



Impact of hypothetical reforms to Capital Gains Tax

A Cebr report for Ryan Howsam
August 2025

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Introduction and executive summary

Cebr is pleased to present the following report to Ryan Howsam, assessing the potential fiscal impact of a hypothetical reform to Capital Gains Tax (CGT).

The treatment of CGT has come under increasing scrutiny as the UK Government seeks to address the tight fiscal position. In the 2024 Autumn Budget, the Chancellor of the Exchequer, Rachel Reeves MP, announced plans to increase the rates of CGT, starting with disposals, in the next fiscal year.

Relatedly, the UK's rate of productivity growth, knocked by the global financial crisis (GFC), remains sluggish, narrowing the fiscal space for successive governments. Aside from the fiscal picture, low productivity growth has resulted in stagnating living standards for many. Part of the blame for this poor performance has been identified as declining business dynamism in the UK economy.

In this report, we model the impact of potential reforms to the CGT regime, under the hypothesis that they would address both the productivity and dynamism problems. Our report is split into three sections. First, we describe the policy proposal in more detail, followed by an outline of the methodology for quantifying the impacts of the policy. Second, we estimate the static and net costs to the Treasury. Finally, we outline some further considerations surrounding this policy.

The main results from our report are:

- The main channels through which the policy could stimulate growth are increasing business creation and increasing productivity.
- Under the most optimistic scenario, a flat fee in exchange for a reduced rate of CGT would inject nearly £2 billion into the Treasury in the first year rising to £11 billion a year after five years. The net yield increases over time, reaching £47 billion and £99 billion in Year 15 and Year 25 post-implementation.
- Under a high business creation scenario, but with lower productivity growth, gains are slower to emerge, with an immediate gain of £500 million. Five years following implementation the annual net return increases to £3 billion, building steadily to £15 billion after 15 years and £37 billion annually by Year 25.
- Under our central case, a high productivity scenario, but with weaker improvements to business creation, the fiscal return is weaker still in the early years, bringing in just £250 million in the first year. This then increases moderately to under £2 billion after five years and £9 billion by Year 15, before reaching £24 billion annually after 25 years.
- Under the most pessimistic scenario, with weak gains in both business creation and productivity, the net yield is marginally negative for the first three years following implementation and reaches only £12 billion annually after 25 years.
- Assuming the effects on business creation and productivity both lie in the centre of their range, we forecast a net return of £640 million in year one of the scheme. Twenty-five years following implementation the annual net return increases to £43 billion.
- The static gain from this policy is negative starting at £300 million in the first year of the scheme, widening to £1.7 billion 25 years following implementation.
- Under reasonable assumptions, we estimate the expected gain at which individuals would opt into the scheme is slightly over £71,000.

“Our modelling tells us that the Treasury could potentially benefit from an immediate cash injection if these CGT reforms were implemented and could substantially benefit over the medium to long term as a result of higher business creation and productivity. Our median impact scenario suggests that the net gain of the proposed CGT reform would be around £640 million in the first year of the initiative, rising to nearly £4 billion after five years. Our research also suggests that the overall fiscal impact over the long term could be significant, depending on economic variables and different scenarios. In the scenario that we envisage being the central case – low business creation and high productivity impact – net tax gains climb to £2 billion by year 5 and accelerate thereafter, reaching £5 billion by year 10 and an annual net gain of £24 billion by year 25. In the event of high business creation and high productivity, the figure after 25 years rises to nearly £100 billion. Even in the most pessimistic scenario – low business creation and low productivity – the net gain hovers around zero for the first years but ultimately reaches £12 billion annually after 25 years. On the basis of our research, it seems an area worth exploring further from a policy perspective, as a potential lever to encourage more entrepreneurship and, potentially, greater sustained economic growth.” – **Sam Miley, Head of Forecasting and Thought Leadership**

Methodology

We begin this report with an overview of the hypothetical policy and its transmission mechanism to the fiscal position of the UK government.

