The Spring Statement: The Detail Behind The Headlines

March 2022

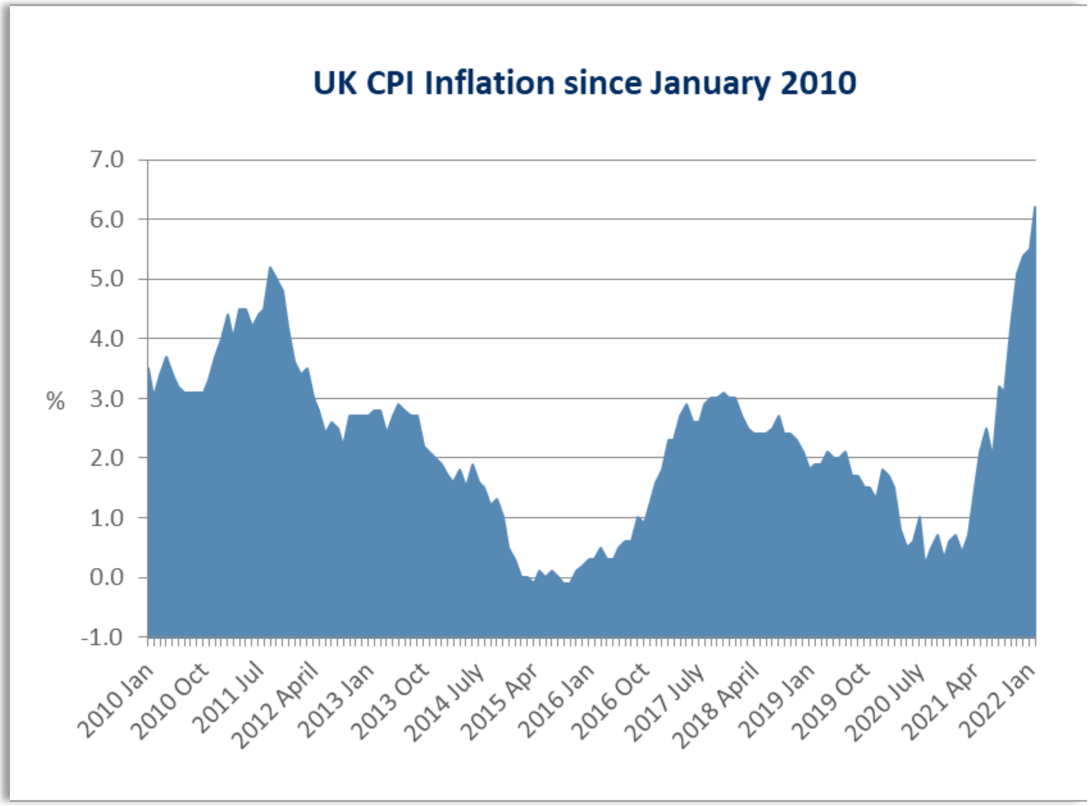
In this edition

24 March 2022

The Spring Statement: The Detail Behind The Headlines

The Chancellor surprised many commentators with his Spring Statement which was more of a mini-Budget.

The Economic Background



If a week is a long time in politics, then the near five months since Rishi Sunak's second 2021 Budget feels close to a lifetime. Back on 27 October, it looked like 2022 would be a year of recovery in which the pandemic faded in the rear-view mirror and 'transitory' inflation duly transited to lower levels. It has not worked out like that.

Omicron was the first disruption, although thankfully its main impact was limited to increased testing costs. Then came the closely linked duo of surging energy prices and rising inflation. When the Chancellor presented the Autumn Budget, CPI inflation was 3.1% (for September 2021), down 0.1% from the previous month (the last downward dip in the graph). That rate set the level of pension and benefit increases from next month.

By early February the latest inflation reading was up to 5.5% (for January 2022) and the Chancellor was launching £9bn of help with utility bills. More than half of the assistance was a heat-now-pay-later loan arrangement, predicated in the belief that energy prices would not be rising beyond October. Exactly three weeks after Mr Sunak's announcement Russia invaded Ukraine, adding another boost not only to volatile energy costs, but also to a swathe of other commodity prices.

Inflation, confirmed to be at 6.2% in February, is more than a cost-of-living-crisis political problem for the Chancellor. It has also thrown a large spanner into the carefully crafted calculations of his two 2021 Budgets:

- The freezing of many allowances and tax bands through to April 2026 now looks a much more brutal tax increase than originally appeared. For example, in March 2021, the Office for Budget Responsibility (OBR) projected that the personal allowance and higher rate tax threshold freezes would yield £8.2bn a year by 2025/26. Last week the Institute for Fiscal Studies (IFS) calculated that on the latest forecasts that figure could be as much as £21bn. The impact is already showing up in PAYE income tax receipts, which 11 months into 2021/22 were 13.6% (£20.3bn) above the corresponding figure for 2020/21.

