Technical Connection

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TAX INCREASE RUMOURS

Are tax increases being considered by the Chancellor, and, if so, which tax might increase and what is the likelihood of implementation?

The press has recently been full of conjecture over what, if any, tax increases the Chancellor may introduce in response to the high levels of Government borrowing. Some newspapers base their headlines on a supposed "leaked" Treasury document, others base them on statements from "a source close to the Treasury" and such like. A Treasury official is stated to have said that the rumours are "rubbish" and that decisions will be made by the Chancellor in the Autumn Budget. Of course, that is when we are likely to get absolute confirmation of what, if any, tax changes we will see introduced.

Right now, though, theories are flying around that the latest "spike" in press commentary could have something to do with "kite flying" to judge the temperature of likely public response to some of the tax changes that could take place. But this itself is just another theory.

Unsurprisingly, there has been no official statement at this point. The "no smoke without fire" phrase comes to mind but, then again, there was similar "smoke" based on "Treasury sources" back in May.

Government debt (and the Public Sector\Net Borrowing) is extraordinarily high (though currently a little lower than the Office for Budget Responsibility (OBR) most recently predicted) and of course strategic thought needs to be given to what to do about it and when.

Paul Johnson, director of the Institute for Fiscal Studies (IFS), has astutely commented that the economy is likely to be smaller in the medium term and that if public spending is kept at a level higher than previously (pre Covid) planned then we (the country) will need higher revenues.

Securing funds (substantially through gilt issuance) has not proved difficult with the markets and Bank of England (BOE) seeming to be happy to hoover up what's been offered to supply the Government with the funds to do “whatever it takes”.

Servicing the debt at today's low (to negative) interest rates also seems to be less than challenging.

Maintaining confidence in UK PLC might become an issue in the future though. Many countries are, of course, seeking funds for Covid-related relief and so there is inevitably some "competition". This could be a driver to the consideration of some form of strategic tax plan to reassure the markets.

But, clearly, dealing with the debt is something that needs to be done over time and, at some point, a clear, long-term, strategic plan must be made clear. This is likely to be multi-faceted, incorporating spending reductions and efficiency (but not austerity), a review of outgoings (reliefs) and a look at increasing revenue through taxation. But, in all cases, without disrupting the recovery. Economic recovery is naturally central to underpin an effective strategy. Without it, and the resulting growth, even if tax rates are increased the yield will be less than optimal.

Most accept that while, in the medium to long term, tax increases are likely, nothing radical needs to be done immediately. Paul Jessop, fellow at the Institute of Economic Affairs, states "Fiscal tightening would slow the recovery...too much uncertainty to make important judgements this autumn".

The IFS and Government ministers have cautioned against tax increases now that would blow the recovery off course and put the economy at risk. Near term increases to income tax, National Insurance (NICs) and VAT therefore would seem to be unlikely. Despite the sense of all this the Chancellor will also have in mind his commitment to sustainable public finances. And, remember, he did hint at a rise in NICs for the self-employed when he introduced the Self-Employed Income Support Scheme (SEISS): “…I must be honest and point out that in devising this scheme – in response to many calls for support – it is now much harder to justify the inconsistent contributions between people of different employment statuses”.

Much of the latest conjecture has been about corporation tax and capital taxes though.

So, what has been talked about and what are the chances of changes being made "any time soon"?

Corporation tax. One of the rumours is that the tax could be pushed up from 19% to 24%. Of course, it could happen. The last few months have taught us that anything can indeed happen. But will it, given the need for the UK to be seen as a “destination” for businesses? This is especially so given the expected, at the very least short to medium term, negative connotations of Brexit. Of course, this will all depend on the “deal” done between the EU and the UK but it's hard to see how terms of trade with the EU are going to improve.

There has also been some talk over the 2% digital services tax (DST) introduced from April this year. Will it be increased - the projected yield is not massive - or will it be ditched? Both possibilities have been mentioned in the press. However, the DST was always intended by Government to ultimately be a temporary tax, to be replaced by a comprehensive global solution.

