

DEMOS

# THE INVESTOR TEST

TAXING INCOME FROM  
WEALTH WITHOUT HITTING  
BRITAIN'S RETAIL INVESTMENT

DAN GOSS

A CITIZEN BUDGET 2026

SEPTEMBER 2026

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# ABOUT A CITIZEN BUDGET 2026

Demos is Britain's leading cross-party think tank. Our mission is an upgraded democracy, with a new deal to mend the broken relationships between state, institutions and citizens. Our work focuses on building trust in democracy, person-centred and preventative public services, resilient information ecosystems and a citizen-centric economy.

For decades, economic policy has been limited by short-termism and top-down, lever-based policies which fail to drive national system-change. Demos now aims to build a '**Citizen Economy**' - one which strengthens the public legitimacy needed for long-term decisions, and engages with questions of culture, social relationships, pride and place to unlock economic systems-change. The tax system is central to this diagnosis. A lack of public legitimacy has prevented successive governments from making the bold changes needed for a fairer, simpler, pro-growth tax system.

The 2026 Budget provides an opportunity to turn the dial. While calls for a perfectly efficient tax system are critical, we cannot overlook the political constraints. A perfectly efficient tax system requires building public legitimacy for bold reform. This Demos series, **A Citizen Budget 2026**, lays out how the government can build that legitimacy through pro-growth tax reforms.

This briefing paper outlines how the government can, by taxing income from wealth at the same rates as income from work, build public legitimacy while simultaneously raising revenue and improving economic efficiency. Subsequent papers and outputs will outline policies that build legitimacy across the fiscal system to enable broader tax reform elsewhere:

- 1. Taxing Extraction:** Tax reforms which signal what the government is against and willing to raise revenue from - specifically extractive, harmful or unproductive economic activity
- 2. Funding the Future:** Tax reforms reflecting the principles by which the government intends to fund future spending needs - social care, council house building and support for young families
- 3. The National Bond:** Using fiscal policy to drive national unity by issuing 'UK Security Bonds'
- 4. A Stronger Fiscal Contract:** Improving value-for-money in government spending to unlock support for tax rises
- 5. A DOGE on Tax:** A new institution which builds legitimacy and challenges orthodoxy to unlock long-term disruptive tax reform

# CONTEXT

## BURNHAM HAS BILLS TO PAY

The new prime minister has his first Budget on 28th October - and he has bills to pay. His cut to business rates for pubs and small venues costs £100 million. Cuts to VAT for electricity bills cost £850 million. There is an £800 million annual shortfall to meet Burnham's council house-building targets.<sup>1</sup> There is a £900 million hole in the Defence Investment Plan, ballooning to around £9bn if the Chancellor fulfils his ambition for defence spending at 3% of GDP by 2030.<sup>2,3,4</sup> Social care needs £7.4 billion just for 10% extra budget.<sup>5</sup>

Beyond this, there are hard-to-measure long-term ambitions such as place-based regeneration, reindustrialisation and tackling the cost of living.<sup>6,7</sup> All require public investment. And even beyond spending needs, the rise in gilt rates since the Spring Forecast has been estimated to reduce the fiscal headroom by £12.2 billion, which the Chancellor may want to restore.<sup>8</sup>

While borrowing offers wiggle room for capital spending, it risks further backlash from the bond markets.<sup>9</sup> Spending cuts should play a role in supporting the public finances, but the turmoil after cuts to winter fuel payments and disability benefits lays the challenge bare.

Tax rises will have to lift some of the weight. In the months leading up to the Budget, Demos will be publishing a series of briefing papers, laying out how the government can raise tax revenue while improving legitimacy in the tax system and securing or improving economic growth. This paper is the first in that series.

## OPPORTUNITIES FOR POPULAR, PRO-GROWTH TAX RISES REMAIN

Last year, drawing on extensive economic analysis and public engagement research, we identified a series of pragmatic, popular, pro-tax reforms that could raise public revenue.<sup>10</sup> Some of the proposals were, to various extents, reflected in the 2025 Budget; the High Value Council Tax Surcharge, a 2% increase in tax on rental income (alongside income from dividends and savings), and higher taxes on gambling. Yet, opportunities for pragmatic, popular, pro-tax reforms remain which could collectively raise £16.4 billion. Each ensures that income from wealth is taxed fairly at the same rate as income from work.

1 Hannah Aldridge, Housing Outlook Q3 2026, Resolution Foundation, 24 July 2026, <https://www.resolutionfoundation.org/publications/housing-outlook-q3-2026/>

2 Bee Boileau and Max Warner, Initial response to the Defence Investment Plan, Institute for Fiscal Studies, 30 June 2026, <https://ifs.org.uk/articles/initial-response-defence-investment-plan>

3 Ministry of Defence, The Defence Investment Plan Funding explainer, GOV.UK, 30 June 2026, <https://www.gov.uk/government/publications/the-defence-investment-plan/the-defence-investment-plan-funding-explainer>

4 BBC. Defence Secretary John Healey and Armed Forces Minister Al Carns resignation letters in full. 11 June 2026. <https://www.bbc.co.uk/news/articles/cgjx64yl7z9o>

5 Re:State, Beyond caring: a new funding model for later-life social care, 16 April 2026, <https://re-state.co.uk/wp-content/uploads/2026/04/Beyond-caring.pdf>

6 Henry Zeffman and Archie Mitchell. Burnham says 20% business rates cut for English pubs 'a first step'. BBC. 23 July 2026. <https://www.bbc.co.uk/news/articles/cq6dg816464o>

7 Stuart Adam et al., Temporary VAT cut on household electricity bills: IFS response, Institute for Fiscal Studies, 21 July 2026, <https://ifs.org.uk/articles/temporary-vat-cut-household-electricity-bills-ifs-response>

8 The Guardian, UK gilt yield: long-term borrowing costs hit 28-year high, 1 September 2026, <https://www.theguardian.com/business/2026/sep/01/uk-gilt-yield-long-term-borrowing-costs-28-year-high>

9 Helen Thomas, 'The bond market will burn Burnham', MoneyWeek, 8 August 2026, <https://moneyweek.com/economy/uk-economy/the-bond-market-will-burn-burnham>

10 Dan Goss, Solving the Tax Puzzle: Eight popular, pragmatic, pro-growth tax reforms to plug the fiscal hole, Demos, September 2025, <https://demos.co.uk/research/solving-the-tax-puzzle-eight-popular-pragmatic-pro-growth-tax-reforms-to-plug-the-fiscal-hole/>

