BRYAN CAVE LEIGHTON PAISNER
PRIVATE WEALTH

Restarting the UK economy: how bad is it and what happens now?

The UK Chancellor has delayed announcing a major economic stimulus package of tax cuts and spending pledges, to tackle the financial impact of the coronavirus pandemic, until the autumn. Measures which could form part of the recovery package and help pay the bill are considered below.

RESTARTING THE UK ECONOMY AND PAYING THE CORONAVIRUS BILL

The UK Chancellor has delayed announcing a major economic stimulus package of tax cuts and spending pledges until the autumn – presumably in the hope that he will have a clearer picture by then of how quickly the UK economy will recover from the impact of coronavirus, and that, if the economy has recovered a little, taxpayers will be more willing to accept future tax rises. Short-term measures to encourage consumer spending now that the majority of shops are allowed to re-open – like a temporary reduction in VAT – could still be announced sooner.

HOW BAD IS IT?

UK GDP (gross domestic product) fell by 20.4% in April 2020 – the biggest fall since records began. The Office of Budget Responsibility's predictions, as at 14 May 2020, are that the UK public sector net debt (PSND) in 2020/2021 will be 95.8% of GDP and that public sector net borrowing (PSNB) will be almost £300bn.

As an indication of how bad it is, at Budget 2006 it was stated that to meet the Sustainable Investment Rule (one of the UK Government's two main fiscal rules), "other things being equal, [public sector] net debt will be maintained below 40 per cent of GDP over the economic cycle".

UK GDP
April 2020

-20.4%

Biggest fall since records started

UK public sector net debt

+95.8%GDP

Office of Budget Responsibility 2020/21 estimate

UK public sector net borrowing

+£298.4bn

Office of Budget Responsibility 2020/21 estimate

As well as spending more than £100bn in measures to support the economy the Government's tax revenues have dropped dramatically.

HMRC receipts for April 2020 were £25.9bn lower than April 2019.

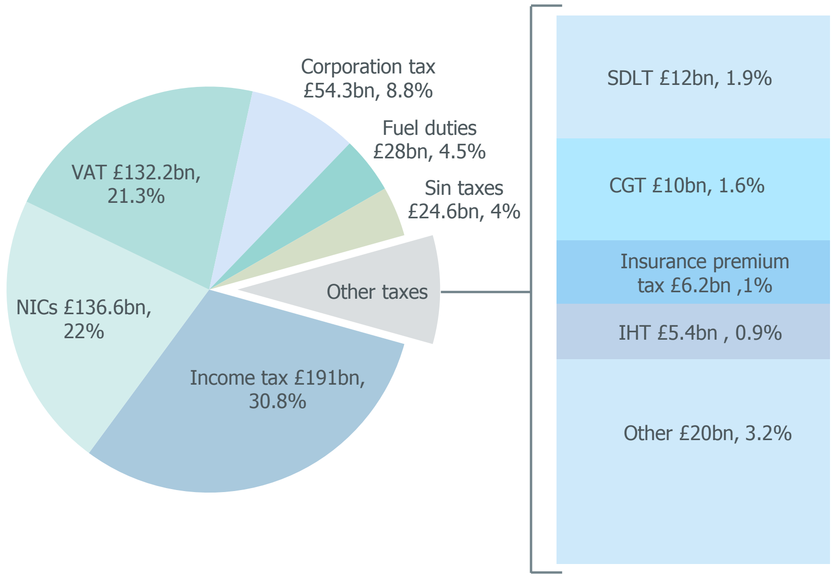
£17.5bn

8.7m jobs furloughed at cost of £17.5bn (31 May 2020)

HMRC tax receipts 2018/2019 (last full year before impact of coronavirus)

Total HMRC receipts 2018/2019

£620.3bn



Impact of coronavirus on HMRC tax receipts April 2020

HMRC receipts April 2020

-£25.9bn

VAT receipts

-£13.9bn

VAT payment deferral policy introduced 20 March 2020

Income Tax CGT,NICs receipts

-£6.3bn

Corporation Tax receipts

-£4.1bn

WHAT HAPPENS NOW?

In the short-term the Government's focus will be on stimulating the economy - but in the long-term the Government will have to deal with the budget deficit, and pay back what it has borrowed, by either cutting spending or raising taxes.

Cutting spending may prove difficult - many of the easy savings have already been made following the 2008 financial crisis. Raising taxes might be easier but, despite the impact of coronavirus on the public finances, as recently as late May, the Prime Minister vowed not to break the Government's 2019 manifesto pledge not to increase income tax, VAT or NICs.

