BREWIN DOLPHIN

Autumn Budget 2018

29 October 2018

Chancellor Philip Hammond heralded that the era of austerity is coming to an end in his third Budget, after discovering he had significantly more money to play with than he had expected.

A dramatic improvement in the public finances gave the chancellor a £13bn windfall[1], enabling him to trumpet higher public spending on health, infrastructure and defence.

However, even this unexpected bonus didn't tempt 'fiscal Phil' to drop his characteristic caution completely. While there were some giveaways, his Budget was notable for its lack of eye-catching announcements.

Fortunately, that meant there were also few tax increases – and where they did occur they were aimed at companies not households. The chancellor focused on trying to stimulate growth through enterprise and intellectual property, notably targeting big digital companies without wanting to hit tech start-ups.

With pensions, savings and estate planning largely untouched (for now), we see this reprieve as a good opportunity to make the most of the tax allowances that already exist. While Mr Hammond avoided the temptation to tinker with the tax system, it might not last long. The huge uncertainty over precisely how the UK will leave the European Union means the chancellor specifically said he may have to upgrade the Spring Statement to a full Budget.

The independent forecasts of the UK's economic prospects on which the Budget is based assume at present that the UK and the EU will strike a deal. So, perhaps this year more than most, it is important not to delay making the most of the tax breaks while you still can – the sooner you claim them the better.

The big picture

The dramatic improvement in the outlook for the UK's public finances gave the chancellor enough leeway to fund previous government pledges of extra money on the National Health Service and housing without big increases in taxes.

Borrowing has persistently come in under forecast. The OBR (Office for Budget Responsibility) expects borrowing to be £11.6bn lower than forecast at the Spring Statement.[2]

But, with so much uncertainty in the air, economic growth remains anaemic by both historic and international comparison. The OBR now expects the economy to grow by 1.6% next year, 1.4% in 2020 and 2021, before picking up to 1.5% in 2022 and 1.6% in 2023.

Inflation is expected to average 2% next year in line with the Bank of England's target.

Guy Foster, Head of Research at Brewin Dolphin, said: "The most unusual features of this Budget were mostly around the timing. Having recently shifted the Budget from spring to autumn the chancellor brought this year's date further forward to the end of October in order to clear the calendar for Brexit legislation and offer some vague promises about additional giveaways on condition that the withdrawal bill passes. The Budget also took place later in the day meaning that the market closed before all the announcements were made.

"What little news there was won't shock investors anyway. The proposed digital tax is a political statement but won't be the sales tax that might have affected UK internet businesses. Duty was frozen on beer and spirits (instead of increasing as it did for wine) which is good news for pubs and (at the margin) Diageo."

Benefit from valuable tax breaks, while you still can

Aside from an increase in the tax-free personal allowance and higher-rate tax threshold there were no major tax announcements for individuals. This makes it an opportune time to make the most of valuable tax allowances, reliefs and exemptions that already exist – especially as this could

1 Ft.com: Hammond set for £13bn a year windfall to ease NHS pressure, 22 October 2018.
2 HM Treasury: Budget 2018. 2.9, 29 October 2018.

be a short-term window of opportunity, with just five months to go to Brexit.

Here, we explain what changes were made in the Budget – and what action you might want to take to make sure your finances are as tax efficient as they can be.

Income tax and ISAs

A planned increase in the tax-free personal allowance to £12,500 and higher-rate threshold to £50,000 will take place a year earlier than planned. The chancellor had previously said these changes would be introduced in 2020-21 – honouring a Conservative manifesto pledge. Now they will occur in April 2019, benefiting more than 32 million taxpayers. The higher-rate threshold will then be frozen in 2020-21[3].

While this will be welcome for many taxpayers, it won't help higher earners who start to lose their personal allowance when they earn over £100,000. The personal allowance is reduced by £1 for every £2 of income above £100,000. This means your allowance is zero if your income is £123,700 or above[4].

This makes the tax-advantaged savings available in an ISA even more valuable. Investment returns are tax-free in an ISA. That means there is no income tax or capital gains tax (CGT) to pay – whether those returns come in the form of interest, dividends, or shares going up in value.

This tax year adults can put up to £20,000 a year into ISAs (so for a couple that is £40,000) and up to £4,260 a year into a Junior ISA for a child. The adult ISA annual subscription limit for 2019-20 will remain unchanged at £20,000. The annual subscription limit for Junior ISAs for 2019-20 will be increased in line with CPI to £4,368[5].

