From: The Rt. Hon. Sir Geoffrey Howe, QC., MP

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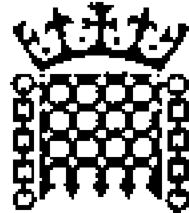

HOUSE OF COMMONS
LONDON SW1A OAA

In recent speeches I have called for the top tax rate on investment income to be cut from the current level of 98 pence in the pound to a new maximum of 75 pence in the pound. I have been asked why, as Tory Shadow Chancellor, I continue to accept the idea of an investment income surcharge in any form. It is a fair question.

The principle of treating earned and investment income differently is nothing new; it dates from the Liberal Budget of 1907. The investment income surcharge was introduced by Anthony Barber in 1972 alongside a much lower standard rate and, as he designed it, was a less burdensome way of applying a similar principle.

Considerable resentment has arisen in the last three years because Denis Healey has substantially altered the shape of the Barber system. Even after the concessions of the 1977 Budget the surcharge is still imposed at crippling levels, much more severe than those originally set by Anthony Barber.

Under the pre-Barber system, in 1969/70, earned income benefited from earned income relief in the form of 2/9 deduction up to £4005 and a 1/9 deduction from £4005 to £5940. Investment income received no such relief and was all more heavily taxed, at the standard rate.

On introducing the investment income surcharge, Anthony Barber set the threshold for liability at £2000. At the time the change was very advantageous to those receiving a medium-sized investment income, including many retired people.

For example, under the old system an investment income of £4000 was liable to income tax at 38¾ per cent (amounting to £1550) and surtax on £2000 (namely £287.50) giving a total liability of £1837.50. Under the new system, when introduced, there was a charge of 30 per cent on £4000 (namely £1200) and a surcharge of 15 per cent on £2000 (i.e. £300) making a total liability of £1500.

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This sharp reduction in the tax on investment income was opposed by the Labour Party. They took their first opportunity, in the 1974 Budget, to lower the threshold to £1000 (or £1500 for people over 65). Conservative opposition defeated the proposal at that time, but it was reintroduced and carried in Labour's second Budget, after the Election of October1974. The burden was made still heavier by the increase of 5 pence in the standard rate.

This is why during the last two years we concentrated our attack upon the level and scope of this extra tax on investment income. In the 1977 Budget Denis Healey recognised the force of our argument. For people over 65 he raised the threshold for the 10 per cent surcharge from £1500 to £2000, and for the 15 per cent from £2000 to £2500. For people under 65 the threshold for the 10 per cent surcharge was raised from £1000 to £1500 but he left the threshold for the 15 per cent surcharge at £2000.

These welcome steps in the right direction do not go far enough. If Anthony Barber's original £2,000 threshold had been raised in line with prices from 1972 onwards, it would now be approximately £4000.

If this continuing grievance was corrected, and if the rates of surcharge were sharply reduced, it would bring substantial relief to those whose standard of living in retirement is heavily dependent on investment income. We are very conscious of the need, on our return to office, to make changes of this kind. And we believe there is room to do so. The total yield of investment income surcharge does not exceed £275 million; and 42 per cent of that is paid by people ober 65 years of age.

We are also conscious of the injustice and positive harm caused by the continuation of tight dividend restraint, which coupled with the surcharge imposes a double blow on those relying on investment income.

Even so, there remains the question whether a practice originating 70 years ago should now be abandoned altogether, so that investment income is treated in exactly the same way as any other. This is the view taken in all Common Market countries, with the exception of France, and in most major economies other than Japan and the United States of America.

There have certainly been important changes in the rest of the tax structure since 1907. On the one hand, there has been increasingly generous treatment of investment income when it is channelled through insurance and pension funds; and, on the other hand, estate duty (rightly regarded as a tax that was largely avoidable) has been replaced by a battery of inescapable taxes on capital, including Capital Transfer Tax and Capital Gains Tax.

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Taken together, these mean that capital is more heavily taxed in Britain than in any other Western industrial economy. That is why we intend, on return to office, to conduct a review of the entire structure of capital taxes. This will take place alongside reconsideration of the proper balance between direct and indirect taxation.

Such a review should certainly involve reconsideration of the case for abolishing investment income surcharge altogether. Ahead of the results of that review we should, of course, be taking the urgent action to which I have referred, on the level and rate of the surcharge as well as to abate the most damaging aspects of Capital Transfer Tax.