Capital taxes. Well, the Office of Tax Simplification (OTS) are right in the middle of this. They have made their recommendations in relation to inheritance tax (IHT) and one of those was to remove rebasing for capital gains tax (CGT) if the asset passing on death is also free of IHT. There are also the more radical APPGIIF (All Party Parliamentary Group for Intergenerational and Inheritance Fairness) proposals. Some IHT change at some point is likely, but as a tax raiser (if that's the supposed prime driver for change) IHT increases are unlikely to "shoot the lights out". IHT raises around £5bn p.a. so even if the yield were doubled it would only reach the level that CGT currently generates - at the top end of estimates.

So, how about CGT? Well, the OTS are currently reviewing it and the Chancellor only recently asked them to. Most of the recent talk in the press was about charging capital gains to income tax. This could be a strong runner - perhaps with even little strong political resistance from the right wing of the Conservative Party. We had 20 years of charging capital gains to income tax from 1988, though we also had indexation (inflationary) relief. So, a return to that might not be impossible. That would pretty much double the rate of CGT for most people.

If it's believed that this is a strong likelihood for a Budget change then what should be done, if anything?

Any rebasing (focused on "starting afresh" under a new higher tax regime) that can be done without triggering a CGT liability, i.e. within the annual exemption, should certainly be considered - subject to the bed and breakfast rules.

But triggering a liability (even at today's lower rates) to potentially save tax in the future would take a little more thought - especially since nothing is certain and no one will know for sure until any change is announced. A "cost/benefit" and "risk/return" analysis will definitely be necessary.

And pension tax relief has to be mentioned. It is "high cost", but there is more to consider (especially in relation to employer contributions) than the superficial attraction of tax saving. A movement to a flat rate of relief is regularly mentioned and cannot be ruled out. So, anybody with unused relief, who has the funds and was going to make pension contributions anyway should, for sure, give more urgent consideration to this.

Wealth tax. Since the Prime Minister (PM)'s statement in PM's question time on the day of the Summer Statement, most consider the introduction of a wealth tax to be unlikely. While the subject has been lying low for a bit, some form of rerating of property for council tax purposes could be possible. The current tax is anchored to 1991 values after all.

In closing, though, the words of Nick Macpherson, Treasury Permanent Secretary during the period of austerity, have a "ring " about them (as reported in the FT): "Sadly, raising the rate of tax on capital (the most mobile factor of production) doesn't bring in any revenue. To raise serious revenue there is no alternative to higher taxes on income or consumption".

But most agree that now is not the time to do that. So deferred pain? Maybe.

And in all this, we can't ignore the Laffer principle. There's a point at which rates of tax (on income or capital or both) cause individuals and businesses to seriously change behaviour - by engaging more concertedly in avoidance or just leaving the country.

We will all be watching out for developments. The rightness or wrongness of tax increases, and in what areas, is one that most have strong views on. Politicians, especially senior politicians (think

Chancellor and PM) do not always agree - so we could be in for more rumour, conjecture and "leaks" as we move towards the Autumn Budget...whenever that is.

OTS CGT REVIEW UPDATE: DEADLINE EXTENDED TO 9 NOVEMBER

On 14 July it emerged that the Chancellor had written a letter to the Office of Tax Simplification (OTS) requesting it 'undertake a review of Capital Gains Tax'. Curiously, there was no announcement of the letter on the Treasury website. The tone of the correspondence was distinctly different from Mr Hammond's (Mr Sunak's predecessor) letter requesting a simplification review of IHT. Although Mr Sunak gave a nod to 'opportunities to simplify the taxation of chargeable gains' his letter also referred to:

