Institute for Fiscal Studies

The characteristics and incomes of the top 1%

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Executive summary

Key findings

To be in the top 1% of income tax payers in the UK (i.e. to be among the 310,000 individuals with the highest income), a taxable income of at least £160,000 is required. £236,000 is required to be in the top 0.5% and nearly £650,000 to be in the top 0.1%. 43% of adults pay no income tax and to be in the top 1% of all adults (or the top 540,000 people), a pre-tax income of at least £120,000 is required.

The top 1% of income tax payers are disproportionately male, middle-aged and London-based. A man aged 45–54 in London could be in the top 1% nationally while still needing a further £550,000 to be in the top 1% for his gender, age and region.

These patterns become more pronounced at even higher income levels. Almost half of the top 0.1% of income tax payers are based in London, over 40% are aged 45–54 and only 11% are women.

The top 1% of income tax payers have become more geographically concentrated since the turn of the century. The 65 (out of 650) parliamentary constituencies with the highest density of people in the top 1% now contain half of all of the top 1%. This is up from 78 constituencies in 2000–01.

Partnership and dividend income account for over a quarter of the total income of the top 1%, and over a third of the total income of the top 0.1%, a much higher share than for those with lower incomes. Partnership and dividend income are taxed at lower rates than normal salaries – a policy choice to tax the incomes of business owners at lower rates than employees, which therefore benefits a significant share of the top 1%.

The top 1% of income tax payers are not a stable group – a quarter of those in the top 1% in one year will not be there the next. After five years, only half will still be in the top 1%.

As a result, someone has a much higher chance of being in the top 1% at some point in their lives than they do in any given year. 3.4% of all people (and 5.5% of men) born in 1963 were in the top 1% of income tax payers at some point between 2000–01 and 2015–16.

Introduction

The richest members of our society get a lot of attention. Much of the public conversation about economic inequality is concerned with, loosely, the top 1%, how different they are from the rest, how they got to where they are, and what – if anything – policy should do about it. It is also a fact that this group is extremely important for the funding of our public services and welfare system, because it pays a large portion of our tax revenues.

Figure 1. Share of national income accounted for, by top 1% of adults
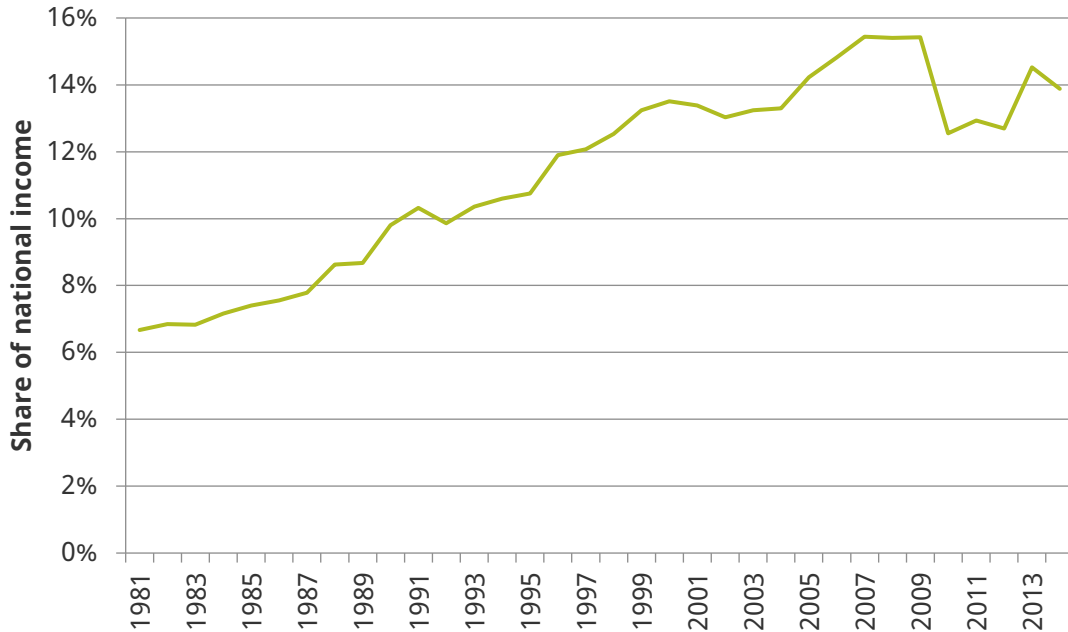
Note: From 1981 to 1989, the top 1% share refers to the share accounted for by tax units (where spouses' incomes are jointly assessed). From 1990, the top1% share refers to the top 1% of adults.

Source: World Inequality Database (https://wid.world/country/united-kingdom/).

The highest-income 1% of adults receive around 14% of national income (Figure 1). This share increased significantly in the 1980s as overall inequality increased, but the group pulled further away from the rest throughout the 1990s and most of the 2000s (until the financial crisis), even though income inequality across most of the population was actually stable or falling over that period.[1]

But the picture we have of this group is often rather patchy or anecdotal. In part, this is because the types of household surveys on which we typically rely for data on economic inequality, while providing broadly representative samples of most population groups, are known to be unreliable when it comes to capturing data on the very richest. In this briefing note, we use data from HMRC's income tax records to document some key facts about the highest-income people in the country.

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[1] For the latest analysis of trends in income inequality more generally, see J. Cribb, A. Norris Keiller and T. Waters, 'Living standards, poverty and inequality in the UK: 2018', IFS Report, June 2018, https://www.ifs.org.uk/publications/13075.

We use a sample of all income tax records – the Survey of Personal Incomes (SPI) – to examine what it means to be in the very highest-income group, and how this varies over time, across different areas, and for different types of people. Then, using self-assessment records that cover almost all taxpayers in the highest-income group, we look at their characteristics, where their income comes from and how the composition of the group has changed over time.

The use of income tax records for our analysis has a few important implications.

First, it means we focus on incomes that are subject to income tax. This will include most sources of income, including that from employment, pensions, unincorporated (self-employed) businesses and dividends; however, some types of remuneration and income will be missing. One issue is under-reporting – some people will be evading tax and we will therefore underestimate their income when looking at tax records that capture only the income they declare. Also, we do not include capital gains, which are taxed on a different basis, or sources of income that are not subject to income tax, such as means-tested benefits and tax-exempt investments. The data will also not include remuneration through employer pension contributions or income that is 'retained' in companies – two ways in which income received, and therefore tax paid, will be deferred to a later year.[2]

Second, the use of income tax data means that we can look at the distribution of income tax payers, rather than all adults, as in Figure 1. In 2014–15, 31 million of the 54 million adults in the UK paid income tax. From this point on, we focus on the top 1% of income tax payers (i.e. the income tax payers with the highest incomes subject to income tax), rather than the highest-income 1% of adults. For the remainder of this note, for brevity **we will refer to those with the highest amount of income subject to income tax as the highest-income people in society, and we will focus on the top 1% of income tax payers based on this measure (for whom we will use the shorthand 'the top 1%').**

The use of income tax records also means that we are focusing on those with the highest incomes, not the highest wealth – and although these are often the same people, the overlap is far from perfect. Also, we focus on individual incomes (as this is what is relevant for income tax), rather than household incomes. These broader measurement issues when it comes to 'the rich' have been discussed further in previous IFS work.[3]

Notwithstanding these challenges, however, the data we use here provide several important advantages, outlined in Box 1, that allow us to learn more about this group than has previously been possible.

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[2] In the case of pensions, the data will not capture contributions made by employers, but will capture that income when it is received by the person in retirement. In the case of retained earnings, much of which is likely to be received as capital gains, this will not be recorded as income in the year it is earned at the company level or the year that it is received at the personal level

[3] P. Johnson, R. Joyce and B. Roantree, 'If politicians talk about the rich, always ask who they mean', IFS Observation, May 2017, https://www.ifs.org.uk/publications/9193.

Box 1. Content and advantages of administrative self-assessment income tax data

In this briefing note, we use the universe of self-assessment income tax records, provided by HMRC, from 2000–01 to 2015–16. Between eight and eleven million people submit a self-assessment income tax return each year (most UK adults are not required to). However, all people with income above £100,000 are required to fill in a self-assessment tax return (as well as all people with self-employment income, all company directors, and those with more complex tax affairs). Because the income cut-off to be in the top 1% of income tax payers is over £100,000 in all years we consider, these data contain information on all people in the top 1%.

The self-assessment data allow us to learn more about those in society with the highest incomes than has previously been possible. Previous analysis of high-income people has generally relied on the SPI, which is itself a sample derived from tax records.[4] We use the SPI in our analysis here when we require a sample of all income tax payers. The information in the self-assessment data is also similar in many ways to the information provided in the SPI: in both sources, we observe a person's age, gender and location (albeit at a more granular level in the self-assessment data). However, the SPI has several limitations when it comes to understanding high-income people in more detail.

First, there is the simple matter of sample size. The top 1% of income tax payers are a group of only around 300,000 people, and even though the SPI oversamples those with the highest incomes, there are only 28,000 records of people in the top 1% in 2015–16. This becomes restrictive when looking at subgroups, such as those at even higher income levels (e.g. the top 0.1% of income tax payers). Furthermore, for reasons of confidentiality, HMRC creates 'composite records' for those with the very highest incomes (generally over £1 million), averaging income sources across a group of people. In contrast, the self-assessment data include almost all high-income people in every year.

