What 30 October might deliver: part 1

Following the discovery of a £22bn black hole, Rachel Reeves warned of 'difficult decisions to meet our fiscal rules across spending, welfare and tax'. What might the day before Halloween entail?

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Rachel Reeves 'spending inheritance' announcement revealed a projected overspend for 2024/25 of £21.9bn and offsetting measures of £5.5bn, leaving a gap of £16.4bn for the current financial year. For 2025/26 the offsetting measures are forecast to deliver savings £8.1bn, but the spending figures will have to await the first part of the Spending Review, due alongside the Autumn Budget.

In her speech on Monday, Reeves said "I have to tell the House that Budget will involve taking difficult decisions to meet our fiscal rules across spending, welfare and tax." Nevertheless, she went on to confirm the Labour "...manifesto commitment that we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT." In a subsequent interview with the News Agents podcast, Reeves said, "I think we will have to increase taxes in the Budget,"

So, what might we see on 30 October? In this technical paper we examine Reeves' options in three areas; the 'locked' personal taxes (income tax, national insurance and NICs), CGT and IHT. Our next technical paper on this subject will look at what might happen to pensions, wealth tax and the definition of all the key fiscal yardstick, debt.

National insurance, income tax and VAT

Before considering any other options, it is important to note that the Labour manifesto pledge was '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.' As the previous government amply demonstrated, not increasing rates still leaves plenty of scope for increasing revenue by freezing or even reducing thresholds. One reason is because together the income tax, NICs and VAT account for 63% of all tax revenue.

Fiscal drag will be less rewarding for the Treasury if inflation remains around the current 2%, but it is still easy money. For example, the HMRC tax ready reckoner says a change of 1% in the personal allowance is worth £1.1bn and a 1% change in the basic rate limit is worth £0.6bn. Ignoring 2% inflation on those two measures for 2028/29 and 2029/30 – adding two years to the existing freeze – would yield £3.4bn in 2029/30 – the year in which the deficit must be falling under the fiscal rules.

The as yet undefined 'working people' reference (see here for Starmer and Reeves differing takes) leaves scope for increasing income tax (and maybe even levying NICs) on income other than earnings – as the previous government did with dividend taxation. There have regularly been calls to align dividend tax more closely with the tax on earnings, a move that would see basic rate taxpayers pay about 16% rather than 8.75% but – at least in theory – mean small cuts for higher and additional rate taxpayers.

The personal savings allowance (PSA), which cost £810m in 2023/24 according to HMRC estimates, may also be in the firing line. It is conceivable that Reeves could scrap it and reinstate deduction of 20% tax at source. Higher interest rates have made the PSA not only more costly, but also created a greater taxable population that is outside self assessment and whose tax liability is collected, if at all, via PAYE coding with an inbuilt lag. Moving back to deduction at source would have a one-off effect of doubling receipts by removing that lag.

Another investment possibility is a cap on the total value of ISA investment, something that the Treasury has looked at in the distant past. The 2023/24 tax relief cost of ISAs is estimated at £6.7bn, a figure that will have again been boosted by high interest rates. Pre-election Reeves said that she favoured the UK ISA, so a limit on annual investment looks less likely that a ceiling on the total investment qualifying for CGT and income tax exemption.

HMRC's latest ISA stats (for 2020/21, alas) show that there were 3.9m ISAs valued at over £50,000 and that 327,000 individuals with income exceeding £150,000 had ISAs with an average value of £94,000.

VAT could also be a target for threshold adjustment. Last year the Resolution Foundation suggested a reduction in the threshold from £85,000 to £30,000, raising a £1.5bn a year. The then CEO of the Resolution Foundation, Torsten Bell, is now Parliamentary Private Secretary to the Cabinet Office Minister (and member of Starmer's 'quad'), Pat McFadden.

Capital Gains Tax

Increases in CGT have been on most hit lists since Labour refused to rule them out in pre-election interviews. CGT is due to raise £15.2bn in 2024/25 and £16.2bn in 2025/26. The HMRC ready reckoner is pessimistic about the benefits of a significant increase in rates. For example, it says a 10-percentage point increase in all rates would *reduce* revenue by about £1.35bn, as greater income (£710m) from the disposal of assets qualifying for Business Assets Disposal Relief (BADR) would be more than offset by a reduction of tax (£2,055m) on unrelieved gains as investors waited for a more tax-friendly climate (or death). A 5 percentage points increase would yield £420m according to HMRC.

These numbers are at odds with some think tank calculations. For example, a few days ago a Resolution Foundation report suggested that raising CGT rates to 16% (basic), 32% (higher) and 37% (additional) and reintroducing indexation relief would produce £7.5bn a year.

The quick and dirty option would be simply to scrap BADR, which HMRC estimates cost £1.5bn in 2023/24.

The general rebasing of values on death is also something that has gained attention as an area for tax-raising reform, particularly when agricultural or business relief also applies. Applying CGT at death was an idea floated in the Office for Tax (OTS) Inheritance Tax Simplification Review. The OTS estimated that for 2015/16, CGT levied at death would raise £1.3bn and affect 55,000 estates (against 24,500 paying IHT). Those numbers, particularly in terms of taxpayer numbers, would skew higher for CGT now, given the reduction in the annual exemption. That underlines one issue about levying CGT on death. As the OTS said '...many more people would be brought into a charge to tax on death than are currently subject to Inheritance Tax... It would also involve a substantial Exchequer cost as well as impacting a much larger number of people.'

Two halfway houses are possible – removing uplift if business or agricultural relief is claimed (assuming either survive) or simply not resetting the base cost for the recipient of an inheritance. That would mean the deceased's base cost would pass across to the new owner in the same way as holdover relief currently operates. The drawback of this would be a much smaller immediate tax boost.

Inheritance Tax

IHT is the second manifesto-unmentioned tax which has attracted media speculation as a Budget target, especially as it arguably does not impact on 'working people'. IHT is projected to yield £7.5bn in 2024/25 and £7.7bn in 2025/26, meaning in total it raises about as much as 1p on the basic rate of income tax.

The recent paper from the IFS is a good summary of the areas that could provide extra revenue...

- *Business and agricultural reliefs*. The IFS put the cost of these reliefs at £1.4bn and £0.4bn respectively. HMRC data show that business relief claimants typically number fewer than 5,000. The IFS proposals were to...
    - Scrap business relief entirely for AIM shares, saving £1.1bn in 2024/25, rising to £1.6bn by 2029/30.
    - Cap the two reliefs to a transferable £500,000 per person. As much of these reliefs is currently claimed by the largest estates, the IFS estimates the change could generate £1.4bn in the current tax year, rising to £1.8bn by 2029/30. The IFS does not distinguish between 'working' and passive asset owners. This would be an option for the government, but would add complexity while reducing tax receipts.
- *DC Pensions* The IFS, along with many others, favours bringing pension death benefits within the ambit of IHT. It also thinks that income tax should be levied at a minimum of basic rate on any funds withdrawn by a successor/dependant, regardless of the age at death of the pension owner. To take account of this additional tax the IFS proposal would apply IHT to 80% of gross funds. The IHT raised would initially be small beer - £0.2bn in 2024/25, rising to £0.4bn by 2029/30.

More radical reform, such as a switch to taxing recipients rather than donors, could raise more money, but would involve a major legislative overhaul. Ms Reeves may feel her political capital is best spent elsewhere.

Comment

The Chancellor has given the clearest possible signs that taxes will rise on 30 October. What we have explained here is by no means an exhaustive list – remember nobody forecast the means-testing of Winter Fuel which arrived on Monday.

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