5 Opie Street, Norwich, Norfolk, NR1 3DW
01603 624 236
barrattandcooke.co.uk

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INVESTING SINCE 1880

November 2024

The Labour Budget

Bigger Than Bargained For

We should preface this document by stating that we are not accountants and that we cannot therefore provide any tax advice, but the Budget is of course impactful on our clients' portfolios, and indeed on our wider investment approach.

Well, the period of endless speculation is thankfully over, with the detail of Labour's first Budget in 14 years now known. Unsurprisingly, it was an impactful one, albeit the scale of increase in 'the state' is bigger than many anticipated.

There is little doubt that what has felt like an epoch of time between Labour's election (4th July) and their first Budget (30th October) was a damaging own goal. Positivity around Labour's pro-growth mantra was quickly diluted by relentless references to the £22bn 'black hole' inherited from the Conservatives (essentially the forecasted overspend on the running costs of public services) and incessant warnings from Starmer and Reeves of a "painful" Budget.

It must be said that Labour have come to power at a time of challenging public finances, with the overhang of the covid-19 pandemic lingering on, the economic cost of which (e.g. critical furlough payments) will be felt for many years to come. Indeed, total government debt approaches £3 trillion (that's £3,000,000,000,000!). With interest rates rising in recent years, the cost of servicing this debt (let alone paying off any of the principle) is staggering, costing over £100 billion a year, or roughly 4% of the country's GDP, almost as much as the Government spends on education.

In order to avoid too significantly increasing the country's already goliath debt burden, whilst still delivering on their ambitions to increase public sector pay, ensuring departmental budgets keep up with inflation and delivering further spending on the NHS and social care, the Government has announced £40bn of tax rises, the biggest single hike for 31 years, pushing the UK's tax burden to its highest level in decades.

Key tax increases announced in the Budget include:

- An increase to National Insurance contributions paid by employers (from April 2025), with the rate rising from 13.8% to 15.0%, alongside a less well publicised cut to the threshold (which almost doubles this cost increase for many employers). This policy change has had the single largest impact on the Government's forecasted tax receipts, raising an additional estimated £25bn a year.
- As was widely speculated, capital gains are to be taxed more punitively, up from 10% to 18% at the basic rate and from 20% to 24% at the higher rate, now in line with property disposals. If there are any silver linings, this is not as material a rise as many feared.
- Less anticipated was the announcement that, from April 2026, agricultural and business assets will no longer benefit from full inheritance tax (IHT) relief, with assets over a £1m tax free allowance to be taxed at 20% (albeit a discount to the standard 40% IHT rate).

A key requirement of the Government is to deliver a Budget which sees public spending funded by tax revenues by the end of the parliamentary term, even if there is a deficit in the early years (as there is currently). Whilst the Budget looks to achieve this, there is a concern that this is predicated on overly-optimistic forecasts, hence a risk of further tax rises to follow.

A secondary requirement of the Government is to deliver a Budget which sees the country's debt burden (as a share of the economy) reducing by the fifth year of the forecast. How can the Government ramp up public investment whilst still delivering on this pledge you may ask? Simply put, by changing the definition of what constitutes the Government's debt! There is a whiff of 'smoke and mirrors' to this, albeit the shift in accounting methodology frees up spending capacity for hospitals, prisons and the HS2 money pit.

Office of Budget Responsibility (OBR) Forecasts

Caveat: One thing is for certain - these estimates will not prove fully accurate!

	2024	2025	2026	2027	2028	2029
GDP	1.1%	2.0%	1.8%	1.5%	1.5%	1.6%
CPI Inflation	2.5%	2.6%	2.3%	2.1%	2.1%	2.0%

It is worth noting that despite the significant spending pledges, GDP growth forecasts are underwhelming at best, with the OBR expecting a modest 'Budget boost' of 0.6% next year.

Key Announcements

National Insurance

From April 2025, employer National Insurance contributions to increase from 13.8% to 15%, alongside a cut to the threshold, raising £25bn p.a.

Capital Gains Tax

With immediate effect, capital gains tax increased from 10% to 18% at the basic rate and from 20% to 24% at the higher rate (see overleaf).

Inheritance Tax Thresholds

The nil-rate band of £325k, as well as the residence nil-rate band of £175k, will now remain frozen until April 2030 (a 'stealth tax' given inflating asset values).

Agricultural Property Relief (APR) and Business Property Relief (BPR)

From April 2026, the first £1m of agricultural and business assets are to remain IHT free, with any excess to incur IHT at a discounted rate of 20%.