| TAX                                                                       | DESCRIPTION                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | BENEFITS                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|---------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Capital gains tax (CGT) reform.</b><br><br><b>£11.3bn<sup>11</sup></b> | <p>CGT currently charges lower rates than income tax, but applies to all gains (including those which an investor could have received tax-free if they instead saved their money in an ISA, i.e 'normal gains'), which creates a disincentive to invest.<sup>12</sup> The government should (1) match CGT rates with income tax, (2) introduce an 'investment allowance' which exempts 'normal gains', (3) remove the 'uplift' at death so that capital gains on inherited assets no longer go untaxed, and (4) introduce an 'exit tax', meaning people leaving the UK with investments pay tax on all gains over £1 million acquired while they were a UK resident. The government should also explore 'scale-up reinvestment relief' - allowing founders to defer CGT and/or benefit from reduced tax rates if they recycle gains into founding a domestic scale-up business. We outline a proposed design in the annex.</p> | <p>Rate equalisation ends the unfair tax advantage for capital gains over wages, including for people who shift income into gains via personal service companies. The investment allowance incentivises investment, stopping investment being penalised relative to spending. Removing the uplift closes the loophole where inherited gains escape CGT altogether, and ends the incentive to hold assets until death purely for tax reasons. The exit tax stops the wealthy avoiding CGT by leaving the UK, disincentivises outward migration, and brings the UK into line with peer countries like Canada and Australia. A 'scale-up reinvestment relief' could also minimise the risk of discouraging investment from high-productivity repeat founders, who may be most responsive to tax changes.</p> |
| <b>Applying NICs to rental income</b><br><br><b>£3.2bn<sup>13</sup></b>   | <p>To ensure rental income (which is not subject to NICs) is charged the same rates of tax as income from work, the government should introduce a new class of NICs for rent, with a basic rate of 18% and a higher rate of 6%. To avoid creating a disincentive to invest in housing, an investment allowance should be introduced removing tax on any 'normal' returns.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | <p>NICs on rental income ends the unfair gap where landlords pay no NICs on rental income, while the investment allowance protects normal returns, so it doesn't discourage investment in housing. Importantly, given that housing isn't a productive asset, taxing it poses less risk to growth than taxing business investment.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

11 Advani A, Lonsdale A and Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. CenTax. [https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024\\_CGTReform.pdf](https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf)

12 Normal returns are those that an investor could achieve simply by keeping the money in a savings account. These returns simply compensate investors for investing their money, and thereby forgoing the opportunity to spend that money in the present

13 The revenue gain will now be slightly less as the estimate does not account for the 2 point increase in tax on rent introduced in 2025. CenTax. Technical Note: Equalising tax rates across different types of income. August 2025. <https://centax.org.uk/wp-content/uploads/2025/09/TaxRateEqualisation-TechnicalNote.pdf>.

| TAX                                                                   | DESCRIPTION                                                                                                                                                                                         | BENEFITS                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|-----------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Introducing Partnership NICs</b><br><br><b>£1.9bn<sup>14</sup></b> | To ensure partnership businesses (which are not subject to Employer NICs) are charged the same rates as other businesses, the government should add an additional category of Employer NICs at 15%. | Partnership NICs would end the tax advantage for partners over employees (which particularly benefits the professional services sector over, for example, manufacturing) and reduce the incentive to route economic activity into partnerships purely to save tax (rather than gearing activity towards what's most productive). The employment allowance also protects smaller partnerships (i.e. those with a wage bill under £90,521 at a minimum). |

## EXPLORING THE INVESTOR PERSPECTIVE

Our 2025 research found that CGT reform, NICs on rental income and Partnership NICs each receive support from both the public and small businesses.<sup>15</sup> We found little cause for concern that small businesses would reduce their investments. Another key stakeholder, however, is Britain's investors.

The UK has a substantial investment deficit and relies too heavily on investors from abroad with little long-term stake in UK society - as laid out in Demos's Citizen Economy strategy.<sup>16</sup> This condition dampens long-term growth and undermines Britain's ownership and control over its assets. Our problem-ridden water system - with historic under-investment and debt-financed dividends extracted by investors abroad - symbolises the problem. Attracting domestic investment from our domestic investors is essential to tackle these problems.

Capital gains, rental income and partnership income all represent potential returns to investors' assets (for partnerships, investors would either have to take a substantial role in the business or act as 'sleeping partners').<sup>17</sup> If reforming taxes on these income streams, we must be cognisant of how it impacts the perspective and incentives of investors - and in particular those domestic investors with a long-term stake in UK society.

<sup>14</sup> Ibid.

<sup>15</sup> Dan Goss, Getting Down to Business: Attitudes of small businesses to popular, pragmatic pro-growth tax rises, Demos, 12 November 2025, <https://demos.co.uk/research/getting-down-to-business-attitudes-of-small-businesses-to-popular-pragmatic-pro-growth-tax-rises/>

<sup>16</sup> Joe Martin and Dan Goss, Citizens Economy: a New Deal to power economic growth and rebuild trust between state and citizen, Demos, 26 June 2026, [https://demos.co.uk/wp-content/uploads/2026/06/New-Deal\\_Citizen-Economy\\_2026.pdf](https://demos.co.uk/wp-content/uploads/2026/06/New-Deal_Citizen-Economy_2026.pdf)

<sup>17</sup> To be classed as such, the business must be registered as a partnership with HMRC, and various criteria must be met. For a Limited Liability Partnership (LLP), for example, a worker can be a partner if: 1) At least 20% of their remuneration varies with the partnerships' profits; 2) They have significant influence over the affairs of the partnership; and 3) They contribute at least 25% of their fixed remuneration as capital to the partnership.

# INSIGHTS

To explore the perspective of UK investors - both their responses to tax reforms and opinions on them - we ran a survey of 1,000 UK investors in August 2026, including 250 with investable assets (excluding residential property, workplace pensions, or cash savings) between £100,000 and £250,000, and 250 with over £250,000 of investable assets.

The sample represents domestic retail investors (who invest their own assets) rather than international, professional or institutional investors, and so is not reflective of UK capital in general. Direct individual investors do, however, reflect just over a tenth of the UK equity market (owning 11.6% of UK equities at the end of 2024) and are, in part, likely to share similar incentives about tax as other investors.<sup>18</sup> Importantly, unlike international investors (who own 59% of UK equities), ultra-rich British investors, or institutional investors over which citizens have an indirect influence, the investors in our sample represent UK citizens with a direct stake in the UK economy and society. These citizen investors play an important role in ensuring capital markets represent the interests of British citizens more broadly - and so their perspective is of particular importance.

The evidence demonstrates that:

- 1. Investor responses to the 2025 tax rise on investment income give little reason for concern.** A minority of investors knew about the specifics of last year's tax rises on investment income, and on net, just 3% say they invested less as a result of changes.
- 2. Investors' expected responses to the proposed tax reforms - in terms of investment, migration, or asset sales - give little reason for concern.** If CGT rates were raised to match income tax rates but an investment allowance was introduced, investors are more likely to say they would increase their investments (25%) than reduce investments (15%). Half expected no change, and a tenth responded 'don't know'. If an exit tax was introduced, 17% of investors say they are more likely to leave the UK, but 20% say they would be less likely to. If NICs were introduced on rental income alongside an investment allowance, investors are more likely to say they would increase their property investments (27%) than reduce them (15%). Partnership NICs is an exception, with a net 5% of investors expecting to invest less in partnership businesses as a result.
- 3. Investors tend to think the proposed reforms would make the tax system fairer.** Investors are more likely to say the CGT reforms, an exit tax, partnership NICs, and NICs on rental income would make the tax system more fair than make the tax system less fair. For example, while 21% say the CGT reforms would make the tax system less fair, 29% say the reforms would make it more fair.

<sup>18</sup> Rupert Hargreaves, Retail investors are returning to UK markets, City AM, 12 August 2026, <https://www.cityam.com/retail-investors-are-returning-to-uk-markets/>

# INSIGHT 1

## INVESTOR RESPONSES TO THE 2025 TAX RISE ON INVESTMENT INCOME GIVE LITTLE REASON FOR CONCERN

The extent to which investors responded to past tax changes is a useful indication of how they might respond to future changes. To test this, we examined responses to and awareness of the 2% tax increase for income from rent, dividends and savings interest, announced in the 2025 Budget and applied from April 2026.

