Capital gains compromise [1]

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The Liberal-Democrat manifesto proposed raising Capital Gains Tax from its 18 percent to parity with income tax, whose current top rate is 50 percent, thanks to Labour's punitive increase. Unfortunately this proposal features in the agreement between the coalition partners. Not surprisingly it is attracting much criticism, since it is, at best, economically illiterate.

It would wreak immense damage on the UK economy. A top rate of 50 percent would be about the highest in the world, and would cause a massive exodus of capital, as people moved to holding assets elsewhere. One of the Treasury's main concerns is the 'leakage' made possible by a wide difference in rates, with some people trying to switch their rewards to capital gains in order to pay lower taxes.

It is doubtful that many people have this option, but the obvious compromise is to adopt the US solution, which distinguishes between short-term speculation and long-term asset appreciation. In the US, gains made within a year are taxed in the same way as income. A preferential rate applies to assets held for more than a year. This was zero for those in the bottom two tax brackets, and 15 percent for most people above that level (though increases are on the way next year).

In the UK we could tax gains made within a year at normal income tax rates, and keep the 18 percent rate for longer term gains. Lord Forsyth's tax commission advocated a tapering down of capital gains taxes, and now a group of MPs which includes John Redwood has suggested a taper which would tax gains within a year at income tax rates, two year gains at 30%, three year gains at 20% and four year gains at 10%, with five and above year gains exempt altogether.

This is clearly the way to meet Treasury concerns without punishing savers and attacking capital investments. The question now is whether the government will listen to the concerns that have been raised, and alter their plans accordingly.