STIMULATING THE ECONOMY

No-one is sure how quickly the UK economy will recover from the coronavirus pandemic or whether the recovery will be 'V-shaped' or be more gradual. Early signs are mixed. Following the re-opening of the housing market, the number of property sales in England in the first week of June was reported to be 6% higher than in the same period in 2019 and up 54% on the last week of May; on the other hand 1,000s of job cuts are now being announced on an almost daily basis.

Reductions in VAT rates? Tax incentives? Tax holidays?

Tax measures aimed at kick-starting the economic recovery could be general, or targeted at helping sectors which have been particularly badly hit.

Given the dire predictions about record rates of unemployment and the fact that over 50% of the Government's tax revenues come from income tax and NICs, saving and creating jobs will be a key focus.

Measures could include:

> Government-funded training schemes

> Exemptions from employer NICs for new employees

> Tax incentives for investing in start-ups (particularly tech start-ups)

> Infrastructure projects (good job creators)

> Reductions in VAT – across the board or for particular sectors

> Exemptions/reductions in stamp duty land tax (SDLT).

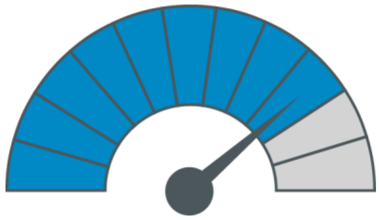
Any rate reductions, exemptions or tax 'holidays' are likely to be temporary.

PAYING THE BILL

Are tax rises likely? Yes. The crucial questions are when, and what taxes? Although inevitable, tax rises are unlikely until the economy is beginning to show signs of recovering from the impact of the coronavirus pandemic.

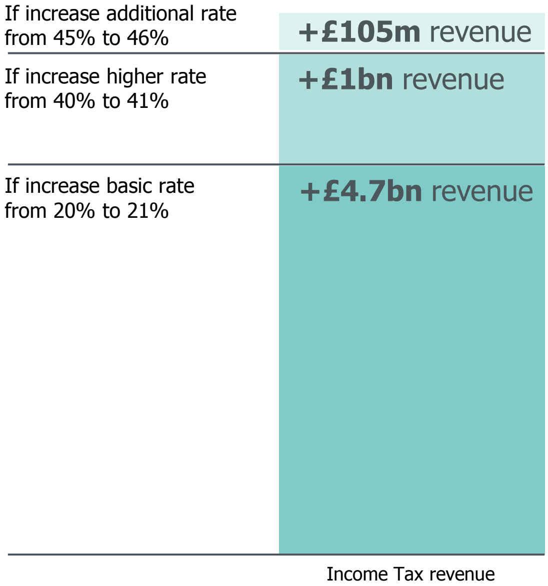
INCREASE IN INCOME TAX RATES

Increase in income tax rates (within next 2 years)



Increasing income tax rates is an easy and effective way of raising more revenue – income tax accounts for more than a quarter of total tax receipts. Simply targeting higher earners would, however, bring in far less than increasing rates in all tax bands. A recent survey suggested that around three-quarters of people would accept an income tax rise of up to 3%.

Estimate of revenue that would be generated by increasing rates of current income tax bands



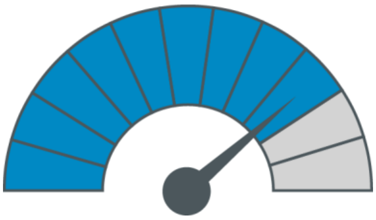
Reform of NICs including an increase in the rate for higher earners (by, for example, introducing a flat rate of NICs or scrapping the upper-earnings limit) or for self-employed people earning more than £9,501 (who currently pay NICs at 9% compared to the 12% rate for employees) could also be an option.

Rates of tax on dividends could be increased to bring them in line with the rates of tax for other income – this would see an increase in the rate from 32.5% to 40% for higher rate taxpayers and from 38.1% to 45% for additional rate taxpayers.

Dividends paid to non-UK residents may also be brought within the charge to UK tax; non-UK resident individuals are currently not subject to UK income tax on UK dividends. In practice this would be done by way of a withholding tax and would be subject to the terms of the UK's existing double tax treaties which may relieve the charge in many cases.

INCREASE IN CAPITAL GAINS TAX (CGT) RATES

Increase CGT rate



Very likely

Tax on capital (rather than income) currently accounts for only around 5% of the total tax take, and an increase in the main rate of CGT is widely predicted.