**CHART 1**  
**A very small minority of investors invested less due to last years investment tax changes**  
*Investment response to tax changes for income from dividends, interest and rent, by value of investable assets*

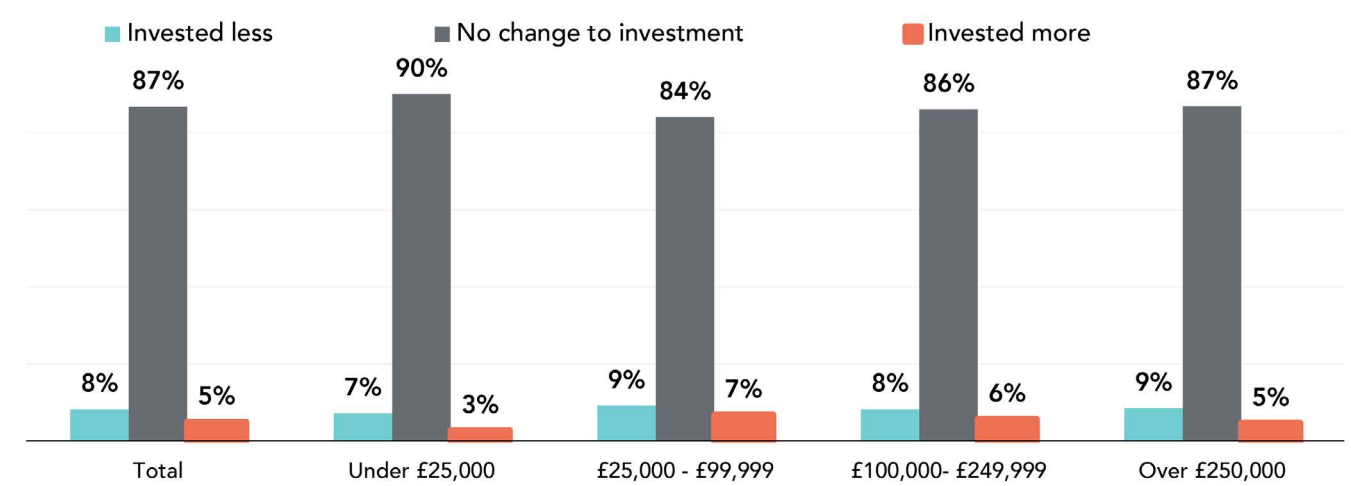
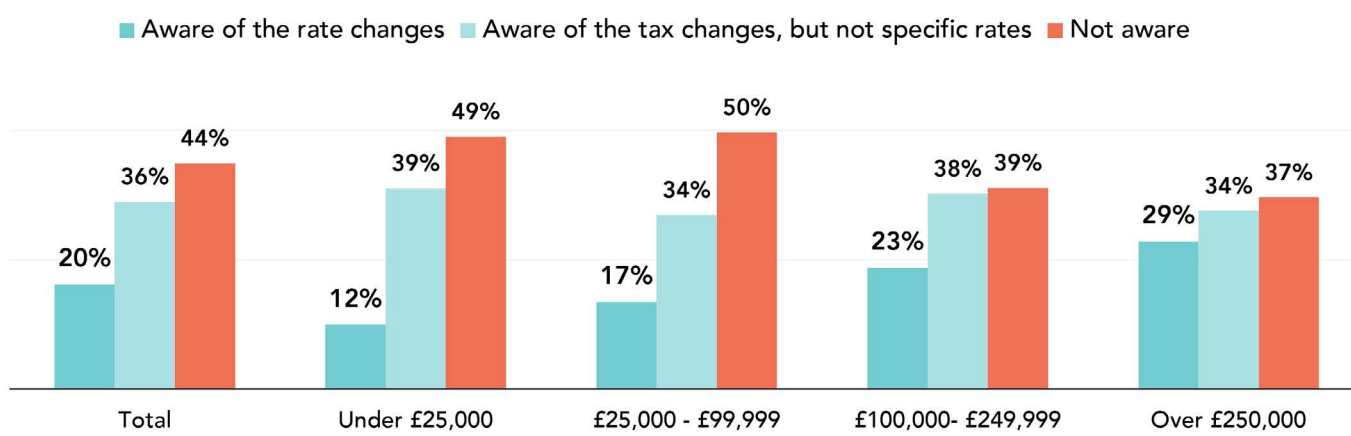


**CHART 2**  
**A minority of investors say they were aware of how much investment tax rates were changed last year**  
*Awareness of the tax chnages for income from dividends, interest and rent, by value of investible assets*



We find that Britain's retail investors report a low investment response. Just 8% of investors say they have invested less as a result of the tax changes, with 5% investing more. The finding is relatively consistent across levels of investable assets; just 9% of investors with over £250,000 of investable assets investing less due to the reforms, with 5% investing more.

The low investment response is unsurprising given low levels of awareness about the tax changes. Just a fifth of investors are aware of the specific change in rates for investment income. Almost half of investors (44%) are not aware of the changes at all, while another 36% are aware of the changes in general, but not the specific change in rates. Awareness of the specific rate changes rises with wealth - being 12% among investors with under £25,000 of investable assets compared to 29% for investors with over £250,000 of assets - but never comes close to a majority.

The evidence establishes a useful baseline: a real, implemented tax rise on investment income produced little measurable retreat from markets. The finding is consistent with our research with small businesses last year. Just 7% of SMEs said the 2024 increase in CGT led them to reduce investment, compared to 18% saying it led them to invest more. Meanwhile, just 6% correctly estimated the new CGT rate for assets benefiting from Business Asset Disposal relief, suggesting engagement with rate increases is low. The main limitation is scale - both of these changes were considerably smaller than CGT equalisation or an exit tax, so a muted response here cannot simply be read across to a much larger change.

## INSIGHT 2

### INVESTORS' DO NOT EXPECT TO RESPOND NEGATIVELY TO THE PROPOSED TAX REFORMS - BE IT ON INVESTMENT, MIGRATION OR ASSET SALES

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#### **CAPITAL GAINS TAX - HIGHER RATES TO MATCH INCOME TAX AND A NEW INVESTMENT ALLOWANCE**

