Tax implications of the Labour Manifesto

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A word from Chris Riley, Head of Tax

I have lived through several elections in my time, but few changes of government. However, as nearly all commentators agree, not since 1997 has a change of government been considered all-but-inevitable even before the poll was called, with the 2024 race appearing to be an election as to who makes up the opposition for a Kier Starmer led Labour Government.

That said, the first election that I can remember was in 1992, with the shock result of a Conservative Majority. Therefore, it is still with a sense of slight trepidation that we present our analysis of the tax policies proposed in the Labour Manifesto.

If elected, the Labour Party, and in particular Shadow Chancellor Rachel Reeves have ruled out an “emergency budget” immediately after the election. This may therefore accord the opportunity to take planning steps before any measures are formalised in legislation. However, the party has also committed to a single “Fiscal Event” a year (which may come as relief to my team) with a general expectation that this will mean a reversion to annual Autumn Budgets presented in October or November, meaning that any time to act remains limited.

Whilst Mark, Stephen and Mimi here focus on the Labour Manifesto measures in respect of taxation, it should of course be remembered that there is plenty of opportunity for changes of path in a five year election cycle. Measures proposed by other parties, not in the Labour pledge, will nonetheless have been monitored with interest, and could be brought to the table by a Labour Chancellor at a later date, if so needed in the prevailing economic circumstances.

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Business Tax

A stable business environment

The Labour Party has placed significant emphasis on being considered a safe pair of hands, promoting a stable environment for businesses. This has been outlined in the key announcements within their manifesto:

- No increases to National Insurance Contributions, Corporation Tax or VAT rates
- A commitment to publish a five-year business tax roadmap within six months of coming into government
- A commitment to retaining the full capital expensing and the annual investment allowance regimes for small businesses.

Labour plans to raise a lofty £5.1bn annually. How will Labour look to meet this goal with no increase in taxes?

56% of the "tax gap" (the level of tax that HMRC believes remains uncollected annually) is attributed to small businesses, with much of this attributed to taxpayer error – rather than fraud or avoidance. Labour has committed to introducing upstream compliance measures to assist small businesses with their self-assessment so that returns are filed correctly from the outset. £555m will provide additional annual funding to HMRC for 5,000 compliance officers and "greater use of AI".

There will however remain a focus on large businesses as these investigations typically require less effort and reap higher rewards to raise the funds needed. One may hope that we can expect to see a better HMRC customer service as a result, however, with the additional HMRC resources and the greater level of scrutiny that AI can potentially provide we can also expect to see a higher number of tax enquiries.

Tax avoidance

In common with all the major parties, the Labour manifesto commits to increase revenues by a significant amount through targeting tax avoidance by all taxpayers, including businesses. Similarly in common with the other parties, there is little context provided as to where the proposed £5.2bn will derive from.

However, the party has previously spoken out in respect of the Corporate Criminal Offence (CCO) which tackles the facilitation of tax evasion, where no prosecution has yet been brought. As of 1 January 2024, there are 11 live CCO investigations and a further 24 live opportunities. Labour MP Margaret Hodge called these findings ''appalling" and stated the lack of enforcement has rendered the law "a paper tiger."

In view of this comment and as a further means to close the tax gap, a Labour government make seek to make the first prosecutions under CCO, or through the introduction of the Economic Crime and Corporate Transparency Act to prevent fraud more generally with larger groups.

