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MORE BUDGET RUMOURS

It’s that time of year.

The weeks ahead of a Budget always yield rumours...and this year is no exception.

It’s generally accepted that the Chancellor would be ill-advised to introduce significant tax changes that could have a negative impact on the economy. The OECD, IFS and IMF have all counselled caution in this regard.

Many expect material tax change to be more seriously considered in the Autumn Budget.

Subject to this, though, the most recent rumours have been around:

- the likelihood of the Budget focus being on extending economic support for businesses, jobs and individuals;
- income tax, National Insurance contributions (NICs) and VAT; and
- corporation tax.

Let’s have a look at the last two of this list of three.

On income tax, NICs and VAT it has been reported in the Financial Times that Chancellor Rishi Sunak has agreed to tie his own hands at next month’s Budget by sticking with the Conservatives’ triple tax lock, which stops him raising the rates of income tax, NICs and VAT.

Treasury officials had hoped Mr Sunak would ditch the Tories' 2019 Election Manifesto commitment, which stops him using the three biggest tax levers to start curbing a deficit that is expected to top £400bn in 2020/21 because of the coronavirus crisis.

Instead, Mr Sunak has agreed with Boris Johnson that the triple tax lock must be maintained, according to Government insiders — a move that could force him to seek increases in other taxes including corporation tax and possibly capital gains tax. "To go back on the manifesto pledge would be a betrayal of trust — pandemic or no pandemic," said one aide to the Chancellor. "It was a very significant pledge at the last election."

It has been rumoured that the Chancellor had been considering corporation tax increases. This is against a background that has the UK corporation tax rate below the average rate for the OECD and materially below that of France and Germany.

The latest rumour is for a special kind of "windfall" tax on those businesses who have done particularly well through the pandemic. Special focus in the press has been on online businesses, with Amazon being in the forefront. There is some talk of using some of any tax raised in this way to help to regenerate the high street. Apparently, some focus groups have shown that the public would (unsurprisingly) support such an "excess profits" charge. Another recent press report though stated that a Downing Street "source" said that the Government was not in favour of an "excess profits" tax. It's worth remembering, though, that last July an official consultation was launched around a fundamental review of business rates, which suggested the potential of an online sales tax. And the Government has already introduced a Digital Services Tax, at 2%, in April 2020.

In relation to any additional tax on business, though, it must be appreciated that although such tax would not appear to obviously affect individuals (possibly explaining their relative popularity among individuals as "revenue raisers"), even corporate tax increases usually end up in at least some of the burden of the tax increase being passed on to the consumer through price increases.

THE GREEN BUDGET

The Institute for Fiscal Studies (IFS) has revisited the Green Budget report it issued in October 2020 and produced updated thoughts on what the Chancellor faces on 3 March.

For the second successive year, in October the IFS published a Green Budget examining the economic and fiscal background to the Chancellor's Autumn Budget … and the Budget never happened. Instead, we had a 12-month Spending Review on 25 November with a few minor income tax changes hidden in the small print. A little over three weeks later the Chancellor was back in plan-revision mode, revealing extensions to both the job retention and loan schemes.

Undaunted – or perhaps accustomed to timing disruptions – on 16 February the IFS presented a set of revised Green Budget ideas, again with economic input from the investment bank, Citi. Much has happened since last October, not least being further UK lockdowns and the emergence of vaccines.

The main viewpoints to emerge were:

- ***UK economic outlook*** Back in October, Citi expected the UK GDP in Q4 2020 to be 6.2% below Q4 2019 levels. The latest figures from the Office for National Statistics (ONS) put the actual fall at 7.8%. Citi's view now is that the vaccine rollout will underpin "a rapid but ultimately incomplete recovery, with substantial reconfiguration still likely to be necessary over the coming years".

Inevitably the economic and pandemic forecasts are intermingled. Citi assumes a gradual fading of virus fears, with some social distancing remaining in place until the end of Q3. As a result, its central case is that by the end of this year the UK economy will still be 3% below its pre-Covid level. It will take until the following quarter (Q1 2022) for an unwinding of household savings to bring the UK up to 1% above its pre-Covid peak. While this is more pessimistic than some forecasts, it comes with considerable uncertainty. Citi's 'plausible adverse scenario', where tight restrictions need to be re-imposed next winter, see the economy starting 2022 still 8% below its pre-Covid level.

One interesting point to come from the Citi analysis is that the £125bn surge in savings that has occurred during the pandemic has been concentrated in higher income households. That would seem to scotch the idea of a mark II version of the Roaring Twenties, as wealthier households have traditionally not been the source of consumer booms – they buy assets with surplus income rather than spend on goods. Indeed, Citi thinks that a large portion of the capital saved "appears to be going into housing". It highlights that expenditure on residential property has jumped much faster than mortgage lending in 2020.