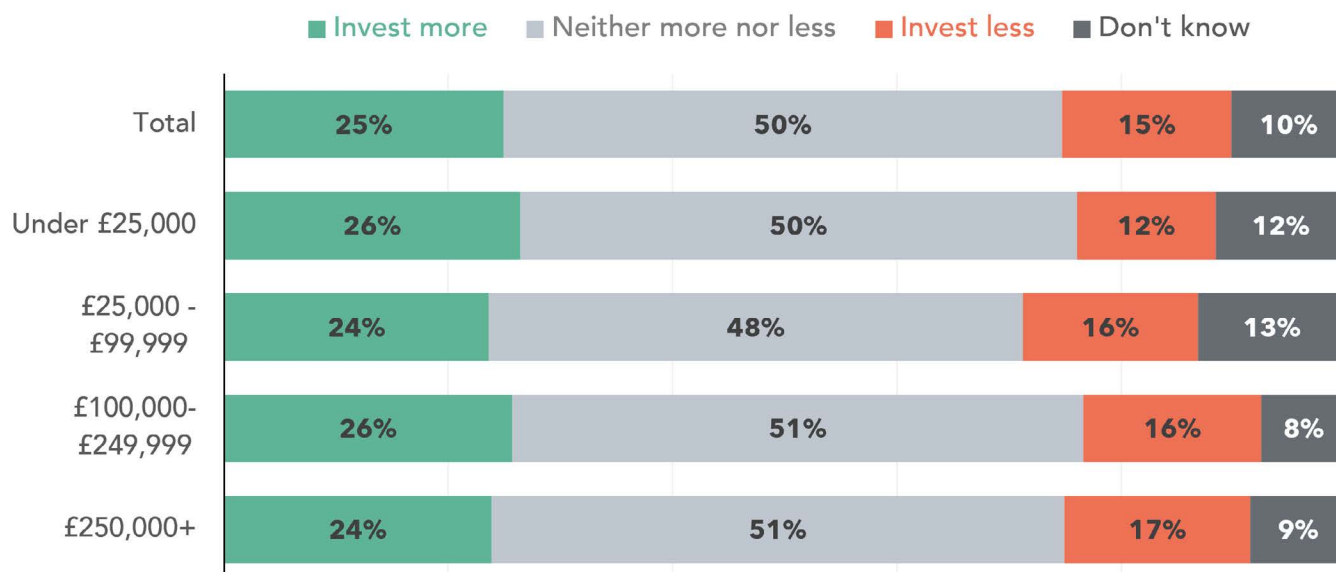
Concerns about raising CGT rates to income tax while introducing an investment allowance include the risk of investors (1) reducing investment, (2) migrating abroad or (3) delaying their asset sales (in the hope that CGT rates would be reduced by a subsequent government).

First, our evidence gives little reason for concern about reduced investment from retail investors. Investors are in fact more likely to say they would increase their investments (25%) than reduce investments (15%) - a finding broadly flat regardless of the level of investable assets. The findings likely result from the introduction of the investment allowance. Investors are currently taxed on gains which they could have received tax-free by just keeping their capital in a savings account, thus disincentivising investment. The investment allowance removes that disincentive.

### CHART 3

#### Facing CGT equalisation plus an investment allowance, more investors would increase investments than reduce them

Investors views on their investment response if CGT rates were raised to income tax rates, and an investment allowance was introduced, by value of investible assets

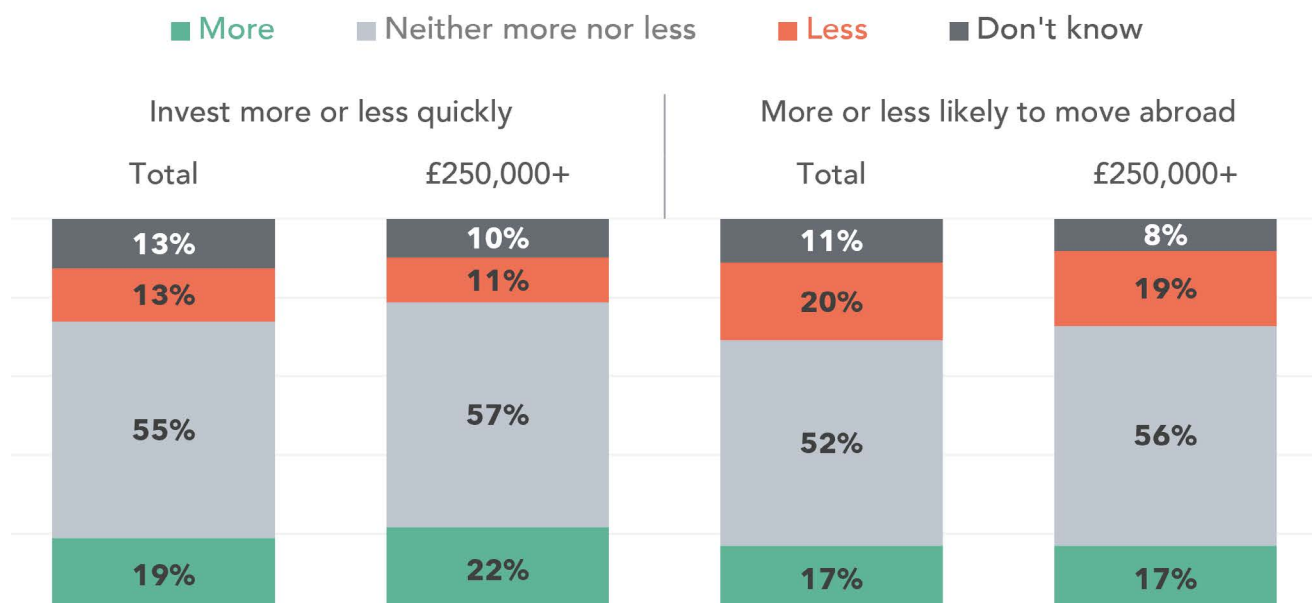


Second, there is little cause for concern that investors would delay asset sales. 19% would sell more quickly against 13% more slowly. Lastly, there is little cause for concern that investors would move abroad, with 17% saying they would be more likely to move abroad but 20% saying they would be less likely quickly - with similar rates for investors with over £250,000 of assets.

### CHART 4

#### Facing CGT equalisation plus an investment allowance, investors tend to say they would sell assets quicker and be less likely to move abroad

Investors views on whether they would sell assets more or less quickly if CGT rates were matched to income tax alongside a new investment allowance



While retail investors are an important stakeholder to consider in CGT reform, they do not fully reflect people who found multiple companies, with potential for extremely high productivity and greater chance of moving abroad to build companies.<sup>19</sup> There is some evidence that such ‘superstar investors’ or more competent entrepreneurs are more responsive to tax reforms than other investors.<sup>20,21</sup>

To minimise the risk of deterring UK investment from this group, the government should explore introducing ‘scale-up reinvestment relief’, allowing founders and early investors to defer CGT, or offering reduced tax rates if they recycle gains into domestic scale-up businesses. This would build on existing reliefs within the Enterprise Investment Scheme, which offer CGT deferral and beneficial tax rates for capital going to early, small UK businesses. Scale-up reinvestment relief would instead target beneficial tax treatment towards repeat founders building a domestic scale-up. These founders may build high-productivity companies that do not qualify for EIS (which is generally restricted to businesses with less than £30 million in gross assets, fewer than 250 employees, and within 7 years of its first commercial sale) or invest more than the annual cap for EIS (£1 million). Research by the Tony Blair Institute suggests that, if such a scheme were targeted at investment in Series B companies (i.e. firms raising their second major round of venture capital funding), and its generosity were half that of the EIS, it would cost the Treasury £230 million annually.<sup>22</sup>

The challenge, however, is how you define ‘scale-up businesses’ to effectively target the firms intended, but simultaneously prevent gaming or creating distortionary incentives. We outline a proposed approach in the Annex.

