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Is 50/50 fair?

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A TUC report on the 50% tax rate.

About the author

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Executive Summary

Alistair Darling announced a 50 per cent tax rate for people with taxable income of more than £150,000 a year in the budget in April 2009[1]. The tax rate was actually introduced in April 2010. Although this tax has been subject to much criticism, and the current government has described it as a temporary measure, it looks set to stay until at least the end of this parliament.

This paper has three objectives: to explain how the 50p tax rate works; to assess how much it might raise in additional tax revenues and to assess whether that liability might be easily avoided, as some have claimed.

It is widely presumed that those subject to the 50p tax rate pay half of all their income in tax to HM Customs & Excise. That is not true. They only pay the 50p tax rate on their earnings in excess of £150,000 and those earnings are reduced in any event by the allowances and reliefs that they can claim for tax purposes. The result is that a person with taxable earnings of, for example, £160,000 has an overall income tax rate of 36% whilst a person with taxable earnings of £1 million pays 47.8% of their income in tax. In other words, a 50% tax rate does not usually mean 50% of income is paid in tax, and when tax allowances and reliefs are taken into account the actual rates paid are often much lower.

Even so, the analysis undertaken in this paper, based on HM Revenue & Customs' own published forecasts, shows that the likely amount of tax to be collected as a result of the 50p tax rate in the current tax year could be in excess of £3 billion and might be as high as £6 billion; a figure twice as high as any budget forecast. This estimate clearly contradicts the claims made by many that the 50p tax rate will raise little or no revenue.

To check the credibility of this estimate analysis has been undertaken on the ways that those paying the 50p tax rate might avoid their obligations to pay it. This shows that at present they enjoy tax reliefs with a cash value of maybe £3.5 billion a year (a sum which has already been allowed for when estimating the 50p tax take of £6 billion). That might be a large sum, but in proportion to the total tax paid by this group of £47 billion it is small: it's not that easy to avoid UK tax using the allowances provided for in our tax law even when on average those subject to the 50p tax rate claim reliefs (mainly, but by no means entirely, with regard to pension contributions) with an average cash value of £14,000 each.

[1] http://www.hmrc.gov.uk/budget2009/personal-tax-ind.htm

Of course taxpayers have other ways of avoiding tax than using the allowances provided in law. Taxpayers can complicate matters voluntarily to reduce taxable income, for example by establishing trusts or by setting up companies to manage part of their affairs which means that income can be recorded as accruing to organisations or individuals other than themselves. Despite all that avoidance activity, which no doubt goes on now just as much as it did when the top rate of tax was 40%, our estimates suggest that these loopholes will not significantly affect the potential tax take – they will already have been built into HMRC estimates.

That then leaves the question of whether there could be any other avoidance measures which mean the tax might not collect the sum anticipated. By far the most likely other such reason is now coming to light, and it is the ability of many of those earning 'salaries' of more than £150,000 a year to have that sum paid to companies they control. It is not known as yet how many people have enjoyed such arrangements under contracts with the government and local authorities, but it appears to be many thousands. If that is the case then it is highly likely to be even more prevalent in the private sector, in which case at least some of that income will be taxed at the small companies' corporation tax rate of 20%[2]. These profits can then be left in the company in the hope that one day either the 50% tax rate is abolished or that the company owner's income has fallen so that the profits can be taken out as a dividend and only be taxed at 40% at most. National insurance is, of course, also avoided in this way.

But there are two obvious ways to tackle this: the first is to introduce a comprehensive general anti-avoidance principle in UK tax law that prevents the use of companies to disguise what is really payment for an employment. The second option is to transform the way in which small companies are taxed so that their profits are assessed on their owners at the time that they arise and not at the time that they are paid out to them. In the absence of either such change the opportunity for avoidance of tax that could undermine the effectiveness of the 50p tax rate will still exist. But this conclusion is far from inevitable – if the Government chose to act, the scope for this type of avoidance to undermine revenues could dramatically reduce.

Some of course argue that this will still not be enough because people in this income bracket will leave the country. This is unlikely. 59% of those likely to pay the 50p tax rate are employees, and it seems very unlikely that there will be mass emigration by the employers of these people, especially as maybe one third of them are in the City of London where, despite the claims to the contrary, moving staff to another location is very hard.

Another 21% of these people are self-employed. The reality is most of these will be in the professions and relocating a professional career is difficult: a knowledge of regulation (whether it be in law, accountancy or another field) or

[2] http://www.hmrc.gov.uk/rates/corp.htm

a licence granted by regulation (e.g. in medicine) is very often the basis on which these people can make such high levels of income. That knowledge and those licenses are very often hard to relocate, and for those running businesses there are often real problems in moving when they are dependent upon the expertise of their owner and serve local geographic markets, as many such businesses will.

Even some of those supposedly living on investment income, making up almost 17% of the 50p rate taxpayers may not be as mobile as the description suggests: many will be receiving that income in the form of dividends from their own companies that they manage in the UK. Like the self employed they will have problems moving so it is only the smaller part of that group with genuine investment income and pensioners, who make up 3% of those in this income category, who might be truly mobile. Some of these people could of course leave, but if they do it will not be enough to materially change the estimates of tax to be collected, not least because many will have family and other connections firmly tying them to the UK.

And it also seems extremely unlikely that those earning over £150,000 will reduce their effort in response to the new tax rate. Given the majority of people in this position are employees, unless they receive a pay cut it's hard to see how their taxable income could reduce. And with millions of people working at the NMW, with marginal deduction rates which are far higher than those of the highest earners in the 50p tax rate bracket (and take home incomes which are far lower), the argument that reduced incentives will lead to reductions in effort appears far-fetched. It is also difficult to see how investment decisions of small and medium sized business owners can feasibly be argued to be taken on the basis of personal income tax rates - these have no impact the company tax rates that would be applied to profit used for investment purposes.

The conclusion is inescapable: using HM Revenue & Customs' own data the 50p tax rate has potential to raise a sum well in excess of the £3 billion last officially forecast, and a figure as high as £6 billion could be generated. In addition the scope for revenues to fall as a result of the rate is far smaller than claimed by many, especially since almost 60% of those paying this tax rate are employees, whilst the number of people leaving the UK to escape this tax will be modest, even if there can be no doubt that some will blame it for their reason to relocate when it is likely a wide range of other factors will also actually be involved in that decision.

But there are still routes open to those who seek to avoid paying tax at the 50p rate, which do have potential to undermine the revenues that it could raise. But this loss of income to the Exchequer is not inevitable. These routes could be easily closed if the political will existed to do so existed to introduce a comprehensive general anti-avoidance principle in UK tax law (that prevents the use of companies to disguise what is really payment for an employment) and to transformation of the way in which small companies are taxed so that their profits are assessed on their owners at the time they arise (and not at the time that they are paid out to them).

