Capital Gains Tax hike led to falling revenues [1]

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The Adam Smith Institute is calling on the government today to slash CGT rates in next month?s Budget in order to boost revenue and economic growth. 2010-11 figures now released by HM Revenue & Customs (HMRC) show that the rise in Capital Gains Tax (CGT) was a failure. Meant to raise more revenue, in fact it raised less.

CGT was raised from 18% to 28% for most taxpayers (entrepreneurs? relief stayed at 10%) in June 2010, nearly three months deep into the tax year. This unusual timing allows economists to see the impact of the rate changes during the year.

Comparing the 78 days from 6th April 2010 to 22nd June 2010, and the 287 days from 23rd June 2010 to 5th April 2011, shows a marked fall in revenues. The annual equivalent CGT revenues under each system are:

There was a 76% drop in normal disposals (taking 18% and 28% together for post-23rd June figures, because figures are not available for the equivalent split for pre-June). Clearly, many people sought to realise gains before the rate increased, knowing that the Coalition Agreement committed the Government to a sharp increase in CGT rate. There was also a 34% drop in 10% ER disposals, probably because entrepreneurs feared further tightening.

However, this highlights the fact that CGT is effectively a voluntary tax, paid only when people choose to dispose of assets. If they perceive rates to be too high, they choose to keep assets rather than dispose of them. Only a few people are forced to sell assets ? many of them elderly people who build up assets throughout their lives and then cash them in to live on.

High CGT rates depress economic activity and prevent the flow of capital to where it can be most productively used. This lowers both economic growth and government revenue. This is why the Adam Smith Institute is urging the government to slash CGT rates to their pre-2010 levels, which would raise more revenue for the Treasury and also stimulate growth.

For example, if someone owns a buy-to-let flat and is thinking about selling it to raise seed money for a new business, the fact that a large chunk of the proceeds has to be paid in tax will deter them. They may well decide to keep the flat and not start the business, thus depriving the state not only of the CGT revenue, but also the taxes that would be paid by the new business and its employees.

People?s reluctance to pay a large cheque to the state is increased by the knowledge that much of their

capital gain is actually due to inflation. Indeed, roughly half of taxable gains are attributable to inflation .

Dr Eamonn Butler, Director of the Adam Smith Institute says: ?The coalition policy of a sharp increase in CGT rates has failed. Not only has it raised less revenue, it has also reduced the available capital in the economy. That is the last thing businesses need at a time when bank loans are so difficult to get.?

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