19 Mokander J et al. From Startup to Scaleup: Turning UK Innovation Into Prosperity and Power. Tony Blair Institute for Global Change. 9th June 2025. <https://institute.global/insights/tech-and-digitalisation/from-startup-to-scaleup-turning-uk-innovation-into-prosperity-and-power>

20 Akcigit U et al. Taxation and the International Mobility of Inventors. American Economic Review. October 2016. <https://swlb2.aeaweb.org/articles?id=10.1257%2Faer.20150237>

21 Bach L. Do better entrepreneurs avoid more Taxes?. Oxford University Centre for Business Taxation. October 2015. <https://oxfordtax.sbs.ox.ac.uk/files/wp15-17pdf>

22 Mokander J et al. From Startup to Scaleup: Turning UK Innovation Into Prosperity and Power. Tony Blair Institute for Global Change. 9th June 2025. <https://institute.global/insights/tech-and-digitalisation/from-startup-to-scaleup-turning-uk-innovation-into-prosperity-and-power>

## AN EXIT TAX

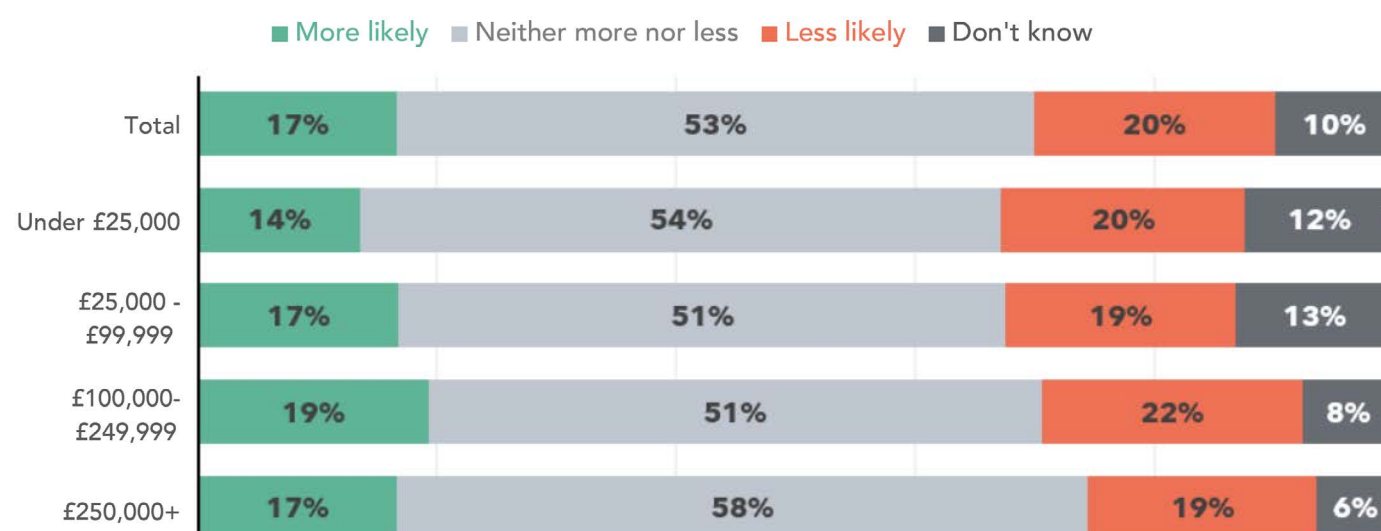
A concern about introducing an exit tax is that it could prompt investors to leave the UK. To avoid the exit tax, investors may seek to reside in another country while acquiring future gains (taking their capital and future tax contributions with them).<sup>23</sup> This concern must be balanced against the opposite incentive; an exit tax could cause investors who would otherwise move abroad to worry about the tax bill if they leave. This is particularly the case for investors moving abroad specifically to reduce their CGT bill (e.g. investors with a large amount of unrealised gains face a substantial incentive to move to a country like Monaco, which doesn't have CGT), as the exit tax removes their entire reason to leave.

For Britain's retail investors, our evidence does not substantiate the concern about investors leaving. On balance, a greater proportion of investors say they would be less likely to leave (20%) than more likely (17%) if an exit tax were introduced - a finding that holds relatively steady across levels of investable assets.<sup>24</sup> We also find no evidence that the investors in our sample would invest less as a result of an exit tax (14% would invest less but 21% would invest more) or delay their asset sales (12% would sell assets more slowly but 17% would sell more quickly).

### CHART 5

#### Facing an exit tax, investors would on balance be less likely to move abroad

*Investors' views on how likely they would be to move abroad if the government introduced an exit tax, by value of investable assets*



<sup>23</sup> If investors with unrealised capital gains did leave the UK following the announcement of an exit tax, they could not avoid the tax on their unrealised gains. The exit tax could be applied for anybody who leaves the UK in the present tax year. If, for example, it was introduced in the 2026 Autumn Budget, the exit tax could be applied to anybody leaving from 1st April 2026.

<sup>24</sup> Note, as a survey of UK-based investors, our evidence is not indicative of the impact of an exit tax on deterring foreign investors from moving to the UK. The proposed exit tax also only applies to gains above £1m, and so affects only a very small number of investors. The survey does not capture the views of this group.

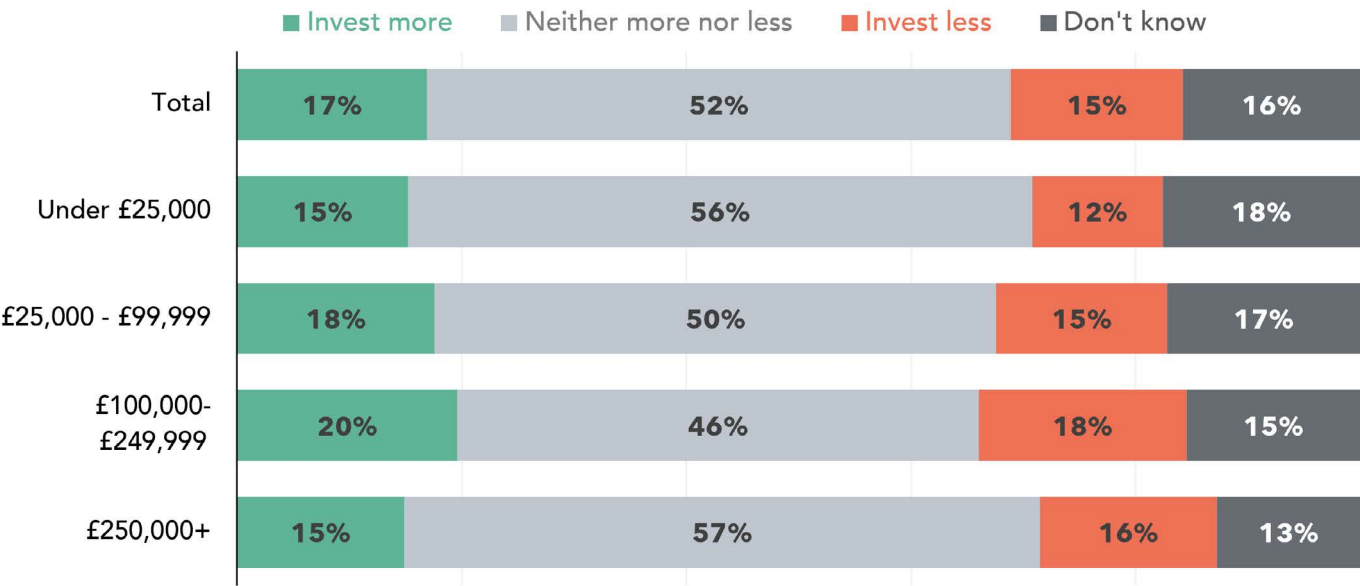
## NICS ON RENTAL INCOME

Our evidence gives little reason for concern that applying NIC to rental income, alongside a new investment allowance, would discourage investment in the private rental sector. Investors are more likely to say they would invest more in property (17%) than less (15%) if NICs were introduced on rental income alongside a new investment allowance - a pattern strongest among investors with £100,000-249,999 of assets, though close to flat among the wealthiest (£250,000+).

