

# A CAPITAL OFFENCE



Bracewell-Milnes & Sutherland



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Dr Harry Brachwell-Milnes

and

Grace Sutherland CBE

From research prepared for:

The Alan Watts Institute

1989

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Adam Smith

The Wealth of Nations, page 800

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'The proprietor of stock is properly a citizen of the world. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left.'

Adam Smith,  
The Wealth of Nations, page 800

## CONTENTS

1. The principles of capital tax reform	1
2. The devil in the detail of capital taxes	7
3. Questions and discussion	12
4. Concluding remarks	15
5. Appendix: taxes on death 1949-1989	16

First published in the UK in 1989 by ASI (Research) Ltd, London SW1P 3BL. (c) Adam Smith Institute 1989.

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The text of this report includes edited typescript of extemporaneous remarks and discussion that took place during a recent ASI seminar in London on the subject of capital tax policy. As such, it may not completely represent the definitive views of the contributors, and care should be taken in the attribution of remarks.

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ISBN 1 870109 48 1

Printed in Great Britain by Imediacopy Limited, London SW1



## THE PRINCIPLES OF CAPITAL TAX REFORM

Dr Barry Bracewell-Milnes

Radical reform is now reaching areas of the economy that were out of bounds until a few years ago. The boundaries of the politically acceptable and the politically thinkable have made large shifts outwards. Among the former intellectual no-go areas that are opening to rational discussion is the abolition of taxes on capital.

This development is much to be welcomed. Taxes on capital are taxes on capitalism and deserve the unremitting hostility of those who support the capitalist system. They are not required for revenue purposes and they are more damaging to the market economy than any other form of tax revenue raised. Whereas low-rate taxes on earnings and/or consumption are unavoidable and in this sense neutral between different economic systems, taxes on capital are avoidable and uniquely damaging to capitalism.

Capital taxes are a controversial subject, and I recognize that what I have to say may be disputed by many. That is not a good reason for not adopting a robust policy position -- especially after what happened in the last budget. There are three capital taxes in this country: inheritance tax, capital gains tax, and stamp duties. I shall be talking principally about inheritance tax and capital gains tax, since the strong objections to the other two do not apply nearly so forcefully to stamp duties.

### Abolition, not reform

The two taxes are not essential parts of the British tax system. They do not bring in much money and they do a lot of damage, and there is no way of reforming them that does not do about as much harm as good, unless the reforms aim ultimately at abolition.

In the 1988 budget the base date for capital gains tax was brought forward from 1965 to 31st March 1982, and the exempt amount was reduced to £5,000 and there were some other smaller changes. But the most important change was that gains would be taxed at income tax rates, and indeed as an addition to the income tax base. What was done in March 1988 represents an uneasy compromise between the principles of taxing capital gains fully as income on the one hand and on the other hand taxing them either not at all (as before 1961) or at lower rates than the top income tax rate (which was what has happened since 1965).

The apology that the Treasury put forward for what they did in raising the rate of capital gains tax of most taxpayers to the



highest rate which has ever been levied in this country (40%) is that while the United States has had a fierce capital gains tax regime for some years, increased the rate in 1986 and has no indexation, this has nevertheless not wrecked the United States economy. However, if you have an economy as large and diverse as that of the United States you can afford a great deal of fiscal mischief although the economy will still go on. But that is not a good reason for having a tax that does damage and is not a necessary part of the system.

The short-term prospect is that the Government are likely to keep to the reforms that they introduced in March 1988, and the present Chancellor in particular is unlikely to undergo a conversion and confess the error of his ways and reduce the rate of capital gains tax to what it was before March 1988 or even lower. Nevertheless there are possibilities of reform within the context and confines of the political practicalities.

### **Inheritance tax**

With inheritance tax, the situation is a much more favourable one. The threshold was increased in March 1988 by £20,000 to £110,000; but more importantly the top rate of tax was reduced from 60% to 40%, which is now a uniform proportional rate above £110,000. The result is that at the top of the scale the situation is more favourable than it has been for a number of years in this country. For modest estates of the order of £250,000 or less, however, the tax burden is higher now than it was in 1975, under Denis Healey: not by a great deal but by something of the order of £5,000 - £10,000 on present-day terms allowing for inflation. The burden is very considerably higher than it was in 1949.