The SPI also provides only relatively broad categories of income source (e.g. 'self-employment income' is combined income from self-employment and partnerships, while 'investment income' covers both dividend and savings income). The breakdown provided in the self-assessment data is more granular, and allows us to pull out important differences between income sources that are indistinguishable in the SPI.

A third benefit of the self-assessment data relative to the SPI is that we are able to follow the same people over time, while the SPI uses different people's tax records each year. The self-assessment data thus allow us to examine the persistence of high incomes at the individual level, and to look at how different a person's chance of being in the top 1% in any given year is from their chance of being in the top 1% *at some point*.

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[4] See, for example, M. Brewer, L. Sibieta and L. Wren-Lewis, 'Racing away? Income inequality and the evolution of high incomes', IFS Briefing Note 76, January 2008, https://www.ifs.org.uk/publications/4108, and M. Brewer and C. Samano-Robles, 'Top incomes in the UK: analysis of the 2015–16 Survey of Personal Incomes', Working Paper, forthcoming.

Figure 2 sets out some basic statistics about the distribution of taxable incomes, and of income tax paid. The highest-income 1% of income tax payers have about 12% of the taxable income (for income tax purposes) and pay 27% of all income tax. Income tax is more top-heavy than the two other biggest revenue-raisers, National Insurance Contributions (NICs) and VAT, although less top heavy than some other (smaller) taxes, notably Stamp Duty Land Tax and Inheritance Tax.[5] Overall, this small group undoubtedly pays a significant share of all of our taxes.

Figure 2. Shares of total income and total income tax paid, 2016–17
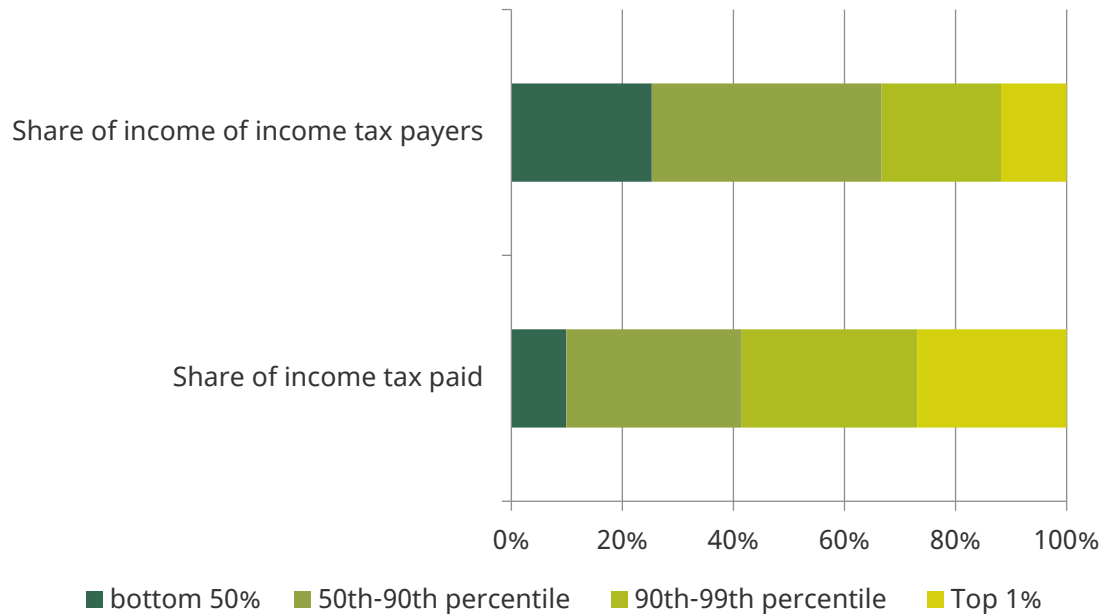
What puts a person in the top 1%?

There were 54 million adults in the UK in 2014–15, and 31 million of those paid income tax. The fact that around 43% of UK adults do not have an income high enough to pay income tax – a fraction that has become considerably larger in recent years as the personal allowance has been raised – is important here. Many statistics on the highest-income people come from income tax records. The top 1% of income tax payers are a group of around 310,000 people, and to be in that group you need a personal taxable income of at least around £160,000. But the top 1% of all adults in the UK are a group of 540,000 people, and to be in that group you need "only" £120,000 per year (Figure 3). Because of the data we use here, we focus on the top 1% of income tax payers.

Figure 3 highlights just how different the top 1% are from even the merely quite well-off. Taking all income tax payers in the UK in 2014–15, the median income tax payer has a

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[5] See H. Miller and B. Roantree, 'Tax revenues: where does the money come from and what are the next government's challenges?', IFS Briefing Note 198, May 2017, https://www.ifs.org.uk/publications/9178.

Figure 3. Median, 90th percentile and 99th percentile in the adult and income tax payer populations, 2014–15
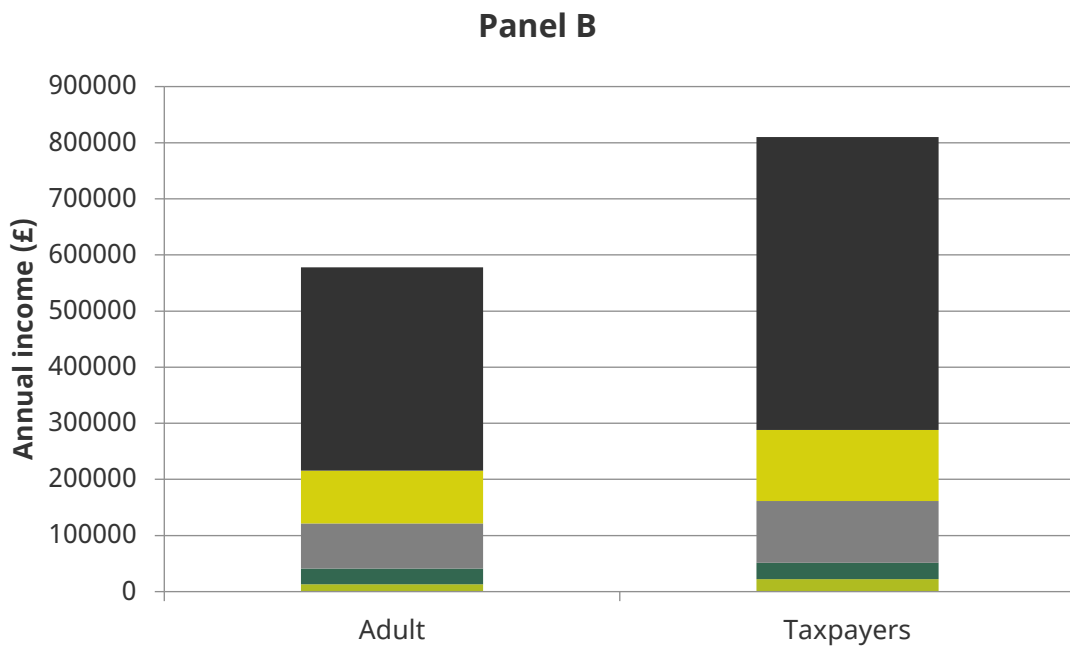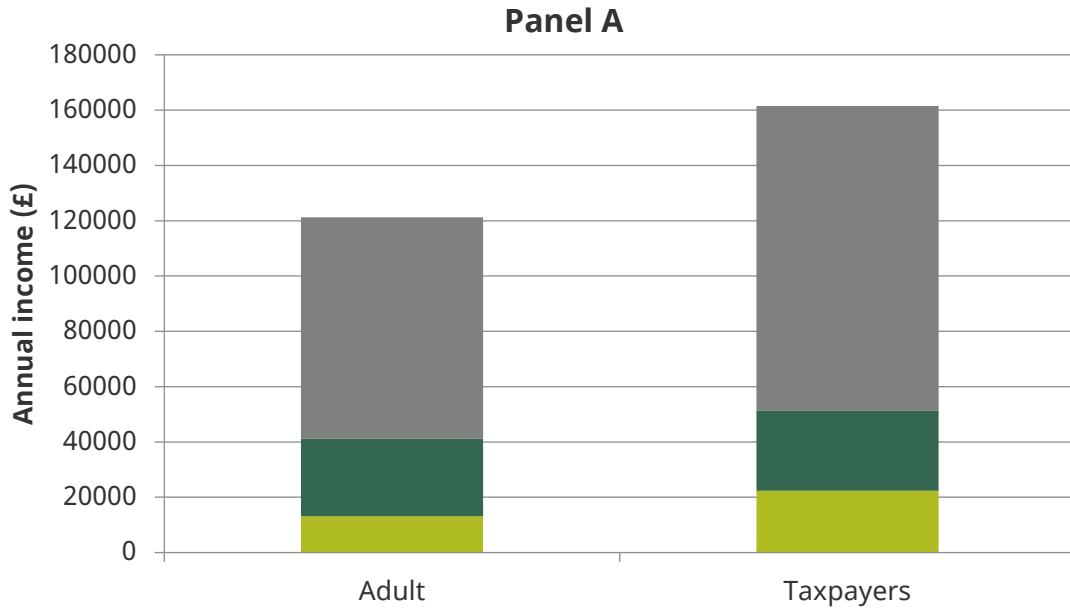
Note: Panel A shows only the median, 90th percentile and 99th percentile. Panel B shows the median, 90th, 99th, 99.5th and 99.9th percentiles. The term 'taxpayers' refers to income tax payers.