Section two

The case against the 50 per cent rate

Alistair Darling announced a 50 per cent tax rate for people earning more than £150,000 a year in the budget in April 2009[3], which was introduced in April 2010. The current Government has always suggested they do not like the tax and have suggested that it's a temporary measure[4]. However, in January 2012 they have also admitted that temporary might in this case mean 'for some time' since they have indicated that it is unlikely to be abolished before the 2015 general election[5].

We will not know for some time yet just how much money it will have raised since tax returns for the year to 5th April 2011 will not be fully processed and accompanied by published statistics for at least a year. Recent reports have suggested that the sum raised might be hundreds of millions of pounds a year, and that H M Revenue & Customs are preparing an estimate of the amount in question for publication in time for the March 2012 budget[6]. This report suggests that estimate may be far too low, and that the tax has capacity to lead to far higher revenues.

Either way, the measure has always been controversial. As the Guardian noted a week after the measure was announced[7]:

The new 50p top rate of tax announced this week was damned by the Sun as "an assault on wealth creators", by the Express as a "70s-style raid", and by the Mail as a return to "the politics of envy".

But a poll in yesterday's Times - a paper that predicted a brain drain, calling Wednesday "a good budget for Switzerland" - suggested that the public rather liked the idea. It found 57% support for the move, as against 22% opposition. A parallel poll in the Telegraph was more emphatic, finding 68% support. It was buried, however, next to a headline that read: "Attack on high earners is a desperate gamble".

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3 http://www.hmrc.gov.uk/budget2009/personal-tax-ind.htm
4 http://news.sky.com/home/politics/article/16145169
5 http://www.telegraph.co.uk/finance/personalfinance/consumertips/tax/9001307/David-Cameron-abandons-plans-to-scrap-50p-tax-at-least-until-2015.html
6 http://www.telegraph.co.uk/finance/personalfinance/consumertips/tax/9001307/David-Cameron-abandons-plans-to-scrap-50p-tax-at-least-until-2015.html
7 http://www.guardian.co.uk/uk/2009/apr/25/alistair-darling-budget-50p-tax

Those comments are typical of many that have followed. Despite appearing popular with the public the 50p tax rate has been subject to continued attacks from those who oppose it. Perhaps the high point came in September 2011 when a letter from '20 high profile economists' appeared in the Financial Times, attracting considerable media attention for a day or more[8]. Their argument was that the 50p tax rate was:

…doing lasting damage to the UK economy. It gives the UK one of the highest personal tax regimes in the industrialised world, making it less competitive internationally and making us less attractive as a destination for both foreign investment and talented workers.

[The 50p tax rate] applies to just 1 per cent of taxpayers, who already pay 24 per cent of all income taxes.

If a small portion of these highly mobile workers move elsewhere because of the 50p rate then it is clearly a self-defeating way for the Treasury to try to raise money, and a reduction in tax avoidance would be more effective. It is often portrayed as a justified tax on the rich but the economic damage it causes means that it is against the interests even of ordinary workers who don't pay it.

The implications of the arguments made against the 50 per cent rate are clear. Firstly, that highly mobile workers will leave the country because of the tax rate; secondly that the tax rate may not actually raise any net funds at all because effort will be reduced as a result of the tax being charged so that the incomes that would have been subject to the tax might simply disappear (the 'Laffer' effect); and thirdly that ordinary people will suffer as a result because no more tax will be paid and there will instead be less economic activity in the UK to employ those with lower earnings.

Each of the arguments is worthy of consideration, and in this report we evaluate the evidence behind each of them. But first of all some myths have to be shattered.

[8] http://www.ft.com/cms/s/0/f29adfc6-d893-11e0-8f0a-00144feabdc0.html#axzz1hoUucake and http://www.ft.com/cms/s/0/d92b0bc4-d7e9-11e0-a5d9-00144feabdc0.html#axzz1X059xJQO

Section three

What does the 50 per cent rate mean in practice?

The 50p tax rate is paid by people enjoying taxable income subject to UK income tax that exceeds £150,000 a year. This automatically means that no company pays this tax rate as companies do not pay income tax.

It is also important to note that a person earning more than £150,000 of taxable income in the tax 2011-12 (which ends on 5th April 2012) does not pay tax at the 50p tax rate on all their income if their total taxable income exceeds £150,000. They only pay tax at the 50p tax rate on the part of their income exceeds that amount. This is shown in the following table:

Table 1 Income tax paid by income band on £160,000

Income band	Tax rate	Income in tax band	Cumulative income	Tax due on band	Cumulative tax due	Cumulative tax rate
£	£	£	£	£	£	%
£0 - £35,000	20%	£35,000	£35,000	£7,000	£7,000	20%
£35,001 - £150,000	40%	£115,000	£150,000	£46,000	£53,000	35%
150,001 - £160,000	50%	£10,000	£160,000	£5,000	£58,000	36%

This person is subject to the 50p tax rate but their income tax rate is, overall, 36% of their income. Their marginal tax rate on their top £10,000 of income might be £50%, but they only pay just over a third of their income in income tax.

In saying this it is important to note that although most people in the UK also have a tax free band of income those earning more than £100,000 a year have now had that band reduced, so by the time a person earns £150,000 a year they do not have the benefit of that tax free allowance. This means that all their income is taxable, as shown in the above example.

While the example above illustrates that paying tax at the 50% rate does not mean that 50% tax is being paid on a person's total income the actual percentage of tax paid on total income will depend on each individual's actual income. For example, someone with £1 million of taxable income would have a tax bill of £478,000 and their cumulative tax rate would be 47.8%.

National insurance is also due by those who earn more than £150,000 a year, either on their earnings from employment or their self employed income. However, national insurance works somewhat differently to income tax. The bands due are for a person in employment paying standard national insurance contributions are set out below:

Table 2 National insurance paid by income band on £160,000

Income band	NIC rate	Income in band	Cumulative income	NIC due on band	Cumulative NIC due	Cumulative rate
£	£	£	£	£	£	%
£0 - £7,225	0%	£7,225	£7,225	£0	£0	0.0%
£7,226 - £42,475	12%	£35,250	£42,475	£4,230	£4,230	10.0%
£42,476 - £160,000	2%	£117,525	£160,000	£2,351	£6,581	4.1%

Even if national insurance is included in the calculation, a person on this maximum national insurance rate does not therefore come near to paying tax and national insurance combined at 50%: their combined rate is in fact just 40%.

At £1 million of taxable income from employment the overall rate of national insurance due on income would be 2.3%. The combined income tax and national insurance rate for such a person would therefore just exceed 50%, but by a very small margin.

The idea that the 50p tax rate means that a significant number of people are paying more than half their income to the government each year has to be laid aside: it is simply not true.

Section four

Which income does the 50 per cent rate apply to?

There is another reason why the actual rate of tax paid by people in the 50 per cent band is far lower than might be assumed: taxable income is not the same as a person's total income.

Income is the amount a person earns. For many people this is their pay from their employment. It can also be a pension, or the profits a person earns from self employment and to all of these can be added any income received from investments, such as savings, whether in the form of cash, shares or other investments and also income from other assets such as buy to let property. The sources that could be involved, especially for a wealthy person, are often numerous. It is a reason why many complain that the tax system is complicated: it has to be to deal with the complex and differing types of income some people enjoy.

