Giving Everyone a Stake

A Liberal Democrat plan for a fairer distribution of wealth

Britain is deeply divided; this is especially true when it comes to wealth.

Everyone deserves the opportunity to work hard and build a good life for themselves, their family and their community. Everyone deserves financial security, a good education, to be able to afford a decent home and have access to high-quality public services.

But for many, that's not the reality today. Britain is one of the most unequal societies in Europe: success increasingly depends on where you live and who your parents are rather than on your own talents and hard work. People are not getting what they deserve for their efforts.

Britain's wealth gap entrenches power and privilege both within and between generations, by generating additional income for owners while restricting opportunities for those with little or no wealth. Through gifts and inheritances, these inequalities are passed down to future generations, perpetuating the divide.

Those without wealth cannot buy property, fund crucial education and training, deal with unexpected life shocks, or pursue their own business and creative ideas.

This is not the future Britain deserves.

45% of UK wealth is owned by just 10% of households, while just 9% of wealth is owned by the bottom half. This looks set to continue, with over half of the net increase in wealth between 2010 and 2014 captured by the top 10% of households. Yet although it is twice as great as income inequality, wealth inequality has paradoxically received far less attention.[1]

Worse still, wealth inequality is likely to worsen in the coming years due to weak wage growth, rising personal debt, workplace automation, declining rates of home ownership and saving, and an increasing flow of inheritances to a minority lucky enough to receive them.

Society is built on trust and a sense of shared purpose between individuals, classes, regions and generations. But Britain's gaping wealth divide undermines this, by

[1] https://www.ippr.org/files/2017-10/cej-wealth-in-the-21st-century-october-2017.pdf

creating the impression that the game is rigged in favour of those that accumulate and inherit wealth.

If we want to create a society where everyone has the opportunity to succeed, we need to give people the skills and resources they need and create a more level playing field. This means tackling inequality through policies that promote a fairer distribution of wealth.

That is why the Liberal Democrats have set out a bold series of proposals to give everyone a stake in our society.

Our plan

While total UK net wealth is increasing year on year, the proportion of it that is taxed has fallen. Total UK wealth has increased from around 300% of GDP to almost 700% over the last 60 years, yet wealth tax revenues have remained fixed at around 4% of GDP, identical to the proportion raised in the mid-1960s[2].

The following proposals would ensure that Britain's wealth is taxed more equitably, promoting a fairer distribution of wealth and generating crucial funding for better public services, an ambitious programme of lifelong learning and the creation of a "Citizens Wealth Fund".

Taxing income from wealth and work in the same way

Liberal Democrats would:

- **Tax capital gains through income tax**, by charging income tax rates and National Insurance and abolishing the separate capital gains tax-free allowance. An allowance linked to inflation or a minimum "rate of return" would be introduced to ensure investors do not pay tax on purely inflationary gains, and tax on capital gains from shares would be lower to reflect corporation tax already paid.

[2] https://www.resolutionfoundation.org/app/uploads/2017/06/Wealth.pdf

- **Abolish the separate dividend tax-free allowance**, but maintain lower tax rates on dividend income to reflect corporation tax already paid.
- **Make all income, be it from employment, capital gains or dividends, taxable through the personal allowance**, so that those who depend solely on income from wealth still receive a generous tax-free allowance.
- **Abolish capital gains forgiveness at death:** by cancelling capital gains tax owed, this loophole encourages people to avoid tax by holding onto assets for longer than necessary.

Why are these reforms needed?

- It is unfair that we tax income from wealth differently from income from work. Though generating a return on assets typically requires less effort than earning a salary through employment, we nonetheless tax wealth less than we do employment income.
- Treating all income identically regardless of origin would remove the incentive for the wealthy to shift employment income into other forms – such as capital gains or dividends – to pay less tax. People should pursue investment and business decisions based on their economic merit, not arbitrary differences in tax rates.
- To illustrate, currently a business owner can pay themselves via a combination of salary, capital gains and dividends and benefit from three separate tax-free allowances and varying tax rates, whereas an employee cannot. The tax system should not discriminate between different types of work in this way.

Who would this impact?

- **Capital gains**: Our proposed changes would affect just 250,000 taxpayers (individuals and trusts combined) currently subject to capital gains tax in the UK, or 0.004% of the population[3]. Moreover, by making capital gains taxable through the personal allowance, those few solely dependent on capital gains income would still receive a generous tax-free allowance.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/654506/Table_14.1.pdf

- **Dividends**: According to official figures, almost 7 million people receive some income from dividends, or around 10% of the population[4]. But by allowing dividend income to be declared through the Personal Allowance (which at £11,850 is much larger than the current £2,000 Dividend Allowance) our proposals would reduce taxes for those dependent on dividend income, while increasing them for those to whom dividends are just an extra source of income.

