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WEALTH MANAGEMENT

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Client Newsletter
Autumn 2024

New Government, familiar challenges

In some respects, the Labour Party's success in the General Election was almost as uneventful as it was large in terms of seats won. Pollsters had been forecasting a Conservative defeat for so long that, by the time the landslide exit poll forecast arrived, there was no sense of surprise. While investment markets are often thought to favour right-leaning governments, they also value stability, a feature lacking over recent years. Thus, there were no sudden changes in gilt or UK share prices on 5 July.

With a majority of 172 and a fresh mandate, the new government should represent a less volatile administration than its predecessor. However, the challenges faced by Rishi Sunak & Co are unchanged merely because 10 Downing Street has a new resident. UK plc still has a debt mountain of over £2,700bn and is expected to add another £87bn of borrowing to the pile by the end of 2024/25, despite the substantial tax increases of the last few years.

In the election campaign, Labour emphasised that it would be relying largely on economic growth to generate the additional revenues needed to restore public services. At best, that growth will not be instant. In the interim, the government will probably be looking for funds elsewhere.

The explicit tax increases in the manifesto

The Labour manifesto listed half a dozen tax-raising measures, all of which had been well-trailed and earmarked against planned expenditure:

- Reducing tax avoidance.
- Revising taxation rules for non-domiciled individuals (going beyond Jeremy Hunt's Budget proposals).
- Applying business rates and VAT to private schools.
- Stopping the capital gains tax treatment of carried interest.
- Levying an additional windfall tax on oil and gas companies.
- Increasing stamp duty land tax rates on residential property bought by non-UK residents.

Overall, the projected revenue raised by these is small beer – £8.6bn a year by 2028/29 – about half of which was attributed to tax avoidance measures, a get-out-of-jail-free-card played by all the main parties.

The tax untouchables in the manifesto

The manifesto said ''We will ensure taxes on working people are kept as low as possible. Labour will not increase taxes on working people, which is why we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT." 'Working people' was left undefined and various political interviewers failed to nail down an answer, with Keir Starmer and Rachel Reeves not quite singing from the same hymn sheet. The careful wording could leave open higher rates of tax on dividend and savings income, including a possible cap on total ISA investment. It could also allow for a tweak that the Scottish government introduced in its last Budget – a new rate of tax ('advanced rate' at 45%, in the case of Holyrood).

The manifesto also placed a cap on corporation tax at 25%, the current mainstream rate, a pledge that could permit Labour to raise or scrap the 19% small company rate, together with the accompanying marginal relief (which creates a marginal rate of 26.5%).

Capital ideas…

Ruling out rate increases to the four main sources of revenue does not mean they are completely off the table for additional tax receipts, as the last few years have amply demonstrated. Thresholds can be frozen (as the personal allowance, higher rate and National Insurance thresholds are until 5 April 2028) or even reduced (as the additional rate threshold was from 2023/24). Lastly, promises can be broken, as happened with the first change to National Insurance in the last parliament.

Beyond such manipulations, the most suggested tax-raising targets are capital gains tax (CGT) and inheritance tax (IHT). Rachel Reeves has refused to rule out increasing CGT, saying only that she has 'no plans' to. The Treasury's own tax change ready reckoner shows that that tax revenue is projected to *fall* if there is a ten-percentage point increase in all CGT rates. The new Chancellor may be learning from a predecessor here. When Rishi Sunak commissioned a review of CGT, one result was an increase in the CGT paid as some investors took what they wrongly thought to be pre-emptive action.

The Institute of Fiscal Studies recently highlighted three opportunities to raise extra revenue from IHT that could appeal to Rachel Reeves. The trio all involved reform to existing reliefs – for business assets (including AIM shares), agricultural property and pension death benefits. Three years ago, Reeves told a Labour conference that she would examine "every single tax break".

The next Budget will be on 30th October – call us to discuss a pre-Budget review of your financial plans.