But all of this assumes that people try to keep these matters straightforward: if taxpayers complicate matters voluntarily, for example by establishing trusts or by setting up companies to manage part of their affairs then it becomes a little more open to their discretion as whether they record income as their own or assign it to these other arrangements that might have lower tax rates than they do themselves. Total income can be somewhat discretionary for those with some wealth.

This, however, is not the end of the story. Offset against this total income are the allowances and reliefs a person can claim that are allowed by tax law. These are many and varied and are discussed in much more detail later in this report. What it is important to note here is that while many of these tax reliefs seek to promote important social and economic goals their very nature means that those paying the highest tax rates usually receive the greatest benefit from these tax reliefs. That is because the reliefs reduce a person's taxable income. That means that a deduction for a relief – for example a payment to a pension plan – of £10,000 for a person earning £35,000 whose highest marginal rate of tax is 20% only gives them a tax saving of £2,000 whilst the same deduction of £10,000 paid for the same purpose by a person earning £180,000 a year with a marginal tax rate of 50% gets a £5,000 tax saving on the same contribution. The obvious unfairness in this is readily apparent. It is very hard to see what justification there can be for the state subsidising the pension contribution of a person earning £180,000 a year by more than it subsidies the same contribution made by a person earning £35,000 a year.

The result of the offset of these reliefs, when available to a 50% tax rate payer, are shown in this table:

Table 3 Impact of tax reliefs on taxable income of an individual with income of £180,000

	£
Income source:	
Employment	140,000
Rental income	18,000
Dividends	15,000
Interest	7,000
Total income (A)	180,000
Allowances	
Pension contribution	15,000
Enterprise investment scheme	5,000
Total allowances (B)	20,000
Total taxable income (A - B)	160,000

The £160,000 of taxable income used for the purposes of calculation in Table 1 can now be seen to be the result of offsetting £20,000 of reliefs against income of £180,000 before tax is calculated on the net sum due (£160,000). The effect on the income tax rate is significant. As noted in Table 1, tax of £58,000 is paid on taxable income of £160,000. However, if gross income was actually £180,000 the effective tax rate on that gross income is not as a result 36% as suggested in Table 1 (which would be the case if gross income were £160,000) but just 32.2%. As it is also the case that in this example £40,000 of the income earned is exempt from national insurance the overall rate paid for that tax would be lower as well at about 3.4% and not the 4.1% shown in Table 2, giving a combined rate of 35.6% on gross income of £180,000 in this case, which again is much less than the headline rate of 50%.

In that case not only is the claim that people are paying more than 50% of their incomes to the government as a result of the introduction of the 50p tax rate arithmetically wrong, it is further undermined by the reliefs and allowances available on many forms of income which further reduce the percentage of tax due on income.

Section five

How many people are likely to pay the 50p tax rate?

Since, as yet, the tax returns for the first year in which the 50p tax rate has been in operation have not yet been processed the honest answer to this question is that no one yet knows. However some very good estimates can be made, and H M Revenue & Customs have made one, as follows[9]:

[9] http://www.hmrc.gov.uk/stats/income_tax/table2-5.pdf

How many people are likely to pay the 50p tax rate?

Table 4 HMRC estimate of number of tax payers per income band

2009-10

Numbers: thousands; Amounts: £ million

Range of total income (lower limit)	All taxpayers	Liability after tax reductions	Total income of taxpayers	Average rate of tax	Average amount of tax
£	Number	Amount	Amount	%	£
6,475	950	86	6,660	1.3	90
7,500	2,650	1,010	23,300	4.3	382
10,000	6,460	6,210	80,500	7.7	960
15,000	5,250	10,300	91,300	11.3	1,960
20,000	6,840	22,900	167,000	13.7	3,350
30,000	5,470	31,700	206,000	15.4	5,790
50,000	1,970	28,900	129,000	22.4	14,700
100,000	326	11,300	39,200	28.7	34,600
150,000	126	6,700	21,600	31.0	53,100
200,000	146	13,900	42,000	33.1	95,400
500,000	28	6,460	18,700	34.5	234,000
1,000,000	14	11,100	30,900	36.0	825,000
All Ranges	30,200	151,000	857,000	17.6	4,980

2010-11

Numbers: thousands; Amounts: £ million

Range of total income (lower limit)	Additional rate (6) taxpayers		All taxpayers	Liability after tax reductions	Total income of taxpayers	Average rate of tax	Average amount of tax
£	Number	Amount	Number	Amount	Amount	%	£
6,475	.	.	933	84	6,540	1.3	90
7,500	.	.	2,610	999	23,000	4.3	382
10,000	.	.	6,380	6,090	79,500	7.7	954
15,000	.	.	5,160	10,100	89,800	11.2	1,960
20,000	.	.	6,910	23,200	169,000	13.7	3,350
30,000	.	.	5,690	33,100	215,000	15.4	5,810
50,000	.	.	2,120	31,200	139,000	22.3	14,700
100,000	.	.	344	12,300	41,200	29.9	35,900
150,000	98	5,930	146	8,190	24,700	33.2	56,000
200,000	138	15,400	143	15,600	41,200	37.9	109,000
500,000	26	7,340	26	7,350	17,700	41.4	281,000
1,000,000	13	12,700	13	12,700	28,600	44.5	1,005,000
All Ranges	275	41,400	30,500	161,000	875,000	18.4	5,280

2011-12

Numbers: thousands; Amounts: £ million

Range of total income (lower limit)	Additional rate (6) taxpayers		All taxpayers	Liability after tax reductions	Total income of taxpayers	Average rate of tax	Average amount of tax
£	Number	Amount	Number	Amount	Amount	%	£
7,475	.	.	2,320	514	20,300	2.5	222
10,000	.	.	6,390	5,030	79,600	6.3	788
15,000	.	.	5,220	9,230	90,700	10.2	1,770
20,000	.	.	7,050	22,300	172,000	12.9	3,160
30,000	.	.	5,930	33,700	225,000	15.0	5,680
50,000	.	.	2,290	33,900	151,000	22.4	14,800
100,000	.	.	369	13,400	44,100	30.3	36,200
150,000	109	6,630	157	8,980	26,600	33.8	57,100
200,000	156	17,700	158	17,700	45,400	39.1	112,000
500,000	29	8,470	29	8,470	19,600	43.2	294,000
1,000,000	14	14,200	14	14,200	31,200	45.5	1,041,000
All Ranges	308	47,000	29,900	167,000	906,000	18.5	5,590

In 2009-10 tax year there was no additional rate or 50p tax charge, so data for that year is blank. However, best estimates (and all this data is estimated since HMRC statistics have largely ceased to be properly updated or published since 2007-08) suggest 314,000 people are likely to have taxable income of over £150,000 in 2009-10. In 2010-11 this number is believed to have fallen to 275,000. The decline may well be explained by people bringing their income from 2010-11 forward into 2009-10 wherever possible to reduce the tax rate due on it. The number is expected to rise again to 308,000 in the current tax year when this temporary aberration caused by the introduction of the 50p tax rate appears to be no longer expected to have an impact. The data further shows that in 2011/12 it is estimated that 35% of taxpayers in this bracket had income of between £150,000 to £199,000; a further 51% per cent had total income of £200,000 - £499,999; 9% per cent had income between £500,000 to £999,999 and about 5% per cent had income of over £1,000,000.