- Last October's Spending Review set cash expenditure amounts for 2022/23 to 2024/25. Higher than assumed inflation devalues the departmental budgets and leaves the government with the awkward fact that not uprating these amounts means a drift back towards austerity. A good example of the problem will be public sector pay, which on average has shown no real growth since 2010, according to the IFS.

- The £500bn plus of index-linked gilts, which looked like virtually free borrowing a year ago, is now a millstone with the RPI inflation which they track running at 8.2% (February 2022). In 2020/21 the government spent £23.6bn on debt interest. For 2021/22 the OBR reckons the cost will be £53.5bn, a 127% increase. 2022/23 sees a further 55% jump to £83.0bn, which, as the Chancellor noted in his speech, is a near quadrupling over two years.

  During the pandemic the Bank of England rode to the Treasury's assistance with £450bn of quantitative easing (QE) and a 0.1% base rate. Now the Treasury may feel the Bank is working against it, with increases in base rate and a gradual unwinding of QE. Both are counter-inflationary measures, but the former reduces the financial benefits of QE for the public finances while the latter removes the largest buyer from the gilts market. That matters when the Treasury has £125bn of gilts to sell in 2022/23.

- Real earnings, i.e. earnings adjusted for inflation, are set to fall. Even the much-trumpeted 6.6% rise in the National Living Wage next month will be short of April's inflation rate. The OBR reckons that real wage growth will be -2.0% in the first quarter of 2023 after inflation peaks at 8.7% in the previous quarter. Add in the covert income tax rise from frozen allowances and overt NICs increases and Joe and Josephine Public will feel considerably poorer. The result will be slower growth. In October the OBR was projecting 6% growth in 2022 and 2.1% in 2023 in its economic and fiscal outlook (EFO). The corresponding figures in the latest EFO are 3.8% and 1.8%. Less growth means less tax revenue.

The day before the Spring Statement the public finance figures showed the Chancellor still to be on course to undershoot the OBR's October 2021 borrowing forecast by over £25bn. The expectation was that he would hold back most, if not all of that bounty for tax cuts ahead of the next election, due by the end of 2024. The Spring Statement proved that assumption both right and wrong…

The Spring Statement Announcements

Although events have consistently conspired against him, Mr Sunak is not a member of the mini-Budget fan club. The fact that the timing of the Spring Statement was revealed on 23 December with minimal detail underlines the point. At the time his hope was to follow the framework introduced by Philip Hammond, with the Spring Statement setting out for consultation matters to be legislated for in the Autumn Budget. To some degree this is what has happened, but faced with a welter of headlines about a cost of living crisis it proved impossible for Mr Sunak not to produce a Statement that had a strong resemblance to a mini-Budget.

The main announcements made on 23 March were:

National insurance contributions

There had been suggestions that Mr Sunak might raise the primary threshold (PT) for Class 1 national insurance contributions (NICs) by more than the planned £6 a week he announced last October. In the event he chose to increase the PT from £190 a week (£9,880 a year) from April 2022 to £242 a week (equivalent to £12,570 annualised) from 6 July 2022. This means that for 2022/23 £11,908 of earnings will be free of NICs for employees. That will rise to the full £12,570 in 2023/24, in line with the frozen personal allowance. For employees with earnings above £11,908, there will be a NICs saving of £269 in 2022/23.

Employers Class 1 thresholds remain unchanged, but the employment allowance will increase by £1,000 to £5,000 for 2022/23.

For the self-employed, the Class 4 lower profits limit will correspondingly be increased from £9,880 to £11,908 in 2022/23, again reaching to £12,570 in 2023/24. If profits fall under these thresholds Class 2 NICs will not be payable. For those with profits above £11,908, the Class 4 NICs saving is £208 in 2022/23.

Together these threshold adjustments claw back a little over one third of the revenue raised by the 1.25 percentage points increase in NIC rates. In a full year around 70% of NICs payers will save more from the threshold increase than they will pay extra because of the rates increase.

These changes will make little difference to answering the question of whether to incorporate, particularly when set against the impact of the 6-percentage point rise in the main corporation tax rate from April 2023.

The fact that the increased rates of NIC are still going ahead means the strengthened arguments in favour of salary sacrifice for pension contributions and low emission vehicles remain valid. Marginal combined tax and NIC rates will still be as high as 48.25% (55.02% if employer's NICs are also taken into account).

Basic rate tax

The basic rate of tax will be reduced to 19% from 2024/25, timed to coincide with the likely date of the next general election. Devolved tax rules means that the cut will apply to non-savings, non-dividend income for taxpayers in England, Wales and Northern Ireland and the savings basic rate throughout the UK.

