RATHBONES

PLANNING FOR A CHANGE OF GOVERNMENT

FINANCIAL PLANNING

LABOUR LOOKS TO BE ON THE CUSP OF TAKING POWER IN THE UK. WHAT CHANGES COULD THEY MAKE TO RAISE MONEY, HOW MIGHT THAT AFFECT YOU AND WHAT CAN YOU DO ABOUT IT?

Could Labour find spare change from capital?

The Labour Party is the odds-on favourite to form the next government, with a roughly 20-point lead in most polls. This won't be a shock to many. Perhaps the most surprising thing is the similarity between Labour and the current Conservative government on key economic issues.

The surprise summer election called by Prime Minister Rishi Sunak for 4 July will offer voters a much narrower choice than the last contest back in 2019. The Brexit issue has now largely been settled and, under Keir Starmer, the Labour Party has abandoned his predecessor's economic radicalism, declaring itself 'proudly pro-business'.

Most importantly for the near-term economic outlook, both parties have reiterated their commitment to strict fiscal rules following 2022's 'mini-budget' fiasco. That will limit the scope for either side to make dramatic changes on taxation or spending (the Conservatives place more emphasis on lowering taxes, and Labour on activist industrial policy to support growth). The two parties are on common ground in other areas too — both have virtually identical targets to increase housebuilding, for example.

Labour had planned to do away with the 'non-dom' tax status that encourages wealthy foreign professionals and investors to move to the UK for work and commerce by allowing them to keep their overseas assets and income out of Britain's tax system. Yet the Conservatives were more like-minded than anyone thought - the government pinched the policy at the Spring Budget. Next April 'non-dom' status will be replaced with a new regime that lasts for just four years, rather than the current 15.

Labour is still trying to show daylight between themselves and the current government. A difficult task! Cynically, one way to do this is by announcing policies that hit certain tones and hit the pockets of small parts of the electorate who are less likely to vote their way. Although, that's just politics in a nutshell, isn't it?

With that in mind, here are some thoughts about what a Labour government may do if elected, how it would affect you as a taxpayer, and ways that savvy financial planning could help you avoid the worst of it.

Income Tax and National Insurance

Under the current government, tax thresholds for Income Tax are frozen until 2028. Labour has promised not to raise Income Tax (National Insurance Contributions are implied) or implement a wealth tax – although this is yet to appear in a manifesto. So, what else could be changed to garner cash for a Labour government?

Pensions relief

Making tax relief on pensions less generous could be an option. The 2024/25 annual allowance for paying into a pension without incurring tax is £60,000 and the current £1,073,100 standard lifetime allowance for tax-free contributions was effectively abolished on 6 April. Labour has said it would reinstate the lifetime allowance, likely at a level that doesn't capture long-serving public sector workers such as doctors, teachers and Whitehall workers. If the allowance is reinstated, workers with large pension pots may consider taking the typically 25% lump sum ahead of the change to minimise its impact. There are complex rules around exactly how much tax-free cash can be withdrawn from a pension, depending on personal circumstances and whether it's a defined contribution or defined benefit scheme.

What can I do about it?

REINSTATEMENT OF LIFETIME ALLOWANCE

You could explore withdrawing tax-free cash or crystallising pensions before the rules are changed. However, there are complex rules around this, so we always encourage people to seek advice first.

What can I do about it?

CHANGE PENSIONS TAX RELIEF 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 sent to a pension and then again when it is 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.

Tax-efficient investing, wealth taxes and Inheritance Tax

Labour has ruled out implementing any form of wealth tax, and there's little wiggle room in Capital Gains Tax (CGT), as the tax-free allowance halved to £3,000 on 6 April 2024. And Labour has promised not to change CGT rates, too (which are a soup of figures depending on the income tax rate you pay and whether the asset is residential property). But there are indirect ways to ratchet up taxes on the wealthy.

Charging VAT on private school fees, as Labour has pledged, is one method. It will add roughly 20% to the sticker price of 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. If possible, prepaying fees ahead of the changes could save you a lot of money. Grandparents could help with this big upfront cost, and it would also double as a tax-efficient transfer of wealth to the next generation.

Individual Savings Accounts (ISAs) were 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 Labour policy thinktank) 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.

What can I do about it?

CHANGE IN DIVIDEND TAX RATES AND ALLOWANCES

It could make sense to adjust your investment portfolio to reduce dividend-paying stocks in favour of those that reinvest in themselves or buy back stock.

What can I do about it?

REDUCTION IN CAPITAL GAINS TAX ALLOWANCES

You can crystallise 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. You can also defer CGT by investing in the Enterprise Investment Scheme.

What can I do about it?

MAKE ISAS 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 are outweighed by the lack of diversification and limited opportunities that the ISA would then offer.

In the Spring Budget, Conservative Chancellor Jeremy Hunt introduced an extra £5,000 of ISA allowance strictly for investment in UK assets (the 'British ISA'), albeit without an implementation date. Labour may ratchet up this quid pro quo of tax savings for investing in UK assets even further, 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 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.

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 Inheritance Tax (IHT), yet Labour Shadow Chancellor Rachel Reeves broadly favours these investment vehicles for the effect they have on UK business growth and the entrepreneurial sector.

Another area that could be in Labour's sights is the reset of capital gains on assets on the death of an owner. When assets are transferred to a spouse on death, any capital gains made are wiped and it is as if the assets have just been purchased at their current value. If the assets are jointly held, this CGT relief extends 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, it 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. 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 applied. A way to prevent this could be using offshore bonds to roll up annual gains without paying CGT and income tax.

Finally, another way to indirectly tax wealth is to increase dividend tax rates or reduce the current £1,000 tax-free allowance on dividends.

REDUCTION OF ADDITIONAL RATE INCOME TAX THRESHOLD FROM £125,140 TO £100,000

This would make pension contributions for individuals with earnings above £100,000 extremely attractive. Because your tax-free allowance is reduced by £1 for every £2 earned above £100,000, this leads to a quirk where earnings above £100,000 are taxed at a 60% marginal rate. If the additional rate threshold was also lowered to this point, it would mean the marginal rate would rise to 67.5% (72% in Scotland).

What can I do about it?

REMOVAL OF BUSINESS PROPERTY RELIEF ON CERTAIN ASSETS/SCHEMES, OR ABOLISHED ALTOGETHER

This would bring potentially large portfolios back into an estate for Inheritance Tax purposes and therefore liable for 40% tax. These assets may 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 may 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 Inheritance Tax bill on your death.

What can I do about it?

REMOVAL OF CAPITAL GAINS TAX RELIEF ON DEATH

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

Planning can help

While not bringing the concerns that a more left-wing Jeremy Corbyn-led Labour Government would have raised, a Starmer government would need to raise money to fulfil its plans. To do that, it may make changes to long-standing taxes, allowances and 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, either through your usual Rathbones contact, your financial planner, or visit rathbones.com/contact-rathbones