Labour's post-election budget

Synopsis: Now that the Labour Party manifesto has been published, what it does not include can give us clues about Rachel Reeves' first Budget.

Date published: 18.06.2024

'A conspiracy of silence.' - That is the description the Institute for Fiscal Studies (IFS) has been using for current government spending ever since the March 2024 Economic and Fiscal Outlook (EFO) was published by the Office for Budget Responsibility (OBR) alongside the Spring Budget. The IFS calculated that Mr Hunt's last fiscal event implied that day-to-day spending on a range of public services outside of health, defence and education will fall by something like £20bn a year in real terms and capital investment drop by £18bn a year.

For its part, the OBR blames the Treasury for putting forward a spending plan that lacks credibility. In January, Richard Hughes, chair of the OBR, explained the HMT's work to the House of Lords Economic Affairs in the following terms...

"Some people have referred to that as a work of fiction. That is probably generous, given that someone has bothered to write a work of fiction, whereas the Government have not even bothered to write down their departmental spending plans underpinning their plans for public services."

Labour, the Conservatives and the LibDems have all ignored this warning. Instead, they have taken the March EFO numbers as sacrosanct and built their manifesto spending plans atop these fictional foundations. What happens when reality hits and a new government must choose between cuts, more borrowing or tax increases?

Cuts to services hardly look possible – no manifestos have made that promise – and likewise further borrowing has effectively been ruled out by all the manifestos adopting very similar falling-debt-after-five-years fiscal targets. That leaves tax increases, where again the manifestos have drawn big red lines. You only have to look back to the last Parliament to see that red lines can be rapidly erased (eg Health and Social Care Levy), but assuming...that does not (overtly) happen; and Rachel Reeves is Chancellor, what are her options?

Income tax

The Labour Manifesto says 'Labour will not increase taxes on working people, which is why we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT.' The reference to 'taxes on working people' is one that has regularly comes from Kier Starmer, which may be driven by the Conservatives' focus the benefits of NICs reduction for those earning around the median income.

The phrasing raises the question of whether income that is not generated by work will see a tax increase. Go back to September 2021 and Reeves was telling the Sunday Times, "I do think that people who get their income through wealth should have to pay more – people who get their incomes through stocks and shares and buy-to-let properties." Now re-read that manifesto pledge – it makes no reference to savings tax rates or dividend tax rates or even the possibility of more tax rates (hat tip to Scotland). There is an argument that if the personal savings allowance and dividend allowance are left in place, then 'working people' would be unaffected by increases to tax on investment income.

National Insurance Contributions

The manifesto statement leaves open the possibility that NICs could be applied to income other than the earnings of those under State Pension Age. Ironically Rishi Sunak set the precedent when he extended the 1.25% Health and Social Care Levy to dividend tax rates. Subsequently, when the levy was culled by Kwasi Kwarteng, the dividend surcharge was left in situ.

The levy also points to another revenue-raising opportunity – inventing a 'new' tax, even if it looks very much like an increase to an old tax. It could be a tempting option, especially if it had NHS/health branding attached. While the Treasury loathes hypothecated tax, in practice the expenditure on health is so large than any hypothecation will only account for a small part of the total bill.

Capital Taxes

On capital taxes, the manifesto is silent, bar a promise (worth £560m a year by 2028/29) to scrap the CGT treatment of carried interest. In recent Q&As Kier Starmer has studiously avoided any commitment on CGT, saying that he cannot write budgets for the next four years now. Just over a year ago Reeves was telling the *Financial Times* that she had "no plans" to align CGT and income tax rates.

Plans can change, but the scope for wringing out more revenue from CGT may be limited. The HMRC illustrative tax change ready reckoner suggests that raising both main rates of CGT by 10% in April 2024 would have *reduced* tax receipts by about £2bn in 2026/27 due to behavioural effects, but the same increase to the Business Assets Disposal Relief rate would have added £0.64bn.

In other interviews around the same time as her CGT comments, Reeves said that a wealth tax was off the table. The manifesto makes no mention of wealth tax and it probably is still off the agenda, at least for the time being. One reason for that is inheritance tax – another missing-in-manifesto item – is a reasonable proxy. The recent IFS proposals to boost IHT revenue by reforming several reliefs (including the IHT pension exemption) would be much easier and quicker to introduce and were estimated to bring in £3.6bn a year by 2029/30.