The policy proposal in full

Cebr was approached by Ryan Howsam with a hypothetical policy to offer an alternative CGT arrangement, involving a flat fee system for business creators, paid up front, in exchange for a lower rate of CGT upon future disposal.

Under the scheme individuals who incorporate a business can pay a flat £5,000 fee in return for a discounted rate of CGT on the disposal of their business. Previously incorporated businesses can also opt into the scheme by paying £5,000. Once the flat fee is paid, the business disposal is subject to a CGT rate of 10%. Therefore, the policy acts a major tax cut for business owners and seeks to encourage business creation.

If this policy were indeed to be adopted, there would have to be strict controls on ensuring that the individuals paying the flat fee created or owned 'real' businesses. Otherwise, individuals would be able to avoid CGT on non-business assets by paying the fee and moving their assets to a shell corporation.

This scheme removes the upper limit on claiming Business Asset Disposal Relief (BADR). BADR is an existing scheme that reduces the rate of CGT paid on the disposal of business assets. Under the current scheme, this relief can be claimed on a maximum of £1 million. There is no such limit for those who opt into the newly proposed scheme.

The static costs

The first step of analysing the impacts of this potential scheme was to determine the costs under the assumption of no external change in behaviour.

We here focus on existing businesses that would opt in to the scheme. There are then three steps to determining the static cost. First, to project the number of business creations and disposals that would happen in the baseline scenario. Second, to project the mean gain of UK businesses and subsequent CGT liability. Finally, to determine the share of existing businesses that would opt in to the scheme.

The number of business creations and disposals were projected based on the working age population forecasts for the UK produced by the Office for National Statistics. This provides the base for calculating the taxable gains on business assets over the future time horizon. To estimate these gains, we calculated the mean gain for business asset disposals over the past four tax years for which there are data. These were then grown in line nominal GDP projections over the future time horizon.

To determine the share of existing businesses that would opt into the scheme and would therefore pay the lower rate of CGT on their disposals, we derive a basic decision rule. This decision rule states that an individual will opt into the scheme if the liability in the scheme is lower than the liability under the current CGT regime, subject to discounting over time. The problem can be defined as follows:

Equation 1 – Decision rule for opting into the scheme

$$£5,000 + (0.1 \times E(\text{Gain}))\beta^t < (\tau \times E(\text{Gain}))\beta^t$$

Here, £5,000 represents the flat fee, 0.1 represents the 10% discounted rate of CGT for those opting in. Gain is the taxable gain, τ , is the tax rate in the period of the disposal in the event of not opting in, which we assume is equal to the current tax rate, β is the discount rate, and t is the number of years until the disposal.

The equation rearranges to:

$$\frac{5,000}{(\tau - 0.1)\beta^t} < E(\text{Gain})$$

For each individual business the exact cutoff will be different, based on their personal discount rate, β , and lifetime of the business, t .

As an example, in 2024, the average age of the business disposed of was slightly over 13 years. Assuming $\beta = 0.99$, and the individual intends to claim Business Asset Disposal Relief (BADR) the cutoff for the expected gain is £71,188. An individual who expects their gain to be above this threshold will opt into the scheme and pay the £5,000 upfront for a reduced liability on disposal.

In our modelling, we use the discount rate the UK government sets for economic impact assessments.

From here we establish the expected gain needed for an individual who owns an existing business, or that would otherwise exist in the future, in order to opt into the scheme. Since, the £5,000 is fixed in nominal terms, under positive inflation the real value of the fee is decreasing over time. This, in turn, decreases the cutoff point for the expected gain and therefore the share of businesses opting into the scheme would, in theory, increase and tend towards 100%. We judge this to not be a plausible policy lever and so it is assumed that the £5,000 threshold is uprated over time, in line with inflation and other relevant macroeconomic indicators.

