	34%	58%
France	34%	56%
Ireland	33%	52%
Sweden	30%	52%
United States	29%	46%
Portugal	28%	58%
Spain	28%	45%
Austria	28%	55%
Germany	26%	47%
Italy	26%	53%
Israel	25%	50%
Australia	24%	47%
Iceland	22%	46%
Japan	20%	56%
United Kingdom	20%	47%
Lithuania	20%	39%
Latvia	20%	31%
Estonia	20%	20%
Poland	19%	36%
Greece	15%	53%
Colombia	15%	39%
Costa Rica	15%	34%
Hungary	15%	34%
Mexico	10%	35%
Slovenia	0%	61%
Belgium	0%	60%
Korea	0%	50%
Luxembourg	0%	47%
Switzerland	0%	42%
Turkey	0%	41%
New Zealand	0%	39%
Slovak Republic	0%	35%
Czech Republic	0%	28%

Source: Tax Foundation, 'International Tax Competitiveness Index 2024' (21 October 2024). Link

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[9] Note that where there are multiple rates of CGT, this table is capturing CGT on the sale of listed shares after an extended period of time.

How should we tax capital gains?

The Chancellor has a range of options for CGT, potentially raising it to 33% or even aligning CGT rates with income tax rates.[10] The most recent reports suggest she will raise CGT for the sale of shares and other assets by several percentage points, but not second homes.[11]

Aligning CGT with income would be the most extreme option and would mean that any capital gain is simply added onto income from employment, dividends etc, and taxed at an individual's marginal rate. In reality, many capital gains are large or made by high income earners, meaning that often capital gains would be taxed at 45% under this approach. This section considers the arguments for and against such changes.

Taxing at the rate of income tax

The primary arguments given in favour of this move are fairness and economic neutrality.

First, fairness. In general, the argument is that income from capital gains is no different to income from other sources like employment. If Sally makes £50,000 from selling an asset, and John makes £50,000 from employment, why shouldn't that income be treated the same?

This was the view of Nigel Lawson in his 1988 Budget:

> 'Moreover, at present, with capital gains taxed at 30 per cent for everybody, higher rate taxpayers face a lower – sometimes much lower – rate of tax on gains than on investment income, while basic rate taxpayers face a higher rate of tax on gains than on income. This contrast is hard to justify.
>
> 'I therefore propose a fundamental reform... the indexed gain will be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income. In other words, I propose in future to apply the same rate of tax to income and capital gains alike.'[12]

A different angle on the fairness argument is the impact on inequality. For example, academics at the Centre for the Analysis of Taxation, Arun Advani and Andy Summers, argue that, for the top 1% of taxpayers, the share of income from capital gains is rising.[13] The lower rate of CGT makes the taxation of total remuneration (gains + income) less progressive.

The second, associated argument is for tax neutrality. Ideally, a tax system should treat income and capital gains the same, meaning there is no incentive to package income as gains purely for tax purposes.

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[10] A. Isaac, 'Rachel Reeves considers raising capital gains tax to 39%', *The Guardian* (10 October 2024). Link
[11] S. Swinford et al, 'Rachel Reeves to raise capital gains tax on sale of shares', *The Times* (16 October 2024). Link
[12] N. Lawson, 'Budget Statement 1988', (HC Deb 15 March 1988 vol 129 cc1004-6). Link
[13] A. Advani and A. Summers, 'Capital Gains and UK Inequality', CAGE Research Centre working paper no. 465 (May 2020). Link

Presently, there are some industries where people can transform their income into a form of capital gain, lowering their tax liability for a gain that is, in reality, employment income.

For example, carried interest is the share of profits that a partner can receive from an investment fund due to their ownership of an interest in that fund. This is treated as a capital gain, meaning that they can legitimately avoid income tax and National Insurance.[14] In their election manifesto, Labour pledged to align CGT on carried interest with income tax.