Source: SPI and Office for National Statistics (ONS) population statistics.

personal taxable income of about £22,000 per year.[6] If we move up to the 90th percentile, we find a taxable income £29,000 higher at £51,000 per year. But, at the 99th percentile, we find a taxable income of £162,000 per year. If you are at the 90th percentile, you may well feel more like the person at the median (21.6 million adults below you in the distribution) than the person at the 99th percentile (just 4.9 million people above you).

Looking within the top 1%, the disparities become increasingly dramatic, as highlighted by Panel B of Figure 3. Taxable income at the 99.5th percentile of income tax payers is £236,625, and at the 99.9th percentile it is £648,205. The difference in income between the median and the 90th percentile is barely even discernible when set against the differences within the top 1%.

The income level required to be at the top of our income distribution has changed over time (Figure 4). These income levels increased substantially during the 2000s – especially at the very top of the distribution. They fell back during the financial crisis – again especially at the very top of the distribution. In 2015–16, the income levels required were still lower in inflation-adjusted terms than before the financial crisis, although caution is

Figure 4. Top income percentiles over time
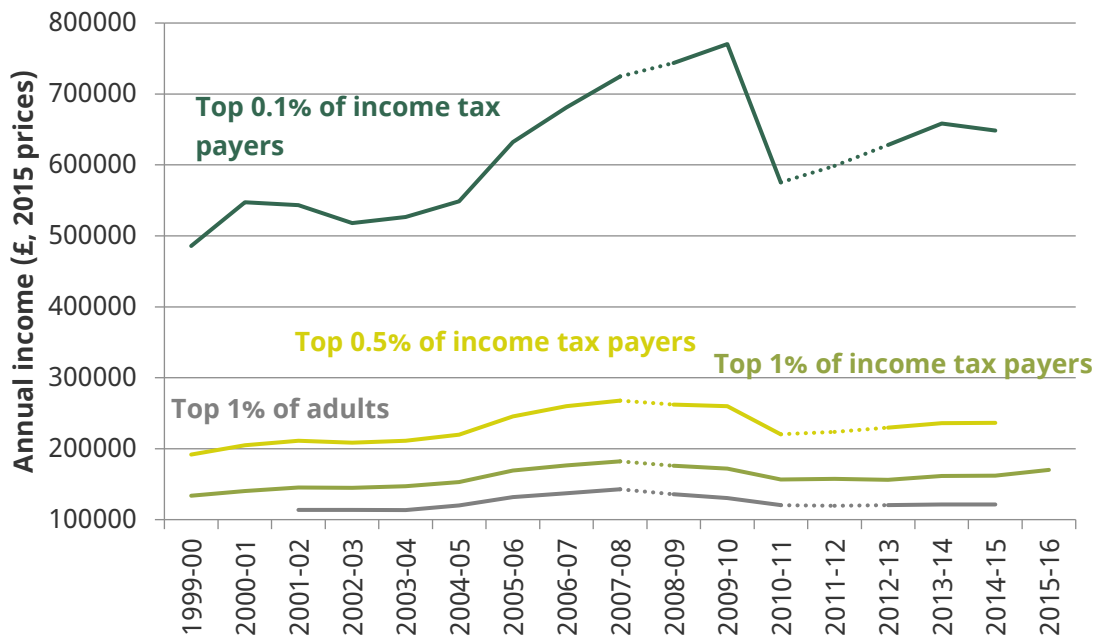
Note: The 2008–09 data points are interpolated because data are not available. For all series apart from the top 1% of income tax payers, the data for 2011–12 and 2012–13 are interpolated due to lack of data availability. Deflated to 2015–16 prices using the consumer prices index.

Source: SPI and ONS population statistics.

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[6] For most statistics in this briefing note, we focus on 2014–15 because statistics for 2015–16 (the most recent year of data) are affected by substantial forestalling of dividends due to a pre-announced tax increase that took effect in April 2016 (see more details below). Therefore, 2014–15 is the most recent year of data we have that is not affected by temporary responses to tax changes, and thus might represent a 'typical' year for the top 1%.

required when interpreting this decline as an underlying trend, given that tax reforms (to the top income tax rate and to the treatment of dividends) have affected the behaviour of high-income people over this period (more details below).

Where you fit into the distribution nationally may be a poor proxy for how you compare to your peers. For example, as Figure 5 shows, top incomes in some parts of the country are very different from top incomes in other parts, though regional price differences (in particular in the cost of housing) means that differences in the standard of living of the

Figure 5. Top 1% cut-offs among men and women by age (top two panels) and region (lower panel), 2014–15
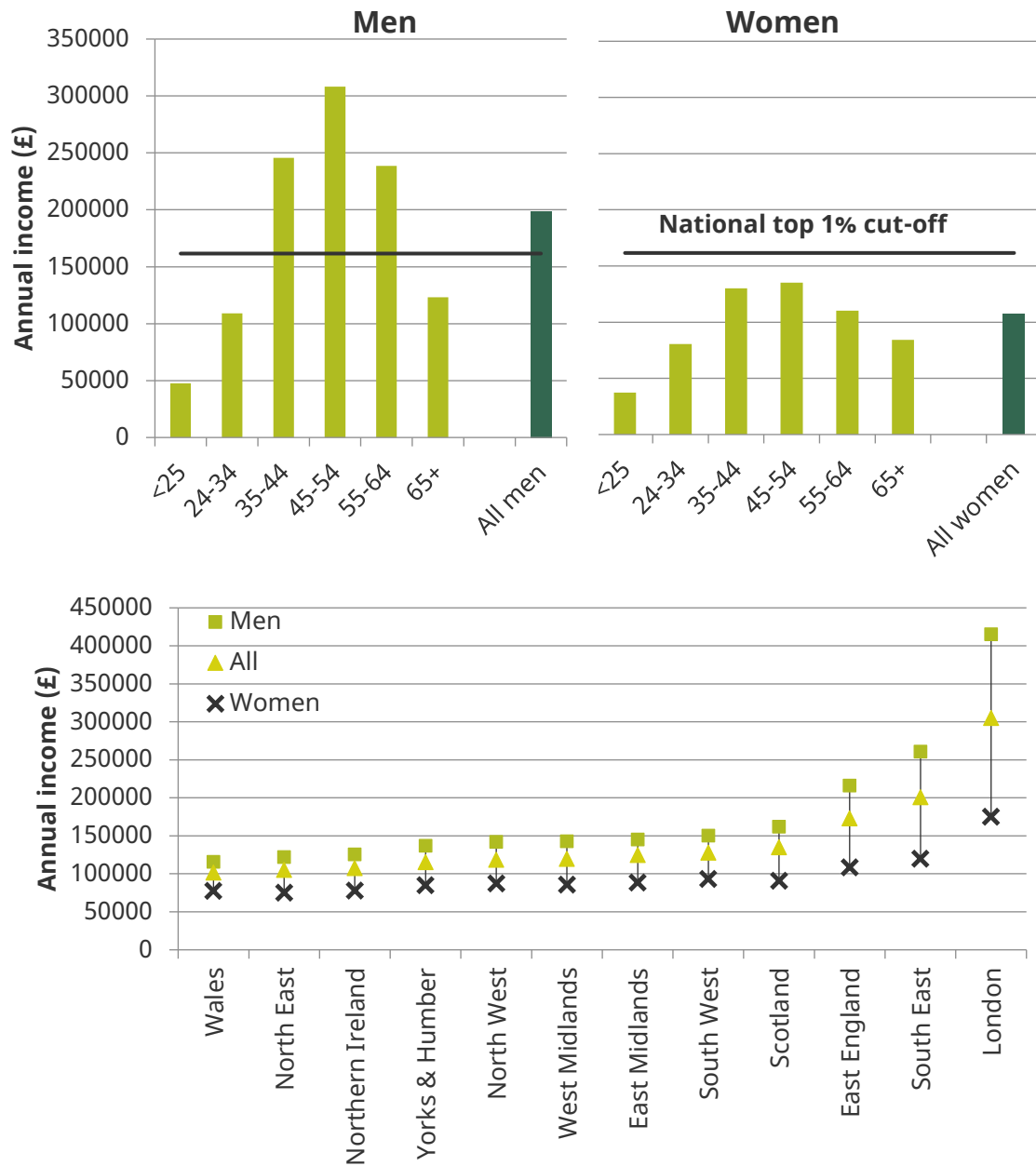
Note: The black line in the top two panels refers to the overall top 1% income tax payer cut-off.

Source: SPI.

most well-off will not differ by quite as much across regions as this analysis implies. You are also far more likely to be in the top 1% if you are in late working-age life or if you are a man. At the most extreme, if you are a man aged 45–54 in London with an income of £162,000 per year, then you are in the top 1% nationally but you would need a staggering *additional* £560,000 (so nearly three-quarters of a million pounds in total) per year in order to be in the top 1% of your gender, age and region. In fact, within that group, you would not even make the top 5%.[7] Conversely, everyone in the top 1% of men aged 45–54 in London is in the top 0.1% nationally.