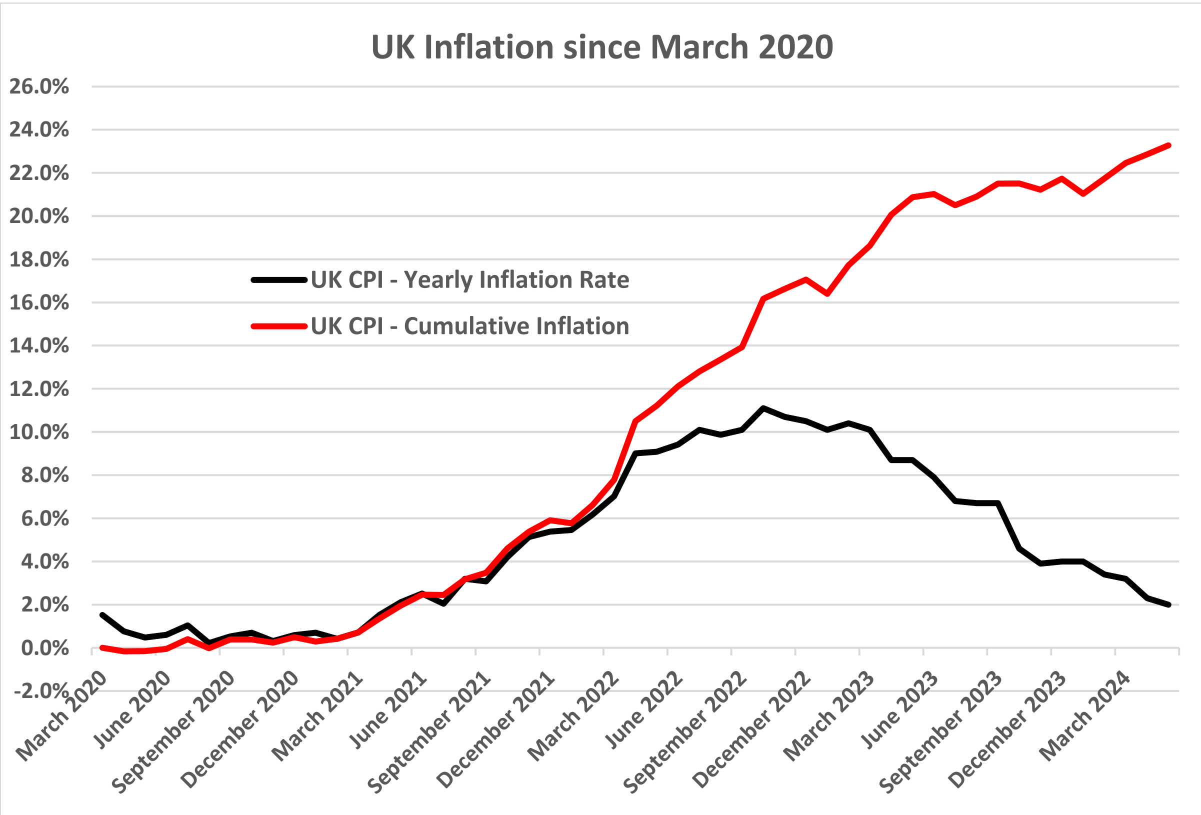
2% inflation or 23% inflation?

In June annual inflation, as measured by the Consumer Prices Index (CPI), was 2.0%, the same as in May. So, why was the cost of living such an issue in the election campaign?

Economists and the rest of us

The standard yardstick for inflation is the change in the CPI over a period of twelve months so, for example, the 2.0% May 2024 inflation reading meant that overall prices of goods and services in the CPI 'shopping basket' were 2% higher than in May 2023. What happened to prices in the interim is irrelevant – the measure only examines two points, one year apart.

While the 12 months yardstick appeals to economists, it is not the way most people think about price changes. You are more likely to think 'I used to pay £x for that and now it's £y' without considering the period over which the change occurred. That matters when inflation has been on a mountainous journey since 2020, which the graph below demonstrates well. The black line is the economist's favourite, annual CPI inflation. The red line shows the cumulative effect of inflation since March 2020, when COVID 19 first hit. By May 2024, the gap between the two was just over 21% - 23.3% cumulative inflation against 2.0% annual inflation.



Source: ONS

Basket cases

It is not only timeframes that differ between economists and the rest of us, but also what goes into the inflation ‘shopping basket’. The CPI basket excludes owner occupied housing costs, which given the path of mortgage rates in the past two years may seem a serious omission. The Office for National Statistics (ONS) does publish an inflation measure, CPIH, which includes those missing housing costs, but it is not widely used. In June it was running at an annual 2.8%, again unchanged from May.

The CPI basket is based on average expenditure, which may not match your expenditure. For example, the three largest components of the CPI basket are Restaurants & Hotels (14.5%); Recreation and Culture (14.6%) and Transport (13.5%). Food, which has been the focus of attention, is lumped together with non-alcoholic beverages in fifth position at 11.3%.

