



September 2024

NEWSLETTER

New Government

Since my last newsletter, a new Labour government has taken office and is preparing for its first budget at the end of next month. They say that government finances are in a much worse state than expected, so tough decisions will have to be made on taxation and spending. As they have promised not to increase rates of National Insurance, Income Tax or VAT (the only taxes which raise significant amounts) it is hard to see how they will be able to plug the financial "black hole" they have talked about. They could still, however, make minor adjustments to those taxes:

1. National Insurance could be extended to unearned income, such as rents or dividends from personal companies. That would fit government thinking, as they have said that it seems unfair for unearned income to be taxed at a lower rate than earned income.
2. Income Tax reliefs on pension contributions and business purchases of plant and equipment could be reduced.
3. VAT could be extended, as it already has been by applying it to private school fees. One target could be books and newspapers, which are currently zero-rated. That would be a slap in the face for the Tory press.

There are plenty of other taxes which could be tinkered with, although they would not raise a great deal. Increases in tobacco and alcohol duties could be justified on health grounds. Likewise, the new tax on vapes, due to start in October 2026, could be introduced earlier. Similarly, increases in fuel duty and road tax for large cars could be justified on environmental grounds. After that, there are things like Air Passenger Duty, Plastic Packaging Tax and Insurance Premium Tax which could be increased without the general public really noticing.

Corporation Tax

One thing the government has not mentioned is its plan for Corporation Tax, currently set at 25% or 19% for small companies with profits up to £50,000. Historically, the rate for small companies was always the same as the basic-rate of Income Tax, which is 20%, so that is an obvious candidate for increase. The chancellor could even decide to abolish the small companies rate altogether and make all companies pay the full rate of 25%.

Limited Companies

The commonest piece of advice given by the amateur tax expert in the pub is that running a business through a limited company will save tax. While that may have been true in the past, it is definitely not the case any more where the owner needs to withdraw all of the profits to live on.

A company works best as a tax-saving vehicle where someone expects to have a very high income for a few years and does not need all of it to live on. Some of the profits can be left in the company to avoid paying the higher rates of personal tax in those years. Later, when the business income has dropped or ceased altogether, those accumulated profits can be withdrawn little by little when the owner is not a higher-rate taxpayer.

Pensioner Benefits

The chancellor surprised everyone when her first policy announcement was to restrict the £300 winter fuel allowance to people claiming pension credit. That has caused speculation that other pensioner benefits may be restricted or abolished.

The most obvious benefit for reform is free prescriptions at age 60. It was set at that age when it was the retirement age for women and had to be the same age for men, although their pension age was 65, to avoid sex discrimination. Now that the state pension age is 66 for both men and women, it would be logical to also set that as the age for free prescriptions.

Another possible target is the free bus pass. Originally it gave entitlement to a half-fare, not free travel, so it could go back to that. However, the argument that pensioner benefits should not apply to wealthier people, which was used to justify the change to the winter fuel allowance, does not really apply here. It is the poorest pensioners who make most use of the bus pass and the better off probably do not even bother applying for one.

Old Tax Debts

I have seen two cases recently where HMRC has sent demands for old tax debts, which the taxpayers had forgotten about. When HMRC is not pursuing payment of a debt, it is easy to assume that it has been written off, but that is obviously not the case.

Non-Doms

I mentioned in my March 2024 newsletter that the last government had stolen the Labour Party's plan to reform the taxation of non-domiciled residents (foreigners living in the UK). Recent reports in the media have suggested that many non-doms are choosing to leave the UK rather than pay higher taxes, so the policy may be self-defeating.

Credit Card Loans

Generally, I would recommend that credit card balances are paid off every month to avoid the high interest charges, which work out at about 25% a year. There are, however, many special offers from credit card companies which give 12 to 18 months zero-interest on cash advances and balance transfers, for a fee of around 3%. That is a fairly cheap way to borrow moderate amounts, provided that you have the self-discipline to manage the loan without incurring additional charges.

The first thing to understand is how credit card companies allocate monthly repayments, which is to set them against the earliest transaction first. The worst thing you can do, therefore, is to use the credit card to make purchases after the cash advance.

For example, consider someone who takes out a new credit card with an interest-free advance of £5,000.00 with a 3% fee of £150.00. The first monthly statement will show a balance of £5,150.00 with a minimum payment of £51.50 (1%). If the card is not used for anything else and at least the minimum payment is made every month, then no other charges will be incurred during the interest-free period.

If the card was used to make purchases of £200.00 after the cash advance, then the first statement would show a balance of £5,350.00 with a minimum payment of £53.50 (1%). Even if the cardholder makes a payment of £251.50 (the £200.00 purchases plus 1% of the cash advance) it will all be allocated to the cash advance and the £200.00 purchases will incur interest charges every month until the balance is repaid in full.

After receiving the cash advance or balance transfer, the card is best locked away so that it cannot be used. Making just the minimum payment each month gives maximum benefit over the interest-free period, but most of the loan will still be owing at the end. The best way to prepare for that is to set aside money each month in a savings account to prepare for that large repayment. It will even earn a bit of interest to offset the charge for the cash advance, making it an even cheaper way to borrow, but it requires discipline.

Tax Estimates

Ever since the introduction of self-assessment, HMRC has always had the power to estimate what tax is due (called a determination) and collect that tax. There is no right of appeal and the only way to displace the determination is to submit the tax return. When penalty charges for late returns were significantly increased about 10 years ago, HMRC seemed to give up raising determinations and just charge and collect the penalties. Recently, though, I have seen a determination, so HMRC policy may be changing.

The "Tax Gap"

This refers to the difference between the tax which should be due and the smaller amount which is actually collected because of fraud and error. All governments seem to think that this is a massive amount and quote figures with no evidence to support them. They then announce additional funding for HMRC to recover this "lost" tax.

The latest announcement was contained in the Labour Party manifesto for the 2024 election, aiming to spend £855m to raise £6bn. I doubt we will ever know whether this has been achieved.

VAT on School Fees

The government has already announced that 20% VAT will apply to private school fees from 1 January 2025. What the government actually collects, however, will not be the full 20%, because the schools will be able to set off VAT paid on costs, such as repairs, electricity and gas, sports equipment and even new buildings. Furthermore, this change could increase costs for the state education system, if some parents take their children out of private schools and those schools also offer fewer scholarships.

Parents who send their children to private schools are also contributing to the state system (without using it) through their taxes, so why discourage them? The policy seems entirely ideological with no logical basis.

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