### CHART 6

Facing NICs on rental income plus an investment allowance, more investors would increase property investments than reduce them

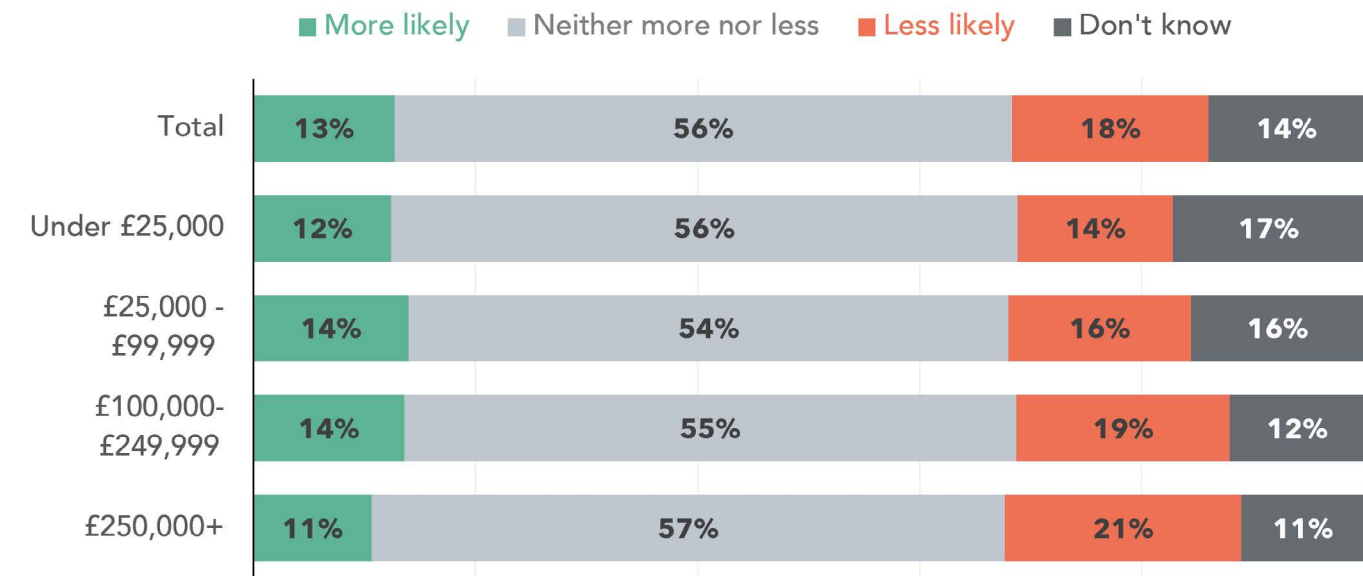
Investors views on whether they would invest more or less in property if NICs was put on rent alongside a new investment allowance, by value of investable assets



PARTNERSHIP NICS

On Partnership NICs, the evidence gives some reason for caution. To raise capital, some partnership businesses may rely on private loans or bringing in new partners (who either take on a substantial role in the business or act as ‘sleeping partners’ without a substantial role). Yet, while the majority of retail investors expect no change in investment (56%), they are, on balance, more likely to say they would invest less (18%) than more (13%) in partnership businesses. The effect is concentrated among the wealthiest investors.

CHART 7  
Facing Partnership NICs, investors would on balance be less likely to invest in partnership businesses  
*Investors views on how likely they would be to invest in partnerships if the government introduced Partnerships NICs, by value of investable assets*



Importantly, however, Britain’s partnership businesses have relatively little reliance on capital from retail investors. Unlike companies, partnerships cannot issue shares to outside investors. Many partnership businesses are also unable to take on a new partner just because they own capital; the majority of partnership income goes to legal, financial or accounting firms, which tend to be regulated professions requiring partners to have certain professional qualifications.<sup>25,26,27,28</sup> In these sectors, the vast majority of partners join because they are qualified professionals, not because they have capital to deploy.

25 Arun Advani, Sebastian Gazmuri-Barker, Andrew Lonsdale and Andy Summers, Equalising National Insurance on Partnership Income: Revenue and Distributional Effects, CenTax, 4 September 2025, [https://centax.org.uk/wp-content/uploads/2025/09/AdvaniGazmuribarkerLonsdaleSummers2025\\_PartnershipNICs.pdf](https://centax.org.uk/wp-content/uploads/2025/09/AdvaniGazmuribarkerLonsdaleSummers2025_PartnershipNICs.pdf)  
26 For example, the Solicitors Regulation Authority requires that all partners in a partnership legal firm be legally qualified, while the Institute of Chartered Accountants rules requires that the majority of voting rights are held by qualified accountants in certain firms  
27 Solicitors Regulation Authority, Authorisation of Firms Rules (in force from 1 December 2023), <https://www.sra.org.uk/solicitors/standards-regulations/authorisation-firms-rules/>  
28 ICAEW, Are you sure your firm is allowed to use the description ‘chartered accountants’?, March 2024, <https://www.icaew.com/regulation/regulatory-news/regulatory-news-2024-03/are-you-sure-your-firm-is-allowed-to-use-the-description-chartered-accountants>

# INSIGHT 3

## INVESTORS TEND TO THINK CGT REFORMS, AN EXIT TAX, PARTNERSHIP NICS AND NICS ON RENTAL INCOME WOULD EACH MAKE THE TAX SYSTEM FAIRER