Criticism of the one-basket-for-all approach has prompted the ONS to experiment with different baskets for different population profiles, e.g. working/not working, with/without children. At present, these rates are only produced quarterly. The March set showed annual inflation rates varying between 5.5% (for those with mortgages) and 3.3% (for private renters) – all rates above the March CPI of 3.2%.

Future inflation

The current consensus is that annual inflation will not be moving far from the 2% target over the next few years, assuming no more shocks like the pandemic or the Ukraine war. With time, the memory of 2020/21 prices will fade, but it may take more than a couple of years given the long period of low inflation experienced in the 2010s – when the CPI rose by 23.3% *over the decade*.

What inflation means for your financial plans

The last few years have been a reminder of the impact inflation can have on almost every aspect of life. That cumulative inflation of over 20% since the beginning of the decade means any financial plans that were built on an assumption of 2% inflation need to be revisited and updated.

Action

You cannot ignore inflation when you visit the supermarket, so do not ignore it when it comes to your financial plans.

Call us for a 2024 update of any plans that have not been reviewed in recent years, be they retirement, investment or life and health protection.

The cost of retirement

How much income do you need in retirement?

The question appears a simple one, but the answer is not. Over the years there have been many attempts to find the right number, some more robust than others. The classic – and now largely abandoned – solution was that retirement income should be two thirds of earnings immediately before retirement. That basis, often a target for last century's final salary pension schemes, has now largely been replaced by calculations focussed on expenditure in retirement.

The change to a forward-looking approach has logic on its side. The costs of working life are different from those of retirement and there is no arbitrary factor linking the two.

The Retirement Living Standards calculations

In 2019, the Pensions and Lifetime Savings Association (PLSA), in conjunction with Loughborough University, developed a set of Retirement Living Standards, designed to provide long term benchmarks. There are three standards: minimum, moderate and comfortable. Each standard considers six main areas: house, food, transport, holidays & leisure, clothing & personal, and helping others. A flavour of the differences between the three standards can be seen in the transport category:

Standard	Definition	Transport
Minimum:	More than just food, clothes and shelter. It is about having what you need to have the opportunities and choices necessary to participate in society.	Bus: Free bus pass. Rail: £100 per person per year, plus £70 for three-year senior railcard. Car: None. Taxi: Couple: £15 per week, per couple; Single: £10 per week.
Moderate:	More than just meeting your basic needs. It means being able to access a range of opportunities and choices, having a sense of security and the option to do some of the things that you would like to do.	Rail: £100 per person per year, plus £70 for three-year senior railcard. Car: three-year-old Ford Fiesta, replaced every seven years. Taxi: £20 per household, per month.
Comfortable:	More than just meeting your basic needs; it is about having a broad range of opportunities and choices, peace of mind and the flexibility to do a lot of the things that you would like to do.	Rail: £200 per year per person, plus £70 for three-year senior railcard. Car: three-year-old Ford Fiesta, replaced every five years. Taxi: £20 a month, per household.

The requirements for each standard are regularly reviewed as retirement lifestyles change. For example, in 2023 there was:

- An increase in the food element for the moderate standard to cover taking friends or family out for a meal, an indirect form of financial support for others.
- A decrease from two cars to one smaller car at the comfortable level, partly a response to rising insurance costs.

The bottom line

The latest costings for the Retirement Living Standards were published earlier this year, based on prices at April 2023. As usual, there are figures for each standard covering couples and singles, living in London and living elsewhere in the UK. The *net* yearly income required for each category (excluding rent) is show below:

Standard	**Single**		**Couple**	
	UK ex-London	**London**	**UK ex-London**	**London**
Minimum	£14,400	£15,700	£22,400	£24,500
Moderate	£31,300	£32,800	£43,100	£44,900
Comfortable	£43,100	£45,000	£59,000	£61,200

All these figures were a significant increase on the previous year, the largest rise being over a third for the single person/moderate standard category. CPI Inflation across the period was 8.7% but that is a universal yardstick and different groups have different experiences.

