# Topical Commentary

## The Labour Budget - First Thoughts

In September, we sent out a Topical Commentary looking at the likely targets for tax increases in the new government's first budget.

Now, after all the uncertainty and speculation caused by Labour's decision against setting out its taxation plans ahead of the election, and subsequent excessive delay in introducing them, the fog is finally starting to clear, although not entirely.

There are countless sources of general commentary on this budget, and we have no wish to add to those, so we focus here on just the areas which impact on the financial planning decisions of our clients.

While the changes we look at are all concerned with higher taxes, it is always worth remembering that, when things get worse, they can always get better again, and these changes may not last forever.

As a counterpoint to that, it is also worth remembering that the changes just announced could have been a lot worse, and there is no certainty further rises won't come along.

While the negative impact of the different measures will depend on individual circumstances, we have ordered the subjects based on our assessment of their degree of gravity, starting with the worst.

**The Taxation of Pension Funds**

With occasional exceptions, pension funds have always been exempt from Inheritance Tax (IHT), as they do not form part of an individual's estate. Instead, income tax has been applied when a beneficiary withdraws the money, other than when the plan holder dies before age 75, when a bizarre rule kicks in and makes the entire fund tax free to the beneficiary.

We thought that weird exemption would go, but it hasn't. Yet.

We also thought the exemption from IHT might go, and it has.

What we hadn't expected was that it would be added in, rather than replace the existing taxation of pension funds on death.

This means we now have double taxation of pension funds on death.

Even where a beneficiary is able to withdraw funds without going into high-rate tax, if the estate, including the pension fund, is above the IHT threshold, 52% of the pension funds value will be taken by the Government, either directly from the pension or through extra tax on other assets.

For the many where the pension fund is too large to be withdrawn within basic rate tax allowances, the total taxation impact rises to either 64% or 67% of the pension fund value.

If the introduction of this double taxation isn't reversed, this is a game changer for pension planning.

To date, for many, paying into a pension has been a more tax efficient use of money than almost any alternative, but now it could land up amongst the least tax efficient.

Where it sits in the hierarchy of tax efficiency will depend on a range of variables, but the world of pension and retirement planning has certainly become even more complicated than it was before. Given how absurdly complex it already was, this is a disappointing direction of travel.

The new rules don't come into effect until April 2027 and are subject to a consultation period, so the changes as presented in the budget may be revised. However, based on what we understand from the budget, transfers of a pension fund on death to a spouse or civil partner will enjoy the same exemption from IHT as applies to other assets.

This means that, if someone dies before age 75 and leaves their pension fund to a spouse or civil partner, they inherit the fund entirely tax free. They could then withdraw it from the pension environment to avoid the double taxation that will apply if they pass away after age 75.

This implies that, for someone with a spouse or civil partner, action taken before age 75 to reflect this change to the taxation of pension funds might backfire, and it won't be until age 75 that changes to strategy are needed.

As for action at or after age 75, this will need to be assessed on a case-by-case basis, but it seems unlikely that the option of delaying withdrawing any tax-free cash entitlement beyond age 75 will be attractive, at least in terms of tax planning.

On the positive side, the speculation that the budget would curtail the tax relief on paying into a pension, or further restrict the access to a tax-free withdrawal of 25% (already capped at £268,275) proved inaccurate, as we had suspected.

With potential changes before the rules come into force in 2027, any planning decisions will normally be best delayed until there is less uncertainty, but some who have previously prioritised pension funding over ISA funding may decide to reverse that stance. This is because an ISA might now have the more favourable tax treatment, although that will depend both on individual circumstances and on tax rules that apply in the future, rather than just those that apply now.

Rest assured, if you have a pension fund we are advising on, we will let you know if we think you should consider making any changes to reflect whatever the new tax rules actually turn out to be, once the mists have cleared and the new rules are in force.

**Inheritance Tax (IHT)**

The inclusion of invested pension funds and lump sum death benefits from a pension in someone's estate for IHT, looked at above, will massively increase the number of estates that get caught by this deeply unpopular tax on the accumulated assets of those who die.

What was once a tax only on the wealthy had already become a tax on a much wider slice of society, due to the combination of property price inflation and frozen allowances. Now pension funds and lump sum death benefits will be included, the reach of this tax has spread far and wide.