Inheritance tax is out of tune with the times and not least out of tune with a good deal of what the present Chancellor has to say. He has been speaking about generating a 'nation of inheritors' on a number of occasions. This phrase had been creeping frequently into his speeches. I last came across it, and to my considerable surprise, in a recent speech on privatization which he delivered in French to an audience in Paris. The translation has it: 'As the years go on, the first generation of owners will pass their homes and their shares on to their children, so that we become not merely a nation of owners but a nation of inheritors too.' What does that say for the value and validity of inheritance tax? How useful a part is it of a tax system? I would argue, a damaging and unnecessary part.

The economic argument against death duties is that a capitalist economy cannot be expected to function as efficiently as it should unless the personal ownership of capital is both widespread and in places deep. The owner is a more efficient and less expensive steward of his own resources than anyone acting on his behalf. Death duties, which are levied on personal ownership but not on ownership by financial institutions or government



bodies, are directly contrary to this principle.

Death duties are the fiscal instrument of the one-generation society in which wealth is cheap and easy to spend and difficult and expensive to transmit to the next generation. Each generation of a prosperous family has to reinvent the wheel in order to stay where it was, which cannot be a sensible use of human effort.

### **Reform prospects**

The budgetary constraints on reducing and abolishing inheritance tax and capital gains tax have never been more favourable. The yields of the two taxes are small, of the order of £1000 million for inheritance tax and rather more for capital gains tax. The figure was £1950 million at the time of the last Budget, but that does not include corporate capital gains). The Budget is in huge surplus, and each new piece of statistical information puts the estimates of the surplus up a billion or so. It could be £15 billion or substantially more by Budget time.

We also have the situation where fiscal drag in its various forms is now so powerful that the Chancellor has to cut taxes by something between £5 billion and £10 billion per year merely to stop the tax burden growing; this was indeed what he did in 1988. One representative body at least, the Institute of Directors, has produced in its recent Budget Representations, published in January, a set of proposals for up to 1992-1993, which include the abolition not merely of inheritance tax but also of stamp duties. Their reasoning is that the amount of revenue from inheritance tax is so insubstantial at present, some £1 billion, that the tax can be abolished: the budgetary fiscal constraints for the first time for many years are no bar to its abolition. The Institute of Directors were a little more cautious about capital gains tax but that is because of the political background, not because of the fiscal background or any budgetary constraints.

### **Longer term reform**

Any reduction in inheritance tax can and should be regarded as steps towards its abolition, unless the Chancellor thinks fit to abolish the tax in one go which is fully within the budgetary possibilities. Capital gains tax is a rather different matter. If they are to stand a chance of adoption any immediate reforms that are put forward from the taxpayer's side will probably have to be compatible with, or at least not diametrically opposed to, what was done in March 1988.

There is a school of thought arguing for the replacement of inheritance tax with capital gains tax on death. At present we have no capital gains tax on death in this country and it would be useless as well as unnecessary to make this change: it would be a change of form rather than substance if one sort of death tax was replaced by another. It would affect some taxpayers



adversely and some favourably, but more generally a capital gains tax on death discriminates against assets that rise in value over time in favour of those which keep a constant monetary value after allowing for inflation. I do not think that that is the form of fiscal distortion that the tax the system ought to encourage.

### **Inheritance tax principles**

Inheritance tax can be traced back to Egyptian times. It used to be levied at the comparatively modest rate of 5% in Roman times.

This rate was rather more than those of the British stamp duty at its highest but not all that much more, and it served a not altogether dissimilar purpose. In ancient times, money came within the grasp of the state most readily when it passed from a deceased to a living person. This was an appropriate time for levying a charge because the state had in any case to make sure that the transfer was going through properly in accordance with will of the deceased.

That was the background for many years until we came to the rise of socialist thinking in the 1880s. In 1894 when Sir William Harcourt introduced estate duty in substitution for some previous charges, he delivered himself of the famous expression: 'We are all socialists now'; and this redistributive zeal was indeed the inspiration of the tax for a number of years. Seligman, writing in 1895 emphasized the 'accidental income' argument for inheritance tax, that if somebody had a windfall that is a good reason for levying an additional tax on it. The Institute for Fiscal Studies said something rather different in 1973, namely that the argument for levying the tax was to spread what would otherwise be an excessively concentrated distribution of wealth.

It is notable that there is no convinced support for inheritance tax nowadays, even some of its natural supporters are deserting it in favour of capital gains tax. The present government tend to argue in favour of inheritance tax only on the principle that we have had some such tax for a number of years and that there might be a rumpus if it were abolished. This argument is correct as far as it goes, but it does not go far.