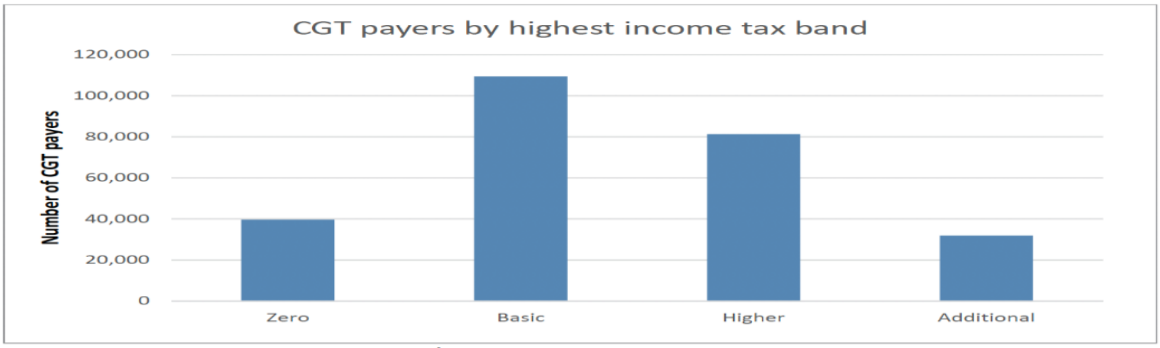
- 'areas where the present rules can distort behaviour or do not meet their policy intent'; and
- 'any proposals from the OTS on the regime of allowances, exemptions, reliefs and the treatment of losses within CGT, and the interactions of how gains are taxed compared to other types of income'.

What has been extended from 12 October to 9 November is the deadline for the 'technical details and practical operations' of the call for evidence.

The OTS had already responded with a scoping document, a call for evidence and, as it did with inheritance tax (IHT), an online survey for individual taxpayers. Together these make clear that the review will be wide-ranging, covering areas including:

- 'the overall scope of the tax and the various rates which can apply';
- 'stand-alone owner-managed trading or investment companies';
- 'interactions with other parts of the tax system';
- 'the practical operation of principal private residence relief'; and
- 'consideration of the issues arising from the boundary between income tax and capital gains tax in relation to employees'.

As was the case with IHT, the OTS has access to HMRC data that is not publicly available. One good example of this, contained in the scoping document, is the 2017/18 distribution of capital gains tax payers by highest income tax band, as shown below:



Source: HMRC Outturn data 2017/18[4]

The issue of how to treat capital gains for tax purposes has been rattling around almost since the tax was originally introduced in April 1965. Of late a number of think tanks, such as the IPPR and the Resolution Foundation, have called for gains to be taxed as income. Ironically that idea was originally put into practice by a Conservative Chancellor (Nigel Lawson) in 1988 and survived for 20 years, albeit with various complicating tweaks along the way (remember taper relief?).

Capital gains tax 'is a modest source of revenue for the Exchequer', to quote the OTS. The latest Office for Budget Responsibility (OBR) projections are that it will raise £10.5bn in 2020/21 (on gains realised in 2019/20) and £7.6bn in 2021/22. Set against a 2020/21 deficit heading above £350bn, doubling capital gains tax revenue would make only a minor dent. However, from a political viewpoint, capital gains tax has similar advantages to a wealth tax in that capital gains tax is perceived as a tax on the rich which will not affect most people (fewer than 300,000 taxpayers paid capital gains tax in 2017/18). It also has the benefit of being an existing tax, so would not require new infrastructure. Having said that, there is an argument that with IHT already in the simplification pot, a case could be made for some rationalisation of capital gains tax and IHT into a single capital tax.

COMMENT

The call for evidence *is divided into two parts: 'principles of CGT', which had a response deadline of 10 August, and 'technical details and practical operation' for which the deadline, as mentioned above, has just been extended from 12 October to 9 November. Those dates (particularly the new 9 November deadline) leave a short timescale for any feed into an Autumn Budget. Interestingly, the OTS says that it 'may publish more than one report on its findings'. It is worth remembering that capital gains tax rates have been changed mid-year in the past (June 2010 by George Osborne).*

BUDGET TIMING CALLED INTO QUESTION

"Today I can inform the House that I have asked the Office for Budget Responsibility (OBR) to prepare an economic and fiscal forecast to be published in mid to late November."
That was the entire content of a written statement issued by Rishi Sunak on Friday 11 September. The economic and fiscal forecast is the EFO (Economic and Fiscal Outlook) in OBR speak, which it is required to produce twice a year. The meaty document (226 pages back in March 2020) usually accompanies an Autumn Budget or Spring Statement.