Who are the top 1% of income tax payers?

We now focus specifically on the national top 1%, using self-assessment income tax data covering almost all people on the highest incomes. These data provide more detail on who these people are, where they live and how they receive their income.

As implied by the analysis above, the top 1% of income tax payers are comprised disproportionately of certain groups. Only 17% of the top 1% are women – so men are more than four times as likely as women to be among those with very high incomes, although more than 17% of women live in a high-income household (because they
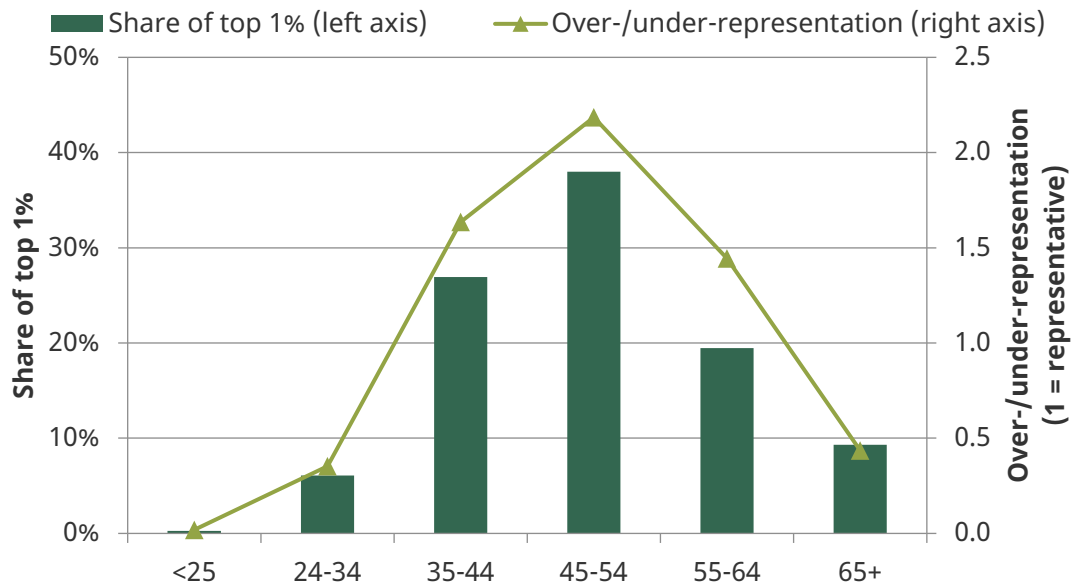
Figure 6. Top 1% by region, 2014–15
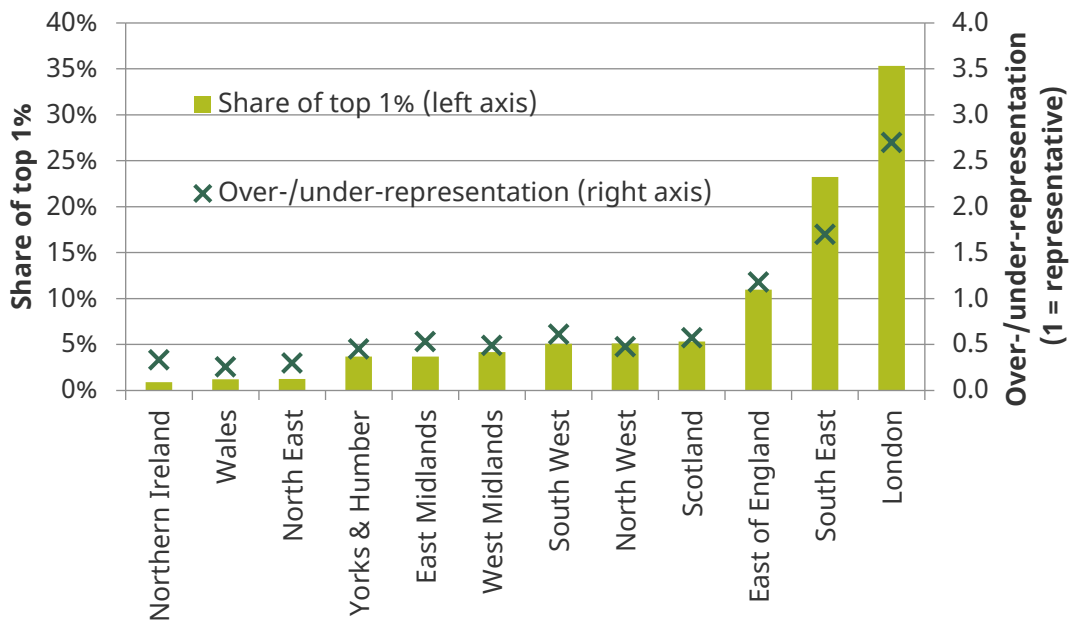
Note: Over-/under-representation measures the share of the group in the top 1%, compared with the share of the adult population as a whole in the top 1%. Approximately 0.6% of adults are in the top 1%. If 0.6% of a group is in the top 1%, then we say that the group is representative.

Source: Authors' calculations (based on the 2014–15 tax year) using HMRC administrative data and ONS population statistics.

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[7] The top 5% cut-off for male taxpayers aged 45–54 in London was £195,805 in 2014–15. All figures provided are for the 2014–15 tax year.

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live with a high earner). Those with the highest incomes are also disproportionately concentrated in London and the South East, which account for a quarter of taxpayers but three-fifths of the top 1% (Figure 6). More than a third of people in the top 1% are in their late 40s or early 50s, which is more than twice as many as one would expect based purely on the size of that age group (Figure 7). This largely reflects the fact that earnings tend to be highest in the latter half of a career as people benefit from labour market experience.
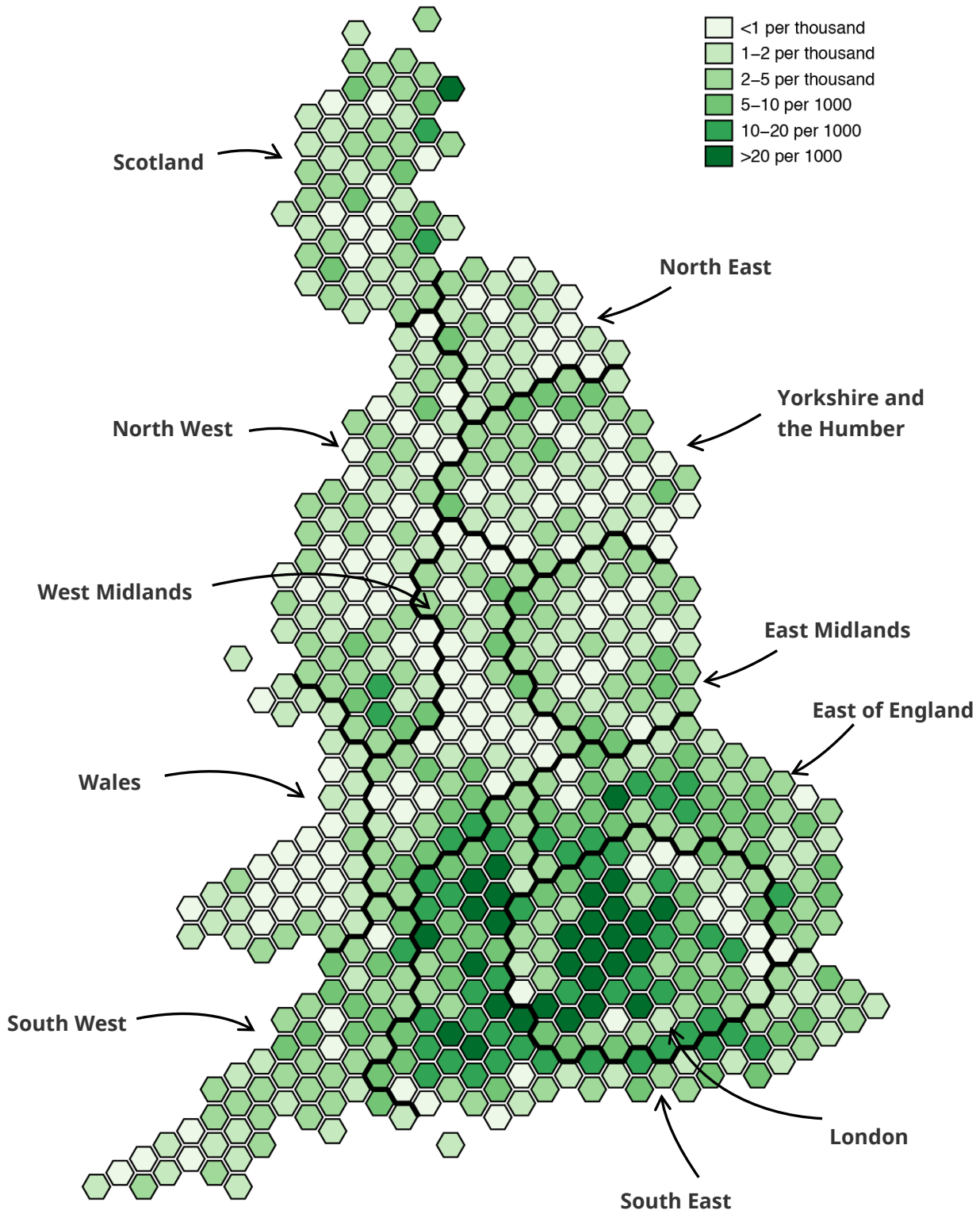
Figure 7. Top 1% by age group, 2014–15

Note: Over-/under-representation measures the share of the group in the top 1%, compared with the share of the adult population as a whole in the top 1%. Approximately 0.6% of adults are in the top 1%. If 0.6% of a group is in the top 1%, then we say that the group is representative.

