RATHBONES

THE NEW LABOUR GOVERNMENT'S PLANS – AND HOW THEY AFFECT YOUR FINANCES

BY RATHBONES FINANCIAL PLANNING
5 July 2024

LABOUR HAS TAKEN POWER IN THE UK. WHAT CHANGES ARE COMING TO MAKE THE SUMS ADD UP, HOW COULD THEY AFFECT YOU AND WHAT CAN YOU DO ABOUT IT?

Keir Starmer's Labour government has promised not to raise taxes on working people, but that leaves investors in uncertain waters. The new government has committed to retain much of the outgoing government's spending and taxation plans, prompting the question: where will the money come from to pay for new policies?

The Brexit issue has now largely been settled and, under Starmer, the Labour Party has abandoned his predecessor's economic radicalism, declaring it's "proud of being pro-business". The party's manifesto pledges to cap Corporation Tax at the current 25%, with potential for it to drop if required to remain competitive against other countries.

The government will abide by strict fiscal rules introduced following 2022's 'mini-budget' fiasco. These rules limit the scope to make dramatic changes in spending without increasing taxes. Labour says it has costed its plans, yet independent watchdogs are dubious that the combination of economic growth and planned new taxes will be strong enough to deliver as much tax as forecast. The taxes that Labour has promised not to hike are Income Tax, National Insurance and VAT. With Income Tax thresholds frozen until 2028, as set by the outgoing Conservative government, the taxman's work in raising more money through tax will be done by inflation and wage growth anyhow.

Labour has also promised not to implement a wealth tax – although this did not appear explicitly in the manifesto. And even if a new wealth tax isn't levied, there are other ways to target wealth. We've put together a summary of potential changes that we think could be implemented; however, they shouldn't be seen as recommendations or financial advice. Tax law is complicated, heavily dependent on your personal circumstances and prone to change.

What you need to know

- Our article is based on our current understanding of UK tax laws and should not be taken as financial advice. We recommend you speak to a financial adviser or tax specialist if you're unsure what to do
- Tax treatment depends on the individual circumstances of each client and may be subject to change in future
- The value of investments and the income from them may go down as well as up and you may not get back what you originally invested

Capital Gains Tax rates

The easiest way for Labour to raise cash would be to increase Capital Gains Tax (CGT). Relatively few people pay CGT – usually less than 0.5% of the population in any one year. However, the percentage of people paying the tax has increased noticeably over the past decade, while the tax liability has jumped more than 300% in that time to £16.7 billion (as of the 2021/22 financial year).

Labour says it has "no plans" to raise Capital Gains Tax rates, and there's little wiggle room on allowances, as the tax-free allowance halved to £3,000 on 6 April 2024. Allowances any lower than that and voters could be filling out tax returns for the odds and ends they've sold. There are exemptions that could be trimmed as well, including antiques/jewellery below £6,000, second-hand cars and wine, Individual Savings Account (ISA) holdings, gambling winnings and capital appreciation on government bonds. It would be a similarly tough sell to scrap these. There's also Business Asset Disposal Relief (formerly known as Entrepreneurs' Relief), which reduces the rate of Capital Gains Tax to just 10% for the sale of 'personal businesses' (where an owner/officer holds at least 5% of the company) to incentivise business creation. Ending this subsidy could jar with Labour's business-friendly stance – besides, a £10 million lifetime cap was slashed to £1 million in 2020, so the Exchequer has already raided this tax relief somewhat.

What could you do about it?

IF CAPITAL GAINS TAX RATES INCREASE OR ALLOWANCES FALL

You can crystalise losses before the change, maximising your allowance. Also, you can use losses from prior years to reduce your liability. You have up to four tax years to report a loss to HMRC, but the losses can be brought forward indefinitely. These losses become more useful as CGT rises because it shields a greater portion of gains from tax. You can also defer CGT by investing in the Enterprise Investment Scheme.

If CGT rates were changed, Labour could equalise CGT with the marginal Income Tax rate, as Conservative Chancellor Nigel Lawson did in 1988. If so, that would double the CGT rate for Higher Rate taxpayers to 40% and by even more for Additional Rate payers to 45% (residential property gains currently attract a higher rate of 24%). Given most CGT taxpayers are wealthier, that would boost the government's coffers considerably. On paper at least: it would also encourage people to avoid the increased levy through a mixture of financial planning, buying offshore bonds, swapping shares for funds that can trade without incurring CGT, investing in the Enterprise Investment Scheme and simply not selling. All of the above could reduce the take. Back in 1988 Lawson increased the CGT rate for the wealthy, yet decreased it for standard rate payers. CGT receipts dropped considerably over the following five years.

What could you do about it?