There are also situations where the distinction between income and capital gain is hard to make, as the (now abolished) Office for Tax Simplification noted:

> 'In many situations, such as those of owner managers, employee shareholders or privately-owned property investment businesses, the line between capital and income is blurred in practice.
>
> 'For example, the owner of an investment property portfolio might consider the acquisition of an additional property to be just another investment. However, if the purpose of the acquisition is to renovate the property and then sell it on at a profit, this is a trading transaction, and the profit is assessable to Income Tax. Not understanding the difference between investing and trading activities can clearly lead to non-compliance, if the taxpayer incorrectly declares a capital gain rather than a trading profit.'[15]

The OTS gave two further examples. The first is share schemes, where employees are paid shares of the company (not all schemes benefit from beneficial tax treatment). The second is retained earnings, where an owner-occupied company can keep earnings within the company, which will be taxed at a lower rate if the company is wound up or sold.

It is very important to point out that simply aligning CGT rates with income tax rates would not achieve neutrality. For example, if there is no accounting for inflation, this means that many people might actually lose money if they sell an asset that has increased in value only in line with inflation. But to achieve true neutrality you would need to account for the 'normal rate of return', which is discussed later.

Arguments against capital gains tax

Double taxation

One powerful critique of CGT is that it amounts to double taxation (see explainer below). If someone invests money, and it rises in value, they will end up with a gain. But where did they get that £1,000 from in the first place? If they earned it as a salary, they will already have been taxed on the money – then, when they invest it, they are taxed on it again, even if its value has actually decreased against inflation.

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[14] Note that there is debate over whether this is actually the correct treatment. See D. Neidle, 'Carried interest – the £600m loophole that doesn't actually exist', Tax Policy Associates (10 March 2023). Link

[15] Office of Tax Simplification, "Capital Gains Tax review – first report: Simplifying by design" (November 2020). Link

Furthermore, they have no way of knowing, when they make the investment, whether it will go up or down. Persuading people to invest is how we deploy capital in the economy, and produce economic growth. A capital gains tax takes a risky but essential economic activity, and penalises it.

Or here's another way to think about it. The price of many capital goods, such as stocks, is determined by the future income people believe they will produce. So, for example, the price of stocks in a company will rise as the anticipated future revenue also rises. The imposition of CGT means that the present value of that income is being taxed when the stock is sold, and the future income will also be taxed. As Rory Meakin has noted, in a contribution for the Institute for Economic Affairs, this can 'present an obstacle to the efficient reallocation of capital assets within the economy.' [16]

It's also important to consider how CGT interacts with other parts of the tax system. For example, a failure to take into account corporation tax already paid when taxing shares would result in a tax rate higher than the top income tax rate.[17]

Explainer: How CGT can be double taxation

Suppose Billy receives £1,000 of income. In a world with no tax, he invests it by buying an asset, which grows by 40% and he sells it for £1,400. Let's imagine the following three scenarios:

1. An income tax of 20% is introduced but there is no tax on capital gains. Billy receives £1,000 and pays £200 in tax. He invests £800, which again grows by 40% to £1,120.
2. No income tax is applied to income that is invested, but CGT is applied to the whole amount of income that is realised. Billy receives and invests £1,000. It grows to £1,400, which he realises by selling his investment. He then pays 20% tax on the whole gain (which is £1,400) and is left with £1,120.
3. Finally, both income and capital gains are taxed at 20%. Billy has received £1,000 of income. He pays 20% in income tax. He invests the remaining £800. The £800 investment grows in value by 40% to £1,120. He has made a capital gain of £320 (£1,120 minus £800) and pays an additional £64 tax (20% of £320 is £64). He is left with £1,056.

It's easy to see that when a 20% rate of tax is applied once, whether when the tax is received or after an investment is realised, it is equivalent. Either way, Billy has 20% less of what he would have earned if there were no tax. By contrast, the combination of income and capital gains means that he is actually paying a higher rate of tax on what he would theoretically get if there was no tax (the difference between £1,400 and £1,056 is £344, which is a tax rate of 24.5%).