Pensions

The chancellor recently described pensions tax relief as "eye-wateringly expensive" prompting speculation that he could be about to do something radical with pensions. So, it will have been a relief for many savers that he had little to say on pensions.

He did not, as some feared, cut the tax-free annual savings limit, or introduce a flat-rate of tax relief. The only notable change was an inflation-linked increase in the lifetime allowance to £1,055,000 in 2019-20[6] (from the existing £1,030,000[7]). The lifetime allowance is the maximum amount of pension saving you are allowed to amass over a lifetime without incurring a tax charge.

Notably, the chancellor didn't even talk about pensions in the Budget speech, though there is little doubt that he or a future chancellor will be tempted to take another look at pensions in the future. Nor does his inaction reduce the need to be careful.

Currently, contributions to pension schemes are made out of income before tax and national insurance is deducted, up to an annual limit of £40,000. However, recent reports suggest some higher earning savers have been caught out by the 'Byzantine' tax-relief rules applied to the annual allowance[8].

The annual allowance is tapered for those with adjusted income of over £150,000. The £40,000 allowance goes down by £1 for every £2 of income above £150,000 until it reaches a lower limit of £10,000. The complexity of the system means there is the danger that you might breach your annual allowance unwittingly, landing yourself with a bill even though you are only trying to do the right thing and save for your own future.

Inheritance tax

Earlier this year, the chancellor asked the Office of Tax Simplification to review the level of complexity in the current inheritance tax system[9]. Its report is due this autumn, and Mr Hammond had nothing to say on it in the Budget.

Once again, given the interest the chancellor has expressed in the subject, and the possibility that there could be changes ahead, it makes sense to make the most of the existing allowances while you still can.

You don't have to wait until death to pass on wealth – as most people do. Transferring wealth while you are alive can have a transformative effect on your family's life and reduce an inheritance tax (IHT) liability.

There are a number of annual gift allowances which you lose if you don't make use of them before the tax year end. For example, you can give away £3,000 each year and this will not be subject to IHT. You can give as many gifts of up to £250 per person as you want during a tax year, as long as you haven't used another exemption on the same person.

If a gift is regular, comes out of your income and does not affect your standard of living, any amount of money can be given away and ignored for IHT. It is also possible to make further tax-free gifts – potentially exempt transfers – but you have to survive for seven years after making the gift to get the full benefit of it being outside of your estate for IHT purposes.

3 HM Treasury: Budget 2018. 4.3, 29 October 2018.
4 Gov.uk: Income Tax rates and Personal Allowances
5 HM Treasury: Budget 2018. 4.5, 29 October 2018.
6 HM Treasury: Budget 2018. 4.5, 29 October 2018.
7 Gov.uk: Tax on your private pension contributions.
8 The Sunday Times: Pension savers caught out by 'byzantine' tax-relief rules, 28 October 2018.
9 Gov.uk: Inheritance Tax Review Call for evidence and Survey, 27 April 2018.

Other points to note

- The chancellor imposed a crackdown on tax avoidance by contractors who claim self-employed status but who the government thinks should be treated as employees. In April 2017, the government introduced new rules to deter public sector employers and workers from using off-payroll working to reduce their tax liabilities. From 2020 they will be extended to the private sector. This move, which will involve reform of the anti-avoidance tax rule known as IR35, will be introduced in April 2020 and only apply to large and medium-sized organisations[9].
- The chancellor rejected calls to scrap Entrepreneur's Relief, which reduces capital gains tax for business owners when they sell up. However, the chancellor tightened the rules extending the minimum qualifying period from 12 months to two years[9].

Looking at the package as a whole, Guy Foster says: "There will be a net fiscal injection afforded to the chancellor by last week's revelation of forecast errors in his favour. That has allowed him to fund the first part of the NHS funding increase which was announced by the Prime Minister earlier in the year, whilst also bringing forward the increase in the higher rate tax threshold and personal allowances by a year.

"All these moves are good news for the economy, even if they are modest. They rather go against the current of greater public support for public spending rather than tax cuts, but Mr Hammond announced real terms increases in departmental budgets from next year, which provides a glimpse of an economy beyond the beginning of the end of austerity.

"The better public finances mean the government expects to be borrowing less next year which helps maintain the value of government bonds. The government also continues to incrementally support new housing supply and incentivise private landlords to sell properties to potential owner occupiers at a time when house prices are already caught in the cross-hairs of stretched affordability and Brexit uncertainty."