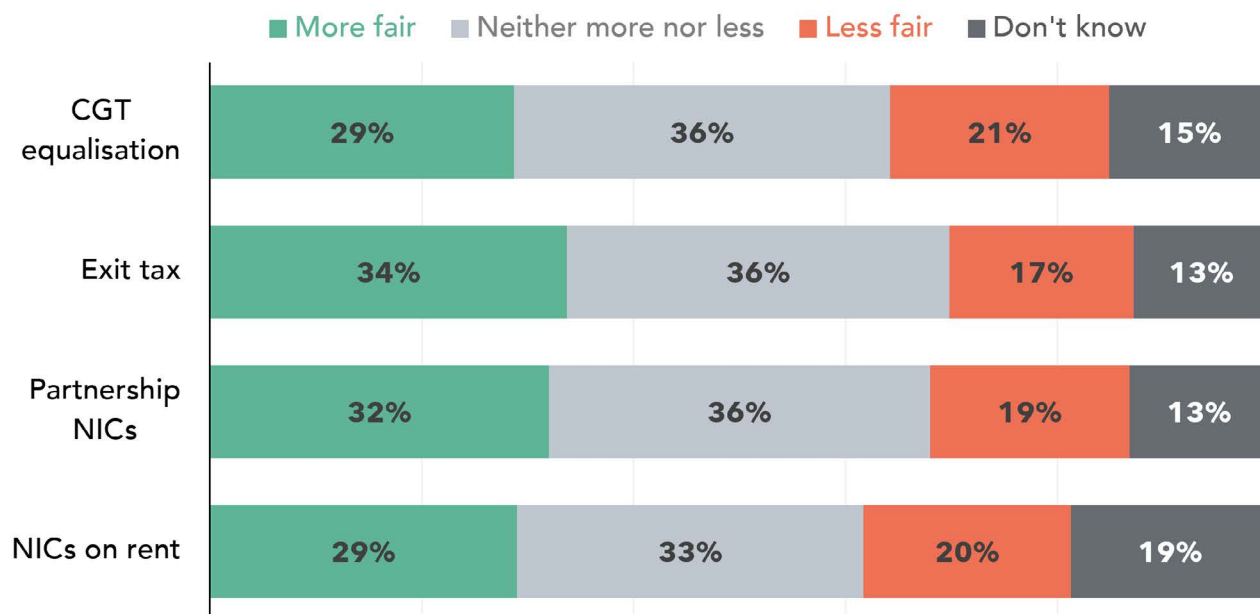
The tax system faces a crisis of legitimacy, with decades of inertia from chancellors concerned about the backlash to radical reforms.<sup>29</sup> The challenge is laid bare by the failure to reevaluate properties for council tax (which remains based on 1991 values) and the recent u-turns on inheritance tax. Rebuilding legitimacy in the tax system is critical if we are to unlock change. While all citizens are arbiters of legitimacy, it is important to understand the sense of legitimacy among citizens with particular stakes in the tax system, including investors.

The evidence suggests that the proposed reforms to CGT and NICs would help rebuild investors' sense of legitimacy in the tax system. For all the proposed reforms, the proportion of investors saying the reforms would make the tax system 'more fair' exceeds the 'less fair' percentage: by 8pp for CGT equalisation, 17pp for the exit tax, 13pp for Partnership NICs and 9pp for NICs on rent. Around half of respondents (between 49% and 52%) say the reforms would make no difference or don't know.

### CHART 8

Investors tend to think matching CGT to income tax with an 'investment allowance', an exit tax, NICs on rent, and Partnership NICs would make the tax system fairer

*Views on whether tax reforms would make the tax system more or less fair*



<sup>29</sup> Joe Martin and Dan Goss, Citizens Economy: a New Deal to power economic growth and rebuild trust between state and citizen, Demos, 26 June 2026, [https://demos.co.uk/wp-content/uploads/2026/06/New-Deal\\_Citizen-Economy\\_2026.pdf](https://demos.co.uk/wp-content/uploads/2026/06/New-Deal_Citizen-Economy_2026.pdf)

For all proposed reforms, net fairness does fall for investors with high investable assets:

- **CGT rates and investment allowance** - net fairness falls from +18pp for investors with under £25,000 of assets to +13pp for investors with over £250,000 of assets.
- **Exit tax** - from +20pp to +8pp
- **NICs on rent** - from +12pp to +3pp
- **Partnership NICs** - from +19pp to +10pp

Yet, across all the reforms, all asset groups are, on balance, more likely to say the reform would make the system fairer. It suggests the reforms would raise legitimacy in the fiscal contract among Britain's retail investors.

# ANNEX

## DESIGN OF SCALE-UP REINVESTMENT RELIEF

Scale-up reinvestment relief could play a key role in mitigating risks from CGT reform. By providing tax deferral or reduced rates for company founders who are selling their assets and intend to reinvest in high-growth firms, it targets a group with high-responsiveness to tax rates and the potential for high-productivity entrepreneurialism. It could address the 'cliff-edge' gap where these founders outgrow EIS support but are not yet large enough to absorb full CGT exposure on reinvestment.

Yet, a CGT relief targeting 'founders reinvesting in scale-ups' needs a definition robust enough to effectively target the investment intended, but to simultaneously prevent gaming. The relief would establish an incentive to develop or adapt a business to fit the definition of 'scale-up' or define investment as 'founding a business', which would make the relief less well targeted and create distortions in the market. The relief must be designed to minimise these risks, with robust definitions of (1) 'founding a business', and (2) 'scale-ups'.

To assess the impact of the relief, evaluate the design, and maintain the option to remove the relief if not delivering value-for-money, the government should ensure continued monitoring and evaluation, with a substantial review of the relief after a set number of years.

### DEFINING 'FOUNDING A BUSINESS'

To target capital with the potential for high productivity entrepreneurialism, the relief should not be open to passive investments. Instead, it should only be open to capital which is (1) realised from the disposal of a business that the owner founded, and (2) used to found a new business.

While UK tax law has no official definition of a 'founding a business', BADR provides a template for 'owner-managers' that can be adapted. BADR treats an individual as qualifying where they hold at least 5% of a company's ordinary share capital and voting rights, are entitled to at least 5% of its distributable profits and winding-up assets, and are an officer or employee of the company. Scale-up reinvestment relief should be restricted to individuals meeting this criteria. However, an individual who joins an established company, buys a 5% stake, and works there for two years would qualify equally.

To define capital that is used to ‘found a business’, scale-up reinvestment relief needs an additional criteria. The relief should only apply to capital which was used to buy shares in the company within, say, two years of its incorporation

## **DEFINING ‘SCALE-UPS’**

A reasonable starting point for defining scale-ups is the established OECD definition for a ‘high-growth enterprise’: over 10 employees and over 20% average annual growth in employment or turnover across a three year period.<sup>30</sup> Depending on the businesses that the government wanted to target, additional criteria could be added, such as a minimum amount of capital raised. The Tony Blair Institute, for example, suggests targeting Series B companies (which typically raise £10-50m).<sup>31,32</sup>

On its own, a test for scale-ups that simply looks at employment or turnover growth creates a series of risks or challenges. The table below sets out how to build on the OECD definition to address each of those risks.

30 Bank of England, Unlocking growth: what can the literature tell us about what’s holding back high-growth firms?, Bank Overground, 2025, using the OECD/ONS definition of high-growth firms as enterprises with average annualised growth in employees or turnover greater than 20% per annum over a three-year period, with more than 10 employees at the start, <https://www.bankofengland.co.uk/bank-overground/2025/unlocking-growth-what-can-the-literature-tell-us-about-whats-holding-back-high-growth-firms>

31 Mokander J et al. From Startup to Scaleup: Turning UK Innovation Into Prosperity and Power. Tony Blair Institute for Global Change. 9th June 2025. <https://institute.global/insights/tech-and-digitalisation/from-startup-to-scaleup-turning-uk-innovation-into-prosperity-and-power>

