WRINGING THE RICH

The new 50% income tax could stifle enterprise and drive risk takers overseas. Report by **David Smith and Iain Dey**

Alistair Darling plans to grab an extra £2 billion a year from the 350,000 people who earn more than £150,000

Peter Hargreaves has been spitting mad since Wednesday afternoon. Thanks to Alistair Darling's 50% tax rate, announced in the budget, the co-founder of Hargreaves Lansdown, Britain's biggest firm of financial advisers, is expected to cough up an extra £500,000 a year in income tax. "I won't pay. I'll leave," said the 63-year-old entrepreneur, echoing the words of hundreds of businessmen.

"Why wouldn't I? If I stay I'll pay half a million more a year in tax. If I leave the country I can save £3m a year. It's almost like the government is offering me a bribe worth £3m a year to go and live abroad."

Hargreaves started his business in a bedroom in Bristol 28 years ago. He and co-founder Stephen Lansdown pioneered the idea of selling investment products through mailshots rather than handshakes on the golf course.

It has been a huge success. When the company floated on the stock exchange in May 2007, just before the credit crunch struck, the two entrepreneurs pocketed £150m between them. About 20 of their staff also became millionaires.

Bristol is still benefiting from the company's success, not only through the 600 jobs it has created. Only two weeks ago Stephen Lansdown sold £7m of shares in the company to finance the construction of a new stadium for Bristol City football club.

If Hargreaves was starting out in business now, however, he wouldn't have chosen Britain. "I sat down with my wife on Wednesday night to start talking about where we are going to go," he said. "I already pay more tax than almost anyone else in this country. I paid £3m last year. I wouldn't mind if it was money well spent."

He added: "Does the government not realise that any time any country in the world has raised taxes the people in the upper echelons pay less tax, because they avoid it. The tax take from the very wealthy will go down and they will end up taxing the poorer people because the wealthy people will just avoid it."

Hargreaves is by no means alone. Senior partners at the big four accountancy firms have been inundated with calls from business people running firms both large and small. The worry is not so much the impact of the tax itself, but the signal it sends out. Entrepreneurs are not welcome anymore.

"Lots of people, who have paid taxes in good faith and helped make the UK a lot of money, are now saying 'enough is enough'," said Michael Wistow, head of tax at the City law firm Berwin Leighton Paisner.

Hugh Osmond, the pubs to insurance entrepreneur, is among those packing his bags. "This is just the start," he said. "Introducing a 50% tax rate is going to raise about £2 billion, they say. That doesn't even knock a hole in the £600 billion or £700 billion of debt that will have to be paid off, through taxes, over the next 10 or 15 years. That makes Britain a pretty unattractive place to do business, when coupled with tougher regulation, more red tape and more high taxes. I think a lot of people will be off. It's highly unlikely that I will continue to have the UK as my country of residence. It's just as easy to work from any close location — Switzerland or wherever."

Jon Moulton, founder of Alchemy Partners, a private-equity firm, said the 50% tax rate would definitely discourage those in the higher earnings bracket from working in London. "A few people will depart on the back of it," he added.

David Giampaolo, chief executive of PI Capital, the investment club for the wealthy, said his members are furious. "This budget makes the country less attractive. It divides the nation and it doesn't motivate people to work harder and earn more — it punishes them. I have Labour supporters in the club and they are upset. I've not come across one person who thinks it's a good budget. Nobody believes the assumptions. I've had 40 or 45 calls from members — all serious business people — and they have been stopped in their tracks by this."

Even those with no intention of leaving are devising plans to get round the taxes.

"I despair when politicians of all colours say they're doing this to make more money for the country," said Robert Hiscox, the founder and chairman of Hiscox insurance, the £1.2 billion specialist insurance firm. "It is absolutely, unassailably true that raising tax rates will reduce revenues for the country. It's done for political reasons, and to appease the many who vote. Immediately, anybody who has got any income will find a way to keep it from being taxed. You will reduce your income so you have less to tax."

Smaller businesses are equally vocal. Peter Waldron, who runs Waldrons Patisserie, a frozen desserts firm that exports to 18 countries in Europe, described the move as a "disincentive" for entrepreneurs. "We have worked hard for many years to build a sound future for ourselves and staff. We feel that as we become more successful we may be penalised financially," he said.

Steve Harkin, owner of Saxon Oil, a lubricants firm in Coventry, was even more vocal. "The people who spend their nights worrying about how to pay the bills are the ones now being told they will be hit with an extra penalty as soon as they pay themselves more than £150,000. What's the incentive to go and take risks if you're just going to be penalised for doing so?"