- ***Outlook for spending*** In common with many other commentators, the IFS says the existing support for households and employers will need to be extended beyond April, but calls for a more targeted approach and gradual phasing out as soon as conditions permit. On the contentious subject of the £20 a week uplift to Universal Credit, the IFS would prefer this to stay, partly because it restores most of the real terms cuts from earlier years. If it is to go – with an accompanying saving of about £6.5bn a year – the IFS says "the government should give [a] clear timetable for gradual removal with lots of notice and communication to recipients". Potential additional spending costs include:

  - Dealing with the NHS backlog in non-Covid care – there are already 4.5m on the waiting list.

  - Addressing the long-run costs of lost schooling. The IFS notes that half a year's schooling would normally cost £30bn.

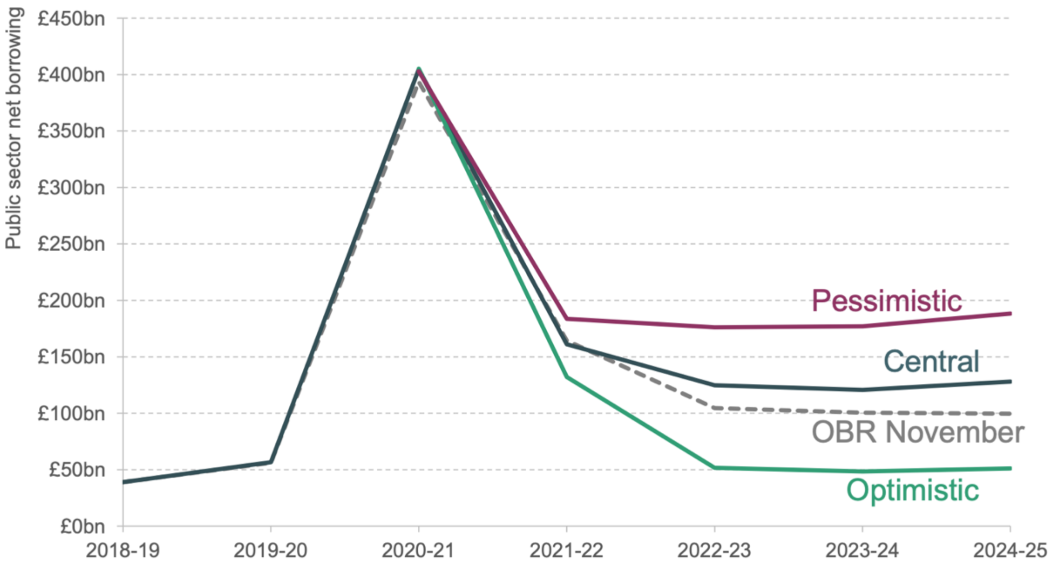
  - Local government will need over £2bn extra by 2025 to cope with cost pressures.

  - Social care still awaits a resolution – the recent White Paper may have been entitled 'Working together to improve health and social care for all' but said little on social care beyond another promise of bringing forward proposals later this year.

  - Boris Johnson's levelling up and green agendas. These are lacking in hard numbers or details, and neither will be cost-free for the Treasury.

- ***Outlook for public finances*** Based on Citi's central scenario, the IFS estimates that the 2020/21 Government deficit will be £400bn. That is £50bn more than the IFS forecast in October 2020 and in line with other independent projections and the Office for Budget Responsibility (OBR). Similarly, the IFS foresees a large fall in the deficit in 2021/22 to around £165bn as the support schemes drop away. However, thereafter the IFS parts ways with the OBR and thinks that the deficit could still be £130bn in 2024/25. The uncertainties in Citi's forecasts shine through here – the pessimistic case is a £190bn deficit, whereas the optimistic scenario sees borrowing back at pre-pandemic levels of about £50bn. There must be a political temptation to hope for the optimistic outcome, but if it does not arrive handling the consequences will coincide with the next Election.

Public Sector Borrowing: Choose Your Optimism Level



In the medium term the IFS is scathing about the £12bn *cut* in spending which appeared in the Chancellor's November plans. It says, "The idea that we will now spend less in the medium-term than we would have done had the pandemic not hit looks implausible. A clear risk to the public finances is that spending will turn out higher, and potentially considerably higher, than is currently assumed."

- ***Tax Outlook*** The bottom line of the IFS/Citi work on the economy and likely spending is that "net tax rises are (even more) likely" with a £60bn a year increase "plausible to balance the books". In the IFS view, raising that sum means acting on income tax, National Insurance contributions (NICs) and VAT. Those are the three areas around which the 2019 Conservative Manifesto drew 'no rate increase' red lines which, reportedly, the Prime Minister remains unwilling to cross. However, Mr Johnson will take some comfort that his namesake at the IFS, Paul Johnson, has said that "For now, Mr Sunak needs to focus on support and recovery". Tax increases can wait.