IF CAPITAL GAINS TAX RELIEF ON DEATH IS REMOVED

This would make it more beneficial to make use of allowances and offset losses where possible. Astute tax planning could help reduce tax liabilities and ensure more of your money is passed on to your loved ones.

Something else that Labour may review is the reset of capital gains on assets on the death of an owner. When assets are transferred at death, any capital gains made are wiped (although Inheritance Tax (IHT) may be payable if the beneficiary isn't a spouse): it is as if the assets have just been purchased at their current value. If the assets are jointly held, this CGT relief applies to the deceased's half share. This is extremely valuable, as it means assets can be disposed of without tax. When combined with Business Relief, this rule can be very powerful indeed. A portfolio can be sold and moved into Alternative Investment Market (AIM) stocks, and under current rules, after two years it would be completely free from IHT. Of course, investing comes with the risk that the value of your investment may fall.

If the CGT reset rules were changed, CGT would be levied on all uncrystallised gains over a person's life and then IHT would be levied where applicable. A way to prevent this could be using offshore bonds to roll up annual gains without paying CGT and Income Tax.

What could you do about it?

IF DIVIDEND TAX RATES AND ALLOWANCES CHANGE

It could make sense to adjust your investment portfolio to reduce exposure dividend-paying stocks in favour of those companies that reinvest in themselves or buy back stock. We suggest talking to an adviser first.

Another way to indirectly tax wealth would be to increase dividend tax rates – perhaps equalising those with marginal Income Tax rates as well – or to reduce the current £500 tax-free allowance on dividends.

Breaking into the pensions piggy bank

Over past decades, the UK built up a range of generous tax incentives for savings, from pensions to ISAs. In recent years the generosity has cooled somewhat. Labour may continue to turn the dial, especially as part of the vague "pension reform" mentioned in its manifesto.

Changing to a flat rate of tax relief on pensions has been discussed in the past. Because tax relief on pensions accrues at your marginal Income Tax rate, the wealthiest receive the largest savings. This may spur Labour to reform pensions toward a single, flat tax rate on pensions (say 20% or 30%) regardless of income band. A flat rate of tax would be much harder for employers and savers to administer and would lead to double-taxation for higher-paid workers. This is because at a flat rate of, say, 30%, Higher Rate taxpayers would pay 10% on income deposited in their pensions (because their marginal rate is 40%) and then another 20% (if they are Basic Rate taxpayers at retirement) when they withdraw them years down the line. This is complicated and would take time to roll out, so it's not something we would expect early in a Labour term. But it's something to watch out for.

Up to £60,000 a year can be deposited before tax into pensions, whether auto-enrolment schemes at work or Self-Invested Personal Pensions (SIPPs).

However, that is much lower than the £255,000 limit in place before the Global Financial Crisis. And changes since 2016/17 have eroded the generosity further for the very wealthy. Today, the annual limit for tax-free payments into a pension is tapered by £1 for every £2 earned over £260,000. The standard annual allowance could be cut, bringing more cash into HMRC's net.

What could you do about it?

IF PENSIONS TAX RELIEF CHANGED TO A STANDARD FLAT 30%

This would greatly reduce the benefit of surrendering your income to a pension to avoid higher rates of tax. For higher earners, it would also mean paying tax twice – once when it's put in a pension and then again when it's withdrawn as income. Financial advice can help determine whether it makes sense to add to a pension and then how to arrange your affairs to keep taxes to a minimum in retirement.

Labour has ditched its plan to reinstate the recently scrapped £1,073,000 standard lifetime allowance for pension pots, above which extra tax was levied, particularly on higher earners. This is good news; however, it's important to remember that there are still limits on what lump sums can be taken tax-free from your pension. And they look pretty similar. There is a new 'Lump Sum Allowance' of £268,275 which is 25% of the old lifetime allowance; a 'Lump Sum Benefit Allowance' limits your total tax-free pensions payouts at death to £1,073,100; and the maximum amount you can transfer overseas without penalty is capped at, you guessed it, £1,073,100.

The ISA is another savings device that has grown increasingly generous in recent years. It was actually introduced by New Labour in 1999, replacing an earlier savings scheme with a more flexible alternative. However, one report by the Resolution Foundation, a thinktank that seeks to improve the living standards of low to middle-income families, has argued that HMRC could save £1 billion each year by capping ISA savings at £100,000. Everything over that would be taxed as normal. Yet the number of people it would affect would be very small: there are just 1.5 million people living in families with more than £100,000 of ISA savings per adult. If this were to come into force, it would make sense for people to reassess what to keep in their ISA and determine whether it made sense to move it to another tax wrapper.