Some businesses will be hit immediately by the new top rate and have no time to try to sidestep it, said Alex Henderson at accountants Price Waterhouse Coopers. "Many unincorporated businesses have year ends of April 30. Their year that starts this week will form the basis for their tax liability for 2010-11, so the budget's effect is to increase their tax rate from this week."

Sir Tom Hunter, the retail and property entrepreneur whose wings have been clipped by the credit crunch, is baffled by the tax move. "It's not government that will get us out of this mess," he said. "The people who will lead Britain out of recession are hard-working business people who build small businesses, grow them, and employ more and more people. We need to be offering tax breaks for those people, not just more of a tax burden."

Carolyn Steppler, associate partner in personal tax at KPMG, said: "From 2010, the UK will have the highest income-tax rate among the largest western economies. If they are losing half of their top-end earnings, entrepreneurs, foreign workers and anyone else who can choose where they work, are likely to think twice before making the UK their base."

KPMG's figures show that the top rate of 50% will be higher than Germany, China and Australia, all on 45%; Italy, 43%; France, 40%, and America 35%.

Despite all the heat generated by the 50% tax, the highest income-tax rate in Britain for more than 20 years, experts say it will not generate the revenues the Treasury is assuming. When the Thatcher government cut the top rate from 60% to 40% in 1988, the effect was to increase the proportion of the tax take from high earners, because it reduced the incentive to try to avoid tax and because it was followed by a period in which those at the top flourished.

Stuart Adam of the Institute for Fiscal Studies said it was virtually impossible to assess whether the £7 billion the Treasury is expecting to raise from taxing those on incomes above £100,000 more heavily — their personal allowances will be removed even before the 50% rate kicks in at £150,000 — will be achieved.

For some, the 50% top rate was a New Labour government returning to its Old Labour roots. "It proves that whatever the rhetoric from Brown on the entrepreneurial economy, the reality is they don't believe in it," said Luke Johnson, chairman of Channel 4 and founder of Risk Capital Partners, a private-equity firm. "It reveals New Labour for what they are, which is redistributive socialists."

Simon Walker, chief executive of the British Venture Capital Association (BVCA), said Britain's other disadvantages would come to the fore now that the top tax rate was going up. "There are only six countries in the OECD with a higher tax rate than the UK — places like Denmark, Sweden and Finland. But the point about those countries is that things work there. People feel they can send their children to a local school and the transport system is effective. The tax change makes Britain a much less attractive place to be based.

"This comes on top of the capital-gains tax increases. None of these by themselves would result in a flight from Britain, but the cumulative effect says Britain is just not a great place to be. I regret that."

Not everybody agrees. Simon Woodroffe, founder of Yo! Sushi and former star of Dragons' Den, said: "The 50% tax rate is the right thing to do. We live in this blame culture, forever pointing fingers at politicians. It's all our faults. Anyone who is earning more than £150,000 is very rich and ought to spend more.

"Does it stop an entrepreneur? I think not. I met very few people who did it for the money. I've met a lot who did it for the fear of not having any money. There's lots of reasons that drive people, whether it's ego or trying to prove something to someone."

This weekend, however, he was in the minority. After the budget, both Darling and Gordon Brown, in an attempt to placate business, hinted that the new top tax rate might be only temporary. One accountant commented that was what William Pitt had said when he introduced income tax at the end of the 18th century. And the 50% rate is not the only thing worrying business.

ON budget night, Richard Lambert, director-general of the CBI, the employers' body, hosted a dinner for some of his members. They were not happy with a 50% tax rate, he said, but what generated most concern was the scale of government borrowing, £175 billion this year — 12.4% of gross domestic product — falling slightly to £173 billion in 2010-11.

The Treasury's projections suggest Britain will need to borrow £606 billion over the next four years and the budget deficit will not drop below £100 billion until 2013-14. Government debt, previously limited to 40% of national income by Labour, will rise inexorably towards 80% before peaking.

"For me the question was whether [Darling] would come up with a rigorous path back to financial stability, and our judgment was that he didn't," said Lambert.

The budget contained £26.5 billion of "fiscal consolidation" over the medium-term, split roughly three ways between higher taxes — including the 50% top rate — a squeeze on government "current" spending, and a reduction in capital spending.

Capital spending on schools, hospitals and other infrastructure projects, previously sacrosanct, is being squeezed, dropping from £44 billion this year to £22 billion by 2013-14.