In 2009-10 tax year 1.04% of all taxpayers had taxable income of more than £150,000. That statistic is expected to have fallen to 0.90% in 2010–11 and to have risen again to 1.03% in 2011-12, albeit with a smaller number of taxpayers that year as unemployment is assumed to have an impact (presumably, since the population is not otherwise declining). What this suggests is that H M Revenue & Customs are not expecting any significant change in the number of people earning above £150,000, or in the higher income brackets either. To test this idea a small survey has been undertaken on the income of the 800 or so partners of PricewaterhouseCoopers – the largest firm of accountants in the UK to see if their incomes have been reasonably consistent over the years subject to these estimates. This survey shows that they each had the following average income each over the last few years[10]:

Table 5 Average income per partner at Pricewaterhouse Coopers

Year to (30 June in each case)	Average income per partner
2007	£778,000
2008	£797,000
2009	£777,000
2010	£759,000
2011	£763,000

This sample of 800 taxpayers suggests that income for top taxpayers may have fallen since 2007, but the change is not significant. The assumption that those with high incomes have broadly weathered the storm of the recession

[10] Data from http://www.pwc.co.uk/eng/aboutus/annual_report_archive.html

reasonably successfully appears to be supported by this evidence and that appears to justify H M Revenue & Customs' belief that in 2011–12 the average incomes of those in each of the income brackets they use for their reporting purposes will be remarkably similar to those actually earned in 2007–08. Evidence that those on high pay (and most especially large company directors) have seen their pay rise significantly in recent years despite the recession also suggests that this assumption is appropriate[11].

So, there appears to be good reason to think that the HMRC estimates as to both the number of people paying the 50p tax rate and as to their likely income levels are likely to be reliable. Based on table 4, using the data for 2011/12, this would suggest that some 308,000 people will have taxable income of over £150,000 in that year. Together they will have a combined total taxable income of some £122 billion in that year at an average of £398,000 each. These are the people likely to be impacted by the 50p tax rate.

[11] See also the work of the High pay Commission in support of this contention http://highpaycommission.co.uk/facts-and-figures/final-report-cheques-with-balances-why-tackling-high-pay-is-in-the-national-interest/

Section six

How much of tax is paid at 50%

Those affected by the 50p tax rate are, according to the HMRC estimates noted above, believed likely to pay £47 billion in income tax between them in the 2011-12 tax year at an average of £152,000 each. Perhaps more important to current debate, however, is estimating the total sum they might pay at 50%. No one seems to be challenging the 40% tax rate that has been in operation in the UK since 1988-89 tax year[12]. The additional tax due as a result of the introduction of the 50p tax rate when compared to the previous 40p top rate is therefore central to discussion of this issue.

To calculate this possible sum the following can be extrapolated from H M Revenue & Customs forecast data for 2011–12 (which, as previously discussed, seems likely to be reliable)[13]:

Table 6 HMRC forecast data 2011-12

Range of total income (lower limit)	*Average income of those in band*	*Part of income subject to 50% tax rate on average*	*Additional tax due per tax payer as a result of 50% tax as opposed to 40% tax*	Number of taxpayers in income bracket	*Total potential additional tax due as a result of operation of 50% tax rate*
£	*£*	*£*	*£*		*£'m*
150,000	*169,427*	*19,427*	*1,943*	109,000	*212*
200,000	*287,342*	*137,342*	*13,734*	156,000	*2,143*
500,000	*675,862*	*525,862*	*52,586*	29,000	*1,525*
1,000,000	*2,228,571*	*2,078,571*	*207,857*	14,000	*2,910*
				308,000	*6,789*

Note: data in italics are authors own calculations based on HMRC data

Average income per band has been calculated with the likely additional tax at 10% (the difference between the 50% and 40% tax rates) being calculated on the average taxable income over £150,000. This HMRC sourced data suggests

[12] http://www.hmrc.gov.uk/stats/tax_structure/incometaxrates_1974to1990.pdf
[13] Based on HMRC Table 2-5, accessed December 2011

that the 50p tax rate will raise about £6.8 billion a year in additional income tax in 2011-12.

H M Revenue & Customs themselves have made more limited claims. Budget data for 2009 suggested that the new rate would raise an additional £1.81 billion of tax[14], which had been increased by the time of the March 2010 budget to between £2.66 billion and £3.05 billion a year[15]. The estimates do not appear to have been revised since then. In other words, the current government has never issued an estimate of the amount of tax that the 50% tax rate will raise.

The official estimates that do exist appear to significantly underestimate the potential income generation capacity of this tax rate as suggested by the above calculation, based as it also is on HMRC's own data. Whilst emphasising that all the income data used is estimated, there appears to be no better reason for accepting the lower estimates published in budget reports than the higher one we have noted above (which is extrapolated from the exact same source) especially, as we will go on to discuss, given the capacity of those subject to this tax to avoid it either by legal tax avoidance or by leaving the UK is likely to be much lower than has been suggested by those opposing the 50p tax rate.

It can therefore be concluded that the additional tax rate for those with taxable earnings of more than £150,000 a year has potential to raise between £3 billion and £6 billion a year, with the higher end of this estimated range being supported by detailed calculations based on HMRC data that reflects known numbers of tax payers in the relevant income brackets in the past and recognised trends in their income distributions in recent years.

[14] http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/bud09_completereport_2520.pdf

[15] http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg_186432.pdf

Section seven

How likely is it that those with income subject to the 50% rate will leave the UK?

To understand a little better how much chance there is that the income of the 50p tax payers will disappear requires some analysis to be undertaken on who is actually likely to be paying this tax, and how much each type of such taxpayer is likely to pay.

The best data we have on sources of the principle sources of income of people who earn more than £150,000 a year dates from the year 2007-08, and can be summarised as follows 16:

Table 7 Income tax liabilities by source of income of those liable for the 50p tax rate

Main source of income	Number of taxpayers with income over £150,000 with this as main income source	Proportion of those with income over £150,000	Total tax paid in 2007-08 by those in this group earning over £150,000 in £'m	Proportion of tax paid by the group as a part of total tax paid by those earning over £150,000
Self employment	68,000	21.3%	£9,330	23.7%
Employment	189,000	59.3%	£23,520	59.7%
Pension	8,000	2.5%	£636	1.6%
Investment	54,000	16.9%	£5,887	15.0%
	319,000	100.0%	£39,373	100.0%

Unsurprisingly, pensioners form a small part of this group (2.5 per cent). Whether they stay in the UK or not is very unlikely to be decided by factors like tax. Health, family ties, climate, other social connections and so on are

[16] http://www.hmrc.gov.uk/stats/income_distribution/3-4table-jan2010.pdf

much more likely to have impact on this group than income, especially as those in this group clearly have more than enough to live on in their old age.

