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What 30 October might deliver: part 2

Synopsis: The second part of our look at what the day before Halloween might deliver in terms of tax and other changes.

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In Part 1, we examined what Rachel Reeves' Budget on 30 October might do to the 'locked' personal taxes (income tax, national insurance (NICs) and VAT), capital gains tax (CGT) and inheritance tax (IHT). In this second part, we stray away from the capital taxes at the top of everyone's Budget target list and examine some other ways to balance the books/fill the black hole...

Pensions

Tax relief on pension contributions is the 'low hanging fruit' which successive Chancellors have done no more than nibble at. HMRC puts the cost of pension income tax relief in 2022/23 for all contributions (employer, employee and self-employed) at £42.5bn. HMRC statistics also show that 56% of up-front income tax relief was given at the higher rate and 7% at the additional rate.

In the run up to the Spending Inheritance statement there was much media comment on a Treasury presentation to the new Chancellor that proposed a flat rate relief of 30%. This would benefit basic rate taxpayers ('working people'?) but, on Institute for Fiscal Studies (IFS) calculations, boost Exchequer receipts by £2.7bn. The revenue-neutral rate would be around 33%, although that makes some behavioural assumptions which are hard to model accurately.

Administration of a flat rate scheme could also be difficult because of the need to 'tax' employer contributions for higher and additional rate taxpayers, especially in the context of defined benefit (DB) schemes.

Another alternative would be to remove some or all NICs relief, worth about £15.4bn for employers and £8.6bn for employees.

The future restoration of the lifetime allowance remains a possibility. Its absence from the Labour manifesto was not confirmation that the idea had been abandoned. A possible easier alternative would be to reduce the maximum pension commencement lump sum from the current £268,275 to, say, £150,000. The inevitable transitional reliefs mean that neither of these changes would be the quick money spinner that reform of contribution relief would represent.

One allowance that has remained in place, the annual allowance, could also be revisited, perhaps with the £20,000 increase introduced in 2023/24 being unwound. However, any such move raises the spectre that looms across all potential pension changes: what will be the impact on senior NHS personnel? The Government will not want another remuneration-based NHS battle having just reached a costly recommended offer for junior doctors.

Wealth tax

Rachel Reeves had said she was not in favour of a wealth tax in interviews she gave before the election. When, in earlier times, she spoke of taxing wealth more heavily, the emphasis was on higher IHT, CGT and income tax (on investments) rather than the creation of a new tax.

In the past consideration of a wealth tax has hit the brick wall that the administrative costs would be significant, relative to the revenue produced. The last serious proposal for a wealth tax from the independent Wealth Tax Commission was for a 5% one-off levy (payable over five years) on wealth (*all* assets) above £0.5m. In 2021, this was projected to produce a total of £262bn over its limited life. Despite the publicity that the proposals received, the only Labour interest was from its far fringes and, a year later, the topic had disappeared.

Given the electorate that Labour gained in July and the complexity of the legislation, it would be a brave move to introduce a wealth tax rather than look for more revenue from existing capital taxes. A wealth tax polls well – most people support taxing somebody richer than they are – but the appeal disappears once it is explained that pensions and homes would fall with the tax's ambit. Nevertheless, a wealth tax continues to be advanced as a policy from the fringes. For example, the Green Party's manifesto proposed a wealth tax of 1% on assets worth over £10m, and 2% on assets worth more than £1bn.

A halfway house on a wealth tax is to apply a minimum tax rate on income above a certain threshold or, as it appears Biden may be considering in the USA, taxing *unrealised* gains.

Reforming the fiscal rules

In her speech on 29 July, Reeves said, '...we will meet our fiscal rules'. These are similar to, but not the same as Jeremy Hunt's. The Labour Manifesto said that...

- The current budget moves into balance, so that day-to-day costs are met by revenues. (In 2023/24 the current budget deficit was £46.9m, 1.7% of GDP and was forecast by the Office for Budget Responsibility (OBR) in March 2024 (pre-Spending Inheritance) to be £20.7m, 0.7% of GDP in the current financial year, turning into a marginal surplus by 2027/28.)

- Total debt must be falling as a share of the economy by the fifth year of the forecast.

Unlike Hunt, Reeves has no explicit limit on overall in-year Government borrowing, but, just as her predecessor was, she is constrained by the five-year debt reduction goal. This is gameable to a point, as it is a rolling target. For Reeves, that means her Autumn Budget will be looking one fiscal year further out than Hunt's March Budget – 2029/30 rather than 2028/29.

History is littered with revisions and technical tweaks to fiscal rules when the targets look unachievable. Currently, the one which is occupying the nerdiest of fiscal experts is a change to the definition of total debt. This is currently defined as public sector net debt excluding the Bank of England - £2,524.4bn or 91.6% of GDP in June 2024. Although the Bank of England debt is excluded, it does figure in the overall number because of the way in which quantitative tightening (QT) is accounted for. This is where matters became arcane, but financially significant.

The rules for quantitative easing (QE) were changed by George Osborne in 2012 to mean that, effectively, the surplus interest earned by the Bank from QE purchases was retained to the Treasury. The then Chancellor also agreed that if the Bank suffered net interest shortfalls and/or capital losses as the result of the QE programme, these would be indemnified by the Treasury. Up until October 2022, the Treasury gained a net £153bn from this bargain, as explained in this OBR note.

By 2023/24, the Treasury was having to pay the Bank of England (BoE) over £44bn to cover excess net interest (thanks to the high Bank Base Rate and low gilt coupons) and the capital losses on bonds sold under QT or reaching maturity (QE generally resulted in gilt purchases at prices above par). Only the interest cost shows up in the annual deficit, but both it and the capital losses are counted in total debt. This has a variety of odd consequences, such as the total debt ex BoE figure being sensitive to the speed at which the Bank sells gilts under QT or its holdings mature. Logically (a dangerous word in this area), it does not make sense for the decisions the Bank makes on managing its balance sheet to impact on the Chancellor's all-important five-year 'headroom'.

A redefinition of debt which revises how QT is accounted for is a possibility on October 30, as is a change or suspension of QT (presented as a Bank decision, which is currently due in September). One estimate, from Toby Nangle at the FT, was that if QT had been stopped at the time of the last Budget, Jeremy Hunt would have had about £22bn of headroom in 2028/29 against the OBR's estimate of £8.9bn.

Comment

There will doubtless be more rumours about how the Chancellor might raise taxes as we move nearer to 30 October. To an extent, she has already picked one target: *wealthier* pensioners who will no longer receive Winter Fuel payments, nor have their care fees capped. They would also be in the line of fire for higher capital taxes. And they are not, generally, 'working people'...