Even so, the Institute for Fiscal Studies says there is still a gap of £45 billion in what the chancellor needs to do in further tax rises and spending cuts to get the public finances back into shape.

Business leaders say answers to how this gap will be tackled need to be provided quickly. "Business will be looking over the next 12 months at which

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How the budget will affect business

HERE are the main points of chancellor Alistair Darling's budget — and their implications.

GDP will shrink 3.5% this year but will grow by 1.25% in 2010 and 3.5% in 2011.
Analysts say Darling has been far too optimistic in his forecasts. The International Monetary Fund is much gloomier, predicting a 4.1% contraction this year and a 0.4% drop in 2010.

The government plans to sell a record £220 billion in gilts this year to shore up its finances.
This figure was £72 billion more than the government's estimate only five months ago, and £20 billion more than recent expectations. Four years ago the figure was £48 billion. The scale of the sale pushed down the pound against the dollar. Recent bond issues have met limited interest and there are fears that Britain's credit rating could be downgraded because of the huge borrowing it has taken on.

A 50% top rate of income tax for the 350,000 people earning more than £150,000.
The big shock, interpreted as a vote winner with the public that will raise some £2 billion a year for Treasury coffers but will inflame business people, driving some of them offshore to live in lower-tax countries. The new levy marks a sharp step up from the existing 40% rate and replaces the rate of 45% that had been planned. It comes into force next April — a year earlier than expected.

Jobcentres: £1.7 billion boost

An extra £1.7 billion will be put into the Jobcentre Plus network.
Darling set out plans to prevent the formation of a "lost generation" with a pledge to create 250,000 jobs and provide an extra £260m for training. From January, everyone who is under 25 and has been out of work for a year will receive a job or training.
Something of a turnaround. The government would not have to pour money into job centres to cope with demand from the extra unemployed if it had not closed so many of them in recent years.

For the housing industry, a £500m package is aimed at restarting work on developments that have been halted by the credit crunch, with more money for social housing. For buyers, the stamp-duty holiday on homes up to £175,000 will be extended to the end of the year.
Together with a renewed pledge to get the banks issuing mortgages again, this was generally well received. However, there was worse news for the hard-hit commercial property sector. The chancellor did not ease the rules for Real Estate Investment Trusts, for example, by allowing deferment of payment of property income dividends.

A £600m scheme that will grant 300,000 motorists £2,000 each to scrap their 10-year-old cars and buy a new one.
Plummeting sales means every little helps the car industry right now but this measure was met with a mixed response because car manufacturers have to chip in half the money.

Doubling capital tax allowances to 40% for firms investing more than £50,000.
A recession tactic to keep companies investing in equipment. The Treasury estimates it will cost £1.6 billion but will support investment of about £50 billion.

Tax breaks to boost exploration in smaller North Sea fields that would otherwise not be viable.
This move, to make it viable to drill for another another 2m barrels of oil, underlined the importance of oil and gas to Darling's tax take. They contributed 28% of corporate tax in the last financial year. Even with a lower oil price they could make up a fifth of corporate-tax earnings this year.

North Sea oil: new tax breaks

Fuel duty will rise by 2p a litre from September and another 2% will be added to alcohol and tobacco duties.
The easy targets, which Darling said would bring in an extra £6 billion by 2012. Hauliers complained that the increase would hit their industry with an extra £810m burden.

Darling's "carbon budget" was designed to cut carbon emissions by 34% by 2020 and included £4 billion to pay for renewable-energy projects and £525m to support offshore wind projects.

He also exempted new power plants from the climate-change levy from 2013.
This restates the government's commitment to green energy just as there were signs that private-sector investment in big projects was ebbing away.

Up to £250m will be diverted from the BBC's pot to help the elderly switch to digital television so that broadband can be made available in hard-to-reach rural areas. A £750m fund will be set up to back start-ups, especially green-technology firms.
Gordon Brown believes that investing in the digital economy can help drag the country out of recession, but hard-pressed media companies had been eyeing the BBC money. The start-up fund will seek to recreate the private-equity group 3i, which was set up after the second world war in order to stimulate new investment in companies.

Prepare for tax rises and a squeeze on public spending

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party is prepared to take on this issue and tackle head-on reform of the public sector and the role it has to play in a future economy," said Steve Radley, chief economist at the Engineering Employers' Federation.

"We now have a huge opportunity not just to tinker at the margins to look at greater efficiency but to fundamentally rethink the role of the public sector and to tackle the thorny issue of public-sector pensions."

In the financial markets, Darling's new borrowing projections went down badly, hitting gilts — government bonds — and sterling. Analysts say the effect would have been greater had not the gilt market been supported by the Bank of England's programme of quantitative easing.