The vague timescale set by the Chancellor has prompted questions about whether there will be an Autumn Budget. His Friday statement follows on from the four week extension (to 9 November) of the deadline for technical responses to the Office of Tax Simplification's capital gains tax review.

There are sound arguments for deferring the Budget, probably until next Spring:

- A Budget in December (November seems ruled out by the deadline set for the OBR) could well arrive before (or possibly during) a winter resurgence of Covid-19 infections.

- There also remains the little matter of finalising Brexit. The next Finance Bill is due to contain another set of international law-breaking measures, this time covering unilateral UK Government decisions on which goods should be subject to duties when crossing into Northern Ireland. The Government might prefer to delay publishing that Finance Bill until the transition period ends on 31 December 2020.

- Whatever was in a (late) Autumn Budget would probably need tweaking – or more – as part of the Spring Statement in the light of conditions (Covid-19 and post-Brexit) at the time.

- From a political viewpoint, delay would also give the Government more time to get the 'hard choices' message across to the public (and some of their own MPs).

- The general consensus among economists is that any serious tax rises will be deferred until the economic conditions stabilise, meaning there is no rush to make (as opposed to announce future) changes.

COMMENT

The Chancellor also has a multi-year Spending Review to produce before the end of the calendar year. This was due last year, but the political turmoil meant that a one-year Spending Round for 2020/21 was introduced instead. Some sort of spending statement is needed from the Chancellor to allow Government departments to set their 2021/22 budgets. However, a full three-year review is subject to many of the same issues as an Autumn Budget in terms of forecasting, so Mr Sunak might deliver another single year stopgap round.

THE TREASURY SELECT COMMITTEE HAS ADDED ITS SUPPORT FOR AN ENDING OF THE STATE PENSION TRIPLE LOCK

The House of Commons Treasury Committee (TC) has added its view on the Triple Lock in a paper entitled 'Economic impact of Coronavirus: the challenges of recovery'. This is a wide-ranging document, covering everything from employment issues (a plea for 'a targeted extension of the Coronavirus Job Retention Scheme') to the Treasury's relationship with the OBR.

One of the more interesting, if brief, sections in the paper is headed 'Manifesto commitments". It is worth reproducing this in full:

"186. The Conservative Party Manifesto 2019 pledged to maintain the State Pension Triple Lock, and also not to raise either Income Tax, National Insurance Contributions or VAT. When asked for reassurances by the Chair at the Liaison Committee whether the Government was going to meet all its manifesto pledges, the Prime Minister stated:

We are going to meet all our manifesto commitments. Unless I specifically tell you otherwise, Mel [Conservative TC chair], the manifesto you and I fought on is—it is an important point.

187. We received some evidence that the Triple Lock on pensions might need to be revisited on a temporary basis next year because the increase in average earnings will be artificially high because of the Government's Job Retention Scheme. The Triple Lock guarantees that pensions may increase by the highest of the following three measures: average earnings; prices as measured by the Consumer Prices Index; and 2.5 per cent.

188. If the Job Retention Scheme and recession result in the increase in average earnings being atypically high from 2020 to 2021, this will make pension payments more generous than they would otherwise have been. This study from the LSE 'The changing size and shape of the UK state' explains how the Triple Lock for state pensions has already increased welfare spending significantly:

The introduction of the 'triple lock' in 2011 (whereby the value of the State Pension grows each year by the highest of inflation, earnings or 2.5%) alongside roughly £12 billion of cuts to working-age benefits has led to a situation in which the State Pension now accounts for 44% of all welfare spending, up from 37% just ahead of the financial crisis.