Source: Authors' calculations (based on the 2014–15 tax year) using HMRC administrative data and ONS population statistics.

The map in Figure 8 gives finer detail on the geographic concentration of where the people in the top 1% live (rather than where they work), showing the picture by parliamentary constituency, with darker green colours indicating a higher density of people in the top 1%. There are 30 constituencies in which more than 2% of adults (the darkest shade of green) are in the top 1%. Of those, 17, or 56%, are in London, and all but two of the remainder are in the South East. It is also notable that, even within London, there are areas with few people in the top 1%.

There have been some changes to the composition of the top 1% over time. Women may only make up about 17% of the top 1% today, but that share has risen from 12% back in 2000–01. Meanwhile, the concentration of the very richest in London has grown by a fifth (i.e. 29% of the top 1% lived there in 2000–01, which has now risen to 35%). The top 1% of income tax payers have also become more geographically concentrated on other measures. For example, half now live in just 65 parliamentary constituencies (52 of which are in London and the South East) compared with 78 constituencies at the turn of the century.

Figure 8. Top 1% by parliamentary constituency (number per 1000 adults), 2014–15

Legend:
- <1 per thousand
- 1–2 per thousand
- 2–5 per thousand
- 5–10 per 1000
- 10–20 per 1000
- >20 per 1000

Map labels: Scotland, North East, North West, Yorkshire and the Humber, West Midlands, East Midlands, East of England, Wales, South West, London, South East

Note: The key refers to number of people in the top 1% per 1000 adults in the constituency in 2014–15. Includes all constituencies in Great Britain (Northern Ireland is not included).

Source: Authors' calculations using HMRC administrative data.

As one would typically expect, as we look further and further towards the extreme of the income distribution, the over-representation of certain groups also becomes more extreme. Figure 9 shows this for the cases of age, region and gender, breaking the top 1% into the top 0.1%, the next 0.4% and the next 0.5%. For example, London accounts for 35% of the top 1% but half of the top 0.1%. Women make up 17% of the top 1% as a whole but just 10% of the top 0.1%.

Figure 9. Age, region and gender within the top 1%, 2014–15
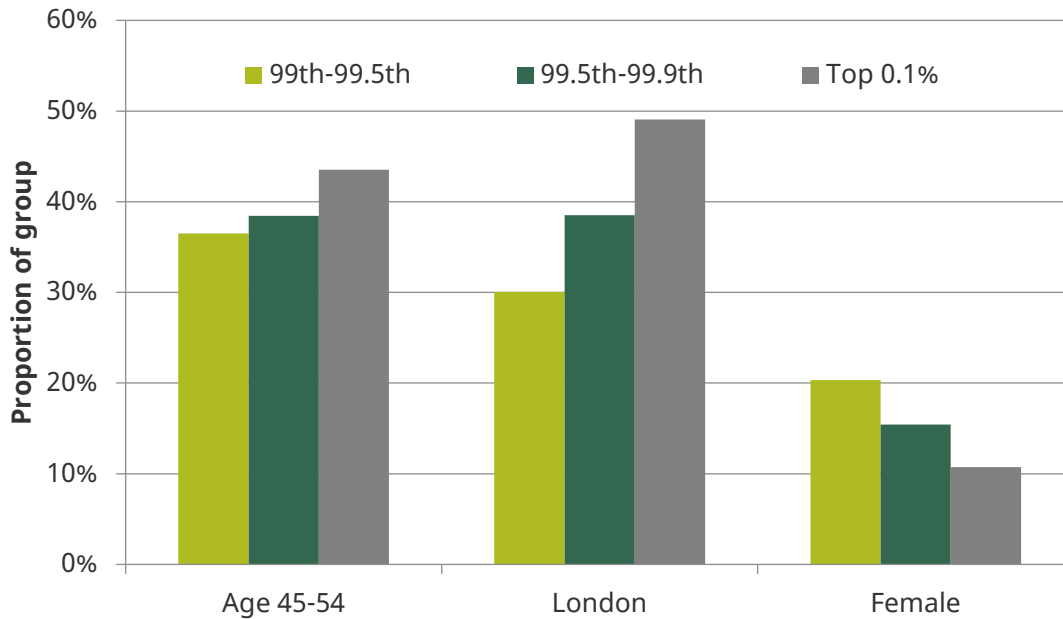
Note: Based on the 2014–15 tax year. The 99th percentile is £162,000, the 99.5[th] percentile is £236,625 and the 99.9[th] percentile is £648,205.

Source: Authors' calculations using HMRC administrative data.

Business income is important for the top 1% of income tax payers

Tax records provide detailed information on the income sources of the top 1%. As noted in the introduction, by focusing on income subject to income tax, we will miss some sources of income and modes of remuneration. Nonetheless, the data will capture much of the income of these individuals, and allow us to learn more about their income sources than has previously been possible.

Employment income is the most important single source of income for the top 1%. It accounts for about 60% of the total income of the group (Figure 10), and is the single largest source of income for two-thirds of the group. However, relative to those on lower incomes, what is notable is that these shares are so low. Even among those with income between £100,000 and £162,000 (the 99th percentile),[8] almost 70% of income is accounted for by employment income. It is even higher for incomes below £100,000.

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[8] Those with incomes above £100,000 are required to fill in a self-assessment form, enabling this comparison. We do not have representative data for those with income below this level.

Figure 10. Composition of the top 1% income of income tax payers, 2014–15
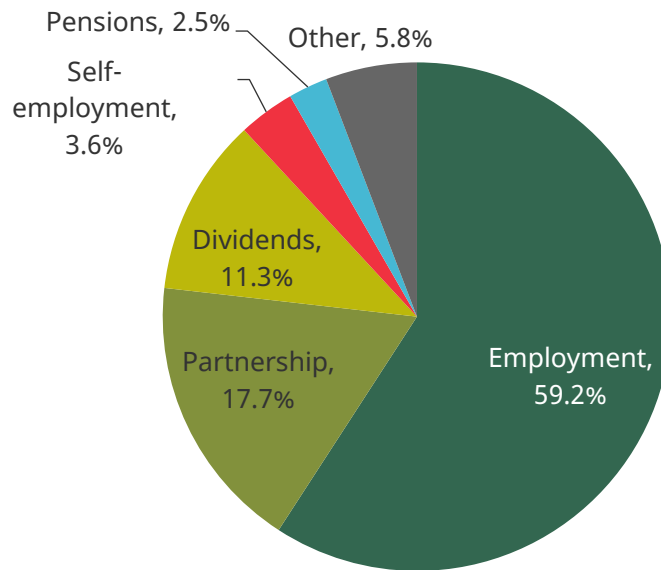
Note: Other income includes income from property, interest, share schemes and foreign income.

Source: Authors' calculations using HMRC administrative data.

The flipside of this is that, relative to the bottom 99%, the top 1% of income tax payers receive more of their income in the form of partnership income or dividends. People receive partnership income when they are the owner of a multiple-owner unincorporated business (a partnership). (Single owners of unincorporated businesses are referred to as sole traders and receive self-employment income.) Dividends may be received from third-party shareholdings but are also the major form of remuneration for company owner-managers. That is, owners of incorporated businesses (companies) will usually receive much of their income in the form of dividends because there is a strong tax advantage to take their remuneration in this way (more on this below). The number of company owner-managers has been growing faster than the number of employees since at least 1990,[9] although the number of partners has been declining since at least 2000–01.[10]

Business owners are thus an important part of the top 1% in the UK – something that is also true of the highest-income people in the United States.[11] Adding up the people in the top 1% whose most important income source is partnership income (14%), dividend income (11%) or self-employment income (4%) suggests that almost one-in-three of the top 1% is a business owner, even though they account for only one–in-five of the workforce overall.[12]

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[9] See S. Adam, H. Miller and T. Pope, 'Tax, Legal form and the gig economy', in C. Emmerson, P. Johnson and R. Joyce (eds.), *The IFS Green Budget*, February 2017, https://www.ifs.org.uk/publications/8872.

[10] See J. Cribb, H. Miller and T. Pope, 'Who are business owners and what are they doing', IFS Briefing Note, forthcoming.

[11] See M. Cooper et al., 'Business in the United States: who owns it, and how much tax do they pay?', *Tax Policy and the Economy*, vol. 30, pp. 91–128, 2016.

[12] See J. Cribb, H. Miller and T. Pope, 'Who are business owners and what are they doing', IFS Briefing Note, forthcoming. Around 6.5 million people either have unincorporated business income or are the company

The UK's tax system taxes income earned through a business at lower rates than employee earnings. This implies a significant tax advantage to work that is done through one's own business. This is an issue that is now fairly well known, and it has been highlighted by previous IFS work, although we recap in Box 2. What has not been known previously is how many of the beneficiaries from this tax advantage are at the very top of our income distribution.