The net costs

The final step was to adjust for behavioural responses to this policy change. The underlying thrust of this policy was to boost business creation and dynamism in the UK. By reducing the taxation on returns to entrepreneurship, it encourages more individuals to start businesses. We therefore focus on the transmission of this policy through business creation. Specifically, drawing on wider academic literature and economic theory we identify the effect on labour productivity and, therefore, output.

The importance of competition and business creation to economic growth was formally theorised by Joseph Schumpeter in the early 20th century. His concept of ‘creative destruction’ identifies the source of growth in market economies as the displacement of incumbents by newer, more innovative firms. These firms capture the returns to innovation, replacing the previous incumbents until they are eventually replaced themselves. This threat and existence of new businesses entering forces firms to continue seeking efficiencies and innovations. Empirically, the transmission mechanism is well-founded with a host of studies finding a positive association between levels of competition and labour productivity.

Since, the CGT tax cut is targeted toward boosting entrepreneurship we present the costs for four scenarios. The matrix below summaries these:

Table 1 – Matrix of four modelled scenarios

	Effect of scheme on business creation	
Effect of business creation on labour productivity	High, High	High, Low
	Low, High	Low, Low

These scenarios are not predictions, but stylised paths designed to show a possible range of outcomes this policy may generate.

Specifically, in the low business creation rate we assume the business entry rate increases by 0.1 percentage points and remains at this rate over the full projection horizon. In the high business creation rate scenario, it increases by 0.5 percentage points. The increase in the level of labour productivity per percentage point increase in business creation rate is 0.2% for the low productivity scenario and 0.6% in the high productivity scenario. These values were selected based on our estimate of the effective tax cut under the policy, in combination with a review of other literature showing the extent to which tax changes impact investment, business creation, and productivity.^{1,2}

Combining these together, generates the aggregate long-run increase in the level of productivity in each of the four scenarios. These are presented below:

Table 2 – Long-run increase in the level of labour productivity for four modelled scenarios

	High business creation	Low business creation
High productivity	3.0%	0.6%
Low productivity	1.0%	0.2%

Median impact scenario

The final scenario modelled takes the median impact on both business creation and then productivity. The business creation rate increases by 0.3 percentage points and the increase in the level of labour productivity per percentage point increase in business creation rate is

1 Djankov et al. (2010) – The Effect of Corporate Taxes on Investment and Entrepreneurship,

2 Cincera and Galgau (2005) - Impact of market entry and exit on EU productivity and growth performance

0.4%. Together this produces a long run increase in the level of labour productivity of 1.2%. It should be noted as this takes the median impact for both business creation and productivity it does not necessarily represent the median path for the net return. This scenario is more representative of a central scenario where the impacts lie in the middle of our range. As with the rest of the report we do not associate a likelihood for this scenario coming to fruition.

The central scenario

Finally, we deem the central, or base, case to combine low business creation with high productivity. Identifying which of the scenarios is the most likely to occur is difficult owing to the uncertainty of the behavioural response. However, Cebr's view is the effect on business creation is likely to be relatively small.

This policy does promise those who start successful businesses lower taxes, there are many other factors which affect the decision to start a business, nor does it reduce the risks involved in starting a business. Most new businesses fail within a few years of being founded. This policy does nothing to reduce the risks, costs and barriers associated with starting a new business. There is then the wider regulatory environment, which results in smaller firms facing substantial costs. Small exporters, especially, face additional costs post-Brexit, despite recent negotiations. The wider macroeconomic environment, with interest rates still elevated and trend growth extremely weak is also unamenable to business creation. Therefore, whilst this policy may encourage a pickup in business creation the effect will, likely, be muted.