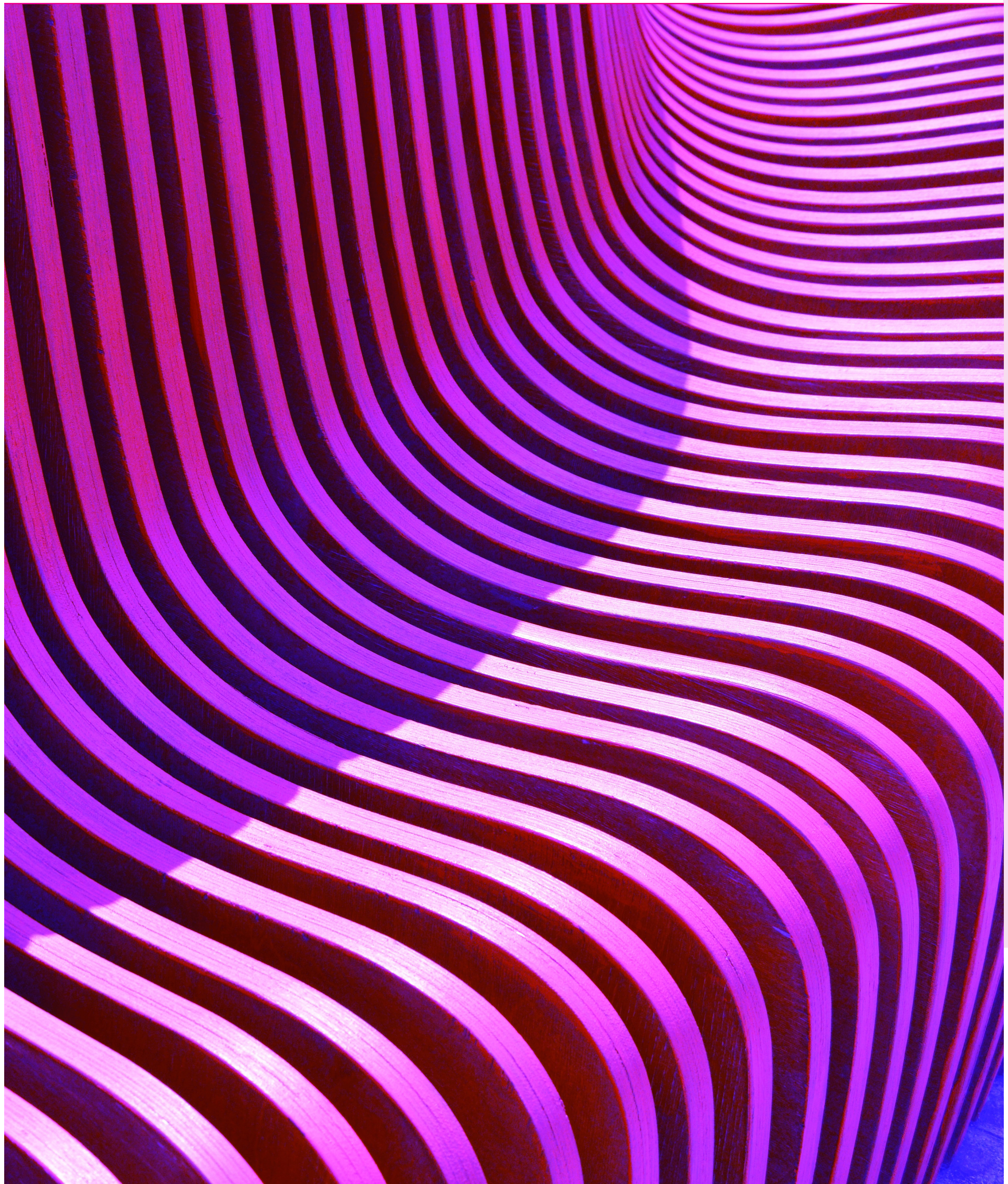
Windfall taxes

The Energy Profits Levy (EPL) - an oil and gas "windfall tax" is another measure to provide additional revenue. This measure was intended to be temporary until oil and gas prices stabilised, however the Labour manifesto looks to extend this until the end of the next parliament. The Energy Security Investment Mechanism would however still allow Labour to "switch off" the EPL before its end date if prices fall below certain thresholds. Furthermore, the Labour party would seek to increase the levy by 3% resulting in an increase in the headline tax rate for companies in scope from 75% to 78%. In addition, the party proposes the removal of certain investment allowances under which oil and gas companies currently recover £91 for every £100 of capital expenditure to reduce their EPL exposure, in line with the move to a low carbon economy.

International tax matters

The Labour party has committed to supporting the implementation of the OECD two pillars:

- Pillar One – the reallocation of large multinationals' profits to jurisdictions where value is created rather than physical presence
- Pillar Two – ensuring multi-nationals with global revenues above €750 million pay a minimum effective tax rate on income in each jurisdiction in which they operate, imposing a Top-Up Tax on profits arising in jurisdictions where the effective tax rate (ETR) is below 15%.



With the international tax reform, OECD two pillars are here to stay irrespective of which party comes into government as they are already legislated, and the UK has committed to their continued implementation internationally. It is estimated these measures will bring in annual revenues of £2.3bn but these estimates are inherently uncertain as they are influenced by how other jurisdictions bring in these measures within their own tax regimes. However, there does remain scope to vary the scale of implementation across UK businesses – for example, the UK applies the default global €750m revenue threshold, but this could be lowered domestically to bring more groups into scope while technically not being a "new" or "increased" Corporation Tax rate.