### **CAPITAL GAINS TAX**

Capital gains tax is a much tougher proposition for reform. There are supporters of the tax not only among socialists but also among classical liberals. This has been true for at least fifty years, since Henry Simons produced his book on personal income tax, and I think it goes back a good deal beyond that.

### **The boundary issue**

The essence of the classical liberal support for capital gains tax is that there are otherwise bound to be problems of distinguishing between capital gains and income. If this



argument is pushed to its logical conclusion the Treasury should treat capital gains, even without indexation, on the same basis as income.

Few countries, if any, have ever had such a system, which in itself is significant -- just as, if the National Health Service is the envy of the world then why has nobody imitated it? Boundary problems are real problems but they are best localized. If two states have a border dispute one possibility is total war between the two, with the victor taking over the territory of the other state. That is one way of resolving a boundary problem but not the best way: it is better to contain and deal with the problem at the point where it occurs, and to come to some agreed demarcation. Similarly for capital gains and income. Any country with an income tax has to fix the boundary with capital gains in one way or another, and the best way is not to annexe the whole of capital gains into the definition of income.

A prime reason why capital gains are not income is the difference between accruals and realizations, which is of central importance for capital gains and of minor importance for income. It is only through the neglect of this difference that the Exchequer always makes a profit out of capital gains tax, even if taxpayers collectively are making a loss. There is no possibility of basing a capital gains tax on accruals and so I will not labour that point.

#### **A tax on savings**

Capital gains tax is essentially a tax on savings, especially if roll-over relief is refused. It is thus what Adam Smith called an 'unthrifty' tax and it is an especially unthrifty tax in that it brings forward the charge on the taxpayer that would in any case be imposed later when the money was spent. It is a mixture of an additional tax on saving, which is undesirable for one set of reasons, and an anticipated tax on future spending, which is undesirable for another set of reasons.

Capital gains tax is rightly criticized for its complexity and because it is in practice largely a tax on inflation. The more fundamental criticism is that it has no valid function in a society and an economy where assets are held for the long term and eventually bequeathed to the next generation.

#### **POLICY PROPOSALS**

##### **Inheritance tax**

The prescription for inheritance tax is pretty straightforward. The rate (at 40%) is much too high, not least on medium estates from £110,000 upwards. The threshold should be increased and the rate lowered. These changes are justifiable on their own terms as well as being steps toward the abolition of the tax.

Also, I would put in a plea for increasing the reliefs, and in



particular the relief for business property. Inheritance tax on business property brings in less than £20 million per year. It is particularly burdensome for family companies and must be the most damaging tax per pound of revenue generated in the whole of our present system.

### Capital gains tax

I have five suggestions that ought not to be unacceptable in principle to reformists of the March 1988 variety:

- \* the first is to reduce or abolish the high rate of income tax. A proportional rate of income tax, for which there are strong and separate arguments, would go far to reducing the present problems and burdens of capital gains tax;
- \* the rate of capital gains tax should also be uncoupled from the rates of income tax, so that capital gains tax does not go up with income tax automatically if a government of another persuasion is elected and raises income tax;
- \* there ought to be a provision for carrying back losses without a time limit and/or;
- \* an exemption for gains realized after a holding period of, say, seven years;
- \* a further suggestion which has support from this Institute among others is rollover relief for portfolio rearrangements, so that the present uneconomic distortions that result from the 'locking-in' effect are overcome.



## THE DEVIL IN THE DETAIL OF CAPITAL TAXES

Bruce Sutherland CBE

Let me begin by quoting Adam Smith's Wealth of Nations:

'All taxes upon the transference of property of any kind, so far as they diminish the capital value of the property, tend to diminish the funds available for productive labour. They are all more or less unthrifty taxes that increase the revenue of the sovereign which seldom maintains any but unproductive labourers, at the expense of the capital of the people, which maintains nothing but productive.'

The essence of the taxes we still have on death lies in egalitarian principles, but another nice quotation, from John Stuart Mill, does demonstrate that these principles, insofar as they are valid at all, are misapplied in the reality of inheritance taxes:

'It is an abuse of the principle of equality to say that one man should not be better off than another if the fact of his being so does not make that other worse off.'

It is a curious thing that one example, where it definitely is the case that making one person better off makes others worse off, is the football pools. The man who is a million pounds better off this week is a million pounds better off because a million other people are one pound worse off to provide the money for it. But we do not tax football pool winnings.