Impacts of reform

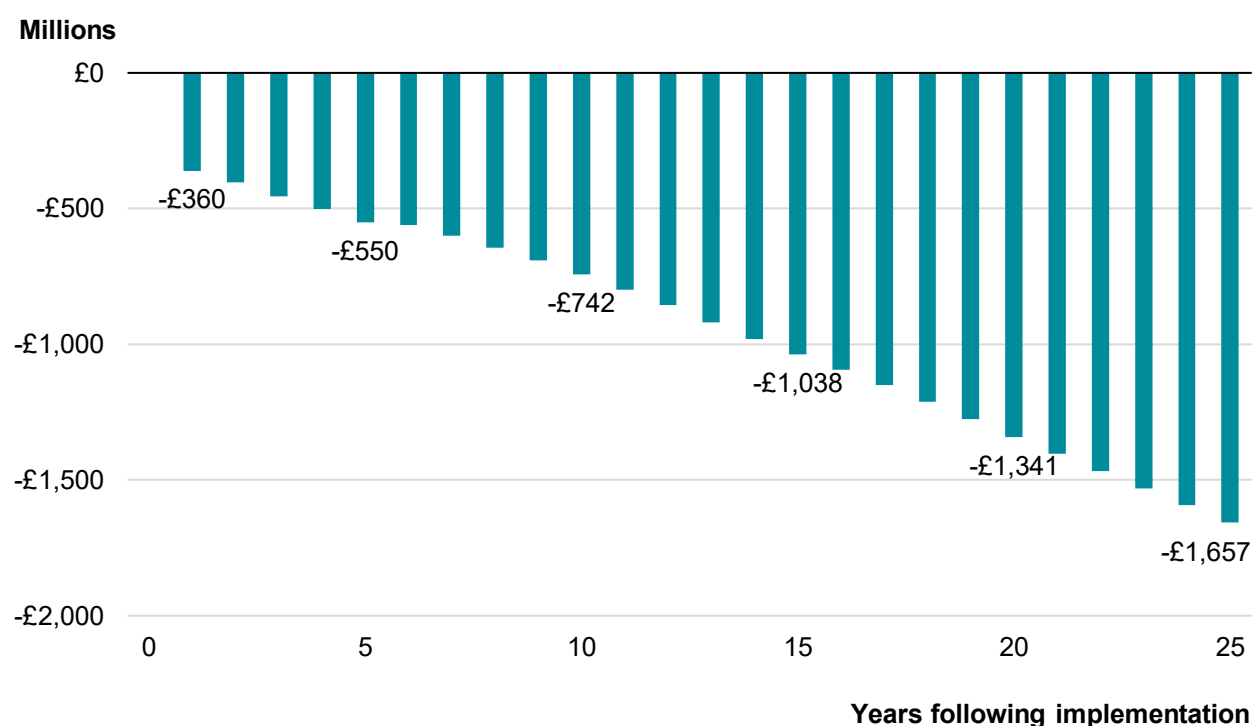
This section of the report considers the gains that the Treasury could make based on the changes to the taxation of business gains.

Static costings

The policy's static cost is negative starting in the first year and grows over time. The reasons for this are the growth in the expected business population, naturally increasing the number of disposals and businesses, combined with growth in the nominal average gain over the next twenty-five years. These two effects combine to increase the aggregate taxable gains substantially, which results in larger forgone revenue from existing businesses or future businesses, who would still have otherwise existed absent the policy change, who opt into the scheme.

In the first year of the scheme, we estimate the static cost totals £360 million. After ten years the loss doubles to £742 million before rising to £1.7 billion in the 25th year following implementation.

Figure 1 – Static cost of proposed CGT reform, 25 years following implementation, nominal terms



