Taxing problem

New Government faces issues

Trevor Williams considers how any potential tax changes will fit with the Government's UK growth target

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Tax policy is critical to the Government's success. With a budget on 30 October concentrating minds, a recent report by the Office for Budget Responsibility shows starkly the future strains on the public finances of an ageing population, climate change challenges and the increases this means for health spending have put into sharp relief the need to think about Budget deficits, debt and how sustainable Government finances are in the long-run.

But the incoming Chancellor faces a more immediate challenge in the upcoming Budget of how to fund spending pledges. One option for Chancellor Reeves is to go ahead with the £24 billion a year future tax rises that were announced in the last Government's Budget but were never implemented.

That would be the easy way out because the previous Chancellor (Jeremy Hunt) could be blamed for everything. However, the new Chancellor, Rachel Reeves, pledged during the election campaign not to increase income tax, National Insurance, VAT, or taxes on working people. That pledge effectively ruled out simply accepting the tax changes announced by her predecessor in the role. With that in mind, what can we expect from the Budget on 30 October?

Boxed into a corner?

With the promises made about not increasing taxes as in their manifesto pledges, there will, therefore, be some tax policy changes from those in Jeremy Hunt's March Budget. Also, there is the case that some will go ahead. These may include the end of temporary business rate relief, the temporary stamp duty cuts, and the temporary fuel duty cut (Jeremy Hunt had planned to increase fuel duty by 5p in 2025 and further in future).

Not continuing with the freeze would raise £5 billion by 2028, so the numbers are quite large. But the gap between the real rate of fuel duty and the real price of petrol is growing larger and larger.

In other words, there is a lot of scope to raise the rate of fuel duty to the levels that they had been previously. Such a move would be very unpopular with the public, no doubt.

New tax rises are likely

Tax rises are already on the way, with VAT on school fees already announced and the removal of business rates relief. But beyond that, there are options to raise revenue despite the Chancellor's ruling out new taxes on workers, VAT and National Insurance.

One possible option is to broaden the inheritance tax base by no longer excluding pension pots and restricting business relief and agricultural tax relief. While some may seem obscure, they may be attractive because they're very technical but could raise about £2 billion.

One of the significant areas of possibly raising tax would be closing off options for paying capital gains tax and forgiveness at death, for example, introducing exit charges when people move abroad as well as aligning marginal rates for employees and dividends. Such a move would be very unpopular by those affected because, for shares, the top capital gains tax rate would rise from 20% to 39.4%, matching dividends. However, they would likely exempt it from inflationary gains, so an average 2% return per year would be tax-free. Again, none of this would be popular with those impacted; however, most tax experts claim it would raise about £12 billion over the course of the Parliament.

As has been widely reported in the news, there are pension tax reliefs, which, if altered, could raise £9 billion a year. Again, this is obscure, but extending employer National Insurance to employer pension contributions and removing employer National Insurance from worker pension contributions would still mean the Government raises the sum just mentioned.

Options remain

In short, despite the many red lines mentioned in the manifesto commitments of Labour, it is still possible to raise £20 billion led by capital gains tax and pension contributions and National Insurance changes. Whether they make the tax system more efficient is a matter for the experts, but those impacted by it will disagree that it's a good idea.

The Chancellor may also look quite closely at options about replacing business rates, how councils are funded and, of course, the future of motoring taxes given electric cars are coming in. If they replace petrol cars as projected, then the tax on petrol won't have the same impact.

On the surface, the Chancellor boxed herself in by the commitments made in the Labour manifesto. In fact, tax options exist that could still raise about £20 to £24 billion or so in taxes over the five years of this Government. One of the issues would be whether the Bank of England would consider these tax increases as holding back economic growth and whether reductions in interest rates would offset some of the financial impact.

Looking at the overall fiscal and monetary policy mix, one needs to consider how this fiscal approach will support the Government's UK growth target of being the best-performing G7 economy and fit in with building three million new homes over the Parliament. ■