[16] Institute for Economic Affairs, 'Taxation, Government Spending and Economic Growth', (2016) p 210. Link
[17] S. Adam, 'The IFS Green Budget: January 2008 - 10. Capital Gains Tax', Institute for Fiscal Studies (30 January 2008). Link

Locking in assets

One of the big problems with CGT is that a taxpayer will often hold on to an asset for longer than they would otherwise to avoid paying gains on it. As the Mirrlees review put it: 'Once an asset has risen in value, there is an incentive to hold on to it, to shield the accrued gain from tax for a longer period.'[18] This is known as the 'lock-in' effect. It's so powerful because it's easy to delay the sale of most assets, even when it is not economically optimal.[19] This is clearly borne out by Reeves' decision not to raise CGT on second properties, because this would slow down the property market further.[20]

In theory, this effect could be avoided by taxing gains as they accrued year by year, rather than when the gain was realised. However, this is not practical for two reasons. First, it would be impractical to value assets year by year – would someone's art collection need to be revalued every year? Second, many people would not have the cash to pay CGT each year.

Discouraging entrepreneurship

An extension of the lock-in argument is the effect on entrepreneurs. CGT punishes entrepreneurs when they sell their business. This is an extension of the 'lock-in' argument. Serial entrepreneurs might be tempted to keep running their businesses when it would be better for them to sell it and start a new one.[21] Additionally, entrepreneurs might be put off from ever starting a business if CGT is too high. There is also evidence from the US that higher CGT rates reduces the level of venture capital funding that entrepreneurs can attract.[22]

Preventing this is the rationale behind the lower rate for Business Asset Disposal Relief – which is also reportedly in the Chancellor's sights.

Taxing inflation and the 'normal return'

One of the most convincing critiques – acknowledged even by many economists on the left – is that unless there is an allowance for inflation, CGT will tax nominal rather than real gains.

But this is not just about inflation: the critique can be extended to the 'normal return on investment', which 'can be thought of as the return that just compensates savers and investors for the delay in consumption (without any additional compensation for risk-taking), and makes them willing to part

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[18] Mirrlees et al, 'Tax by design', Institute for Fiscal Studies (13 September 2011) p 296. Link
[19] For example, in Australia there is evidence of investors waiting one year after purchase to sell assets because this attracts a lower rate: D Hanlon and S Pinder, 'Capital Gains Tax, Supply-Driven Trading and Ownership Structure: Direct Evidence of the Lock-In Effect', 21st Australasian Finance and Banking Conference 2008 Paper (August 2008). Link
[20] E. Courea, 'Reeves to leave capital gains tax on property untouched, reports say', The Guardian (17 October 2024). Link
[21] This is an argument modelled in V. Chari et al, 'Business Start-ups, The Lock-in Effect, and Capital Gains Taxation', Yale Department of Economics Working Paper. Link
[22] L. Dimitrova & S. Eswar, 'Capital Gains Tax, Venture Capital, and Innovation in Start-Ups', Review of Finance (September 2022). Link; William M. Gentry, 'Capital Gains Taxation and Entrepreneurship', American Council for Capital Formation (November 2010). Link

with their money.'[23] For an investor, this is the annual return that would make them completely neutral between investing and spending the money today.

If there is no allowance for this normal return, then there would still be a bias against investing, if CGT and income tax rates were equal. But crucially, without an allowance for the normal rate of return, the *current* rate of CGT punishes anyone whose gains are below the normal return (while it offers an advantage for investors for very large profits). In effect, they are worse off than when they bought their asset. It's important to remember that, while some investors achieve very large gains on their investments, many assets are sold without large gains.

If the UK is to keep or raise CGT it should deal with this issue by giving an allowance for the normal return, which is unfairly punishing many investors. The Institute for Fiscal Studies (among others) has proposed CGT reform where tax would only be applied above the normal return.[24] This would remove many of the economic distortions caused by the current system.

There is no good reason to raise CGT in the current circumstances

While there are valid arguments for reforming CGT, an outright rise risks being hugely damaging. Raising it would damage incentives and undermine investment decisions. Furthermore, as the next section shows, it might not even raise much money.