Taxing transfers between the generations

Liberal Democrats would:

- **Abolish inheritance tax and instead tax recipients of transfers at current income tax rates**. All transfers – including large gifts – would be taxed, rather than just transfers made at or seven years before the giver's death, as is currently the case.
- **Give every individual a lifetime tax-free allowance of £250,000, recognising parents' legitimate desire to pass down to their children. Transfers received beyond this allowance would be progressively taxed at rates of 20%, 40% and 45%, like employment income.** Small annual gifts below a specified amount would be exempt and not count towards the lifetime allowance, as would spending on a child's education and transfers to spouses and charities.
- **To minimise the avoidance opportunities plentiful under the current inheritance tax regime, certain reliefs would be maintained but reformed** by: increasing minimum ownership periods; introducing provisions to claw back relief if inherited assets are sold off too quickly; and introducing tests to ensure that property receiving relief was not acquired purely for tax purposes.

Why are these reforms needed?

- While we recognise the desire of parents to provide for their children, we also need limits on how much the wealth of previous generations determines the prospects of future ones. We believe a person's life chances should be determined as far as possible by their own efforts, not those of their parents and grandparents.

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[4] https://www.gov.uk/government/publications/income-tax-dividend-allowance-reduction/income-tax-dividend-allowance-reduction

- The current inheritance tax system is simply not fit for purpose. Moreover, given the substantial accumulation of wealth among older generations and the declining economic prospects of younger generations, annual flows of inheritances are predicted to double over the next two decades and play an increasing role in shaping society[5].

Who would this impact?

- Under inheritance tax just 4% of estates are taxed[6]. Our alternative proposals, while restricting reliefs and taxing all gifts rather than just those left behind at death, would still leave most people untouched. With the average lifetime inheritance received being £90,000, and over half of the population receiving no inheritance whatsoever, our lifetime tax would affect only those receiving substantial wealth[7]. Moreover, by taxing recipients rather than givers, we would encourage givers to spread their wealth widely to benefit from as many individual tax-free lifetime allowances as possible.
- When it comes to inheriting property, with the average UK home worth £225,000 in 2018, our lifetime allowance of £250,000 would allow this to be inherited tax-free. In London, where the average house price is £472,000, an individual inheriting this would pay £44,000 in tax[8]. However, the ability to combine lifetime allowances under our system would enable two or more people to inherit the London home completely tax-free.

- Our proposed system would be more generous on lesser inheritances and less so on larger ones, thanks to its progressive rate structure. While under inheritance tax no tax is paid on individual estates worth £325,000 or less, a flat tax rate of 40% is paid on anything above this. Under our system, although individuals would have a lower tax-free allowance, tax paid above this would start at just 20% and only reach higher rates of 40% and 45% on transfers above £500,000 and £1 million respectively.

[5] https://www.ifs.org.uk/uploads/publications/bns/bn192.pdf
[6] https://www.resolutionfoundation.org/app/uploads/2018/05/IC-inheritance-tax.pdf
[7] https://www.ifs.org.uk/uploads/publications/bns/bn192.pdf
[8] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/housepriceindex/february2018

Rebalancing pension tax relief

Liberal Democrats would:

- **Set tax relief on pension contributions at a flat rate of 25% and abolish employee National Insurance on those contributions**, substantially boosting saving among lower earners while reducing relief for higher earners.

- **Limit the tax-free pension lump sum to £40,000**, restricting the amount of relief those with the largest pension pots can receive without paying any tax, while leaving 75% of pension drawdowns unaffected.

Why are these reforms needed?

- Not only does it cost the Treasury £41 billion annually[9], but the existing system of pension tax relief is deeply regressive, with 63% of tax relief going to the top 15% of taxpayers[10]. This minimises the incentive to save for lower earners and will exacerbate future pensioner inequality.

- A flat rate of tax relief higher than the basic rate and lower than the top rate would be fairer, by cutting relief for higher earners already able to save adequately for retirement while boosting saving among lower earners. Although the current system of tax relief for pension contributions is designed to mirror tax rates paid on pension income withdrawn in retirement, in practice over 98% of higher earners become basic rate or non-taxpayers in retirement[11].

- While reforming tax relief on pension contributions would reduce pensioner inequality in the future, limiting the tax-free pension lump sum would address intergenerational inequality now by reducing a substantial state subsidy to the older generation. Not only is this reform justified given the scale of that inequality, more generally it is difficult to defend allowing a significant proportion of pension pots to go completely untaxed.

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[9] https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/565/565.pdf
[10] https://www.resolutionfoundation.org/app/uploads/2016/03/Pension-tax-relief.pdf
[11] Ibid

- By being most generous to those with the largest pension pots and the highest marginal tax rates in retirement, the lump sum is regressive and should be reduced.

Who would this impact?

- Restricting pension contribution tax relief as proposed above would increase the proportion of total relief given to the 90% of taxpayers with incomes under £50,000 from half to two-thirds, and decrease the share of relief given to the top 1% of taxpayers with incomes over £150,000 from 13% to 7%.[12]

- Using examples of specific earners to illustrate, under these changes a full-time NLW earner – comprising 3.4 million workers by 2020 – would see a 16% increase in their retirement pension pot and a full-time median (average) earner a 12% increase.[13][14]

- With the average UK pension pot estimated at around £50,000[15], restricting the tax-free lump sum to £40,000 would only impact the largest pots, with owners of pension pots worth up to £160,000 not seeing any change. According to the Resolution Foundation, over 75% of pension drawdowns would be unaffected by this reform.