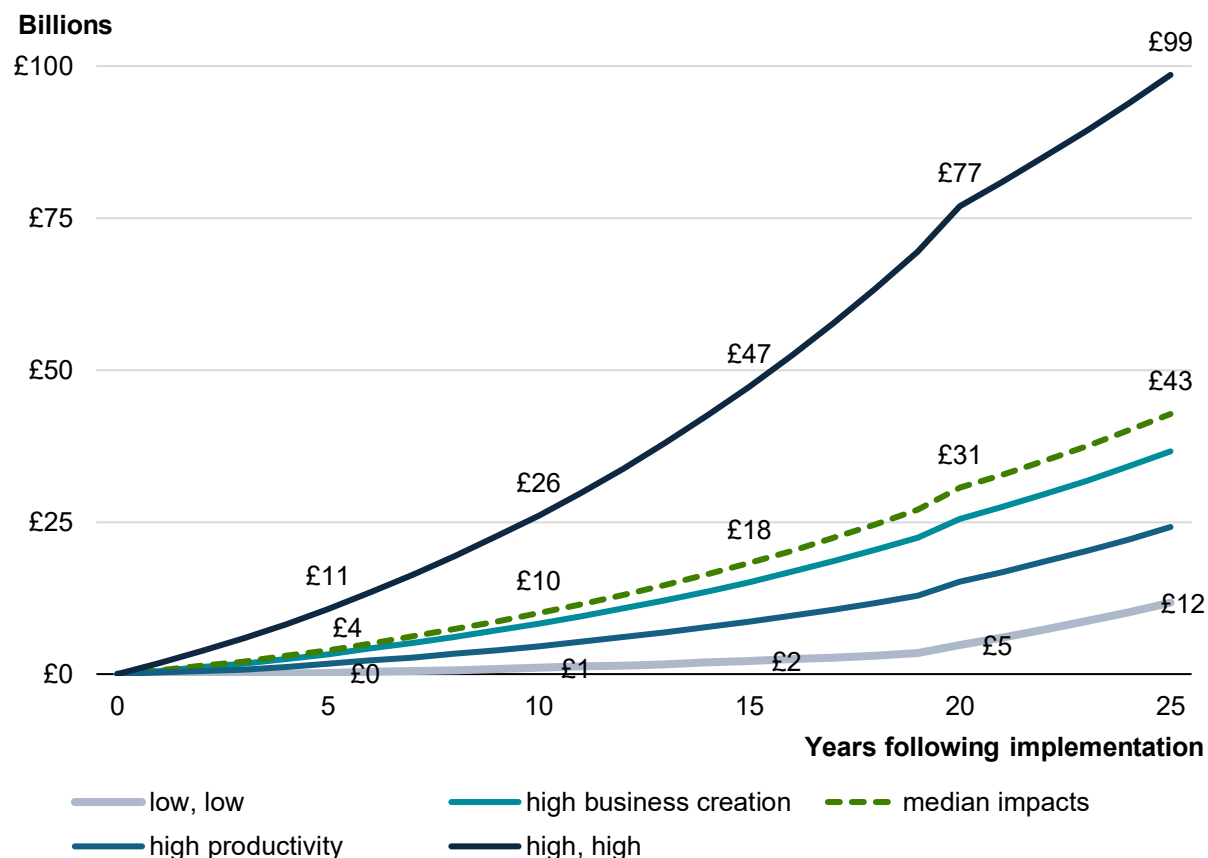
Net costings

The net costings take into account the effect of this policy on business creation and subsequently the level of labour productivity in the economy as a whole. As outlined in Table 1 above, we identify four scenarios, each of which affects the net costings differently.

Low business creation, low productivity

In the pessimistic scenario with a small increase in business entry rates and a small impact on labour productivity, the net gain hovers around zero for the first five years of the policy. After this point, the net gain does pick up marginally, reaching £12 billion annually after 25 years. Given the nominal size of the economy and government spending is expected to more than double by then, this represents a marginal yield to the Treasury.

Figure 2 – Net gain of proposed CGT reform, 25 years following implementation, nominal terms



Low business creation, high productivity

Under a scenario where productivity improves strongly but business entry rates remain relatively weak, the policy produces a more modest but consistent uplift. Gains climb to £2 billion by Year 5 and accelerate thereafter, reaching £5 billion by Year 10 and £9 billion by Year 15. By Year 25, the annual net gain reaches £24 billion. The outcome highlights that while productivity is a critical driver of long-term fiscal gains, without a parallel surge in business creation the potential remains underexploited.