In previous campaigns, the Labour party has proposed closing the Eurobond "loophole" and levying dividend withholding taxes on distributions to "tax havens" – although the latter was not defined at the time. The former concerns debt securities listed on a recognised stock exchange, where if certain conditions are met there is an exemption from withholding tax (which normally stands at 20%) but there is a concern that much debt is "technically" listed purely to secure the relief. Regarding the second measure, the UK is one of the few more economically developed countries to not have withholding tax on dividends so introducing this may not be viewed as misaligned to that of the worldwide platform.

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Personal tax

Income tax and National Insurance

Labour say they are focusing on wealth creation. Their much lauded promise is they will not raise taxes on working people. What they mean by this is they will not increase income tax or national insurance.

However, the manifesto is silent on the income tax and national insurance thresholds, which are currently frozen until April 2028. The freezing of the bands creates an increase in real terms for many taxpayers.

We also have the question of what is meant by “working people”. Labour leader Kier Starmer refers to “people who earn their living, rely on our services and don’t really have the ability to write a cheque when they get into trouble”.

Whilst Shadow Chancellor, Rachel Reeves, was very quick to row back on this definition, suggesting that Labour are looking at protecting the lowest earners, with middle to higher earners potentially facing tax increases by closing the following ‘loopholes’.

1. Capital Gains Tax (CGT)

There is plenty of speculation that Labour will aim to, at least in part, cover the shortfall in tax revenue by raising the rate of CGT. Currently, CGT is charged at 20% on most assets, 24% on property and 28% on carried interest.

Labour may look to align income tax and CGT rates. If this is to come into place, we hope that some form of indexation will be reintroduced.

2. Carried Interest

Labour have stated that “Private equity is the only industry where performance-related pay is treated as capital gains” Reeves having previously called the carried interest tax loophole “absurd”.

Labour will consult on the proposal to treat carried interest as income. This means that carried interest could be taxed at up to 45%, with the industry pushing for a compromise between the current rate of 28% and the top income tax rate of 45%.

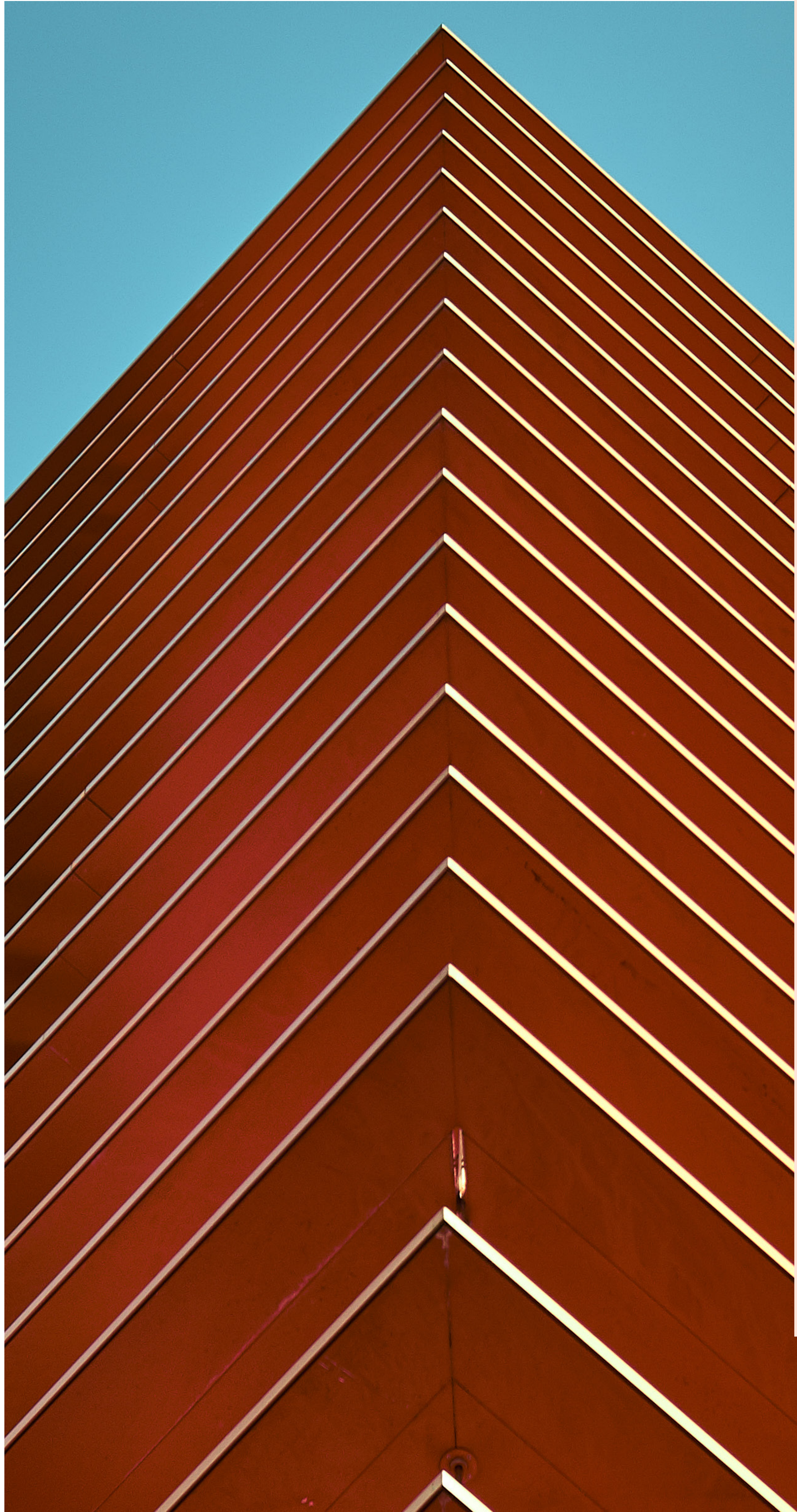
Reeves has said she is confident that there will be “no exodus” from the UK, and that this will not create problems with Labour’s pro-business manifesto.