For those with investment income making up their main source of income, totalling some 54,000 people or 16.9 per cent of the total people likely to pay the 50% tax rate, this may not be quite so true. However, for this group the situation may not be as clear as the evidence of the primary source of income suggests. It may well be the case that many of those who declare that they have investment income as their primary source of earning may in fact be in receipt of dividends from their own companies. We have no way of knowing the number who might be in this situation, but it could be a significant number of those in this category of income earners. Tax planning by paying dividends to owners of private companies to avoid national insurance charges that would arise if salaries were paid instead remains a popular tax planning mechanism that the UK government has, despite past efforts, failed to curtail. The result is that there may be fewer living on 'real' investment income than the raw statistics suggest, and rather more who are actually tied to earning from a business that they own than the data implies.

For the purposes of analysis those who are being paid in dividends in this way are much the same as the self-employed (21.3 per cent of the group), who may have considerable difficulty relocating outside the UK since in many cases their businesses are located here due to specific market conditions that they exist to exploit, or because of the particular nature of the services they supply. This is especially true for the self-employed, who are especially inclined to provide services rather than goods. As such it is hard to draw conclusions on how mobile this group might be although some do, undoubtedly, have the opportunity to move at will if they so wished.

There are over 4 million self-employed people in the UK at present[17]. It is immediately apparent that less than 2% of this group earn more than £150,000 a year and as such this level of profits is unusual. That implies there must be special characteristics that those doing so enjoy that means others cannot replicate their success. The most likely of these characteristics that results in high profits being generated is that those enjoying such high income do so because they either have specialist knowledge that lets them make super-normal profit or they enjoy some form of privilege that limits their risk from competition that might otherwise reduce their income. Lawyers, qualified accountants, dentists and doctors are all in both these groups and are likely to be heavily over-represented amongst those earning more than £150,000 whilst being self-employed. Their knowledge is both specialist, frequently country specific, and also regulated so that they alone have the right to supply certain services. So, for example, only a registered doctor may undertake medical procedures. More than that, the vast majority of such doctors are in fact

[17] http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/november-2011/table-emp09.xls

licensed by the state as they will either be general practitioners in the NHS, who are officially self employed, or they are part-time hospital consultants as well making additional earnings in their own time on a self-employed basis, as some choose to do. Both these groups of doctors would have problems moving out of the UK and making the same income: their UK registration means they are most likely to maximise their earnings in this country.

The same is also true of lawyers and accountants: most of these have specialist knowledge of UK regulation and that is the basis of their incomes. Many would have problems transferring their skills to other jurisdictions. Significant numbers of the self-employed with high earnings are likely to be in such categories.

For those who are not in such groups but who have high earnings from self employment other constraints on their movement from the UK might well apply. First, by definition their businesses are usually very dependent on them as owners and managers: it is their skill that is the foundation of the trade. Second, most will serve particular markets. Frequently these are geographic and will very often involve a service element. It is hard, if not impossible in many cases to relocate service related businesses away from their customers. Personal contact is very often the basis of the trade. In that case even if relocation of the owner might be possible key staff and the business itself would have to stay where the market demands, which is likely to be within the UK. Given that lines of communication would then be strained, so prejudicing profits, the process of relocation to save relatively modest sums of tax is very unlikely; it would simply not be economically sensible. In that case it is fair to conclude that it is likely that both very many of the self-employed and quite probably a large number of those living off investment income, have strong reason for remaining in the UK, particularly if the tax rate differential as a result of doing so is just 10%.

That just leaves the likelihood of the employed leaving the UK in response to this tax rate to consider. This is the largest group of those with taxable earning above £150,000 a year, representing almost 60% of those in this income group (and an even larger proportion than that of those with taxable earnings of more than £500,000 a year).

Whether or not these people can relocate will, to some degree, depend upon the willingness of their employers. The vast majority of these employers are in the private sector; according to a 2010 report just 170 civil servants earned more than £150,000 a year[18]. So who are the rest (the remaining 188,830)? It is hard to know, but at the top of the scale the directors of FTSE companies and senior bankers are bound to dominate, with professional footballers probably making up the numbers. Although these people are supposedly mobile the reality is that although some of their employers talk of leaving the UK for tax purposes, and a few have, almost none have relocated their staff

[18] http://www.guardian.co.uk/politics/2010/jun/01/top-earning-civil-servants-named

outside the UK when doing so. In the case of football clubs (many of which are owned offshore) that is hardly surprising, but as the Guardian noted in 2009 when considering a number of corporate relocations to Ireland[19]:

The media company UBM also says it has moved to Ireland. The firm only occupies a single floor of a townhouse in Dublin's Merrion Square, where no more than five or six staff work.

In the six months since its move, UBM says it has held three board meetings in Dublin and three in other parts of the world. At UBM's large Thames-side office block in London, the British staff continue to fill up four floors.

They added:

Henderson Global Investors has only three staff at its Dublin suite of off-the-shelf rental offices, compared with 550 who continue to work at its main London office. A receptionist in Ireland said: "They are not here a lot of the time."

This seems to be the reality behind many of the claims that relocation will occur in the face of tax changes: companies may try to change their tax residence but the vast majority of their staff actually stay put in the UK. There are good reasons for that: relocation of staff is expensive and disruptive and in a great many cases they simply could not service their client base except by being in the UK.

That is not to dispute that a few people could, individually relocate and claim their residency change to be the result of the 50p tax rate. H M Revenue & Customs appear to have assumed this in their tax estimates. The reality is, however, that it is extraordinarily unlikely that most, or even a significant number of the 189,000 employed people in the UK with taxable earnings of more than £150,000 a year will leave the UK as a result of a modest change in their tax rate. Indeed, any reasonable guess would be that the vast majority will stay, not least because the overall change in tax rate for most of these staff is small and there are a great many other factors to take into account other than tax when considering relocation, both corporate and personal.

[19] http://www.guardian.co.uk/business/2009/feb/10/ireland-tax-gap-staff-levels

Section eight

So can those earning more that £150,000 a year simply avoid their tax bills?