Action

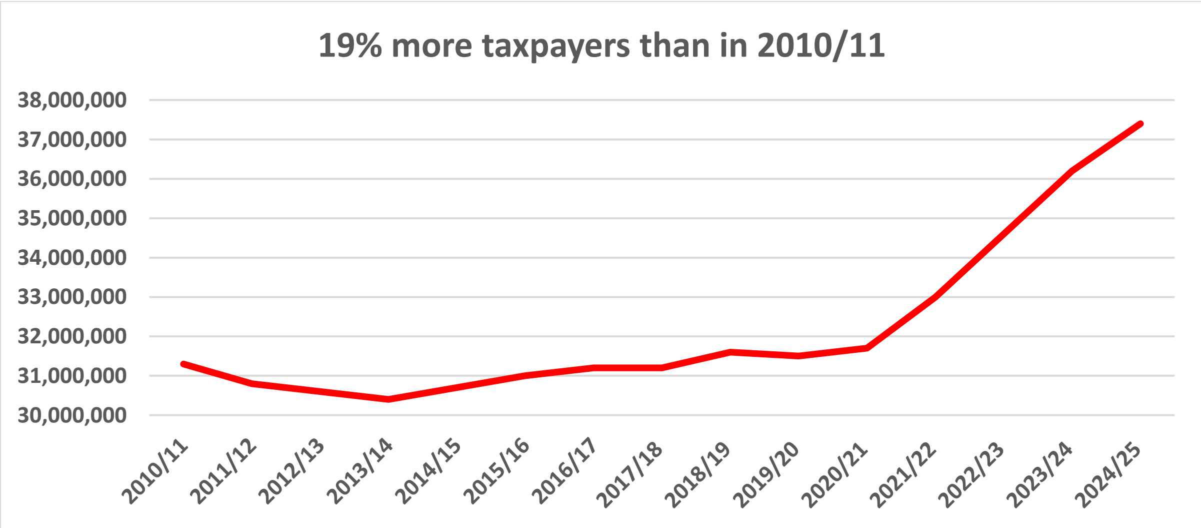
To put these figures into some context, the current State Pension is £11,502 a year (before tax). The further you want to be from that bus pass minimum standard, the more you are going to need additional income – pension or otherwise – in retirement.

We can provide you with an assessment of what living standard your current retirement plans will provide and the actions you can take to move nearer to the comfortable category.

Taxing times

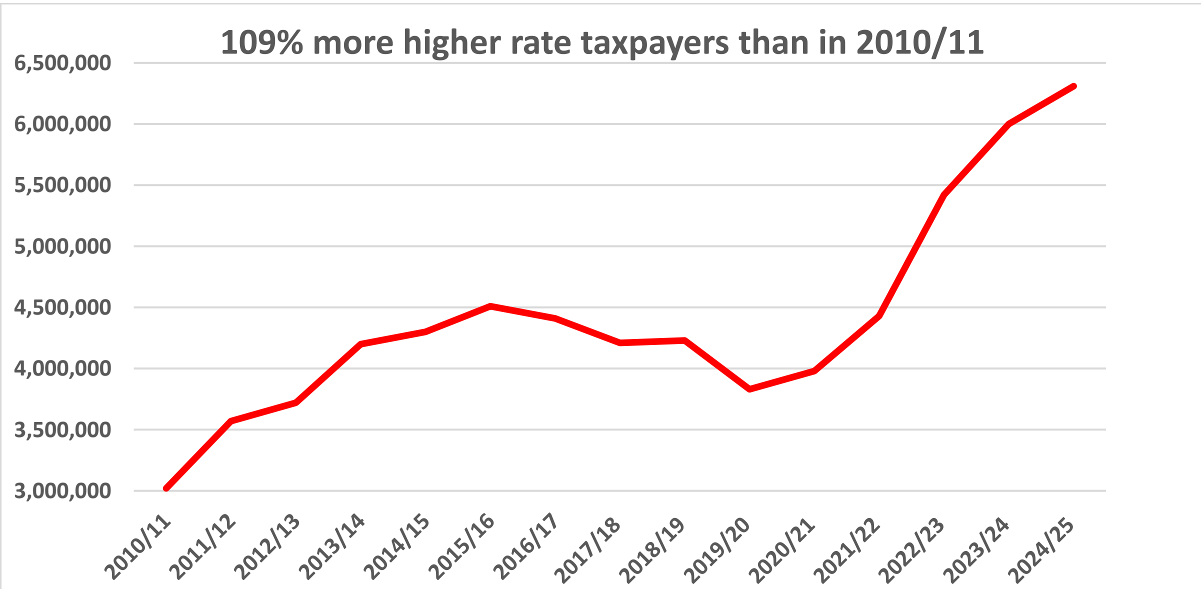
HMRC may not be able to answer its phones promptly, but their statistical department is usually on time with annual data updates. Thus, in June, the latest analysis of income tax revenues and taxpayers, including estimates up to the current tax year, was released. In summary, more of us are paying more tax…