Box 2. Tax breaks for business incomes

Normal salary income attracts income tax and NICs at both the employee and employer level. In contrast, self-employed and partnership income is not subject to an equivalent of employer NICs and is charged self-employed NICs at a lower rate. This implies a significant tax advantage to work that is done through one's own (unincorporated) business.

Company owner-managers also have a tax advantage relative to employees. After earning income at the company level, they can choose to pay themselves in the form of a salary (which will be deducted from corporate profit), dividends (which will be paid out of post-corporation tax profit) or capital gains (upon company sale or dissolution, also paid out of post-tax profit). They can minimise the total amount of tax they pay in-year by paying themselves a small salary (taking advantage of tax-free allowances in the national insurance and income tax systems), and taking any further remuneration in the form of dividends (because the combined corporate and dividend tax rate is lower than the tax rate on salary). If they are willing to delay withdrawing income until company sale or dissolution, they can reduce the amount of tax they pay further by withdrawing any retained profit as capital gains at that point. We return to this below.

The tax system implies that total tax paid on a job generating the same amount of income varies significantly across legal forms. Figure 11 shows that, for a job generating £200,000 per year, the tax paid for the partner or owner-manager would be around £13,000 lower than for an equivalent employee.

Figure 11 does not capture all differences in tax treatment across legal forms. For example, partners will generally have more scope to deduct work-related expenses from their income than employees. But employees and owner-managers have access to a more generous treatment of pension saving – pension contributions made by an employer are not subject to NICs.[13] One important tax benefit for owner-managers, not captured in Figure 11, which is particularly important at higher incomes, is the capacity for the owners to retain profits in their company.

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owner-manager of a one or two director company. In 2015–16, the workforce totalled around 32 million people. The 6.5 million includes those for whom business income is not their main source of income.

[13] For a detailed discussion of further differences in tax treatment, see section 7.3 of S. Adam, H. Miller and T. Pope *Tax, Legal form and the gig economy* in C. Emmerson, P. Johnson and R. Joyce (eds.) *The IFS Green Budget*, February 2017, https://www.ifs.org.uk/publications/8872.

Figure 11. Tax due on job generating £200,000 of income in different legal forms, 2018–19
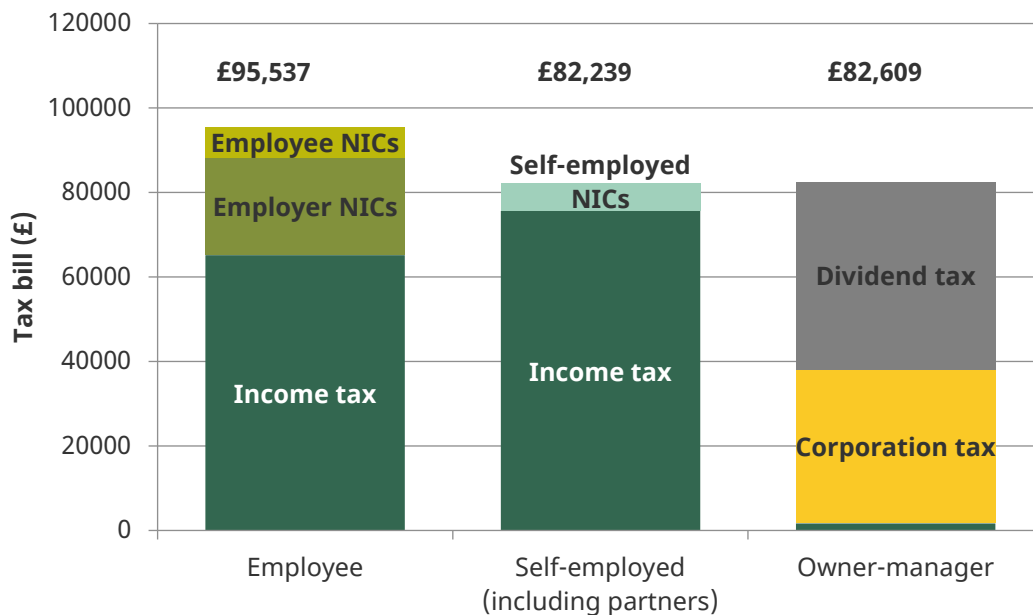
Note: This exercise ensures that employer cost is equal across legal forms. As a result, the employee salary is lower than the taxable profit for the partner and owner-manager (by the value of employer NICs). We assume that the owner-manager follows the optimal withdrawal strategy of paying herself a salary equal to the primary threshold and paying herself in dividends for the remainder.

Owner-managers pay personal tax on income only when it is withdrawn. By keeping income inside the company wrapper until the company is sold or dissolved, and then taking the income out in the form of capital gains at that point, the owner-manager could benefit from entrepreneurs' relief – a lower 10% rate of capital gains for business owners – compared with a dividend tax rate of 38.1% above the additional-rate threshold (£150,000). Evidence from tax data suggests that this is a strategy employed by a significant share of high-income owner-managers. For example, owner-managers who are the only director-shareholder of their company earning business income (corporate profit net of corporation tax plus the salary paid to the director) of £150,000 each year on average, pay out only £100,000 on average in the form of salary and dividends.[14] This implies that one-third of their profits are being retained each year.

The importance of partnership income at high-income levels is especially notable. Partnership income is even more important for the top 0.1% than the top 1% – almost a quarter of top 0.1% income is from partnerships (Figure 12). And overall, 7% of partners[15] are in the top 1%, while 58% of all partnership income accrues to those in the top 1% (i.e. the top 7% of partners). High-income partners tend to be based in a small number of sectors in the economy: 85% of those in the top 1% who get most of their income from partnerships are based in financial and professional services (which includes hedge

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[14] See H. Miller, K. Smith and T. Pope, 'Intertemporal income shifting and taxing owners of closely held companies', mimeo, 2019.

[15] That is, those with some partnership income.

funds), business services (which includes consulting and legal services) and the medical industry (which includes General Practitioner doctors).[16]

Figure 12. Composition of the top 1%, top 0.5% and top 0.1% income, 2014–15
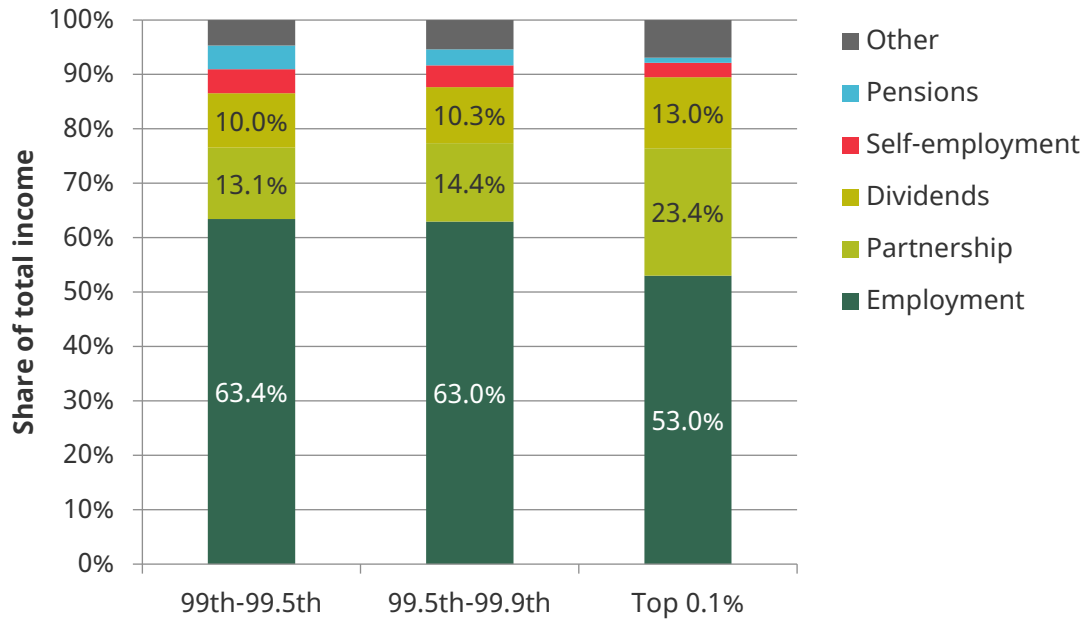
Note: Other income includes income from property, interest, share schemes and foreign income. 99th percentile is £162,000. 99.5th percentile is £236,625 and 99.9th percentile is £648,205.

Source: Authors' calculations (based on the 2014–15 tax year) using HMRC administrative data.

The importance of partnership income in the top 1% grew steadily, largely at the expense of employment income, over the eight years leading up to the financial crisis (Figure 13), even though the total number of partners was falling over that period. The share of top 1% income from dividends over that period was mostly stable, despite the number of owner-managers growing more quickly than the number of employees.

Since 2008–09, the shares of top 1% income coming from different sources have been extremely volatile. This instability largely reflects variation in dividend income, which itself reflects responses to changes in tax rates. In both 2009–10 and 2015–16, dividend income increased significantly because tax rises had been pre-announced to take effect in the subsequent year, a phenomenon known as 'forestalling' (i.e. taking income earlier than it otherwise would have been taken in order to pay a lower tax rate on it). These forestalling responses were significant. Dividend payments to individuals with incomes of more than £150,000 were almost 75% higher in 2009–10 than in 2008–09,[17] while in 2015–16 just 100 people were able to reduce their tax bill by a total of £100 million by withdrawing

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[16] Only 22% of all partners are based in these industries, but at high-income levels it is these industries that dominate. We are able to provide statistics on the industry of partners (but not others in the top 1%) as the data only provide an industrial classification for unincorporated business owners.