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[23] S. Adam & H. Miller, 'Taxing work and investment across legal forms: pathways to well-designed taxes', Institute for Fiscal Studies (26 January 2021) p 66. Link

[24] See: S. Adam et. al, 'Capital gains tax reform', Institute for Fiscal Studies (6 October 2024). Link; T. Clougherty, 'Can we reform Capital Gains Tax to go for growth?', Business Money (2 September 2024). Link

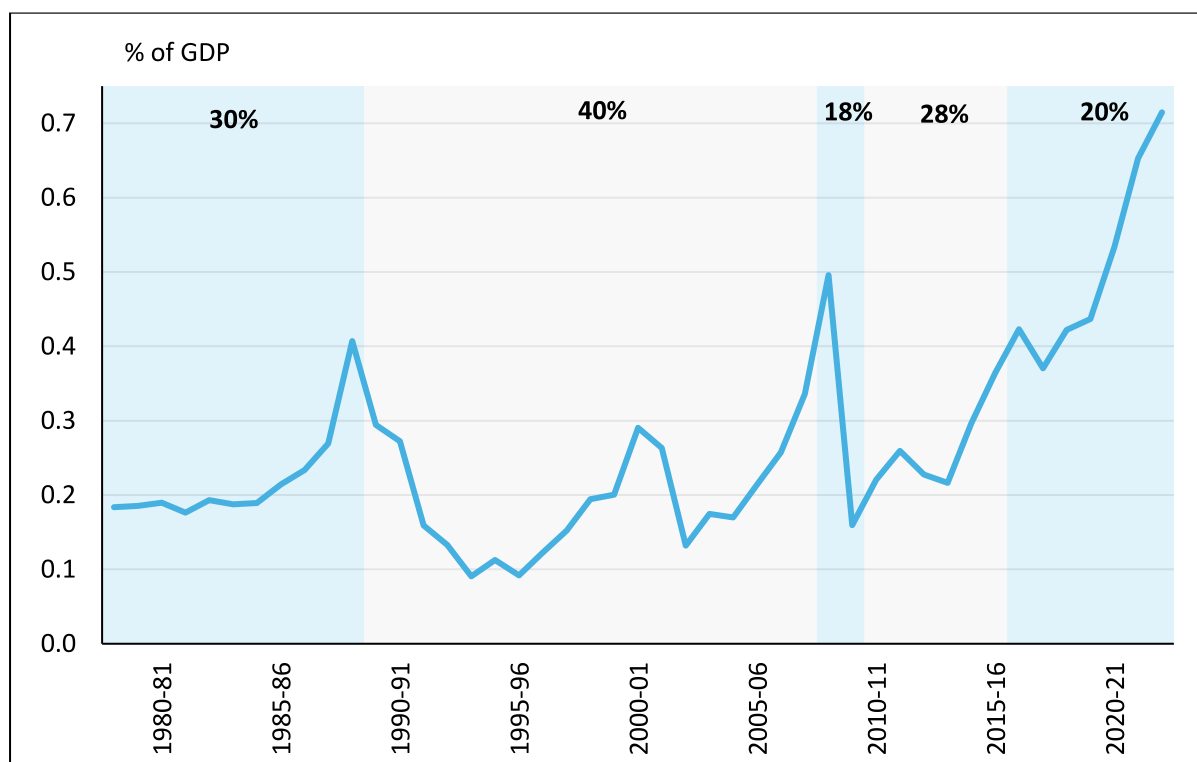
Evidence on revenue

The impact on revenue

When considering the revenue impacts of a CGT rise, it's important to distinguish between transitional and long-term effects.

The transitional effects occur when an anticipated rise in CGT leads asset holders to sell assets before the tax rise comes into effect, avoiding the higher tax rate (alternatively, if the rate is being lowered, they might not sell assets until a lower rate comes into force). There is, as the tax expert Dan Neidle has acknowledged, a huge amount of evidence for this. Clearly, when we look at the history of CGT in the UK, there is evidence that higher tax rates do not lead to higher revenues. And there are clearly years where there are large sales of assets in anticipation of future tax rises.

