A look ahead to the Autumn Budget

Britain at a crossroads

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The government has been handed another challenge as borrowing figures deteriorated this summer, constraining its ability to announce large spending plans in the short term. Cumulative levels of borrowing in the current financial year reached £16bn in April to July. Based on average borrowing patterns from the last three years, borrowing for the full financial year is set to be around £5bn over the Office for Budget Responsibility's March forecast of £29.3bn.

The extra borrowing implies that meeting the fiscal targets set by the previous Chancellor will be more difficult, as the headroom for any extra spending could shrink to just £22bn.

The Chancellor announced an extra £15.5bn of government spending in the September Spending Review, of which £13.4bn is to fall in the 2020-21 fiscal year. Additional spending is expected to be announced in the Autumn Budget alongside a relaxation of fiscal targets.

Melissa Geiger from KPMG Tax Practice says that with a new Prime Minister and Chancellor in office, Brexit still on the horizon and political upheaval expected in the autumn, predicting tax announcements for the Autumn Budget feels quite dicey.

Timing of the Autumn Statement

Melissa thinks that the first issue is knowing when the Autumn Budget might be. The expectation was that it would be in November, shortly after 31 October, the date we are due to leave the EU. But within a few days of Boris Johnson's election as leader of the Conservative Party, rumours of an emergency Budget were swirling and the Chancellor, Sajid Javid, has not ruled out having one before Brexit. Currently, mid-October seems to be the most likely option.

The second issue is the growing likelihood of a general election in October or shortly thereafter. The government's lost majority and its determination to stick to the 31 October Brexit deadline have made an election almost inevitable.

Put all this together and it is not clear whether the government is in election mode or Brexit management mode. The truth is probably that they are in both. In the meantime, what might be announced on tax?

What we have heard so far

The starting point is perhaps what both the Chancellor and the Prime Minister said during their respective Conservative party leadership bids.

Both candidates suggested tax cuts, but Mr Johnson's were by far the most ambitious.

In relation to personal taxes he had two main tax proposals: raising the higher-rate threshold for individuals from £50,000 to £80,000, and raising the threshold at which National Insurance contributions (NIC) begin to be paid.

The justification for the increase of the higher-rate threshold was to remove the effect of years of fiscal drag that was gradually pulling more people into higher rate taxes (the increases in the threshold failing to keep up with income growth). The news was not all positive for those higher earning individuals. The upper earnings limit for NIC purposes (at which point individuals move from paying 12% NIC to 2%) is normally linked to the higher rate threshold. So if the two thresholds were to remain pegged, any tax saving would be in part counteracted by NIC increases.

The measure would be eye-wateringly expensive: the Institute for Fiscal Studies (IFS) predicted it would cost about £9bn and benefit four million of people with the highest incomes. Those with the most to gain would be high-income pensioners who do not pay NIC on their earnings and would realise the tax break in full.

Mr Johnson also suggested raising the level at which people start to pay NIC which would help low earners but, again, this would be expensive to implement. The IFS predicted a £1,000 increase in the threshold would take 600,000 workers out of NIC and cost the government £3bn a year. Most of the heavy lifting on redistribution for those on low incomes is done by the benefits system rather than the tax system and several commentators have been quick to point out that changes to universal credit might be a better way of helping those on low incomes.

Mr Johnson didn't just comment on personal taxes, however, he also proposed cutting the rate of corporation tax. The corporate tax rate in the UK currently stands at 19% and is due to decrease to 17% in 2020. It is already reasonably low in comparison to most of the G20.

Mr Johnson did not state the rate to which he would seek to cut corporation tax (and whether he would want to match former Conservative Party leader candidate Jeremy Hunt's ambitious 12.5% proposal) but his justification was that cutting the corporation tax rate would increase tax revenues.

Total tax revenue, however, is a function of the tax base as well as the tax rate, and the base for corporates in the UK has been broadening for some time. The extent to which the headline rate cut is responsible for increased corporate tax revenues is therefore questionable. And whilst businesses will always welcome a rate cut, offering increased tax simplicity and certainty might be a better way to encourage international competitiveness and generate foreign investment and jobs.