High business creation, low productivity

In the scenario where business entry rates increase significantly but productivity improvements remain modest, the policy delivers steadily rising gains. After a slow start, with a net gain of just £3 billion after five years, the trajectory becomes more pronounced, reaching £15 billion by Year 15. By Year 25, annual net gains rise to £37 billion. While this

represents a substantial fiscal return compared to the low-growth case, the absence of a strong productivity boost tempers the overall impact.

High business creation, high productivity

In the most optimistic case, where both business creation and productivity growth respond strongly, the reform yields transformative fiscal gains. Net gains rise quickly to £11 billion after just 5 years, reach £47 billion by Year 15, and climb sharply thereafter. By Year 25, the annual net return reaches £99 billion, a scale that would materially alter the fiscal landscape. This scenario underscores the outsized role that dynamic entrepreneurship combined with higher productivity can play in delivering sustained fiscal dividends but gains of this size would require significant improvements across two specific impact channels.

Median impact scenario

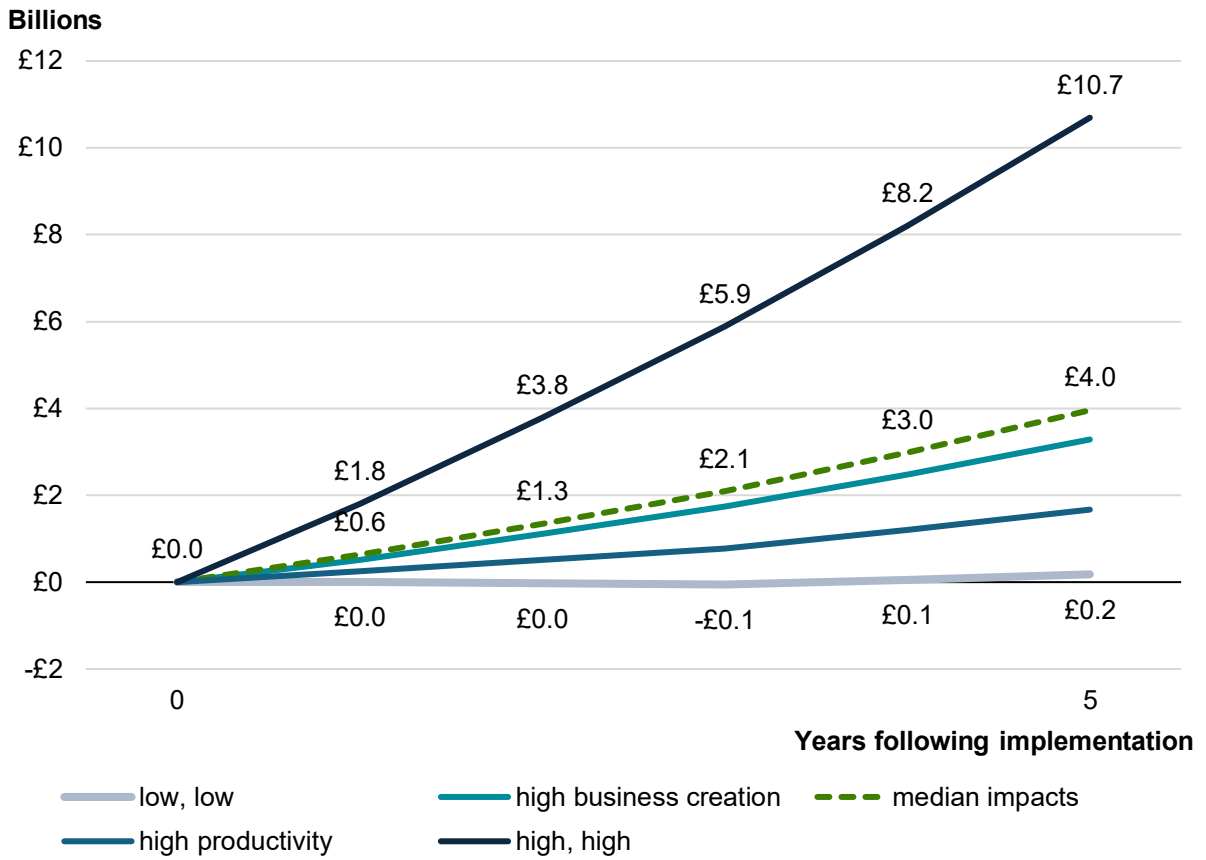
In the median impact scenario, the net return accelerates at a moderate pace. By the fifth year of implementation, the net return reaches £4 billion a year topping £43 billion after 25 years. As stated earlier, the median impact scenario does not necessarily generate the median net return. Business creation is the dominant impact channel, explaining most of the variation between scenarios. Consequently, the median impact scenario delivers a higher net return than either of the low business creation scenarios. It also delivers a slightly higher net return than the high business creation, low productivity scenario pointing to the role of the productivity channel.