Scotland will receive additional funding under the Barnett formula, allowing it to make its own decision on tax rate. It currently has a small basic rate tax band, sitting between 19% (starter) and 21% (intermediate) bands.

In practice the cut in basic rate tax, which will cost about £6bn a year from 2024/25, can be viewed as either:

- A partial reversal of the NICs increase; or
- An unwinding of some of the Treasury's inflation-driven revenue gains from the freeze to the personal allowance and higher rate threshold.

As the OBR notes, despite this future income tax cut, the overall result of recent Budget measures is to 'raise the tax burden from the 33.0% of GDP recorded in 2019/20 to 36.3% in 2026/27 – its highest level since the late 1940s.' Viewed another way, tax planning has become more important now than in the past 75 years…

Fuel duty

The rate of fuel duty on petrol and diesel will be temporarily reduced by 5p a litre for 12 months with immediate effect. The cost of this is £2.4bn. In practice the 'giveaway' is closely matched by the extra VAT revenue on fuel which the Chancellor is receiving from the rise in pump prices since last October (when average petrol prices were 138.6p a litre according to the ONS).

VAT on energy saving materials

VAT relief on energy saving materials is to be expanded to cover certain items such as wind turbines and the VAT rate reduced to zero for five years from 1 April 2022. Part of the aim behind this is to encourage domestic solar panel installation. The Spring Statement suggests it will mean savings of 'more than £1,000' on a typical roof top set up, a figure which appears to have been calculated assuming the current VAT rate applicable is 20%: it is in fact 5%. These changes will not apply to Northern Ireland because of its unique relationship with the EU. Instead it will receive an adjustment under the Barnett formula.

Research & Development tax credits

From April 2023, all data, cloud computing and pure maths costs associated with research and development (R&D), will qualify for relief.

Business rates: green relief

From 1 April 2023 until 31 March 2035 targeted business rate exemptions were due to be introduced for eligible plant and machinery used in onsite renewable energy generation and storage, and a 100% relief for eligible low-carbon heat networks with their own rates bill. To encourage more rapid take up, the start date has been brought forward a year to April 2022.

Tax Plan

Towards the end of his speech, the Chancellor waived a copy of his Tax Plan at the opposition benches. His words suggested that this document was the start of a broad consultation leading up to the Autumn Budget. In practice the Tax Plan has just a dozen pages, three of which are just blank (and blue). Much of the rest repeats the Spring Statement measures between stock photos of shopping aisles and petrol pumps. To the extent that any plan can be detected, it picks up on how to incentivise investment, a theme of Mr Sunak's recent Mais lecture. This has three aspects:

1. ***Capital*** The Chancellor plans to reform capital allowances for investment, starting from April 2023 when the current temporary 130% super-deduction ends and simultaneously the corporation tax rate rises from 19% to 25%. Implicit in this is the possibility of raising both allowances and tax rates to avoid any loss to the Exchequer. Mr Sunak is not convinced as much as George Osborne was that headline corporation tax rates are key.
2. ***People*** The Chancellor wants to examine the operation of the Apprenticeship Levy and consider alternative ways to encourage businesses to invest in training.
3. ***Ideas*** In his speech Mr Sunak highlighted that in the UK research and development (R&D) expenditure is only half the OECD average, while the country spends more than most other nations on providing tax relief for R&D. His conclusion was that "Something is not working". To rectify the situation, the Chancellor intends to reform R&D tax credits.

Changes already announced

Even if the Spring Statement is not classed as a mini-Budget, there were two Budgets and several other financial announcements in 2021 and early 2022, many of which will take effect in just over two weeks' time, on 6 April:

UK income tax

The first Budget of 2021 froze the personal allowance for 2022/23 at £12,570 and the basic rate band at £37,700 (outside Scotland), leaving the higher rate threshold also on ice at £50,270. A thaw is not scheduled to occur until 2026/27. The OBR now projects inflation in the four years from the start of 2022 to total 15.5%, compared with a forecast of 7.8% it made a year ago. That difference underlines the heightened impact of the freeze.

As part of the NHS/social care funding exercise, dividend tax rates will rise by 1.25ppt from 2022/23:

UK Marginal Rate	Basic	Higher	Additional
2020/21 Dividend Rate	7.50%	32.50%	38.10%
2021/22 Dividend Rate	8.75%	33.75%	39.35%

The dividend allowance, like the personal savings allowance, is unchanged for 2022/23.