When considering how much revenue the 50 per cent rate will generate, it is also important to consider the extent to which individuals required to pay it could simply avoid it. This remains another question to which there can be no final answer as yet, or on current trends, for some time to come. The last reasonable data on which to estimate the use of allowances and reliefs by those earning more than £150,000 come from the tax year 2007-08. Data for that year suggests the following[20]:

Table 8 Use of tax deductions and reliefs by income band

Range of total income (lower limit)	Total income			Total deductions and reliefs			Personal allowances	Total tax			Average rate of tax	Distribution of total income by numbers
£	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	Amount	No. of individuals	Amount	Mean	%	%
5,225	719	4,050	5,630	69	22	312	3,750	719	27	38	0.7	2.2
6,000	1,040	6,750	6,500	190	86	452	5,420	1,040	124	119	1.8	3.2
7,000	1,170	8,830	7,530	211	117	554	6,390	1,170	247	211	2.8	3.6
8,000	2,760	24,800	9,000	439	300	684	16,300	2,760	1,140	413	4.6	8.5
10,000	2,720	30,000	11,000	637	351	551	16,300	2,720	2,190	805	7.3	8.4
12,000	3,880	52,200	13,500	1,120	701	625	23,600	3,880	5,160	1,330	9.9	12.0
15,000	5,430	94,600	17,400	2,160	1,690	782	31,800	5,430	11,900	2,200	12.6	16.7
20,000	6,850	168,000	24,500	4,070	4,280	1,050	37,400	6,850	25,500	3,720	15.2	21.1
30,000	5,340	201,000	37,700	4,070	7,670	1,880	28,100	5,340	34,500	6,460	17.1	16.4
50,000	1,290	74,900	58,000	971	2,940	3,020	6,790	1,290	17,200	13,300	22.9	4.0
70,000	605	49,900	82,400	439	2,080	4,750	3,190	605	13,500	22,300	27.1	1.9
100,000	328	39,600	121,000	244	2,130	8,750	1,730	328	11,800	36,000	29.8	1.0
150,000	128	21,900	171,000	96	1,200	12,500	673	128	6,970	54,500	31.8	0.4
200,000	96	23,100	240,000	73	1,400	19,200	506	96	7,580	78,800	32.8	0.3
300,000	53	20,000	375,000	41	1,350	33,200	280	53	6,810	128,000	34.1	0.2
500,000	28	19,200	679,000	22	1,540	70,100	149	28	6,660	235,000	34.7	0.1
1,000,000	14	31,700	2,290,000	11	2,150	193,000	73	14	11,400	823,000	36.0	0.0
All ranges	32,500	870,000	26,800	14,900	30,000	2,020	182,000	32,500	163,000	5,010	18.7	100.0

What this data makes clear is that in that year 319,000 people representing 0.98% of income earners had taxable income over £150,000 and between them earned £115.9 billion, which was 13.3% of all declared taxable income in the UK.

This table also, importantly, shows that deductions, reliefs and the personal allowance all had a big impact on the actual amount of tax paid in 2007/08.

20 http://www.hmrc.gov.uk/stats/income_distribution/3-5table-jan2010.xls

So can those earning more that £150,000 a year simply avoid their tax bills

Most (but not all) tax reliefs work by offsetting an allowance against a person's total income that has the effect of reducing their taxable income. The most significant allowances are as follows, with the estimate made by H M Revenue & Customs of their cost in terms of tax foregone in 2010/11 being shown[21].

Many of these tax reliefs are to be welcomed: for example Individual Savings Accounts (ISAs) enable people on middle incomes to build up savings without being liable for tax; tax credits provide a vital boost to family incomes and tax relief on childcare makes it more affordable for many households to balance the commitments of work and home. Few would argue with these reliefs, and as importantly many allowances, such as those for tax credits and childcare are in any event only available to those with incomes of well below £150,000 a year and do not affect the matters under consideration.

Table 9 Estimated costs of the principal tax expenditure and structural reliefs

Estimated costs of the principal tax expenditure and structural reliefs	
	£m
	2010-11
Income tax	
Relief for:	
Registered pension schemes	20300
Share Incentive Plan	230
Save As You Earn	135
Enterprise Management Incentives	135
Approved Company Share Option Plans	55
Individual Savings Accounts	2100
Venture Capital Trusts	150
Enterprise Investment Scheme	170
Professional subscriptions	80
Rent a room	120
Seafarers' Earnings Deduction	180
Exemption of:	
First £30,000 of payments on termination of employment	1000
Interest on National Savings Certificates including index-linked certificates	180
Premium Bond prizes	120
Income of charities	1500
Foreign service allowance paid to Crown servants abroad	*95*
Personal Tax Credits	*5530*
Employer Supported Childcare exemption	*550*
Personal allowance	*51300*
Income tax and corporation tax	
Double taxation relief and foreign dividends exemption *	15000

[21] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.xls

For someone on an income of £150,000 the consequence of using these reliefs has been noted in table 3, above.

It is important to note when reviewing table 8 that by 2010-11 tax year the personal allowance had been abolished for those earning more than £150,000 a year. The gross value of personal allowances in 2007-08 to which table 8 refers was £5,225 a year. Those allowances were worth £1.681 billion in gross terms in that year to those earning over £150,000 which meant that at the 40% tax rate then in operation they had a tax cost of £672 million. In 2011-12 the personal allowance is £7,475. Assuming there were the same number of taxpayers earning over £150,000 in 2011-12 as in 2007-08 some £2.38 billion of allowances would have been given to those earning over £150,000 in 2011-12 at a cost of about £1.2 billion in terms of tax foregone. This, however, did not happen as this allowance had been abolished for this group of income earners. A significant tax change resulting in a substantial tax saving for the Exchequer appears to have resulted as a consequence. However in terms of savings from the abolition of allowances all is not quite as it seems.

The following table analyses, in very broad terms, the tax reliefs and deductions, other than the personal allowance, offered to those with taxable income over £150,000 in 2007-08:

Table 10 Other tax reliefs and deductions offered to those with taxable earnings over £150,000

Range of total income (lower limit)	Contributions to occupational pensions			Contributions to personal pensions			All other interest, charges and deductions (1)			Total deductions and reliefs		
£	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean	No. of individuals	Amount	Mean
150,000	40	292	7,360	47	676	14,500	39	235	6,090	96	1,200	12,500
200,000	31	314	10,100	34	734	21,800	31	356	11,600	73	1,400	19,200
300,000	17	280	16,200	17	631	36,200	20	443	21,800	41	1,350	33,200
500,000	8	241	29,000	9	628	69,000	13	674	51,000	22	1,540	70,100
1,000,000	5	365	77,800	4	480	126,000	7	1,300	179,000	11	2,150	193,000
	101	1,492		111	3,149		110	3,008		243	7,640	

The total gross value of tax reliefs other than the personal allowance (i.e. the sum deducted from income and not the tax value of that deduction) for those with earnings over £150,000 a year in 2007-08 amounted to £7.64 billion. It should however be noted that there have been some policy changes since this table was produced, and as yet HMRC have given us no new data to establish what the consequences may be.

The first such change is the removal of a right to a personal allowance to those in the group under consideration at a combined tax cost to them of £1.2

billion, as noted above. This does not, however, affect the estimate of £7.64 billion: the cost of personal allowances was excluded from this sum.

Secondly, pension tax relief is now limited for those in this group to £50,000 a year. Calculating the cost of this change relies on the interaction of the data in Table 10 above for 2007/08 and additional data published for 2011/12 by H M Revenue & Customs[22]. What the above table shows is that relatively few higher rate tax payers do appear to have paid £50,000 a year into their pensions. For example, just over 5,000 employees earning more than £1 million had total contributions to their occupational pensions run by their employers of an average of £77,800 each at a total cost of £365 million. The cap would have disallowed about £130 million of this tax relief at a saving to the Exchequer in the form of additional tax paid of about £65 million at the 50% rate. Those with lower average incomes had average contributions low enough for the cap to have had little impact on them.

