Preparing for the Budget

On 3 March 2021, Chancellor Sunak will deliver the latest national Budget. Last year, Sunak cancelled the traditional 'Autumn statement' in favour of providing a near-term 'Winter Economy Plan'.

This means that the new Budget may offer us our first real glimpse into the government's longer-term plans to tackle the fallout of both the COVID-19 pandemic and the UK's post-transition relationship with the EU.

This is only Rishi Sunak's second Budget announcement, having replaced Sajid Javid at the helm of the country's financial planning just weeks before the 2020 Budget. With lockdown playing havoc with UK employment levels and economic activity, it goes without saying that pandemic support is likely to play a central role in the new budget. But what can we expect in terms of changes to the current tax rules, and what will the Budget mean for individuals and their financial plans?

Which tax areas could see change?

We could see a sharp rise in the rate of **capital gains tax** (CGT) in March. The Chancellor has already asked the Office for Tax Simplification (OTS) to look into CGT, and its first report has been published. The OTS report includes a recommendation to increase CGT rates to align more closely with those of income tax, on the grounds that the gap between CGT and income tax distorts taxpayers' behaviour. This is because many investors actively seek to create gains taxed at a top rate of 20% (except for residential property which is taxed at 28%), compared with earned income which can be taxed as high as 45%. If these rates were aligned, investors would no longer have an incentive to try to turn income into gains. However, CGT does not raise much revenue when compared with other taxes – currently, CGT accounts for approximately £9.5bn in tax revenue from fewer than 300,000 taxpayers each year.

Further thought might be given to how any significant rise might affect business owners who are looking to sell. Until relatively recently, these owners were able to benefit from 'entrepreneurs' relief', which resulted in an effective 10% rate of CGT for gains of up to £10m. In the March 2020 Budget, this was replaced by the less generous '**business asset disposal relief**', which only allowed the 10% rate to be applied to gains of up to £1m.

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Business owners could also be affected by changes to **inheritance tax reliefs**, namely **Business Property Relief** (BPR) and **Agricultural Property Relief** (APR). The main rationale for this is to prevent the sale or break up of businesses or farms to meet the cost of inheritance tax following the death of the owner.

A 2019 OTS report into IHT suggests the removal of the capital gains ‘base cost uplift’ on death where the assets concerned have not been subjected to IHT, due to IHT reliefs. At present, when someone dies, there is no capital gains tax to pay on profits they may have made on investments. If the ‘uplift’ on death was removed where an IHT relief was claimed, tax could be payable on the gain in value of the business.

The OTS have also made recommendations for the simplification of the rules relating to **gifts made during a person’s lifetime**. There are a number of annual IHT exemptions, such as the £3,000 annual exemption, as well as the ability to gift surplus income, this latter relief being particularly attractive to those with high levels of income. It is possible that these will be wrapped up into a single annual exemption which may be less generous overall.

Which areas are likely to remain untouched?

Income tax, national insurance and VAT form the largest sources of revenue for the UK government, together accounting for almost 60% of total tax revenue. The government did make an election pledge against increasing income tax, national insurance or VAT. While this promise was made before the pandemic, it would still be a surprise to see changes in these areas.

Meanwhile, in recent years, a number of measures have been introduced to limit the amount of **pension tax relief** which can be claimed. This includes the ‘tapered annual allowance’, which restricts pension contributions for the highest earners, and which has added much complexity to the pension savings regime. While there have been suggestions of a flat rate of pension tax relief – perhaps at 20% or 25% – this might be a stretch in the midst of a pandemic. Those hoping for a major overhaul of the pension regime may need to wait for a future budget.

Can we mitigate the impact of potential tax increases?

Unfortunately, by the time a major tax change is announced, it is often too late to take action. Equally, though, it is risky to make planning decisions ahead of time based purely on speculation.

As we write, many savers with investment profits are considering whether or not to sell before the Budget, in order to ensure that any capital gains tax is paid at the current (pre-Budget) rate. If it is an investor’s intention to take these profits and reinvest them into other assets, it could very well be a worthwhile course of action. However, if they would otherwise have no real desire to sell, then it may not be sensible to create a tax liability at this point, when by continuing to hold the asset no tax would be payable for some time.

We always advise our customers to ensure that all of their available annual tax allowances are fully used. This includes the personal allowance of £12,500, the dividend allowance of £2,000, and the capital gains tax allowance of £12,300.

What does this mean for families coordinating their financial strategies and resolving complex financial affairs?

Tax aspects are just one part of overall wealth planning for families to consider in the current environment. Among our clients, we feel that there has been a recent increase in the number of people making or updating their wills, which in turn has led many to give thought to lifetime giving. This could mean helping grown-up children onto the housing ladder, or aiding those who already have their homes to pay down their mortgages. In addition, given the potential for changes to some inheritance tax reliefs, some of our clients who had been considering making gifts have been moving ahead with their plans.

Making substantial changes on the grounds of pure speculation is never advisable. But for those who had already planned to make a change, it may be worth considering if alterations to current tax rates would impact the timing of your decision. Of course, we always advise seeking advice on your tax position before making any significant decisions.

The value of investments and any income from them can fall and you may get back less than you invested.

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