"The UK is returning to high borrowing, high debt and, in our view, much weaker growth than the government believes," said Gerard Lyons, head of research at Standard Chartered. "Add in the greater regulation that is likely to hit, and one wonders how the UK will prosper as the shift in the new world economic order, which is already under way, gathers momentum. As we see a further shift in the balance of economic and financial power from the West to the East, to those economies with low taxes and which save and invest, how will the UK be able to prosper?"

Although Britain has not suffered the humiliation and damage faced by Ireland of a downgrade in its sovereign debt status — the ratings agency Moody's reaffirmed the UK's AAA ranking on Friday — the fear is that any further deterioration in the public finances — with the chancellor relying on an early end to the recession and a brisk recovery — could tip Britain over the edge.

Friday's figures showed a drop of 1.9% in Britain's gross domestic product in the first quarter of this year, gloomier than most economists expected. Signs of "green shoots" in some surveys had prepared analysts for a smaller drop. Economists at Goldman Sachs said the figures could eventually be revised higher. Even so, the numbers added to doubts about the chancellor's forecast of a drop in GDP this year of 3.5%, followed by a 1.25% upturn next year. If it is not achieved, the government's borrowing red ink will be greater. Yields on 10-year gilts have risen to 3.5% from a low point last month of 2.95% in response to such worries.

"The question is probably not whether UK debt is downgraded, because there are other countries that would be in line for a downgrading first," said George Buckley, a Deutsche Bank economist. "Britain will be able to finance its debt; the real issue is at what level of gilt yields and sterling it will be able to do so. You could easily see a combination of a substantially weaker pound and significantly higher gilt yields."

Whatever happens, business is prepared for further tax rises and a tighter squeeze on public spending, though most do not expect it until after the election. Even the announcements made so far imply a significant tax hit, however, according to calculations by the Institute of Directors.

Richard Baron, the institute's head of tax, said the key was the extent of the tax "swing" from temporary cuts to subsequent increases, equivalent to £20 billion.

"To move from a tax cut of £13,330m in 2009-10 to a tax cut of only £515m in the next year means a tax increase, from one year to the next, of £12,815m," he said. "That's a big hit on the economy when the recovery ought to be getting under way.

"Then we get another big hit in 2011-12, putting up taxes by £7,865m relative to 2010-11. This just isn't giving the economy room to breathe. It shows the danger of squeezing the economy through tax rises, when the only sensible route is to put the brakes on public spending once the recession is over."

THE IRONY is that the budget contained a number of smaller measures for business that in normal circumstances would have been warmly received. The biggest tax cut was a £1.6 billion doubling of first-year capital allowances to 40%, which industry had been urging. Another £755m was allocated to allowing firms to defer business rates and carry back losses for tax purposes.

"The chancellor appears to have understood that it will be business driving the economy out of recession, and there are some good measures that reflect this," said David Frost, director-general of the British Chambers of Commerce.

The car industry was pleased with the scrap scheme to give owners of 10-year-old cars a £2,000 trade-in for a new one. Firms were unhappy that they must meet half the bill, but the Society of Motor Manufacturers said it would get people back into showrooms, kick-starting market demand.

The motor industry's plight was underlined by figures on Friday showing last month's car production at half the level of a year ago. "It should give motor manufacturers greater confidence to increase production levels after the scaling back of production and reduction of working hours seen at plants right across the country," said David Raistrick, UK manufacturing industry leader at Deloitte.

Businesses welcomed the government's £750m Strategic Investment Fund, a third of which will go to low-carbon projects, intended "to support advanced industrial projects of strategic importance", though they warned against returning to a policy of "picking winners". Other measures also welcomed included a boost for credit insurance (see page 8) and action to support jobs and training.

In a normal year this would perhaps have been enough to win the budget a thumbs-up from business. This is not a normal year and the bigger, grimmer picture overshadowed the positive features.

This weekend the Forum of Private Business, which represents small firms, released a survey showing that more than two-thirds of its members thought the measures intended to help them would be ineffective and more than nine out of ten thought it had done nothing to reduce their costs or improve their changes of survival.

Sometimes budgets look better a few days after the event. Sometimes they mature with age. It will be a very long time before business learns to love what the chancellor did last week.

Additional reporting by Matthew Goodman

“ IT'S TIME TO RETHINK THE ROLE OF THE PUBLIC SECTOR AND TO TACKLE THE ISSUE OF PUBLIC-SECTOR PENSIONS

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