Contributions to personal pensions, often used by the self-employed, were, however, higher. Nine thousand people earning more than £500,000 made an average contribution of £69,000 each. Using the logic noted above, and applying the 50% tax rate, the saving for the Exchequer by restricting reliefs for this group would be about £86 million, whilst the same restriction for the 4,000 people earning more than £1 million a year contributing to personal pension schemes would have saved the Exchequer about £144 million in tax relief given. The total saving from the restriction would be therefore about £295 million.

This combined group has therefore lost allowances worth about £1.495 billion as a result of losing the personal allowance and pension tax relief, the vast majority relating to the personal allowance and not the pension tax relief.

That said, however, if the pattern of pension saving in 2011-12 was the same, bar the cap on contributions, as in 2007-08 then pension tax relief for this group would still cost just over £2 billion in tax subsidies a year; an average subsidy of just over £9,500 per person in terms of tax saved on average pension contributions eligible for tax relief of about £19,000 each. HM Revenue & Customs suggest the total cost of income tax subsidies in 2009-10 (the latest year for which data is available) amounted to £19.7 billion[23]. In that case the 1% of people earning over £150,000 enjoy more than 10% of the total subsidy for pensions given each year.

As significant is the fact that interest, other charges and other deductions still cost maybe £1.5 billion a year in absolute tax lost terms when given to this group of people – at an average saving of £13,670 per claimant at present tax rates if the profile of claims now is the same as in tax year 2007-08. In that case, and overall, allowances and reliefs (totalling £7.64 billion less £295

[22] http://www.hmrc.gov.uk/stats/income_tax/table2-5.pdf
[23] http://www.hmrc.gov.uk/stats/pensions/table7-9.pdf

million of pension tax relief) given to the 243,000 people claiming them amongst the 319,000 people earning over £150,000 in 2007-08 would, even after allowing for the restriction in pension reliefs, if otherwise still claimed in the same amount cost about £3.5 billion in tax foregone by HM Exchequer a year in current terms – at an average of about £15,000 for each person making a claim for such allowances or about £11,500 for each person with taxable income over £150,000 a year.

The likely breakdown of those additional allowances and reliefs over and above pension contributions is noted below, but it is interesting before doing so to note that the average pay of a classroom assistant in the UK is about £12,500 a year[24]. Of course national and insurance and pension contributions have to be added to that sum to calculate their true marginal cost of employment but the result would be a figure not far different from £14,500 per annum. There are about 21,400 primary schools in the UK serving approximately 4,850,000 pupils[25]. That is roughly 162,000 classrooms. If tax relief on pensions and other allowances were abolished for the 1% of highest income earners claiming them in the UK then each of those classrooms could have more than an extra teaching assistant and many of the resources they would need to do their work. This is the sort of trade of decision made when allowing tax reliefs to those on high pay when tax could be collected instead.

In that case it is important to assess what these reliefs given to the highest paid are so we can have a better understanding of what the other reliefs and allowances are that the wealthiest enjoy, totalling in all just over £3 billion worth of gross claims in 2007-08. The main tax reliefs have been shown in Table 9, above.

What is interesting to note is how limited in value many of these tax reliefs (after excluding pensions) that those that those earning more than £150,000 can claim are. Table 9 indicates by the use of italics those unlikely to affect those earning more than £150,000 and by the use of underlining those that do not change the calculation of taxable income.

However that still leaves reliefs like the Enterprise Investment Scheme, Venture Capital Trusts, approved share option plans, Enterprise Management Incentives and Share Incentive plans to consider, all of which may well feature very heavily on the list of the reliefs under consideration for use by those earning more than £150,000 a year. Together these have a gross value of, in 2010/11 of £740 million. Those with wealth are by far the most likely to use these schemes, simply because they either require the claimant to have significant savings they wish to invest in such schemes, matched by an appetite for the risk associated with them, or they are usually designed for use by the

[24] http://www.teaching-assistants.co.uk/job-information-for-teaching-assistants.htm

[25] http://www.cilt.org.uk/home/research_and_statistics/statistics/primary_statistics/how_many_schools_and_pupils.aspx

senior, and therefore best paid, employees of a company. They are not, however, by themselves, even if they were only claimed by those in this group (which is unlikely) able, by some way, to explain all the additional claims for relief made by those earning over £150,000, which means other alternatives must be found.

What else then might make up the £3 billion cost? A large part of the tax relief given is on the income of charities – granted through individual tax payers through gift aid arrangements - must be a major factor. It has to be the 'missing link' in the equation that we are seeking to solve[26]. And there is one other component, which is the offset of interest costs against rental income (and, more rarely, the cost of purchasing business assets) of those with high income who are operating buy to let properties or other businesses. Of all the options available, these categories of relief are the most likely to cover the claims this group of high-earners make.

In summary therefore the reliefs that save those earning more than £150,000 more than £3.5 billion in tax under current tax rules as detailed in table 9 above are likely to be as follows, although the precise split between those other than pensions cannot be known:

1) Tax relief on their pension giving savings of £2 billion a year;
2) Tax relief worth in terms of tax saved of up to £ £370 million on various share based savings schemes, although the sum is likely to be less than that for this group;
3) Tax relief on gifts to charity worth up to £750 million in terms of tax saved, although with the likelihood being that the amount attributable to this higher paid group is somewhat lower than this;
4) Tax relief on interest on borrowings, most likely to be related to their acquisition of buy to let and holiday properties almost certainly worth more than £500 million a year.

[26] Higher rate taxpayers personally benefit from this tax relief. Anybody who is a taxpayer can give money to a charity under the Gift Aid scheme. If that is done the charity can reclaim the basic rate tax paid by the taxpayer from HM Revenue & Customs. For a basic rate taxpayer that is the end of the story. For each £1 they give the charity claims back the basic rate tax at 20% - meaning they reclaim 25p (the £ given is net after tax so the pre tax amount presumed to be given is £1 divided by 80% which is £1.25, with 25p being the tax reclaimed). For a higher rate taxpayer this is not the end of the story. If they put the gift on their tax return then they get tax relief for the donation at their full marginal rate of tax. So a 50% rate tax payer who gives £1 to a charity under Gift Aid is still deemed to have paid over £1.25 with the charity reclaiming the 25p in tax but the taxpayer claims relief on the higher rate sum at 50%, meaning that they can claim a refund of 62.5p. The charity has already had 25p so the higher rate tax payer cannot get that back and so instead they benefit by 37.5p (62.5p less 25p). This means that 50p taxpayers actually personally benefit by tax refunds of greater amount than a charity does when they gift money to charity.

To put it another way: the expenditure of approximately £3.5 billion on tax relief for this group in society – at a cost of near enough £14,500 each - is either a direct subsidy to the savings that make them better off than the vast majority in society, so increasing the wealth and income gaps and inequality in society, or it is a direct subsidy to their incomes through the tax system because they have given to a charity under a system which provides them with more benefit than the charity receives as a result.