[17] J. Browne and D. Phillips, 'Estimating the size and nature of responses to changes in income tax rates on top incomes in the UK: a panel analysis', IFS Working Paper 17/13, August 2017, https://www.ifs.org.uk/publications/9676.

dividends averaging £30 million each from their companies in that year rather than in a subsequent year when a higher tax rate would have applied.[18]

Figure 13. Variation in the top 1% income composition since 2000–01
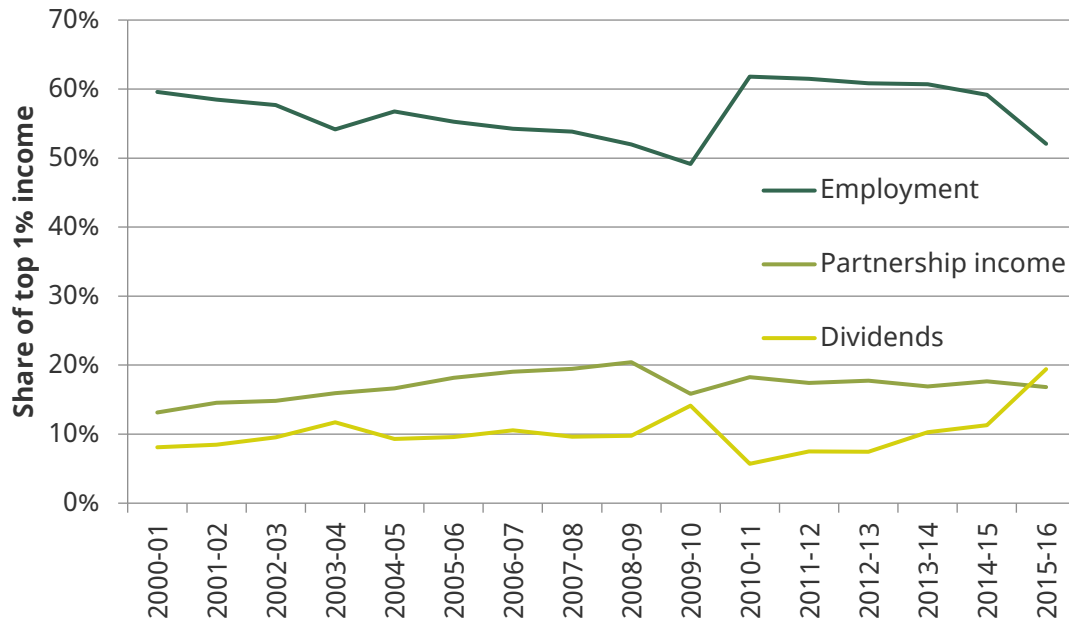
Source: Authors' calculations using HMRC administrative data.

Company owner-managers have an incentive to retain, and do retain, a substantial fraction of profit earned at the corporate level in their company (Box 2 explains this in more detail). As a result, many of these individuals have the flexibility to increase dividend pay-outs significantly in years before tax increases, regardless of whether income (i.e. corporate profit) earned in that year was higher or lower than in previous years. The volatility in Figure 13 is thus an important reminder that changes in statistics such as the top 1% share of income, which rely on tax records, can be influenced by tax-motivated changes in behaviour that may not reflect 'real' or long-lasting changes in underlying economic activity.

A further implication of company owner-managers' ability to retain profit in the company wrapper is that these retained earnings will be an important missing source of income from traditional income measures (including the one used in this briefing note). (Employer pension contributions similarly create a wedge between annual remuneration and observed income for employees.) If the retained earnings are eventually paid out as dividends, then – as with pension contributions – they will be captured in our income measure when the individual receives the income in a later year. However, if retained earnings are eventually received as capital gains upon company sale or dissolution, they will not show up in our income measure either when the profit is earned or when the income is received.


Staying in the top 1% of income tax payers

As ever, when examining how incomes are distributed, it can be important to appreciate that people's circumstances change a lot over a lifetime, and this means that assessments of someone's position based only on a 'snapshot' of information can be misleading. This also applies to the top 1%: it is not a fixed, unchanging group of people.

In 2015–16, around 300,000 people were in the top 1%, but between 2000–01 and 2015–16, over 900,000 people were in the top 1% at some point. Figure 14 shows how likely people in the top 1% are to stay there in subsequent years. Only around three-quarters of people in the top 1% in one year will be there in the next year, while only half will still be in the top 1% in five years. We also see that people leave the top 1% and then return again – while half of those in the top 1% this year can expect to be in the top 1% in five years, only 30% will be there for every one of those five years. Only 11% of the people who were in the top 1% in 2000–01 were in the top 1% for every year up to and including 2015–16.

Figure 14. Probability of staying in the top 1%
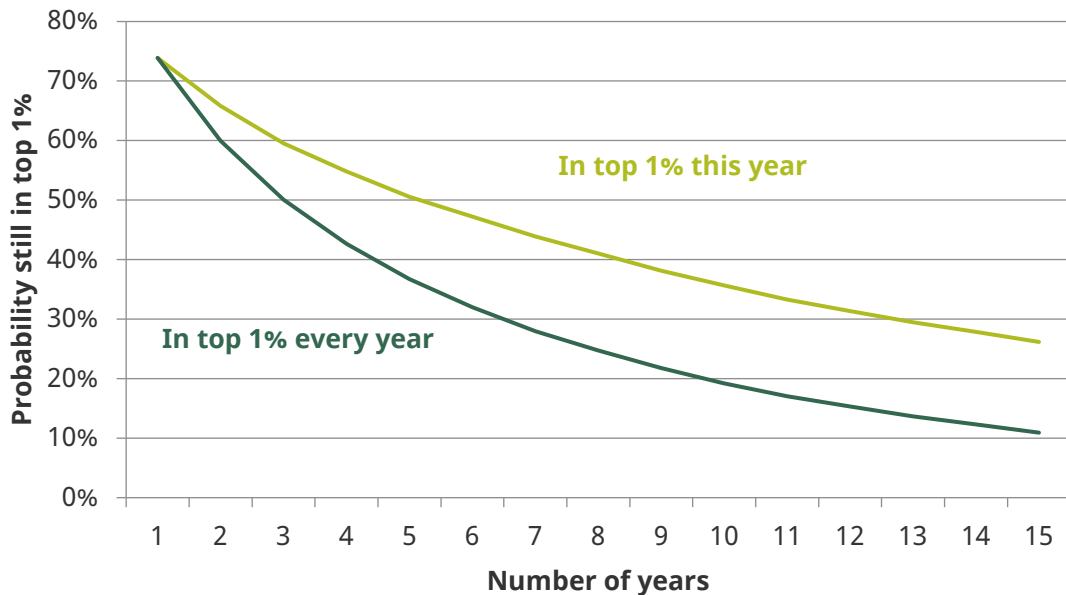
Note: The dark green line shows the probability that an individual has been in top 1% for every year, and the light green line allows individuals to leave the top 1% and then return at a later date. Statistics are pooled across the years 2000–01 to 2015–16. These probabilities have been stable over time.

Source: Authors' calculations using administrative HMRC datasets.

This 'churn' is important – somebody who has a high income in only one year is different from one who has a high income consistently. It also means that people have a significantly greater chance of being among the highest-income people at some point in their lives than they do in any single year. For example, using the 15 years of tax data available here, we see that of those born in 1963 (aged 53 in 2016), on average around 10,000 (1.1%) were in the top 1% in any given year between 2000–01 and 2015–16, but three times as many (i.e. 31,000, or 3.4%) had been in the top 1% at some point over that period. For men in this birth cohort, the figure rises to 5.5%. Of course, over their whole

lifetimes – as opposed to the 15-year period we observe here – the figures will be higher still.

Some types of people are more likely to remain in the top 1% for longer time periods than others. We find that:

- Those with higher incomes are more likely to stay in the top 1% for longer.

- Over longer time horizons, people who were younger in 2000–01 were more likely to stay in the top 1% than older people (Figure 15). This is despite the fact that young people tend to have lower incomes than older people who are in the top 1%. However, it makes sense given that older individuals will retire, while if an individual is already in the top 1% at a young age, they are likely to remain there for some time as incomes tend to grow strongly between early and mid career.

- Even at the same income levels, men are around 5 percentage points more likely to stay in the top 1% for five years than women (Figure 16). Within the top 1%, men also have higher incomes than women, on average, making them even more likely to stay in the top 1% for longer.

- Splitting people according to their main income source, we find that partners are more likely to stay in the top 1% for five years than employees with the same income (Figure 17). This might suggest that the activities of partners are no more – and possibly less – risky than for high-income employees. Those who rely principally on dividend income, however, are less likely to remain in the top 1%, a fact that is true whether or not we include or exclude 'forestalling' years.