Full costings, first five years of implementation

Table 3 – Net gain of proposed CGT reform, first 5 years following implementation, nominal terms

	Low, low	High business creation, low productivity	Median impacts	Low business creation, high productivity	High, high
Year 1	-£1,710,032	£511,355,509	£640,536,692	£256,652,334	£1,795,848,957
Year 2	-£27,508,321	£1,112,522,113	£1,345,969,749	£510,674,345	£3,788,190,860
Year 3	-£54,922,605	£1,741,458,587	£2,085,853,720	£777,397,268	£5,879,481,630
Year 4	£53,169,631	£2,480,644,315	£2,983,390,317	£1,202,919,838	£8,196,827,484
Year 5	£179,900,097	£3,284,300,126	£3,957,058,925	£1,670,241,885	£10,693,793,591

Figure 3 – Net gain of proposed CGT reform, 5 years following implementation, nominal terms



Further considerations

The case for the policy not only depends on the fiscal costs and wider economic impacts of the policy but further issues, some of which are discussed here.

Tax avoidance

One of the main considerations a policy such as this would face is ensuring that it does indeed encourage new legitimate business ventures. If designed poorly, it is foreseeable that many individuals with significant gains may try to lower their CGT liability by transferring their assets to a newly incorporated business. If this were the case, the net gains to the Treasury would be reduced. The effects on productivity would be more muted, while the forgone revenue would be larger. To avoid this, restrictions may need to be placed on how soon the gains can be realised or the transferring of assets to businesses.

Wider business environment

The above hints at another consideration: the uncertainty of the behavioural response to the policy change. The costings presented above are based on the assumption that lower CGT rates on businesses will encourage business creation, as entrepreneurs are able to retain more of the returns to their risk taking and labour. Furthermore, there is the paradox of creative destruction, where if competition erodes the position of incumbents, then there is no incentive to innovate today, as those gains will diminish quickly. As a result, there is an incentive for incumbent firms to erect barriers to entry to extract rents, as opposed to increasing productivity.

There are also wider factors driving business creation other than compensation. A poorly designed regulatory environment can be more burdensome for smaller businesses, deterring start-ups. Another important consideration is access to finance, ensuring new businesses have access to capital in order expand will play a major role in the decision to create new businesses. The impact of this policy on business creation rates will be mediated by these other variables.

Distributional considerations

This study does not model the distributional aspects of the policy. However, a government implementing such a scheme would have to consider these impacts. It is likely this policy would have a regressive impact on the UK's income and wealth distribution, at least in the short run, as the individuals who pay CGT tend to be wealthier than average. The individuals with the largest gains pay an outsized share of CGT receipts hence, if their liability is cut, it is this group that stands to benefit. Over the longer term, these effects may be tempered by the gains to productivity, which should enable average workers to increase their real wage.

Ultimately, acknowledging these considerations is important to presenting a comprehensive assessment of the proposed policy, one that is wider in scope than the study presented here. The dynamics of the policy change would also depend significantly on prevailing economic and policy circumstances, which themselves change over time.