Another change is to limit the IHT exemption enjoyed by farmland under the Agricultural Property Relief (APR). To date qualifying agricultural land has enjoyed 100% exemption. From April 2026 this will be capped at a value of £1 million, after which a 50% reduction to the normal 40% IHT rate will apply, creating a tax rate of 20%.

APR was introduced in 1984 to protect the long-standing tradition of farms passing from generation to generation but has created an unintended opportunity for the wealthy to shelter assets by purchasing farmland, since the exemption extends to land that is tenanted rather than farmed by the owner.

This change will discourage that practice, which may be no bad thing, but there will be some deeply negative consequences for traditional farming families.

Of more impact to many, Business Property Relief (BPR) on shares traded on the Alternative Investment Market (AIM) will have their exemption removed and tax will be applied at 20%. That's half the normal rate, but who knows if this is just an interim phase on the way to removing all the IHT benefits from owning AIM listed stocks, further discouraging investment in our smaller companies?

Those already holding AIM shares as part of their IHT planning will probably continue to hold them, as 20% tax is still better than 40%, but the cut in the tax benefits will almost certainly discourage new investment now the compensation for the extra risks has been cut in two.

On the positive side, the ability to make lifetime gifts and avoid IHT entirely if you survive 7 years has remained. That means for those with assets they are confident will always be surplus to their needs, avoiding or mitigating IHT can be a relatively simple process.

Unfortunately, though, most of us are not in that position, especially when the possible need for funding care fees in later life is factored in.

Following these changes there will be many who may need to review their existing IHT mitigation arrangements and probably even more who need to start looking at this subject for the first time, as their estate will now be caught in the net.

Atkins Bland is, of course, here to help if this is a subject you would like to discuss with us.

**Capital Gains Tax (CGT)**

The basic rate for gains on disposing of assets other than a taxable residential property has increased from 10% to 18%, and the high rate from 20% to 24%. This has brought the rates in line with those applying to residential property that aren't exempt as the main residence of the owner.

An increase in CGT rates seemed almost inevitable and we suspected they might rise to align with income tax rates. This change has, therefore, been less bad than it could have been.

In addition, the exempt allowance of £3,000 a year, which has been reduced over the last 3 years from £12,300, has remained, so there is still some ability to control CGT through use of that.

Perhaps of most importance, though, is the fact that, so far, the exemption from CGT on death has been left in place. That means CGT can be avoided entirely, through a decision not to sell.

Not all assets can be treated that way, but the fact that the rules facilitate avoiding CGT altogether through that route suggests this could be a delayed change rather than one that won't come along one day, assuming we continue with our long-term pattern of an ever-expending public sector and ever-increasing taxation to fund it.

No new planning points have come from the increase in CGT rates but using yearly CGT allowances and sheltering as much as you can in ISAs, which are exempt from CGT, remains a fundamental part of sensible investment planning.

**Other Points**

The above are the areas of change that we feel may result in changes to planning strategies.

While there were no positive changes to counter these negatives, there was some good news as other bad stuff that could have come along hasn't.

Notable amongst these are:

**ISAs:** The allowances remain the same and there has been no overall cap introduced.

**Income Tax:** Rates have not been increased and Labour has said the freeze on allowances will end after April 2028.

**Wealth Tax:** There is still no sign of this being introduced.

**Our Conclusion**

Labour has said this was a one-off budget and implied that such a massive increase in taxation will not be repeated.

When considering that, we should remember that they promised not to increase NI as part of their election campaign and then did so a few weeks later, once elected.

They also promised not to increase taxes for working people and yet all these taxes will obviously do that.

Our conclusion is that it is unsafe to think the changes many had feared, and which haven't been announced, won't be later, but also wise to be mindful that there is bound to be another change of government at some stage, and that may reverse some of these tax increases.

We live in a world of uncertainty and politicians here and elsewhere have been adding to that relentlessly in recent times.

While financial planning should have a foundation in whatever is in force at the time, potential changes need to be considered before making decisions which could backfire if the reasons they were made change.

At Atkins Bland we will do our very best to help all our clients navigate their way through all these actual or potential changes to the tax regime, but we believe acting in haste might result in poor decisions, so we generally advocate patience to allow the clouds to dissipate and the dust settle.

**Important Notes**

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader.

This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied.

The value of investments will fall as well as rise, as can any income produced or generated, an investor, therefore, may get back less than invested.

Inflation can reduce the real value of capital and the income it generates.

Past investment performance is not a reliable guide to the future.

Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy.

The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective.

Errors and omission excepted.

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