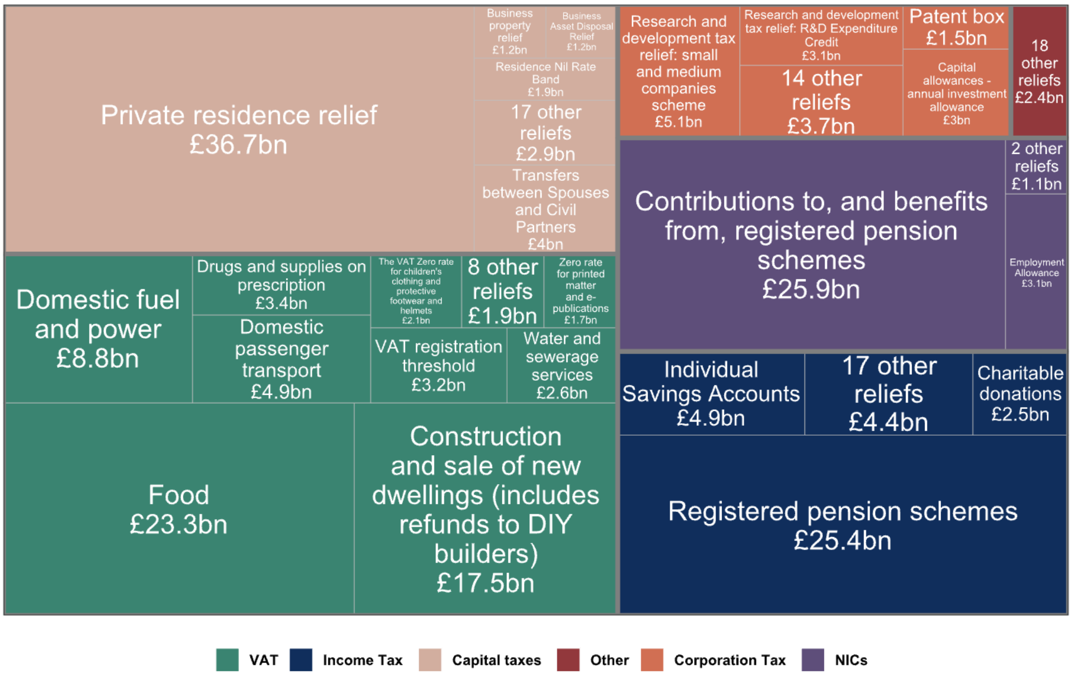
Pensions

The reinstatement of the lifetime allowance (LTA), which Reeves promised in her response to last year's Spring Budget, is also a manifesto no show. Its absence was trailed at the start of the manifesto week in the *Financial Times*. The LTA's continued demise has not been formally confirmed (or denied) by Labour, although such is the power of the FT, many have now taken it as a fact. That may be reading too much into the LTA's manifesto absence.

Reliefs

Another of Reeves 2021 comments was that "…we will look at every single tax break. If it doesn't deliver for the taxpayer or for the economy then we will scrap it." HMRC told a 2022/23 Treasury Committee meeting that there were 1,180 tax reliefs in force, so there is plenty for a new Chancellor to examine beyond the cliched low hanging fruit of the reliefs for pension contributions, as this HMRC treemap illustrates…

Estimated costs of costed non-structural tax reliefs in 2022 to 2023



Tweaking the largest relief – the CGT exemption for private residences – is not as much of an electoral suicide pill as it once was, given that owner occupation is now down to 65% in England. Some European countries effectively charge CGT on downsizing, ie if all sale proceeds are not reinvested in the new home.

However, over the weekend the option of tax on private residence gains has been shut down by Starmer following suggestions in the *Daily Telegraph* that this was on a hidden CGT agenda.

Council tax

According to the latest EFO, council tax will raise £46.9bn in 2024/25, making it the fifth largest source of revenue. Council tax – a devolved tax – is unmentioned in the Labour manifesto, although there is a detail-free pledge to 'replace the business rates system, so we can raise the same revenue but in a fairer way'.

In England, council tax bands are based on April 1991 values. Since then, UK house prices have risen by 371% according to Nationwide, but this hides a wide dispersion. Greater London prices are up 567% while those in the North of England have risen 225%.

There were more section 114 (aka 'bankruptcy) notices issued by English councils in 2023 than in the 30 years before 2018, underlining the precarious state of local government finances. A recent Local Government Association survey revealed that close to one in five councils "think it is very or fairly likely that [they] will need to issue a section 114 notice' by the end of 2025.

A reform of council tax could be woven into devolution of more power and finance to the regions and could also provide a subtle shift of some (additional) tax raising responsibility away from Westminster. Additionally, creating new top price bands can offer another simpler, indirect form of wealth tax.

Comment

In theory a three-year Spending Review (2025-2028) is due out by November. That would force any new Chancellor to turn the not-even-fiction into some hard facts.

While the word 'review' occurs 16 times in the Labour manifesto, on no occasion is it preceded by the word 'spending'. It is quite possible that Labour will have a one year Spending Review, giving it time to draw up the three-year version. That could have ramifications for Reeves' first Budget...and her second.

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