More taxpayers…



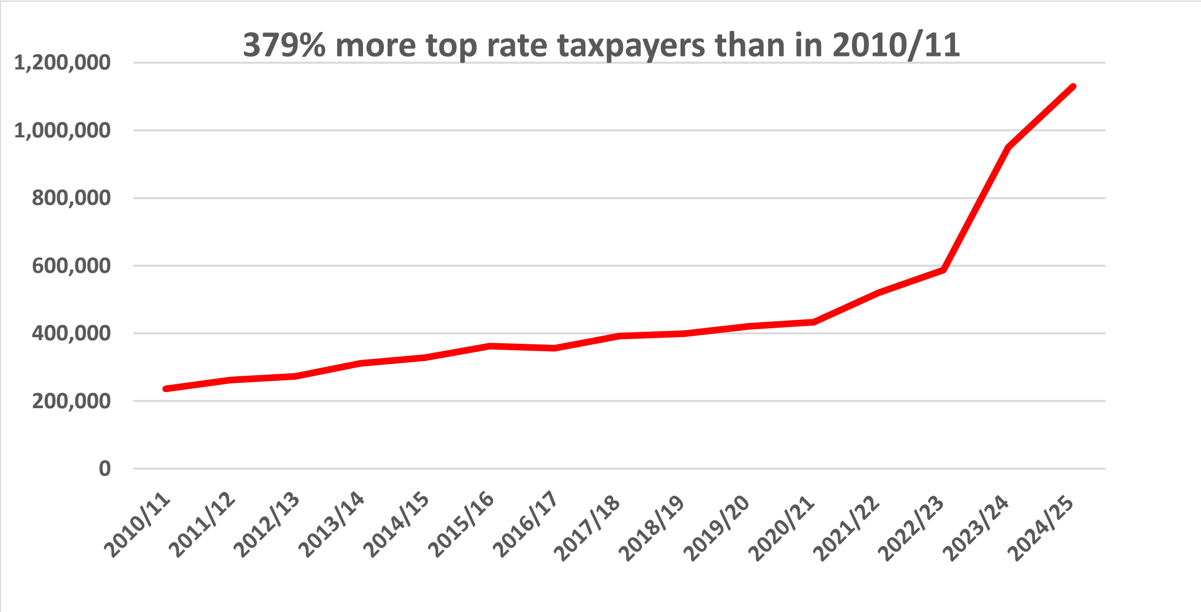
The income taxpaying population in the UK first exceeded 30m in 2004/5. By 2020/21, it had reached 31.7m. The personal allowance rose by just £70 in the following tax year was then frozen. The impact of that freeze is clear in the way that the graph moves sharply upwards. HMRC's well publicised administrative difficulties become more understandable – if not forgivable – when the 18% rise in their 'customer' base over four years is taken into account.

More higher rate taxpayers…



The rise in overall taxpayer numbers is dwarfed in percentage terms by the growth in those who pay tax at the higher rate (42% in Scotland and 40% in the rest of the UK). The upward march reflects cuts in the higher rate threshold between 2011/12 and 2015/16 and then, after a brief respite, the subsequent freeze in the 2020s. Whereas in 2010/11 about one in ten taxpayers suffered the higher rate, by 2024/25 it is projected to be just over one in six.

And proportionately many more top rate taxpayers…



The data on the top rate of tax has been complicated by this tax year's introduction in Scotland of the advanced rate of tax at 45% on taxable income above £62,430, sitting below the country's top rate of 48% (against 47% in 2023/24). In the rest of the UK, the highest tax rate is the additional rate of 45%. HMRC's statisticians count Scots who pay either 45% or 48% as top rate taxpayers. This has dragged over 100,000 Scottish taxpayers into the highest category for the current tax year.

There was also a large jump in additional/top taxpayers in 2023/24 when, after a freeze in the £150,000 threshold from 2010/11 to 2022/23, there was a near £25,000 cut to £125,140.

No change before 6 April 2028

The personal allowance and higher rate threshold are legislated to remain unchanged up to and including 2027/28, while the additional/top rate threshold is effectively fixed until the government decides otherwise. The additional revenue these freezes generate is already built into future spending plans, so it is unsurprising that the governing parties (Labour and SNP) have said nothing about bringing forward the date of any thaw.

Action

The drift into tax and through the tax bands has been a feature of the past decade. It is unlikely to change under the new government. HMRC estimate that, in 2024/25, higher rate and additional rate taxpayers will account for over £72 of each £100 of income tax revenue, despite representing only one in five of the income taxpaying population.

If your income tax bill is rising faster than your income, we can explain the options available to stem the onward march of the Treasury into your earnings and investment returns.