Scottish income tax

Scotland shares the same personal allowance with the rest of the UK, but a different set of tax rates and tax bands are levied on non-savings, non-dividend income – primarily earnings:

Band	Tax Rate %	Taxable Income £	
		2021/22	2022/23
Starter	19	0 - 2,097	0 - 2,162
Basic	20	Over 2,097 -12,726	Over 2,162 -13,118
Intermediate	21	Over 12,726 – 31,092	Over 13,118 – 31,092
Higher	41	Over 31,092-150,000	Over 31,092-150,000
Top	46	Over 150,000	Over 150,000

The threshold for the higher rate of income tax (41% in Scotland) will be frozen at £43,662, over £6,600 below that south of the border. A Scottish resident with earnings of £50,270 a year – the higher rate threshold outside Scotland – faces an extra income tax charge of £1,545 a year compared with their English counterpart.

Welsh income tax

The National Assembly for Wales kept with the rates of the rest of the UK (excluding Scotland), although in theory it could have diverged.

National insurance contributions

The Class 1 national insurance contribution (NIC) employer secondary threshold for 2022/23 will rise by 3.3% to £9,100 a year. The Class 1 upper earnings limit (for employees) and Class 4 upper profits limit (for the self-employed) is frozen at £50,270, in line with the frozen UK higher rate income tax threshold.

Class 2 NICs, once set for abolition, will rise to £3.15 a week for 2022/23.

A 1.25 percentage point increase will apply to rates for all contribution under Class 1 and Class 4 for 2022/23, before being replaced by the new, separate 1.25% Health and Social Security Levy from 2023/24. Both employees and self-employed workers above state pension age (66 at present) will be subject to the new levy from 2023/24, but will otherwise remain exempt from NICs.

Company cars

For 2022/23, company car tax will see some rationalisation. For all but the highest emission vehicles already subject to a 37% scale charge, cars registered since 6 April 2020 will be subject to a 1ppt increase in the scale charge. The scale charge on older vehicles will not alter, with the result that from 6 April 2022 a single CO2 emissions-based scale charge table will cover all cars, whether their emissions are measured under the NEDC or its successor WLTP rules.

The 4% diesel surcharge will remain for diesel cars not meeting the RDE2 emission standard (which became a statutory requirement at the start of 2021).

For electric vehicles (EVs) with zero emissions, the scale charge will increase from 1% to 2%.

Inheritance tax

The main nil rate band and residence nil rate band are frozen at £325,000 and £175,000 until 2026/27.

Capital gains tax

The capital gains tax annual exemption of £12,300 will also be frozen until 2026/27.

Pensions lifetime and annual allowances

The lifetime allowance will remain at £1,073,100 until 2026/27 while the annual allowance stays at a maximum of £40,000, subject to the taper and money purchase annual allowance rules.

Automatic pension enrolment

Contribution thresholds and rates for workplace pensions operating under the automatic enrolment provisions for 2022/23 will all be unchanged:

	2021/22 and 2022/23
Earnings trigger for auto-enrolment	£10,000
Employer minimum contribution	3% of band earnings £6,240 – £50,270
Employee contribution before tax relief*	5% of band earnings £6,240 – £50,270
Maximum potential total contribution	£3,522

* If employer pays minimum required of 3%

Value added tax

The reduced 12.5% rate for hospitality, holiday accommodation and attractions will end on 31 March 2022, at which point the rate will revert to the 20% standard rate.

Student loans

Although not a Budget measure, the changes to student finance announced earlier this year were largely seen as driven by the Treasury. For former students repaying Plan 2 student loans (provided in England & Wales for courses starting from September 2012 onwards) the repayment income threshold will be frozen at £27,295 until 2025/26. For Plan 1 loans (earlier English and Welsh students) the threshold rises by 1.5% to £20,195 for 2022/23. The same percentage level of increase applies to Plan 4 loans (Scotland only), with a new threshold of £25,375. Further changes apply for new students from academic year 2023/24.

The reform of student finance produces a significant impact on government finances, partly because of the way in which projected loan write-offs are capitalised. For example, in 2022/23 the Exchequer will benefit by over £11bn because it can expect to write off much less of the outstanding Plan 2 loans thanks to higher repayments. Gains then fall to £3.8bn in 2023/24, rising to over £7bn by 2026/27. The corollary is that graduates will be correspondingly poorer.

So what to do?

All tax changes current, imminent and future need to be factored into your financial plan. Those announced in the Spring Statement and those already announced are no exception.

This is especially important as we run up to the end of the current tax year and set financial plans (incorporating tax efficiency) for the new tax year that is about to start.

If you have any questions, please speak to your Wealth Manager in the first instance.

All tables have been provided by Technical Connection courtesy of information available from https://www.gov.uk/government/publications/spring-statement-2022-documents

RAYMOND JAMES®

Head Office Ropemaker Place 25 Ropemaker Street London EC2Y 9LY
www.RaymondJames.uk.com