### INHERITANCE TAX

It seems to me the justification for having a tax on death must be reconsidered. In today's world, should we have one? We got it because in feudal times the only occasion on which a feudal monarch could exact cash, rather than service in kind, from his tenants in chief, was on their deaths when fines, escheats and wardships could be levied. Uses (or trusts) were invented to avoid these exactions. In due course death duties in various forms were introduced in succession to those feudal levies and they have continued to the present time. Gift taxes have generally been introduced to protect the yield of death duties. But it remains questionable whether a tax on property passing on death is appropriate in today's society.



### **Ease of abolition**

The low yield emphasizes the point. Inheritance tax works plus residual payments of estate duty and capital transfer tax yielded £1.07 billion in 1987-88 and are expected to yield £1 billion in 1988-89 -- which works out at 0.58% of the total yield of taxes and national insurance.

When the famous Rooker-Wise amendment was being discussed some time in the late 1970s, Joel Barnett (from the Treasury Front Bench) justified it by saying that it was 'well within the budgetary tolerance' -- it could cost £500 million that year. Today, the equivalent number would be greater than the yield of inheritance tax. So its abolition remains within budgetary tolerance, according to Joel Barnett's view at least.

### **Burden on everyone**

It seems very odd that a government which claims to encourage the ownership of wealth acts directly to reduce the ownership of wealth.

There has been much recent concern about the supposed fall in savings. There is a slight anomaly in those figures because the capital element of your mortgage payments is not regarded as savings for this purpose, and the ending of the double mortgage relief last year has diverted vast amounts of money, which might be saved elsewhere, into mortgages. But tax is still a powerful disincentive to save, an oddity given this government's ambitions.

I did some sums last year and in March 1988, compared the yield of tax to that in April 1949 (when Sir Stafford Cripps reformed the estate duty and abolished the legacy duty and succession duty). Having indexed by the RPI the bands on which capital transfers are taxed and interpolated the rates in 1974, when the capital transfer tax came in, on those same bands, it becomes clear that the capital tax burden is increasing for some (see Appendix). For estates between £200,000 and £300,000 the charge in March 1988 was slightly heavier than it was in 1974 when the capital transfer tax started. And for estates from £110,000 through to £600,000 the charge gets up to 186% of what it was under Stafford Cripps's estate duty. The highest burden of capital taxes on death in this country, ever, was that pertaining in the last year of Ted Heath's administration. Interesting, given the attitude of the party in government to taxation and inheritance.

### **Anomalies**

Looking at the details of the tax there are some quite incredible anomalies. An individual, who is entitled to the income from settled property, is treated for the purpose of tax as if he owned the capital. So if an individual on his death bed gives away his right to the income (the value of which actually is



almost negligible because he is expected to die next week), he is still treated for tax as if he owned the whole of the capital.

Conversely, with the reversion of that property: where the individual knows that next week he is going to get the whole of the capital, at that point he is treated as owning nothing.

Valuation relief is given for productive assets -- business and agricultural property -- but at a lower rate for holders of small minority interests (who are by definition most exposed to risk, since they cannot influence the management of the assets), than for holders of controlling or larger minority interests (who can control to a greater or less degree the destiny of their investments).

The rules for the taxation of gifts made within seven years before death can result in more tax being chargeable on the second or larger gifts in a series during the seven years before a death than would have been due had those gifts not been made.

If A makes a gift to his son B, and then a few years later A falls on hard times and B makes a gift back to A, then both of them have got the same property in their lifetime rollup. So we had introduced a CTT relief for mutual gifts. When the inheritance tax came in, they abolished that. About a year after the tax came in, regulations were made that were supposed to take care of the double charges. They have not. If a father gives his house to his son on the terms that the father will continue to live in it, then (because the father has reserved a benefit for inheritance tax purposes) he is treated as if he still owned the house. If his son dies while the father is still there in the house, he is treated as if he owned the house too -- so it is in two estates simultaneously.

There are a number of anomalies like these and for all these reasons the tax should be abolished. Mr Lawson basks in his record of abolishing one tax each year. This year, inheritance tax is the fittest candidate.

#### CAPITAL GAINS TAX

Capital gains tax is a politically motivated tax. The Royal Commission on the Taxation of Profits and Income reported in 1955, by a large majority that we should not have a corporation tax, we should not tax companies differently from individuals and partnerships and we should not have a capital gains tax. A minority report, which was signed by Nicholas Kaldor, George Woodcock, and another TUC representative, advocated a corporation tax and a capital gains tax, contrary to the views of the great majority. In the first budget of the new Labour government in 1965 both corporation tax and capital gains tax were introduced.