  The subject of a one-off wealth tax was raised in questions, but the IFS does not see it as a solution. The Wealth Tax Commission proposals were aiming to raise about £260bn over five years, but the IFS calculation is that £60bn *a year* is needed. Thus, a one-off wealth tax would not provide a long-term solution. It is worth remembering that the wealth tax idea started life as a big bang solution to the one-off cost of the pandemic some time before its long-term consequences came into view. The IFS repeated its calls for the alternative of radical reform of the existing taxes that target wealth – capital gains tax (CGT), inheritance tax (IHT) and Council Tax.

- ***Managing debt*** In the central scenario, debt is going to be around 100% of GDP in the medium term. While the net cost of servicing that debt is cheaper as a proportion of Government revenues than it has been in the last three centuries, the IFS again highlighted the dangers created by the Bank of England's quantitative easing (QE) programme. Roughly half of all conventional (non-index-linked) gilts will soon be owned by the Bank, which ultimately means the cost of that borrowing is not fixed, but directly linked to the base rate. The corollary is that the Government and the Bank must retain the confidence of the markets as the standard defence of a rise in interest rates would lead to an immediate sharp increase in debt servicing costs.

COMMENT

We said of the October Green Budget that the figures were full of uncertainty. That continues to be the case with these revised numbers.

BOUNCE BACK LOANS – BORROWERS CAN DELAY REPAYMENTS BY AN EXTRA SIX MONTHS

The Government has announced that businesses that took out Government-backed Bounce Back Loans will now have greater flexibility to repay these loans

Originally, Bounce Back Loan Scheme loan terms were to be up to six years. However, under **Pay as You Grow options, announced on 24 September 2020**, borrowers will have the option to repay their loan over a period of up to ten years (instead of six) - reducing their average monthly repayments by almost half.

In September the Government announced that borrowers would also have the option to move temporarily to interest-only payments for periods of up to six months (an option which they can use up to three times), or to pause their repayments entirely for up to six months (an option they can use once and only after having made six repayments).

However, on 8 February the Government announced that the option to pause repayments will now be available to all from their first repayment, rather than after six repayments have been made, meaning businesses can choose to make no payments on their loans until 18 months after they originally took them out.

The Government says that it has made it clear that lenders are expected to offer Pay as You Grow options to all borrowers under the Bounce Back Loan Scheme and lenders will therefore proactively and directly inform their customers of Pay as You Grow. Borrowers should only expect correspondence three months before their first repayments are due, and all borrowers should receive identical information on Pay as You Grow being offered.

REVIEW OF THE UK FUNDS REGIME

The Government is seeking input on issues across both tax and regulation as part of its review of the UK funds regime.

In its March 2020 Budget, the Government announced it would carry out a review of the UK funds regime, covering tax and relevant areas of regulation. The review started with a consultation on the tax treatment of asset holding companies in alternative fund structures, to which the Government responded in December 2020, and also published a consultation into some particular aspects relevant to asset holding companies. Asset holding companies are used as intermediate or asset holding entities in investment fund structures. Their role is to facilitate the flow of capital, income and gains between investors and underlying investments.

In January, the Government published a policy paper 'Review of the UK funds regime: a call for input'. This is intended to set out the scope and objectives of the review, and invites stakeholders to provide views on which reforms should be taken forward and how these should be prioritised.

This review is wide-ranging and lists 38 questions for consideration, the first of which asks for the top three priority proposals for Government implementation and why. The next ten (numbers 2. to 11. below) cover the UK's approach to funds taxation and ask about the scope of change, as follows:

2. How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer. Could anything have made these reforms more effective, particularly in terms of increasing the attractiveness of the UK as a location to set up funds?

3. Why has uptake of TEFs [Tax-Elected Funds] been limited? Please explain any operational or commercial factors that have influenced their uptake. How could these be addressed?

4. How would the proposals in paragraph 2.9 improve tax efficiency of multi-asset authorised funds? Please explain how the proposals would work in practice and how a proportionate impact on HMRC could be ensured.

5. Are there are any additional changes the government could consider to reduce tax leakage in multi-asset/balanced authorised funds?

6. Where funds are already tax neutral, how would a tax-exempt status for funds influence decisions about how and where to set up funds?

7. How would tax-exempt funds affect the competitiveness and attractiveness of the UK funds regime? Please explain your answer providing evidence and international comparisons where possible.

8. What would be the likely impact if changes were made to the REIT [Real Estate Investment Trusts] regime in the areas discussed in paragraph 2.16? To what extent could investment in the UK be expected to increase, and what would be the drivers for this? Could such changes be expected to impact the extent to which funds with UK and foreign property assets are managed in the UK?