AIM Shares

From April 2026, inheritance tax relief on AIM shares to reduce from full relief to discounted relief, with IHT charged at 20% (see overleaf).

Pensions

From April 2027, unspent pensions will fall within the scope of IHT (see overleaf).

Private Schools

From January 2025, VAT will be charged on private school fees, also removing their business rates relief from April 2025.

Non-Domicile Reform

From April 2025, non-domicile tax regime is to replaced by a residency based regime.

National Living Wage

From April 2025, the National Living Wage is to increase by 6.7% to £12.21, with the National Minimum Wage (for 18-20 year olds) to increase by 16.3% to £10.00.

Income Tax and NI Thresholds

From April 2028, these personal tax thresholds will rise in line with inflation.

Compensation Schemes

Funds set aside to compensate for the infected blood scandal (£11.8bn) and the Post Office scandal (£1.8bn).

Stamp Duty Land Tax

Surcharge on second home purchases increased from 3% to 5%.

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Policies Most Pertinent To Portfolios

Capital Gains

With immediate effect, capital gains tax (CGT) rates have increased:

- Basic rate: from 10% to 18%.
- Higher rate: from 20% to 24%.

There were real concerns that CGT rates would rise further still (perhaps into line with income tax rates of 20% and 40% respectively), or that CGT uplift on death would cease to apply, so this is a reasonable outcome for investors. The current (small) tax free allowance of £3,000 remains the same (£1,500 for Trusts).

We continue to manage portfolios whilst being sensitive to CGT considerations. However, as noted above, even at the increased rates, the capital tax regime is not overly penal.

Pensions

From 6th April 2027, unspent pension pots (and death benefit arrangements) will be liable to inheritance tax (IHT), impacting what is currently a very favourable arrangement for inter-generational planning.

AIM Shares

From 6th April 2026, the tax reliefs associated with AIM shareholdings are to be reduced. Currently, certain such shareholdings qualify for full IHT relief (at 40%), but this will be reduced to a discounted rate of IHT (at 20%).

Maintaining the Status Quo

ISAs

The ISA allowance remains at £20,000 per tax year, with JISAs at £9,000. In the context of higher CGT rates, ISAs are increasingly beneficial (for tax free capital gains and tax free income).

Dividends

The tax free dividend allowance remains at £500 for individuals and the rates of tax on dividends will remain unchanged at 8.75% (basic rate), 33.75% (higher rate) and 39.35% (additional rate).

Authors

Edward Sidgwick CFA FCSI
Associate Director

Sam Matthews FCSI
Associate Director

Alastair Jackson FCSI
Associate Director

Important Information

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Financial Markets Reaction to the Budget

Equity Markets

On the day of the Budget, the moves were:

- FTSE 100 Index: -0.7%
- FTSE 250 Index: +0.3%
- FTSE Small Cap Index: +0.7%
- FTSE AIM Index: +4.0%

As can be seen, AIM aside, there was a relatively muted reaction to the Budget in equity markets. The rise in AIM reflects a degree of relief that associated tax reliefs were only reduced, not pulled altogether.

Gilt Markets

The Government issues significant gilts each year (forecast at £296.9bn this year), partly to re-finance existing gilt issues as they redeem, partly raising fresh funds for spending not by covered by tax receipts. Buyers of gilts (predominantly insurance companies and pension funds) demand a return (or yield) on such investments, the level of which is impacted by the credibility of the Government's fiscal position.

At the time of writing, the Budget has not had the same calamitous impact on the gilt market that we saw following the Truss/Kwarteng mini-Budget in September 2022 (which led to gilt yields spiking sharply higher), but there has still been a marked rise in gilt yields (albeit, crucially, in an orderly fashion):

- Gilt yield (10yr) on 1st October: 3.94%
- Gilt yield (10 yr) on 31st October: 4.45%

Gilts have risen as Starmer and Reeves will need to keep gilt buyers on side, given the central role that they play in funding the public purse.

Currency Markets

To make any comments about the strength or weakness of the Pound, one must caveat that this is typically in the context of another currency (i.e. if the Pound rises against the Dollar, this could be driven by weakness in the Dollar as opposed to strength in the Pound).

Currency markets are little changed in the immediate aftermath of the Budget:

- GBP/USD on 29th October: 1.3015
- GBP/USD on 31st October: 1.2899

- GBP/EUR on 29th October: 1.2030
- GBP/EUR on 31st October: 1.1852

The Pound is marginally weaker against the Dollar and Euro, but immaterial.