Those reliefs may appear generous, but to return to the question being addressed, are they sufficient of themselves to ensure that those earning more than £150,000 a year can avoid all the tax they owe by use of these obvious tax planning opportunities, deliberately provided by the government? The answer is no; that cannot be the case. The opportunity to increase pension tax relief is now limited, and all other reliefs save only about £1.5 billion or so a year in tax for this group who between them pay £47 billion a year in tax. It is, as such, very obviously wrong to claim that this group can simply avoid all taxes imposed upon them, at least using these opportunities.

This leaves those wishing to avoid the tax they owe the standard options available to all tax avoiders. These are to:

1) Reallocate their income to a person or entity that has a lower tax rate than the individual whose activity really generates the income. The people or entities to whom the income is diverted might be:

    a) Other members of a person's family e.g. a spouse or children;

    b) A trust for the benefit of a person's family;

    c) A company owned by the individual but taxed at lower rates than those they might enjoy;

    d) In the case of those who can do so (which is mainly those not domiciled in the UK), an offshore company or trust.

2) Changing the location of a transaction. This is much easier for those not domiciled in the UK than for those who are so domiciled, but in both cases the opportunity exists if care is taken to relocate a transaction out of the UK if commercial justification for doing so can be created, with lower tax being paid in many cases as a result.

3) Changing the nature of a transaction so that it appears to be something different from what it actually is. This is commonplace, the most popular tactics being to:

    a) Convert income into capital gains, which are almost always taxed at lower rates;

   b) Convert earned income into unearned income such as dividends to avoid national insurance charges that only apply to earned income;
   c) Provide benefits in kind to an employee that are taxed at less than their full value.
4) Delay recognition of income e.g. delaying a bonus so that it is taxed later, so saving on cash flow in the meantime.
5) Obscuring the information available on a transaction, at which point tax avoidance begins to blur into tax evasion.

All of these are, of course, possible, but for employees the opportunities are in many cases limited. For those who are company owners or self employed all such options are already likely to be reflected in the base HMRC data used for the purposes of calculation in this report, since the attraction of saving tax at 40% is likely to have been enough to incentivise those with income of more than £150,000 to undertake such activity before the 50% tax rate came in. In other words, the scale of tax avoidance is unlikely to have risen significantly as a result of the additional tax rate when the incentive to avoid already existed.

If therefore those who are employed and self employed are unlikely to leave the UK for commercial reasons as a result of this, in many cases, quite small tax increase, what of those with more mobility? What if pensioners and those living off investment income left? They after all do not have commercial reasons for staying here and they do potentially represent 19.4% of those paying tax at 50% and in 2007-08 paid one sixth of all taxes paid by those earning over £150,000. That sum would now potentially be £7.8 billion, or more than the total tax that the 50p tax rate might raise based on calculations noted in this report.

There are good reasons for thinking that whilst some in this group might leave (of course) many will not. First, as already noted, many of those appearing to have investment income as their primary source of income will in fact be business owners receiving dividends from their own companies and they do, therefore, have the same incentive to stay in the UK and manage those companies as do the self employed and many employees. Second, many, and most especially pensioners will have strong family reasons for staying in the UK. They have not left to avoid 40% tax and are unlikely to abandon families for reason of the 50% tax, especially as the tax rate does not impact very much on this group. Third, there has been no indication of weakness of demand for high-end London housing where many with such wealth will live. There appears little sign of an exodus.

That then leaves the question of whether there could be any other reasons why the tax might not collect the sum anticipated. By far the most likely other such reason is now coming to light, and it is the ability of many of those earning 'salaries' of more than £150,000 a year to have that sum paid to companies they control. It is not known as yet how many people have enjoyed such arrangements under contracts with the government and local authorities, but it appears to be many thousands. If that is the case then it is highly likely to be even more prevalent in the private sector, in which case at least some of that income will be taxed at the small companies' corporation tax rate of 20%[27]. These profits can then be left in the company in the hope that one day either the 50% tax rate is abolished or that the company owner's income has fallen so that the profits can be taken out as a dividend and only be taxed at 40% at most. National insurance is, of course, also avoided in this way.

There are two obvious ways to tackle this: the first is to introduce a comprehensive general anti-avoidance principle in UK tax law that prevents the use of companies to disguise what is really payment for an employment. The second option is to transform the way in which small companies are taxed so that their profits are assessed on their owners at the time that they arise and not at the time that they are paid out to them. In the absence of either such change the opportunity for deferment of tax that could undermine the effectiveness of the 50p tax rate will still exist.

[27] http://www.hmrc.gov.uk/rates/corp.htm

Section nine

Conclusion

What does all this evidence suggest? We believe it is the following.

First, the 50p tax rate has potential to raise considerably more than the approximate £3 billion forecast in the March 2010 budget[28]. The total calculated here, based on HM Revenue & Customs own published estimates, validated by past known patterns of income and payment could be as high as £6 billion a year (although, as we discuss below, tax avoidance measure have potential to reduce this amount).

Secondly, given the number of people paying this tax rate and the scale of their income their opportunities to avoid this liability are much more restricted than many have claimed, although some do exist. Given the potential revenues this tax could raise, the case for Government action to close these loopholes is compelling.

Thirdly, whilst there will, no doubt, be some who will leave the UK who will say they have done so as a result of this tax charge there is no reason to necessarily assume that this is the case. Those on high incomes frequently move between locations for a wide variety of reasons. Tax is not always high on their list of priorities and since many other countries have tax rates not dissimilar to those now used by the UK unless a tax exile really wants to live in a tax haven (which many will not as they tend to be isolated locations) the opportunities to really escape tax altogether are actually quite limited.

Fourthly, many will simply not have the opportunity to leave the UK despite their higher tax bills, and this might curiously particularly affect those who might initially appear to have the most flexibility on this issue since they are the owners of their own companies or are self-employed. Many of these will be tied to the country by their skills, regulation or the market place for the services they supply to being located in the UK.

Lastly, tax reliefs provided to this group, who represent about 1% of all UK taxpayers, remain extraordinarily high – and have an average cost for each of the 300,000 or so people involved of in excess of £14,000 in actual cash cost a year. The obvious question arises as to whether that is a good use of taxpayer funds at a time when there is such pressure on government spending.

[28] http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg_186432.pdf

And more widely, claims recently made about the inventive effects of the tax rate do not appear to be founded on fact. As our report has shown, the majority of people in this position paying the 50p rate are employees, so unless they receive a pay cut it's hard to see how their taxable income could change. And with millions of people working at the NMW, with marginal deduction rates which are far higher than those of the highest earners in the 50p tax rate bracket (and take home incomes which are far lower), the argument that reduced incentives will lead to reductions in effort appears far-fetched. It is also difficult to see how investment decisions of small and medium sized business owners can feasibly be argued to be taken on the basis of personal income tax rates - these have no impact the company tax rates that would be applied to profit used for investment purposes.

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