32 Sullivan K and Seaman J. Series B funding: guide for startup founders. Seed Legals. 20 December 2022. <https://seedlegals.com/resources/series-b-funding-guide/>

| RISK                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | PROPOSED SOLUTION                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
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| <p><b>1. Exclusion of certain high-productivity firms</b></p> <p>The OECD 'growth' test requires 20%+ average annual growth in employment or turnover over three years, with a floor of 10+ employees at the start of that window. This excludes two narrower categories of high-growth firms:</p> <ol style="list-style-type: none"> <li>1. Companies that are pre-revenue or early-revenue, where growth shows up in valuation rather than turnover.</li> <li>2. Companies that started the three-year window below the 10-employee floor, which includes many of the fastest-moving, most capital-light companies.</li> </ol> | <p>To address the challenge around excluding certain high-productivity firms, we propose an alternative qualifying test alongside the 'growth' test: the 'market validation' test.</p> <p>Businesses could qualify under the 'market validation' test if they are pre-revenue or early-revenue, or have under 10 employees. Rather than employment or turnover growth, those businesses would need to see, during a priced equity round from an institutional investor within the past 24 months, growth in their valuation by a certain percentage (e.g. 50%).</p> <p>The EIS already relies on similar principles, as its 'Knowledge Intensive Company' rules recognise that some high-potential companies cannot meet a standard revenue test, and gives them different thresholds.<sup>33</sup></p> <p>This 'market validation' test would need multiple safeguards:</p> <ul style="list-style-type: none"> <li>• The lead investor must not be connected to the founder or reinvesting individual - again drawing on precedent from the EIS, which includes criteria that investors are not connected to the company.</li> <li>• The equity round must exceed a minimum size relative to the company's existing capital base, so it cannot be a token investment.</li> <li>• At least two unconnected institutional investors must participate, rather than a single friendly cheque.</li> </ul> |

<sup>33</sup> HMRC, VCM16060 – EIS: income tax relief: general requirements: meaning of 'knowledge-intensive company', Venture Capital Schemes Manual, <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm16060>

| RISK                                                                                                                                                                                                                                                                                                                                                                                                                    | PROPOSED SOLUTION                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
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| <p><b>2. Ease of gaming growth in a single-year</b></p> <p>The fact that the 'growth test' examines a three-year average helps prevent businesses qualifying for the relief by boosting employment or turnover in a single year. However, it does not wholly fix the problem. A business could feasibly see 0% growth across two years and then artificially boost growth to 60% in a single year to meet the test.</p> | <p>HMRC should add an additional criteria to the 'growth test': a minimum level of growth in each individual year of the three-year period (e.g. 5%) so single-year gaming fails even where the overall average would pass. For companies under three years old, which cannot be tested against a three-year window at all, HMRC should defer the CGT liability on the reinvested gain until three years have elapsed, then assess retrospectively – confirming the relief if met, or clawing back the deferred liability with interest if not.</p> <p>The deferred-assessment mechanism for young companies mirrors an existing EIS mechanism directly: income tax relief is granted at the point of investment but is provisional for three years, and withdrawn later if the company ceases to meet qualifying conditions within that period.<sup>34</sup></p> |
| <p><b>3. Gaming of the employment criteria</b></p> <p>The employment-growth criteria in the 'growth test' could be gamed by insourcing previously outsourced or agency staff to inflate headcount, without any real change in economic activity.</p>                                                                                                                                                                    | <p>HMRC should look at whether the people actually doing the work have changed, not just the company's employment figures. UK employment law already has a precise test for exactly this scenario: under the Transfer of Undertakings (Protection of Employment) Regulations, bringing a previously outsourced activity in-house is a 'service provision change'.<sup>35</sup></p> <p>Firms qualifying for relief under the employment criteria should be required to state that their employment growth is not based on 'service provision changes' – i.e. people who were substantially performing the same role, for the same business, in the same way, in a period before joining the payroll. If evidence suggests that a firm states this inaccurately, HMRC should then investigate.</p>                                                                  |

<sup>34</sup> Khan N. EIS Tax Relief: Rates, How to Claim, and Investor Eligibility in 2026. Sleek. 10 August 2026. <https://sleek.com/uk/resources/eis-tax-relief-rates-how-to-claim/>

<sup>35</sup> Gately Legal. TUPE or not to TUPE: service provision changes. 23 November 2022. <https://gateleyplc.com/insight/article/tupe-or-not-to-tupe-service-provision-changes/>

| RISK                                                                                                                                                                                                                                                                                                         | PROPOSED SOLUTION                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>4. Spin-out and demerger restructuring</b></p> <p>Companies, or clusters of founders, could be incentivized to restructure - turning a fast-growing division into a shell company, or winding up and recreating a business - to appear as a newly-qualifying scale-up and benefit from the relief.</p> | <p>HMRC should deny relief where (1) there is substantial continuity from the original businesses to the business in which capital is being recycled – e.g. over 30% common ownership, a transfer of IP, or customer contracts – and (2) it is reasonable to conclude that accessing relief was a main purpose of the arrangement. Shared founders, employees, or sector similarity alone should not be sufficient for denial of the relief.</p> <p>Multiple precedents support this design. EIS limits relief for investors connected to the company, as determined by ownership of over 30% of share capital, voting power, etc.<sup>36</sup> HMRC’s Targeted Anti-Avoidance Rule (TAAR) targets transactions where “it is reasonable to assume that the main purpose, or one of the main purposes of the winding-up is the avoidance or reduction of a charge to Income Tax”.<sup>37</sup></p> |
| <p><b>5. Sectors where growth can be manufactured</b></p> <p>Businesses in property, financial trading, or asset leasing could show strong turnover growth through leverage or asset revaluation, rather than genuine productive scaling.</p>                                                                | <p>HMRC should mirror EIS’s exclusion of certain sectors which present the greatest risks of growth through leverage or asset revaluation than scale: property development, financial activities including banking, insurance, money-lending and hire-purchase financing, leasing of assets, dealing in land or financial instruments, and other excluded trades.<sup>38</sup></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <p><b>6. Relief captured via largely overseas operations</b></p> <p>A company could satisfy the growth test largely through overseas employment, while delivering little of the intended domestic economic benefit.</p>                                                                                      | <p>For the requirements around employment growth, HMRC should demand that a minimum share of employment growth sits within the UK for the company to qualify. This mirrors R&amp;D tax credit tests. Relief for contracted-out R&amp;D and outsourced workers is restricted to activity undertaken in the UK unless it would be ‘wholly unreasonable’ to replicate the necessary conditions – geographical, environmental, legal or regulatory – within the UK.<sup>39</sup></p>                                                                                                                                                                                                                                                                                                                                                                                                                  |

36 Income Tax Act 2007, s.170 (meaning of ‘connected’: shareholding, voting power, or winding-up entitlement of more than 30%); HMRC, VCM11080 – EIS: income tax relief: the investor: connection: persons interested in capital etc of company, Venture Capital Schemes Manual, <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm11080>

37 Income Tax (Trading and Other Income) Act 2005, s.396B (company winding up: targeted anti-avoidance rule); HMRC, CTM36305 – particular topics: company winding up TAAR: targeted anti-avoidance rule, Company Taxation Manual, <https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm36305>

38 HMRC, VCM3010 – excluded activities: meaning of ‘excluded activities’, Venture Capital Schemes Manual, <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm3010>

39 Corporation Tax Act 2009, s.1138A (restriction of relief for contracted-out research and development and externally provided workers where the activity is undertaken outside the UK, for accounting periods beginning on or after 1 April 2024); HMRC, Research and development tax reliefs: new contracting out rules and overseas restrictions – guidance, GOV.UK, <https://www.gov.uk/government/consultations/draft-guidance-research-and-development-rd-tax-reliefs-new-contracting-out-rules-and-overseas-restrictions/research-and-development-tax-reliefs-new-contracting-out-rules-and-overseas-restrictions-draft-guidance>

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