#### Revenue-driven

It is what I call a Revenue-driven tax. It is difficult to get



any tax amended, to persuade officials of the need to remedy anomalies. Those of us who have been engaged over many long years in trying to persuade the Revenue of this are aware of the problem. Ideally you have to catch any anomalies before they get into a Bill. A Bill's publication gives its governmental sponsors a vested interest in preserving it intact, and once on the statute book it is very difficult to get it altered unless the anomaly is particularly glaring (or perhaps it works against the Revenue, in which case it is altered very quickly!) Because of its complexity, capital gains tax is probably the most difficult to get amended.

The principal reason why we had changes last year was undoubtedly the boundary problem. The Revenue argues for ever whether something is income or capital. The introduction of indexation when inflation got to the levels it did in the 1970s, gave rise to a new debate on whether we should have indexation of capital gains -- that unless we did something, we would be taxing inflation as if it were a real gain. The Revenue fought against it strongly. When finally Geoffrey Howe decided in 1982 that we must give relief, it was introduced in the most cumbersome way possible, as if to prove it would not work. We have had that problem ever since.

Then there is the Green Paper on residence. One of the real motivations behind that paper was the fact that some of us had pointed out the nonsense of the capital gains tax providing a positive incentive for people, about to sell their businesses or land, to take the precaution of living in some more favourable climate for a year or two, realizing their gains as non-residents, and then coming back.

The tax undoubtedly inhibits people who would otherwise be of a mind to switch investments from so doing. It was for this reason that the capital gains charge on gilts was abolished -- because it was clogging the gilts market. Naturally the government could not put up with that. And it is significant that when the charge was abolished in April 1969, the gilts market was at an (almost) all-time low, so the loss to government in tax was negligible.

### **Anomalies**

As far as the anomalies are concerned, individuals and trusts have an annual exemption so that over the years a small donor can get rid of his gains. Companies do not, but there is no particular reason why not.

No distinction is made between 'lumpy' assets, such as a farm or a business, and fungible assets such as securities which one can sell one at a time. While an individual might be able to phase the sales of his securities holdings over years and utilize his annual exemptions, he cannot do that with his farm or his business, so it imposes a penalty on individuals who hold such assets.



The interaction with inheritance tax is such that gifts made within seven years of death can be penalized for CGT purposes. Losses can only be carried forward, not back.

### The future

Mr Bush's administration with a large amount of experience about the effect of different capital tax rates behind it, is proposing to decouple capital gains tax and income tax rates, and to reduce the capital tax rate from 28% to 16%. Normally in recent years we have had the view that we lead the way in tax reform; but now we have this bold lead from the United States. Let us hope that we shall follow.



## QUESTIONS AND DISCUSSION

**Dr Eamonn Butler:** The Chancellor has only recently reformed capital gains tax and inheritance tax. Would the reforms we are proposing not be seen as a embarrassing U-turn?

**Dr Barry Bracewell-Milnes:** As far as income tax is concerned, he has recently reduced the top rate from 60% to 40% and I would foresee a continuation of that process of reduction. There is no embarrassment in pursuing that goal. Similarly for inheritance tax, where Mr Lawson raised the threshold from £90,000 to £110,000 last time round. So a continuation of this process well above the present £110,000 need not cause him any embarrassment -- quite the contrary, it is more of what he has done already.

Capital gains tax is a trickier proposition and I think that a thoroughgoing reform may not be on the cards in the very short term. But it is plausible in the long term or even perhaps in the medium term. Lawson may not be a fixture for years and years, though for the present it is right to avoid reform plans that would be contradictory to what he did last year. My proposals need not cause embarrassment of the kind that you were referring to, although they could well be opposed by the Inland Revenue for other reasons.

**Bruce Sutherland CBE:** Nigel Lawson is a skilled politician and knows the need to get something done to remove these unfortunate comparisons with Sir Stafford Cripps and Denis Healey.

**Rodney Atkinson:** In terms of the income that is generated by a capital sum, the inheritance tax threshold of £110,000 hardly represents what most people would call 'wealth' at all. Many people who are not wealthy enjoy a fairly secure stream of income of that order.

Or let me provide another example. Compensation awards for injury and loss of life can rise to £1 million for the loss of a husband -- so that sum again, reflecting as it does the lost earning potential of the deceased, is obviously not to be regarded as great 'wealth', unless you believe that the wealthiest people in this country work on North sea oil rigs who are judged worthy of such settlements. So awards like that are another good guideline for what people consider to be a normal stream of income and not 'wealth' at all.