CGT revenue as a percentage of GDP, with headline rates of CGT



Source: OBR, 'Historical public finances database', (20 July 2023). Link; D. Neidle, 'The history of UK capital gains tax in five charts', Tax Policy Associates (10 February 2024). Link

It's important to note here that the response is dependent on the size of the rise – a one percentage point rise in CGT rates would have a much lower impact than a ten percentage point rise. (At present all we know is that the Chancellor is planning on raising it by 'several percentage points'.)[25]

[25] S. Swinford et al, 'Rachel Reeves to raise capital gains tax on sale of shares', *The Times* (16 October 2024). Link

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As well as the British precedents, there are also plenty of international examples. In the US, the CGT rate was raised in the 1980s. The Congressional Research Service notes:[26]

> 'Between 1985 and 1986, realizations rose from $170.6 billion to $324.4 billion, falling to $144.2 billion in 1987. A study of this phenomenon using taxpayer data showed that these gains occurred in December, and were seven times the gains in December of the previous year. This increase, which took place when a tax increase was passed for the following years, was evidence of the magnitude of transitory realizations responses and contributed further to concerns about the reflection of transitory responses in the econometric studies.'

In general, the economic literature agrees that there is a major short-term response to an announced tax rise. That is because, for most assets, it is easy to move the sale forward in time.[27]

The longer-term consequences are less clear. A report by the Congressional Research Service notes the range of elasticities (the percentage change in revenue compared to a 1% change in the rate of tax) between 0.22 and 0.9 when the CGT rate is 22% (i.e., a change from 22% to 23%). The starting rate and the size of the rate increase are important here, because the elasticity might change depending on the starting point and whether you want to raise CGT by one percentage point or 10.

The Congressional Research Service's assessment of the literature (based largely on US data) suggests raising the rate will increase revenue, but the amount it can raise is very difficult to estimate.

There's less data here in the UK. However, HMRC produces 'ready reckoner' statistics, which show the estimated effects of illustrative tax changes on tax receipts.[28] These are estimates – so the following analysis should be treated with caution.

For a small increase in the tax, the estimated effect is positive but small – raising the higher rate of CGT by 1% will raise just £110 million in 2027-28. But a 10 percentage point rise will actually lose money – the Treasury will lose £2 billion in 2027-28. If accurate, this would be disastrous. Not only would a CGT rise distort investment decisions and damage the economy, it would also lose the Government revenue.

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[26] Congressional Research Service, 'Capital Gains Tax Options: Behavioural Responses and Revenues', (19 January 2021). Link

[27] For example, see L. Burman and W. Randolph, 'Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data', The American Economic Review Vol. 84, No. 4 (September 1994), pp. 794-809. Link

[28] HMRC, 'Direct effects of illustrative tax changes', (28 June 2024). Link

HMRC ready reckoner statistics

Capital gains tax policy change	£ million		
	2025-26	2026-27	2027-28
Increase Business Asset Disposal Relief rate by 1 percentage point	5	135	135
Increase Business Asset Disposal Relief rate by 5 percentage points	15	560	530
Increase Business Asset Disposal Relief rate by 10 percentage points	35	815	710
Increase lower CGT rate by 1 percentage point	0	15	15
Increase lower CGT rate by 5 percentage points	-25	50	30
Increase lower CGT rate by 10 percentage points	-95	10	-30
Increase higher CGT rate by 1 percentage point	-10	170	110
Increase higher CGT rate by 5 percentage points	-115	255	-140
Increase higher CGT rate by 10 percentage points	-400	-985	-2,025
Increase Annual Exempt Amount by £500 for individuals & £250 for trusts	0	-30	-25

However, not everyone agrees with this analysis. For example, the Resolution Foundation argues for aligning CGT rates for shares with dividends tax rates (39.35%) and CGT for property with the tax on wages (so income tax plus National Insurance), albeit alongside the introduction of inflation indexing as discussed above. It estimates that this would raise £8 billion, before accounting for behavioural change.[29]

This is a big assumption – behaviours will certainly change as a result of this policy, and therefore the revenue will definitely be less than £8 billion.

