# Pre-Budget thoughts on capital taxation

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**For Financial Advisers to use with their clients**

Rachel Reeves 'spending inheritance' announcement revealed a projected overspend for 2024/25 of £21.9bn and offsetting measures of £5.5bn, leaving a gap of £16.4bn for the current financial year. For 2025/26 the offsetting measures are forecast to deliver savings £8.1bn, but the spending figures will have to await the first part of the Spending Review, due alongside the Autumn Budget.

In her announcement Reeves said "I have to tell the House that the Budget will involve taking difficult decisions to meet our fiscal rules across spending, welfare and tax." Nevertheless, she went on to confirm the Labour "…manifesto commitment that we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT." In a subsequent interview with the News Agents podcast, Reeves said, "I think we will have to increase taxes in the Budget,"

So, what might we see on 30 October? Well, there are a number of areas in which tax may be raised and in this article I examine the Chancellor's options in relation to capital taxation - capital gains tax and inheritance tax.

**Capital Gains Tax :**

Increases in Capital Gains Tax (CGT) have been widely discussed since Labour refused to rule them out in pre-election interviews. CGT is due to raise £15.2bn in 2024/25 and £16.2bn in 2025/26. The HMRC ready reckoner is pessimistic about the benefits of a significant increase in rates though. For example, it says a 10-percentage point increase in all rates would reduce revenue by about £1.35bn, as greater income (£710m) from the disposal of assets qualifying for Business Assets Disposal Relief (BADR) would be more than offset by a reduction of tax (£2,055m) on unrelieved gains as investors waited for a more tax-friendly climate (or death). A 5 percentage points increase would yield £420m according to HMRC. These numbers are at odds with some think tank calculations. For example, a Resolution Foundation report suggested that raising CGT rates to 16% (basic), 32% (higher) and 37% (additional) and reintroducing indexation relief would produce £7.5bn a year.

The "quick and dirty" option would be simply to scrap BADR, which HMRC estimates cost £1.5bn in 2023/24.This may be unlikely though.

The general rebasing of values on death is also something that has gained attention as an area for tax-raising reform, particularly when agricultural or business relief also applies. Applying CGT at death was an idea floated in the Office for Tax (OTS) Inheritance Tax Simplification Review. The OTS estimated that for 2015/16, CGT levied at death would raise £1.3bn and affect 55,000 estates (against 24,500 paying IHT). Those numbers, particularly in terms of taxpayer numbers, would skew higher for CGT now, given the reduction in the annual exemption. That underlines one issue about levying CGT on death. As the

OTS said '…many more people would be brought into a charge to tax on death than are currently subject to Inheritance Tax… It would also involve a substantial Exchequer cost as well as impacting a much larger number of people.'

Two halfway houses are possible – removing uplift if business or agricultural relief is claimed (assuming either survive) or simply not resetting the base cost for the recipient of an inheritance. That would mean the deceased's base cost would pass across to the new owner in the same way as holdover relief currently operates. The drawback of this would be a much smaller immediate tax boost.

**Inheritance Tax**

In heritance Tax (IHT) is projected to yield £7.5bn in 2024/25 and £7.7bn in 2025/26, meaning in total it raises about as much as 1p on the basic rate of income tax. The recent paper from the IFS is a good summary of the areas that could provide extra revenue:

- Business and agricultural reliefs: The IFS put the cost of these reliefs at £1.4bn and £0.4bn respectively. HMRC data show that business relief claimants typically number fewer than 5,000. The IFS proposals were to:
    - Scrap business relief entirely for AIM shares, saving £1.1bn in 2024/25, rising to £1.6bn by 2029/30.
    - Cap the two reliefs to a transferable £500,000 per person. As much of these reliefs is currently claimed by the largest estates, the IFS estimates the change could generate £1.4bn in the current tax year, rising to £1.8bn by 2029/30. The IFS does not distinguish between 'working' and passive asset owners. This would be an option for the government, but would add complexity while reducing tax receipts.

- DC Pensions: The IFS, along with many others, favours bringing pension death benefits within the ambit of IHT. It also thinks that income tax should be levied at a minimum of basic rate on any funds withdrawn by a successor/dependent, regardless of the age at death of the pension owner. To take account of this additional tax the IFS proposal would apply IHT to 80% of gross funds. The IHT raised would initially be small beer - £0.2bn in 2024/25, rising to £0.4bn by 2029/30.

More radical reform, such as a switch to taxing recipients rather than donors, could raise more money, but would involve a major legislative overhaul. This may not be seen as the right time for this kind of radical change.

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