Figure 15. Variation in probability of staying in the top 1%, by age
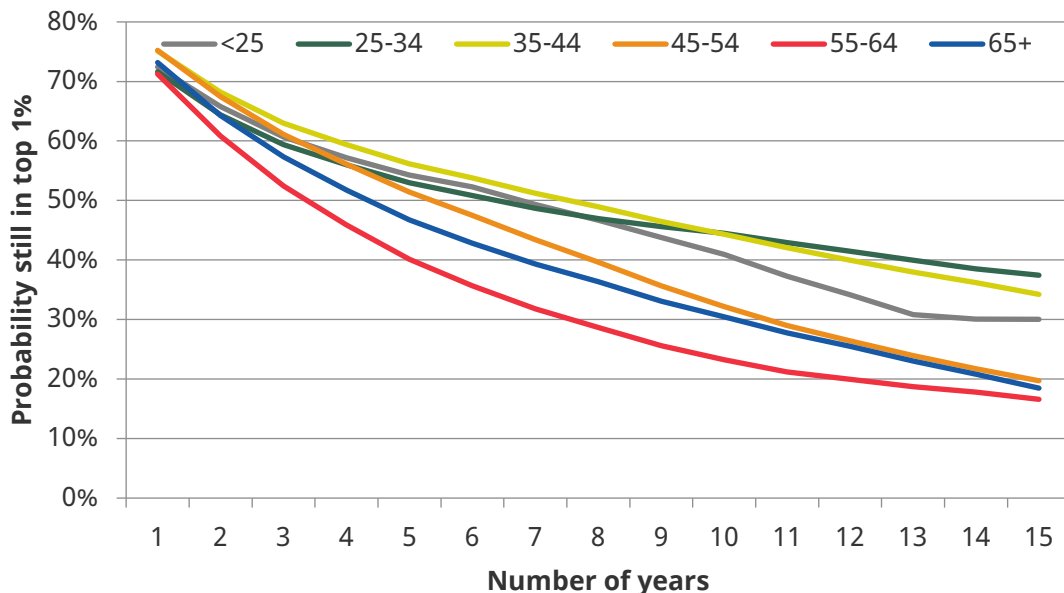
Note: This figure shows the probability of still being in the top 1% according to age bracket in year 0. Equivalent to the dark green line in Figure 14 (i.e. does not require that the individual is in the top 1% in every year).

Source: Authors' calculations using administrative HMRC datasets.

Figure 16. Probability of being in the top 1% five years later, by gender
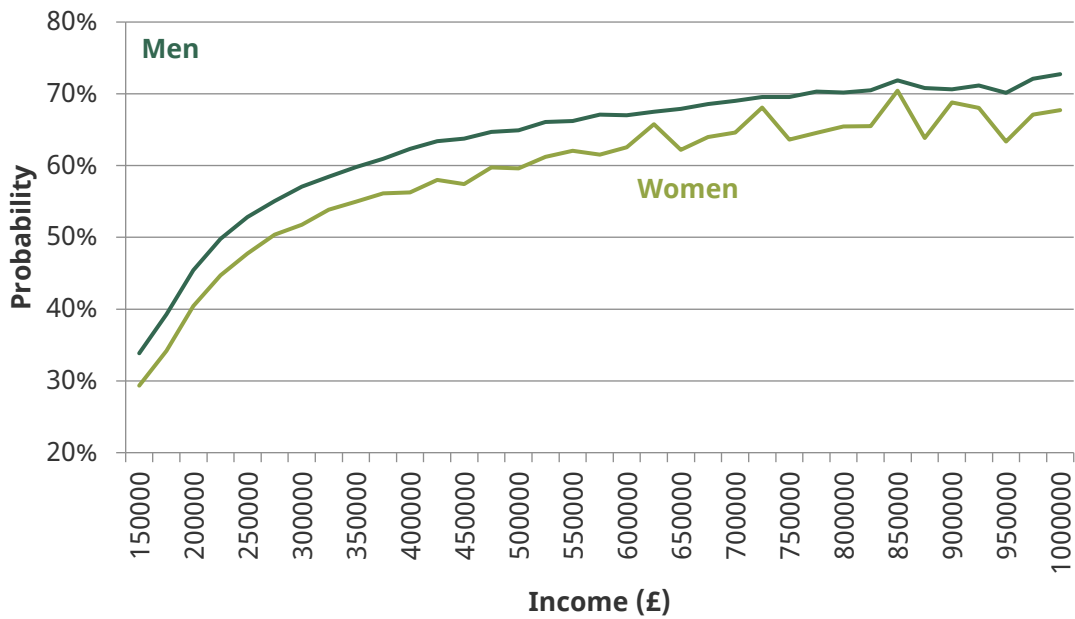
Note: Based on people in the top 1% from 2000–01 to 2011–12. It does not require that an individual is in the top 1% for all five subsequent years – only that they are in the top 1% in five years' time.

Source: Authors' calculations using HMRC administrative datasets.

Figure 17. Probability of being in the top 1% five years later, by main income source
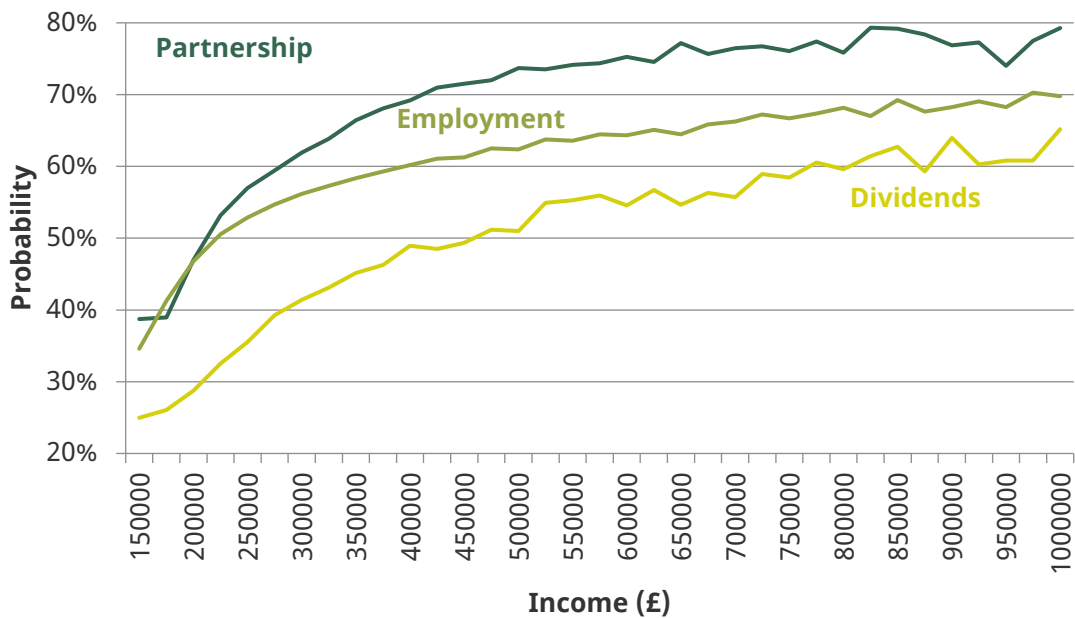
Note and Source: See Figure 16.

Conclusions

In this briefing note, we have used data from income tax records to examine in some detail the characteristics of the oft-discussed 'top 1%', focusing specifically on the top 1% of income tax payers.

The top 1% of income tax payers are geographically very concentrated. Half of them live in just 10% of the parliamentary constituencies (65 out of 650), many of which are in London and the South East. Given that those in the top 1% are also disproportionately likely to be in middle age, and to be male, people in the top 1% may not feel especially high income relative to their peers. A man aged 45–54 in London with an income of £162,000 would be in the top 1% nationally, but would not even be in the top 5% for their age, gender and region, and would need a staggering extra £550,000 per year to be in the top 1% for their age, gender and region.

Understanding more about the top 1% is important in debates about inequality, but it is also important from a fiscal point of view. The top 1% of income tax payers pay 27% of all income tax, as well as a significant share of other taxes. The regional dimension is arguably particularly important here – tax revenues, and hence the funding of our public services and welfare system, are very sensitive to a relatively small group of people based in London.

On the theme of tax, our analysis highlights that a substantial fraction of the top 1% earn their income in the form of partnership income and dividends, which accrue to the owners of unincorporated and incorporated businesses, respectively. Both forms of income are taxed at lower rates than salary – the result of a policy choice to tax business owners at lower rates than employees. Our estimates here suggest that almost one-in-three people in the top 1% are business owners, meaning that this policy choice provides substantial tax breaks to some of the highest-income people in society.

It is tempting to think of the 'top 1%' as a stable, never-changing group – as popular debate often seems to do, at least implicitly – and it is certainly the case that a large majority of people will never be in the top 1% of income tax payers. But people do move in and out of the group frequently. Only half of the top 1% of income tax payers in one year will be in the top 1% five years later. And the flipside is that many more people will have very high incomes at some point in their lives than in any single year. Looking at a generation that has just gone through its peak-income years (i.e. those born in 1963, who were 53 in 2016), on average, around 10,000 (1.1%) were in the top 1% in any single year between 2000–01 and 2015–16, but three times as many (31,000, or 3.4%) had been in the top 1% at some point since 2000–01. For men in this birth cohort, the figure rises to 5.5%. Of course over their whole lifetimes – as opposed to the 15-year period we observe here – the figures will be higher still.