Finally, Mr Johnson hinted at stamp duty changes – raising the threshold at which stamp duty becomes payable to £500,000 and reducing the highest rate from 12% to 7%.

By contrast, Mr Javid was relatively light on tax policy announcements during his leadership bid other than saying he would consider an emergency budget that would help prepare for a no-deal Brexit and would include tax cuts for businesses and individuals.

There were no bold reforms, although he said he would like to cut taxes for the lowest earners. He also mooted removing the 45% tax rate for those on incomes of over £150,000. As a measure this would primarily benefit the top 1% of earners and his justification was that this would increase 'dynamism'. There may be some credence to this, as the reduction in the additional rate from 50% to 45% initiated by George Osborne is considered to have resulted in additional tax revenues (although some argue these figures are distorted by higher earners delaying bonus payments).

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Melissa Geiger,
Head of International Tax and Tax Policy, KPMG in the UK

Specific tax policies remain hard to pin down

Since being appointed Chancellor there has been no clear policy signalling from Mr Javid. He declares himself to be a fan of a simpler tax system, as all Chancellors do. He also described himself as a "low tax guy", wanting efficient taxes that focus on maximising revenues which, he says, does not mean imposing the highest rate possible.

It is in relation to stamp duty that he has made the most waves after being reported to be considering shifting stamp duty from the buyer to the seller in an attempt to help first time buyers. He later distanced himself from the idea, although he seems to believe that something radical is needed in relation to housing.

There is some degree of crossover between Mr Javid's and Mr Johnson's approaches to tax.

Both Mr Javid and Mr Johnson seem comfortable with a loosening of the fiscal purse strings, at least in the short term, to give a shot in the arm to the economy.

The radical raising of the higher-rate threshold, however, seems to be too fundamental a change. It would drive a hole in the public finances that would be significant and Mr Johnson's contention that it would be paid for by fiscal headroom seems ambitious.

Mr Javid may, however, pursue the removal of the 45% rate which, whilst it would benefit the highest of earners, may well generate an overall increase in tax revenue. It might also have the knock-on effect of appealing to a more Conservative voting base and keeping the more mobile earners in the UK.

Without a doubt they will seek to do something for lower earners, perhaps an increase in the NIC threshold, but also through changes to universal credit.

It is likely that there will be some measures around stamp duty but probably more along the lines of tinkering with rates than fundamental reform. A reduction of the highest rate, which was mooted by Mr Johnson during his leadership bid, might help relieve stickiness at the top end of the market, particularly in London, and again would appeal to a more Conservative voting base.

Several media outlets also report there may be a temporary reduction in the VAT rate from 20% to 17.5%. This would potentially boost spending, particularly at a time when the falling pound is making some consumer goods more expensive.

The complications of pensions tax relief, particularly in relation to NHS workers, has attracted multiple headlines over the last few months. The government has announced some proposals which will increase flexibility for such workers. There has, however, been increasing noise about extending the changes to all public sector employees and, of course, the pensions tax charges can also impact on private pension schemes. All of this may lead to an announcement of a more root-and-branch review of the current pensions rules, which are widely seen as too complicated and difficult to understand.

Business taxes may provide more surprises

It is in relation to corporation tax that any budget will be more interesting with Brexit playing a pivotal role in defining the direction of travel. A no-deal Brexit might usher in radical changes, including significant cuts to the headline rate of corporation tax, accompanied by increased investment incentives in relation to innovation.

It will be interesting to watch the UK Digital Services Tax proposals. The tax is due to come into force in 2020 and will impose a 2% tax on revenues from certain types of digital activity relating to UK users. Philip Hammond positioned this as a temporary, but necessary, tax that would be reviewed (in 2025) once the OECD had completed its wider international project on how to tax an increasingly digitalised economy.

In the meantime, however, France has enacted a similar Digital Services Tax that has been met with a strong response from the US. We can expect a similar reaction in relation to the UK proposals.

However, the UK Digital Services Tax was never intended to be a big revenue raiser and bearing in mind the positive mood music from the US in relation to post-Brexit trade deals, it is possible that the UK Digital Services Tax will be sacrificed on the altar of international relations.

All in all, the Autumn Budget is promising to be an interesting ride and perhaps the best prediction is to 'expect the unexpected'.

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