**Bruce Sutherland:** Of course the world has changed a great deal and people are generally much wealthier than they were just after the war. Large numbers of ordinary people now find their houses and other assets taking them into the inheritance tax net. If we



returned to Cripps' rates up to £600,000 then inheritance tax could well start to wither like development land tax. The first attempt to tax development value in land was started by Lloyd George in 1908 when he introduced increment value duty, and it lasted for only two years. Then after the War there was betterment levy which soon died. If we matched Cripps and applied inheritance tax at his rate to estates under £600,000 then the total yield would be so small that there would be scant justification for retaining the tax at all. When the tax gets to the stage where it produces almost nothing then it has to be repealed. That is what happened with development land tax.

So I believe inheritance tax could be abolished. There would be the ritual outcry, an uproar in Parliament, demonstrations in Hyde Park, and then it would be gone and that would be the end of it. But the politicians are still cautious, even Geoffrey Howe who was at one stage seriously considering whether he should abolish one of these two taxes. Somehow we have to persuade them that the majority of people in today's world would not worry if inheritance tax were abolished.

As far as the capital gains tax is concerned the problem is that it is Revenue-driven. The Revenue having achieved their long-term objective to get rid of the boundary will fight in the last ditch to keep it. The Revenue, I believe, has too large a role in policy making, as opposed to the administration of taxes. The one hope would be Barry's approach.

**Edgar Palamountain:** I am chairman of the Wider Share Ownership Council. Like the Adam Smith Institute and other bodies we do put in our annual Budget proposals for the Chancellor and on this occasion we are particularly worried about his red face. So for the first time we suggested, again not alone, that rollover relief should be extended to capital gains tax. If capital gains tax is supposed to be like income tax, essentially a tax on cash flow, there is no case for imposing it before the money gets into your pocket. Therefore I would have thought the case for exempting portfolio adjustments of capital assets is extremely strong.

**Tom Griffin:** Since the early 1970s, the United States have moved their capital gains tax rate up and down like a yo-yo. So they have acquired a large body of evidence about its effects. The correlation between the capital gains tax rate and the volume of stocks traded and coming into the public market was really quite remarkable. The tax really is a clog on markets as Bruce Sutherland says.

**Dr Barry Bracewell-Milnes:** I think this is a very important point. I took soundings from an official within the Treasury on the subject of what had been going on in Whitehall in preparation for the changes to capital gains tax in March 1988. As far as I was able to learn the Treasury were in total ignorance of the work done in the United States by Lawrence Lindsey and of the statements made on the subject by the US President, Vice-



President and Treasury Secretary. Yet it is all on the record: the Heritage Foundation in Washington did a first class job in collecting all that information together.

Professor Lawrence Lindsey has done more work on this than perhaps any other academic in the world, research which has been facilitated by the laboratory material available to him because of the frequent changes in the capital gains tax rate in the United States. His research shows that you have in the United States a revenue-maximizing rate of capital gains tax of 15% give or take, as compared with a much higher revenue-maximizing rate of income tax of around 40%.

This discovery confirms one of the points that I was trying to make earlier -- that capital gains are not income. If you have a revenue-maximizing rate on one tax that is half or less of what it is on the other, it is clear that the two taxes are quite different animals. If you are not talking about the same animal then boundary problems take on a fresh perspective; they must be resolved as genuine boundary problems and without the damaging expedient of subjecting capital gains to the rate of tax charged for income.



## CONCLUDING REMARKS

Dr Barry Bracewell-Milnes

Quite a number of people have been talking fancifully about the possibility of paying off the National Debt in less than twenty years. In my view a much better use of that money would be to effect radical tax reductions. The wealth-creating effects of such an initiative would bring into play the possibility of abolishing even income tax, as well as all the capital taxes. You could then move towards an expenditure tax -- not of the kind recommended by James Meade and others, but one based on the principle that you pay a proportion of what you spend.

It is interesting and significant that there are so few countries in the western world that have no major distinctions in the treatment of income and capital gains for the individual taxpayer. In continental Europe, they live with big differences in the tax treatment of incomes and capital gains, and yet they do not seem to have serious difficulties.

Most countries find a way of living with these boundary problems. We found a way of living with them ourselves, on a rather grand scale, in the days when we had capital gains tax at nil and income tax at 97.5%. A gap of that size does make the system creak a bit; but now that we have the maximum rate of income tax down to 40%, a capital gains tax rate of 0% would still produce less than half the problem we succeeded in living with then. So I hope to see dramatic cuts in capital gains tax as time goes on.