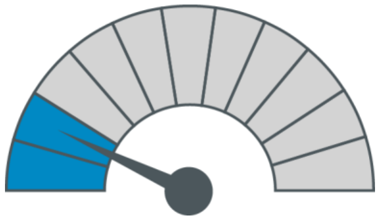
Currently higher rate taxpayers pay CGT tax at 20% on all gains, other than residential property gains and carried interest which are taxed at 28%. It would not be surprising to see the rate of CGT for all gains increased to 28%. Some argue that the Government should go further and equalise the rates of tax on all income and gains so that money generated from wealth is taxed in the same way as earnings.

Tax on personal income accounted for > 50% of total receipts in 2018/19

Tax on capital and other receipts accounted for a little over 5% in 2018/19

INTRODUCING A WINDFALL TAX OR WEALTH TAX

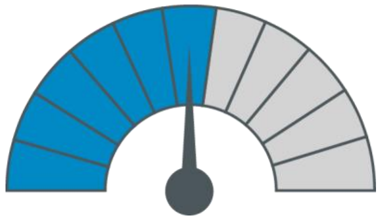
Increase in corporation tax rate



Unlikely

An increase in the corporation tax rate is unlikely given the Government will be seeking to support business growth and investment. However, more than half of the UK public in a recent survey supported an "excess profits tax" on companies that have thrived during the pandemic.

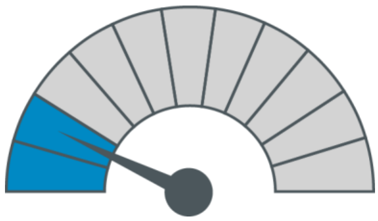
Introduction of windfall tax (corporate)



Moderately likely

One of the merits of one-off taxes of this sort is that the cost of the crisis is borne by current taxpayers, who have benefitted from the support measures, rather than future taxpayers.

Introduction of wealth tax



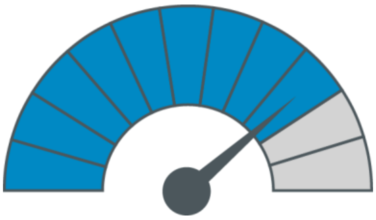
Unlikely

Another survey suggested that people would approve of a wealth tax for those with assets over a certain threshold. However, evidence suggests that the amount raised would only be around 1-2% of all revenues raised, and that a wealth tax would be disproportionately costly to administer.

It would be easier, both administratively and politically, and likely raise a similar amount, to increase the rate of CGT and restrict or remove certain CGT or inheritance tax (IHT) reliefs.

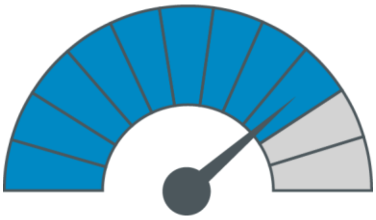
RESTRICTING TAX RELIEFS

Changes to IHT rules & restriction/ abolition of IHT reliefs



Very likely

Abolition/reduction of CGT reliefs



Very likely

It is likely that the Government will look at restricting or abolishing certain CGT and IHT reliefs, which are widely considered to benefit the wealthy, including: CGT main residence relief and the tax-free uplift on death, and IHT reliefs for business and agricultural property. Abolishing IHT reliefs for business property (including relief for AIM shares, and shares in family trading companies) alone could save the Government an estimated £6bn over the next 5 years. Further restrictions on funding pensions, or tax free withdrawals from pensions are also an option, following the push to have savings made out of post-tax, rather than pre-tax earnings.

SHOULD I BE TAKING ANY STEPS NOW?

Estate planning should never be driven purely by tax considerations – but the pandemic will have prompted many to consider whether their financial and personal affairs are in order.

If you are considering taking any action, it would be worth doing so sooner rather than later.

Checklist of possible steps:

- **Ensure your charitable-giving is effective**, both in terms of the impact it has and its tax-efficiency (see our recent blog post on Philanthropy and Covid-19: seeking to maximise the impact of charitable giving)
- **Dispose of, or gift assets, standing at a gain** – so that any gains are subject to tax at the current CGT rates
- **Make lifetime gifts** - under the current rules no IHT will be payable on gifts to individuals if you survive seven years
- **Make use of available CGT and IHT reliefs** - for example, by passing shares in family companies to the next generation or into trust
- **Take dividends** where appropriate
- **Potentially take distributions from non-UK trusts**, particularly where such distributions would be subject to CGT.

If you have a question on the above, or would like to learn more, contact BCLP's Private Client team.

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