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Can Labour's New Budget Steady the Ship? Big Moves On UK Tax Reform and Fiscal Stability

By Sandy Bhogal and Bridget English
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New governments always have grand ambitions, and this Labour government is no exception.

We heard constant rhetoric during the election about growing the economy and improving social justice (and using the tax regime to do that). So imagine their disappointment when they took power and got a proper look at the country's finances.

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This was the cue for an intensive press campaign about balancing the books, £22 billion ($28.5 billion) blackholes, and the need for fiscal responsibility to reassure the international financial markets. Not a budget for growth, but a revenue raiser which didn't "formally" breach manifesto commitments but would hopefully leave people saying "that could have been worse".

The changes were leaked in advance and a number of the headline measures had been previewed with industry, so there were few shocks, huge amounts of technical material and plenty to consider. The highlights being:

- The largest portion of increased tax collections will come from changes to employer national insurance contributions (NICs). From April 2025, rates will increase from 13.8% to 15% and the threshold above which employers pay NICs will fall from £9,100 to £5,000. To mitigate the impact of this change on small businesses, the Employment Allowance will increase from £5,000 to £10,500. The Office for Budget Responsibility (plus every talking head on TV) predict that many businesses will pass the cost on to employees by adjusting wage increases and limiting job creation, thereby reducing disposal income in circulation (which in turn, risks reducing consumption, and revenues from taxes like VAT).
- As was widely trailed, from April 2025, capital gains tax rates will rise (albeit less steeply than some had feared): from 10% to 18% for basic rate taxpayer, and from 20% to 24% for higher rate taxpayers, while carried interest will be taxed at a uniform 32% (up from 18%, or 28% for additional rate taxpayers). However, from April 2026, carry will instead be taxed as income. This means it will be subject to income tax at 45% and NICS at 2%, but reduced by a multiplier to an effective rate of around 34% if certain conditions are met. A technical consultation has commenced on the details of this new regime, with the hope that it simplifies the existing anti-avoidance rules and finds ways

to ease the administrative burdens associated with carry and other equity incentives.

- The Chancellor has broadly retained the previous government's proposal to scrap the remittance basis of taxation (the so-called "non-dom" rules), with relatively minor tweaks (e.g. extending, from three to four years, the grace period during which new residents' off-shore income will not be taxed in the U.K.) Attempts have been made toward simplifying employment tax rules for internationally mobile employees (by removing the need for HM Revenue & Customs' (HMRC's) prior approval of the allocation of employment income between U.K., and non-U.K., work for payroll purposes). However, new limits on the extent to which overseas work remains outside the U.K. tax net (being the lower of 30% of employment income or £300,000) will likely have the opposite effect—potentially driving an increase in the complexity of multinational payroll arrangements. The direct and indirect contribution of non-doms and the internationally mobile to U.K. tax revenue, and to London's reputation as a financial and commercial hub, should not be underestimated and it is hoped that the government, will, by way of counteraction, give further thought to measures to protect and bolster the UK's competitiveness.
- As in recent years, the so-called "tax gap" (being the gap between tax legally owed, and tax collected) permeated the budget. HMRC plans to employ 1,800 new debt collectors and 5,000 new compliance staff, while late payment interest will increase by 1.5% (to 9% currently). In addition, (despite the litany of regimes introduced over the last decade) further measures are proposed to (a) crack down on promoters and facilitators of avoidance (on which consultations will be launched in early 2025), and (b) improve standards of tax advice, by requiring all tax advisers dealing with HMRC on clients' behalf to register (as well as giving further consideration to potential regulatory intervention in the tax market). Given the existing tools at HMRC's disposal to tackle avoidance, it may perhaps be wondered whether the proposals are likely to close the tax gap in any meaningful way (as the majority of the tax gap arises in the SME sector).

The government is positioning this budget as a "one and done" revenue raiser for the duration of this parliament. The U.K.'s reputation for fiscal stability has suffered in recent years, with six different prime ministers in eight years and the dramatic market reaction to the uncosted "mini-budget" of September 2022. The government is, therefore, justifiably eager to provide corporate taxpayers with an element of certainty when forward planning their tax affairs. This was evident in the publication of a Corporate Taxation Roadmap, which committed the government to maintaining the 25% corporation tax rate (as well as other taxpayer-favourable measures, such as full expensing for certain capital expenditure and R&D tax reliefs) for the current parliament.

With the U.S. election reaching its conclusion this week, the global economy will have the opportunity to settle down after a concentrated period of political uncertainty across the G20 countries. The Labour government now has to seize the opportunity over the course of this parliament to make good on its election promises and improve the UK's reputation as a predictable and business-friendly tax jurisdiction.

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