189. The Government must be willing to be flexible, even on manifesto commitments, in response to the crisis. Lifting the Triple Lock on pensions next year is a sensible proposal and should be carefully considered."

COMMENT

This is not the first time that a House of Commons Committee has called for the abolition of the State Pension Triple Lock. The Work & Pensions Select Committee made a similar call in 2016 which the Government ignored. Had the 'smoothed earnings link' suggested back then been adopted, we would not now be facing the possibility of a 5% rise in state pensions from April 2022. The only solace for the Government is that the 2020/21 earnings recovery projected by the Resolution Foundation in its June report is beginning to look optimistic.

WORLD ALZHEIMER'S MONTH - A REMINDER OF THE IMPORTANCE OF GRANTING A POWER OF ATTORNEY

Globally, dementia is one of the biggest challenges we face, with nearly 50 million people living with dementia worldwide. According to the Alzheimer's Society, there are currently around 850,000 people with dementia in the UK. This is projected to rise to 1.6 million by 2040. 209,600 will develop dementia this year, that's one every three minutes. 1 in 6 people over the age of 80 have dementia and there are over 42,000 people under 65 with dementia. World Alzheimer's Month (September) is an international campaign to raise awareness and highlight issues faced by people affected by dementia.

The impact on individuals and their families can be devastating and yet all too often people are reluctant to discuss this issue. Once a person loses capacity, they are unable to make their own decisions. Ideally, to ensure that in such a situation there is someone you can trust that will make those decisions on your behalf, you will have granted a power of attorney to someone to act on your behalf. The problem with dementia is that it is an illness that affects capacity and can, in some cases, do so at a rapid rate. With a rapid loss of capacity, once that capacity is lost it is too late to appoint an attorney.

There are two types of power of attorney, one for dealing with property and financial matters and one for dealing with health and welfare. In England and Wales these are called Lasting Powers of Attorney (LPAs), in Scotland, Continuing Powers. A precursor to LPAs in England was the Enduring Power of Attorney. Such powers, if executed before 1 October 2007, are still valid and they need to be registered on the onset of incapacity. An LPA can be registered straight away. It must be registered before it can be used.

COMMENT

As a result of the pandemic we have already seen an increased demand for LPAs. Given how often financial advisers still come across clients who have lost capacity but have not appointed an attorney under an LPA or EPA there is clearly a need to encourage clients to take this important step. And this month seems like an ideal opportunity to raise this important topic.

NORMAL MINIMUM PENSION AGE WILL RISE TO 57 IN 2028

Back in March 2014, when George Osborne announced new pensions flexibility in the Budget in the first consultation paper on those reforms, the following statement was made:

"The government … proposes to increase the age at which an individual can take their private pension savings at the same rate as the increase in the State Pension age. It is important people have the opportunity to plan properly for this change and so the government proposes to wait until 2028 (when the State Pension age will rise to 67) to fully implement this change. From 2028, people will not be able to draw their private pension benefits without a tax penalty until age 57, whether or not this is the point at which they stop work. From then on, the minimum pension age in the tax rules will rise in line with the State Pension age so that it is always ten years below."

That proposal for a steadily increasing normal minimum pension age (NMPA) has languished ever since, with no legislation to bring it into being. The procrastination had started to make some people wonder whether the idea had been quietly parked, especially in recent years when Government majorities on anything mildly contentious were by no means guaranteed.

At long last the silence has been broken. On 3 September John Glen, the Economic Secretary to the Treasury, confirmed in a written parliamentary answer to a question from Stephen Timms that the NMPA will rise to 57 from 2028. Although no specific date has emerged (there are no details yet on the Treasury or Parliament websites), it seems probable the change will take effect from 6 April 2028, catching anyone born after 5 April 1973.

INCOME WITHDRAWAL RATE FOR SEPTEMBER 2020

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in September 2020 is 0.5%.