The most detailed analysis has been done by Advani, Summers and Andrew Lonsdale.[30] They propose the following policy package: 1) Align CGT rates with income tax rates; 2) Introduce an investment allowance, exempting the normal rate of return; 3) Remove the 'death uplift', where there is no CGT applied when the owner dies and an asset is inherited; 4) Introduce an 'exit tax', so that any gains made while in the UK are paid when someone stops being a UK resident (they would also exempt any gains made before someone becomes a UK tax resident); 5) Increase the generosity of capital losses so that you can set them against other income. This package is very similar to that proposed by the IFS.

Using data from tax year 2019-20, they estimate that this full package would raise £15.7 billion on a static basis, and £9.6 billion on a dynamic basis. Applying this analysis to 2025-26, they estimate the full package could raise £14.3 billion on a dynamic basis, almost doubling the revenue from the tax.

The authors are respected academics, but we need to apply caution to their analysis. First, the behavioural response is highly uncertain (as they acknowledge). They assume an elasticity of 1 for

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[29] A. Corlett, 'Revenue and reform: What tax changes could – and should – we see in Autumn Budget 2024?' Resolution Foundation (10 September 2024). Link

[30] A. Advani et al, 'Reforming Capital Gains Tax: Revenue and Distributional Effects', Centre for Analysis of Taxation (11 October 2024). Link

their central estimate, but provide an estimate where the elasticity is two, which would reduce the additional revenue in 2026 to £5 billion. This uncertainty is exacerbated by the authors' analysis of the distributional consequences. As they note, most of the gains of around 90% of CGT taxpayers will be below the normal rate of return, meaning they will be better off under these proposals, because after the investment allowance is applied they would be exempt (they might even be able to claim a loss). However, the very wealthiest who earn the largest gains will be hardest hit – the top 0.1% would be paying 110% more CGT (ie more than twice as much) under these proposals.[31] These are precisely the people who will find it easiest to leave because of this tax, or might never come in the first place.

Second, it's worth noting the broader context. In principle, we support moving the tax system towards greater neutrality between different types of income. But Britain's income tax system is already beset by high marginal tax rates, especially at higher income levels. Increasing marginal rates for capital gains might achieve neutrality, but could have other negative consequences.

In other words, a comprehensive reform of CGT might on balance be desirable, but could also lead to some of the wealthiest leaving the UK. If the top income tax rate was, say, 35% or 30%, this proposal to align CGT with IT would have fewer adverse consequences. But making it so that high earners are very heavily taxed both on capital and labour is potentially a recipe for having fewer of them.

Conclusion

As with many of its other mooted tax increases, it is clear that Labour is playing a dangerous game with capital gains tax. Keir Starmer has argued that those with the 'broadest shoulders should bear the heavier burden'.[32] But £40 billion is an awful lot of money to raise – and those with the broadest shoulders are also those with the flightiest feet. Along with changes to non-dom status and potential rises on inheritance tax, employer's National Insurance, etc, the reasons for staying in the UK for ultra-wealthy investors, entrepreneurs and job creators are dwindling.

As we have shown, a CGT rise will probably raise little revenue in the short run, as people hold on to their assets or sell them as soon as possible. The full effects are uncertain, but it is very possible that any rise in CGT will raise much less revenue than analyses suggest, and could very easily be revenue-negative. More worryingly, it could damage economic growth in the future.

Changing CGT should therefore be considered only in the context of much wider reform to the CGT base, marginal rates of income tax, and other damaging aspects of the tax system. British tax policy has long focused on making marginal changes to find additional amounts of revenue (or make giveaways) without considering the incentives and coherence of the whole tax system. The tax rises Labour appears to be planning would not just be bad for growth, but make this problem even worse.

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[31] A. Advani et al, 'Reforming Capital Gains Tax: Revenue and Distributional Effects', Centre for Analysis of Taxation (11 October 2024). Link. See Table 7a, p 42.
[32] K Starmer, 'Keir Starmer's speech on fixing the foundations of our country: 27 August 2024' 10 Downing Street. Link