9. Are there any other reforms to the REIT regime that the government ought to consider, and why?

10. Regarding the proposals covered in this call for input, are there any specific considerations that the government ought to take account of in the context of the UK's double taxation treaty network? Please provide as much detail as possible.

11. What are the barriers to the use of UK-domiciled LP Funds [Limited Partnership Funds] and PFLPs [Private Fund Limited Partnerships], and how might tax changes help to address them? Please provide detailed proposals and explain your answers.

This call for input closes on 20 April 2021. The Government will then analyse the responses and intends to consult on specific proposals for reform, prioritising measures that have the greatest impact and those that can be delivered swiftly.

ZERO-RATE EMPLOYER NICs FOR ARMED FORCES VETERANS: MORE INFORMATION

In January, HMRC published a technical consultation on draft legislation that will enable employers to apply a zero-rate of secondary Class 1 Employer National Insurance contributions (NICs) on the earnings of armed forces veterans during the first year of their civilian employment.

It is intended that the new rules will take effect from 6 April 2021 and will provide employers with a relief worth around £5,000 for each qualifying armed forces veteran they hire. This consultation is still open. It closes at 11:45pm on 8 March 2021.

In the meantime, on 10 February, the Government published a policy paper setting out that although this relief will be available from April 2021, from April 2021 to March 2022 employers will need to pay the associated secondary Class 1 NICs as normal and then claim them back retrospectively from April 2022 onwards. However, from April 2022 onwards, employers will be able to apply the relief in real time through PAYE.

The policy paper also states that relief will be available to all employers of armed forces veterans regardless of when the armed forces veteran left the regular armed forces, provided they have not previously been employed in a civilian capacity. Employers will be able to claim relief if they employ an armed forces veteran during the qualifying period, which starts on the first day of the armed forces veteran's first civilian employment since leaving the regular armed forces and ends 12 months later. They can claim relief even if the employment starts before 6 April 2021, but will only be able to claim for the remaining qualifying period.

QUARTERLY STAMP DUTY LAND TAX STATISTICS - Q4 2020

Quarterly statistics on residential and non-residential SDLT transactions valued at £40,000 or above have recently been issued.

The latest stamp duty statistics issued by HMRC show that following the introduction of the stamp duty land tax (SDLT) holiday there has been a significant increase in transactions since the last quarter with total receipts being 47% higher in Q4 than in Q3.

The figures also show:

- Residential property transactions in Q4 2020 were 44% higher than in Q3 2020 and 16% higher than in Q4 2019.
- Non-residential property transactions in Q4 2020 were 26% higher than in Q3 2020 and 6% lower than in Q4 2019.
- Residential property receipts in Q4 2020 were 33% higher than in Q3 2020, but 22% lower than in Q4 2019.
- Non-residential property receipts in Q4 2020 were 81% higher than in Q3 2020, but 3% lower than in Q4 2019.

- Since the introduction of first-time buyers' relief up until the end of Q2 2020 there have been over 540,900 claims that have benefited, and the total amount relieved by these claims is £1,294 million over the period.

- 61,800 transactions were liable to higher rates for additional dwellings (HRAD) in Q4 2020, with the 3% element generating £333 million in receipts, an increase of 34% from the previous quarter, and a fall of 19% compared to 2019 Q4.

- The percentage of residential receipts from HRAD transactions has remained similar at 48% when compared to both Q3 2020 and Q2 2020.

STATUTORY RESIDENCE TEST – MORE FLEXIBILITY REQUESTED FOR TAXPAYERS STRANDED IN THE UK DUE TO CORONAVIRUS

HMRC is being urged to make its policy on UK residence more flexible as individuals who normally live abroad may inadvertently become UK resident because they are stranded in the UK.

The statutory residence test (SRT) already contains an exception that allows days spent in the UK due to exceptional circumstances to be ignored and HMRC has provided guidance on its interpretation of that exception during the current pandemic.

However, that exception is limited to 60 days, and many foreign individuals may have been unable to return to their home country before this time limit expired.

Also, the exception does not apply to all parts of the SRT where day counting is relevant. Many individuals stranded in the UK are required by their employer to work remotely and will have what is known as a 'work tie' if they work in the UK for more than three hours on at least 40 days. This reduces the number of days that they can spend in the UK before becoming UK resident.

And for company directors, there is a potential danger that an inability to return home might make their company UK resident because of the 'central management and control' test for corporate residence. Although, this might be eased under a relevant double taxation agreement.

The results of the above can be that some people will have become UK resident due to circumstances beyond their control, generating potentially significant additional tax liabilities.

STEP (the Society of Trust and Estate Practitioners) has been in dialogue with HMRC to resolve these issues, along with other professional bodies including the Chartered Institute of Taxation (CIOT) and the Institute of Chartered Accountants in England and Wales (ICAEW).

INCOME WITHDRAWAL RATE FOR FEBRUARY 2021

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 February 2021 is 0.5%.