Making property taxation fairer

Liberal Democrats would:

- In the short run, **introduce additional council tax bands encompassing the country's highest-value properties**, using the additional revenue raised to cut tax for households in lower bands. The small minority of low-income/high property value households would be able to pay the extra tax in instalments, or upon sale of the property.

- As a long-term aspiration, **we will review the case for a simple percentage-based and proportional annual property tax**, based on up-to-date valuations.

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[12] Ibid
[13] Ibid
[14] https://www.ifs.org.uk/tools_and_resources/where_do_you_fit_in
[15] https://www.telegraph.co.uk/financial-services/investments/investment-pensions-service/what-is-a-good-pension-pot/

Why are these reforms needed?

- Council tax is broken and no longer fit for purpose. Introduced as a temporary replacement for the abandoned poll tax, it has instead remained in place without any substantial changes since then. Property values remain those of 1991, with bands not having been adjusted to account for large increases since then. The result is a deeply regressive tax, with lower-value homes paying a much higher percentage of property value in tax than higher value homes.
- Although in the long run – as has been recommended by the IFS, OECD, IPPR and Resolution Foundation among others – council tax should be scrapped and replaced with a better property tax, changes to the existing system are needed in the short run to rebalance the burden of tax towards wealthier homes and ease it on lower value ones. We believe this should take the form of additional bands, with additional revenue channelled into tax cuts for households in lower bands.
- In the long term, we will review the case for replacing council tax with a simple annual proportional tax on residential property. Through regular revaluations and a simple rate, such a tax would actually keep up with increases in property value, be easier to understand, ensure wealthier households pay their fair share, and avoid the unnecessary complexities of council tax bands.

Putting the nation's wealth to work

The proposals outlined above would lead to a fairer distribution of wealth in Britain, by ensuring that the wealthy pay the same in taxes as workers, taxing intergenerational transfers in a fair and proportionate way, and rebalancing pension tax relief away from a minority of high earners.

But they would also raise substantial additional tax from the very wealthiest at a time when the public finances remain under severe strain and spending cuts continue to bite. **We expect these reforms to raise an additional £15 billion per year**, though this is likely to grow as the rate of wealth passed down increases in the coming years.

This would still only amount to a tax rate of around 5% on wealth as a share of GDP, compared to taxes worth 33% of GDP on income – a six-fold difference. It is only fair that those in society who have accumulated large amounts of wealth pay a greater share of tax. With wages stagnating and personal debt rising, Britain's workers deserve a break.

Liberal Democrats would use revenues from higher wealth taxation to:

Create a "Citizens Wealth Fund"

- A proportion of the annual revenue raised from higher wealth taxation should be used to create a Citizens Wealth Fund. By actively investing in stocks, bonds and physical assets, the fund would enable the country as a whole to benefit from the returns to investment typically only available to the wealthy.

- The fund would be kept at arm's length from Government and run by professional fund managers, albeit with robust accountability measures and a strong emphasis on environmentally sustainable and ethical investment.

- Such funds have proved successful in Norway, Canada and Alaska, to name just a few examples. The UK has missed numerous opportunities to establish a sovereign wealth fund – from squandered North Sea Oil revenues to the proceeds of past privatisations – but wealth taxes provide another golden opportunity.

- To illustrate, if provided with an initial £50 billion public endowment (consisting for example of revenues from future sales of the government's stake in RBS and other public assets, and a long-term public bond issue) on top of £5 billion per year from higher wealth taxation, after a decade the fund would be worth **£100 billion** and generate an average of **£4 billion per year**, assuming a modest 4% average annual rate of return.

- Once the fund became large enough to generate a substantial annual return, this would represent a new source of public funding, whose ultimate use we do not determine here.

Launch an ambitious programme of lifelong learning

- Britain's economy is changing rapidly, and people risk being left behind if they aren't equipped with the skills and knowledge needed to flourish in the future workplace.

- Liberal Democrats believe that an ambitious, nationwide programme of lifelong learning – funded by higher wealth taxation – is the only solution, with people empowered to develop their skillsets throughout their careers.

- Sir Vince Cable has established a Lifelong Learning Commission which is considering what such a programme would look like, including the possibility of creating publicly funded Education and Skills Accounts for all adults.

Increase spending on public services

- Cuts to the essential public services we all rely on have gone too far, resulting in declining levels of service and increasing difficulties recruiting staff. An ageing population risks worsening the situation as demand for health and social care rises in the coming decades.

- Liberal Democrats are already committed to substantially boosting spending on public services, through our proposed penny on the pound on income tax for the NHS and our plans to reverse unjustified Conservative tax cuts. But we want to take a step further, by devoting a share of the revenue raised from higher wealth taxes to fund our cherished public services.

Liberal Democrats