In this year's Spring Budget, Conservative Chancellor Jeremy Hunt promised an extra £5,000 of ISA allowance strictly for investment in UK assets (the 'British ISA'), albeit without an implementation date. This hasn't appeared in either main party's manifesto, so its future is uncertain. The "pension reforms" promised in Labour's manifesto may include keeping this idea alive as a way to boost investment in the UK. It may even ratchet up even further this quid pro quo of tax savings for investing in UK assets, perhaps by reducing the general ISA annual allowance and adding to the allowance for British ISAs. That would greatly reduce the choice available to investors and could introduce a large bias to sterling investments in portfolios, which could reduce returns relative to the risk taken on. This bias would create additional risks and require investors to make difficult assessments about whether tax-efficiency offsets a balanced portfolio comprising the whole global market. Or Labour could leave the plan by the wayside.

Tax-incentivised investments such as Venture Capital Trusts, the Enterprise Investment Scheme and Business Relief investments are due to come under the microscope in 2025. They offer a range of generous relief from Income Tax, CGT and IHT, yet Labour Shadow Chancellor Rachel Reeves broadly favours these investment vehicles for the effect they have on UK business growth and entrepreneurship. We will have to wait and see what next year brings on this front.

What could you do about it?

IF ISAS ARE MADE UK-ONLY INVESTMENT VEHICLES

This would be a radical move that would greatly reduce the diversification and potential returns of all UK taxpayers. If it were to be introduced, portfolios would need to be reappraised to determine whether the tax-sheltering benefits of the ISA were outweighed by the lack of diversification and limited opportunities that the ISA would then offer.

VAT on school fees

Charging VAT on private school fees, as Labour has pledged, is another way to raise money without upsetting most voters. It will add roughly 20% to the sticker price of private education at a stroke. The plan to end private schools' 80% relief from business rates could well be passed on to parents through higher fees too.

The average cost of private school education in the UK is about £15,000 a year (not including boarding fees), up 20% in inflation-adjusted terms since 2010. Throwing another 20% of VAT on top is therefore essentially akin to adding more than a decade's worth of price rises overnight. For a while, it was hoped by some that boarding fees would be left exempt from VAT. However, Labour has now unambiguously confirmed that boarding will be included in its legislation. The government has said that it would levy VAT from January 2025 at the earliest.

If possible, prepaying fees ahead of the changes could save you a lot of money. Grandparents could help with this big upfront cost, which would also double as a tax-efficient transfer of wealth to the next generation. Be sure that prepayment plans are robust. Invoices for prepaid fees must be carefully itemised to ensure they clearly show the terms, years and pupils to which they relate. A single line labelled 'prepaid school fees' could come a cropper with the taxman. Then there's the timing of payment. Typically, receipt of payment for goods or services crystallises the tax point for the transaction (where this falls before the provision of the education). That means the VAT applicable is the rate set at the point of payment (so a payment today would be exempt).

Beware, however, as Labour has said that it intends to introduce measures that will prevent prepaid school fees from avoiding VAT. It's unclear how far into the past it would reach to retrospectively add VAT to prepayments. For example, would it leave alone payments made before they were elected, yet capture those made after? Or just capture those payments made after legislation was passed, or tabled? Similarly uncertain is how much prepayment it would accept. Allowing the first year or two, say, but none after. We won't know the answers until the government sets out its legislation.

What could you do about it?

THE ADDITION OF VAT TO PRIVATE SCHOOL FEES

Prepaying school fees could save you thousands of pounds in VAT. While a large outlay, it could make sense for those who have the cash to comfortably do so. Help from grandparents could also double as a tax-efficient transfer of inheritance to the next generation. There are risks, however, that the government will retrospectively add VAT to prepaid fees, so caution is warranted.

What could you do about it?

IF BUSINESS PROPERTY RELIEF IS REMOVED FOR CERTAIN ASSETS/SCHEMES, OR ABOLISHED OUTRIGHT

This would bring potentially large portfolios back into an estate for Inheritance Tax purposes, making them liable for 40% tax. These assets might also be subject to Capital Gains Tax if their value had increased since they had been purchased. Without the generous tax incentives, these riskier assets might no longer be suitable for some investors. These portfolios would need to be carefully reinvested to minimise tax and improve their risk-reward profile. There are also life assurance policies that can be taken out to ensure the money is there to pay any IHT bill on your death.

Planning can help

While not triggering the concerns that a more left-wing Jeremy Corbyn-led Labour Government would have raised, Starmer's government will most probably need to raise money to fulfil its plans to improve a range of public services. To do that, it may make changes to long-standing taxes, allowances, investment schemes and rules that could hit the unwary. Sensible financial planning will help you maximise the opportunities available now and avoid some of the pitfalls the future may bring.

Get in touch with us today to see if we can help, through your usual Rathbones contact, your financial planner, or by emailing us **here**.