

# Britain's taxes must attract wealth creators



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Politicians the world over have much in common. When their economies are growing, they claim the credit. Never mind the risk-taking entrepreneurs, or the workers who struggle to increase their productivity – it's the politicians who done it. George Bush claims his tax cuts produced America's long-running prosperity; Gordon Brown says it's his prudent and skilful economic management that has produced a decade of growth.

Then the business cycle, dicey sub-prime loans, inflation and a slowdown rear their ugly heads. Suddenly, it's the other guy's fault. In America, the blame is laid on imprudent borrowers and lenders; in Britain, the culprit is America.

Along with the buck-passing comes an attempt to assert some control over economic events. Britain is to have more regulations and changes in the tax system. Some reforms are needed. So it is good news that the regulatory scheme is to be tweaked to give depositors better protection, and the regulators more power to move in on troubled banks. Others being mooted are less helpful, among

these, the plans to undermine the independence of the Bank of England by giving the Chancellor power, in a crisis, to take control of interest rates and the money supply. Politicians faced with a sinking economy, and a threat to their jobs, will inevitably turn to the printing presses for help, on the theory that by the time the inflationary impact is felt, they will be safely ensconced in the House of Lords.

There are also plans to raise taxes in the teeth of the coming slowdown. Capital gains taxes on entrepreneurs who have created small business and tens of thousands of jobs are to be raised to compensate for revenues lost by reducing inheritance taxes (a George Osborne proposal so popular that Brown felt it necessary to play copycat after sensibly resisting similar proposals while at the Treasury). Never mind that this will reduce the incentive to create such businesses, and reward many people whose sole contribution to the economy has been to be lucky in their choice of parents. Worse still, the change is retroactive: entrepreneurs, lured into taking the substantial risk of creating a business with the promise of a 10 per cent capital gains rate, now find it likely to be increased by 80 per cent. Venture capitalists must now factor the risk of retroactive tax raids when they price the capital start-ups need.

The Government also proposes to force "non-doms", foreigners resident in Britain but intending to return to their original domicile

some day, to pay income tax on their worldwide incomes in addition to the taxes they already pay on income earned here. Failing that, they – more precisely, we – will be required to pay an annual per capita fee of £30,000 to HM Treasury.

There are two tests to which any tax should be put: equity, or fairness; and economic consequences, lately known as the supply-side effect. The Treasury proposal fails the first,

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and might fail the second.

Brits living in America pay tax on their world-wide incomes, whereas Americans living here are taxed only on what they earn in the UK. So it sounds eminently fair that Americans here pay what Brits there pay. Which would be true if all aspects of both nations' tax codes could be brought into equality. But they can't. British citizens working in America pay sales taxes that are generally 8 per

cent or less; foreigners living in Britain pay VAT of 17.5 per cent, and no one is proposing that the new move towards equalisation includes lowering VAT paid by non-doms. Moreover, fairness requires that important changes be signalled enough in advance to give affected taxpayers sufficient time to reorder their affairs. Non-doms who might choose to get on their bikes – or jets – have homes to sell, and children in school. Fair warning, to borrow from auctioneers, would seem to be required.

The second criterion tax should meet is efficiency: will its imposition have positive or negative effects? The Treasury guesses that relatively few non-doms will leave, even though many are internationally mobile financial professionals who can easily do business in places that have far less onerous tax regimes. In America, interest payments on mortgages, and charitable contributions, are deductible, and taxpayers do not hit the highest tax rate as soon as in Britain. Submitting US income to the more aggressive UK tax code is not a decision to be taken lightly.

The Government argues that the cost of the new fee alternative to allowing the Treasury to tax worldwide incomes is so tiny for the likes of Russian oligarchs and the very, very rich that payment will come out of petty cash. Nor is it concerned about the impact on, say, a Filipina nurse: she has no worldwide income, and therefore will elect to pay tax on that zero sum rather than incur the £30,000

annual fee. It has that right.

It is the middle-level investment bankers and such who are whipping out their calculators. The fee is not deductible from US income tax, as it is not covered by the treaty between the US and UK that is designed to avoid double taxation. A couple considering paying the combined £60,000 fee would have to earn about \$400,000 in America in order to pay US income tax and the 40 per cent levy the UK government lays on imported income. For them, the question will be: do I want to allocate about \$400,000 of my US earnings to UK taxes in order to ply my trade in the City rather than on Wall Street? Or in Switzerland? Given the refusal, so far, of most investment banks to agree to top up the salaries of their UK-based employees, the answer might well be "no", especially if the non-doms also have overseas capital gains that HM Treasury now lusts after.

None of this is to say that the non-dom tax is bad policy. We just don't know. But it is arguably unwise to introduce it at a time when the economic storm clouds are gathering over the City and the economy. Right now, Britain needs every job and every bit of purchasing power it can get.

True, it is good politics to tax people who can't vote – although taxation without representation, as it was called when last practised in Britain, triggered the American war for independence – but it might not be good economic policy, at least not just now.