It should be noted that if carried interest is taxed at 45% then this would potentially give the UK one of the higher rates in Europe.

3. Abolition of the non-domicile status

Whilst Labour has long hailed the abolition of the non-dom regime, the current Tory government attempted to steal their thunder and announced the abolition of the non-dom regime in this year’s Spring Budget.

Labour have said they support most aspects of the Tory plans, proposing to replace the non-dom rules, including the four-year arrival window and the 10-year window for inheritance tax. However, Labour says they will close the loopholes in Rishi Sunak’s ‘non-dom’ plan. This means removing the planned discount for the first year of the new rules.



They have also stated the intention to end the use of offshore trusts to avoid inheritance tax. We can assume that by offshore trusts they mean excluded property trusts, as the inheritance tax position of a trust is determined by the domicile of the settlor, not the residence of the trustees.

Labour plans to include all foreign assets in a trust within UK inheritance tax, whenever they were settled (as opposed to only those settled after 2025 as the Tory's propose). The manifesto gives minimal detail of what the position will be, and as a result there is little real analysis that can be done on the previous announcements by the Tories.

But there are still opportunities for non-doms and long term residents in the UK, with Labour indicating plans for a November Budget which will provide a window of opportunity to review current trust structures, and the possibility of unwinding them without a tax charge before treatment changes.

4. Tackling tax avoidance

Labour believe they can raise an extra £5 billion a year by "cracking down on tax dodgers".

However, a lot of what Labour is calling "loopholes" and "avoidance" are statutory rules, including those for carried interest and non-doms. These are not people exploiting the tax rules in a way they were not intended to operate, they are using the rules in the way Parliament intended.

In an effort to close more loopholes and protect the "working people", what else might a Labour government do to raise funds? There is speculation that Labour might look to tighten up or possibly end reliefs for Inheritance Tax, such as Agricultural Property Relief and Business Relief. Could they look at changing the 25% tax free on pension commencement, or making tax relief on pension contributions less generous? Remove or restrict Principle Private Residence Relief for the main home? Could they get rid of the Enterprise Investment Scheme (EIS) or Seed Enterprise Investment Scheme (SEIS)?

Ending reliefs such as EIS/SEIS would arguably go against Labour's stated intention of being pro-business. Ending Business Relief and Agricultural Property Relief would hit hard working entrepreneurs and business people who have built up their wealth in their businesses.

If carried interest and non-dom rules were loopholes, what other statutory tax reliefs could be considered loopholes and therefore, removed by Labour?

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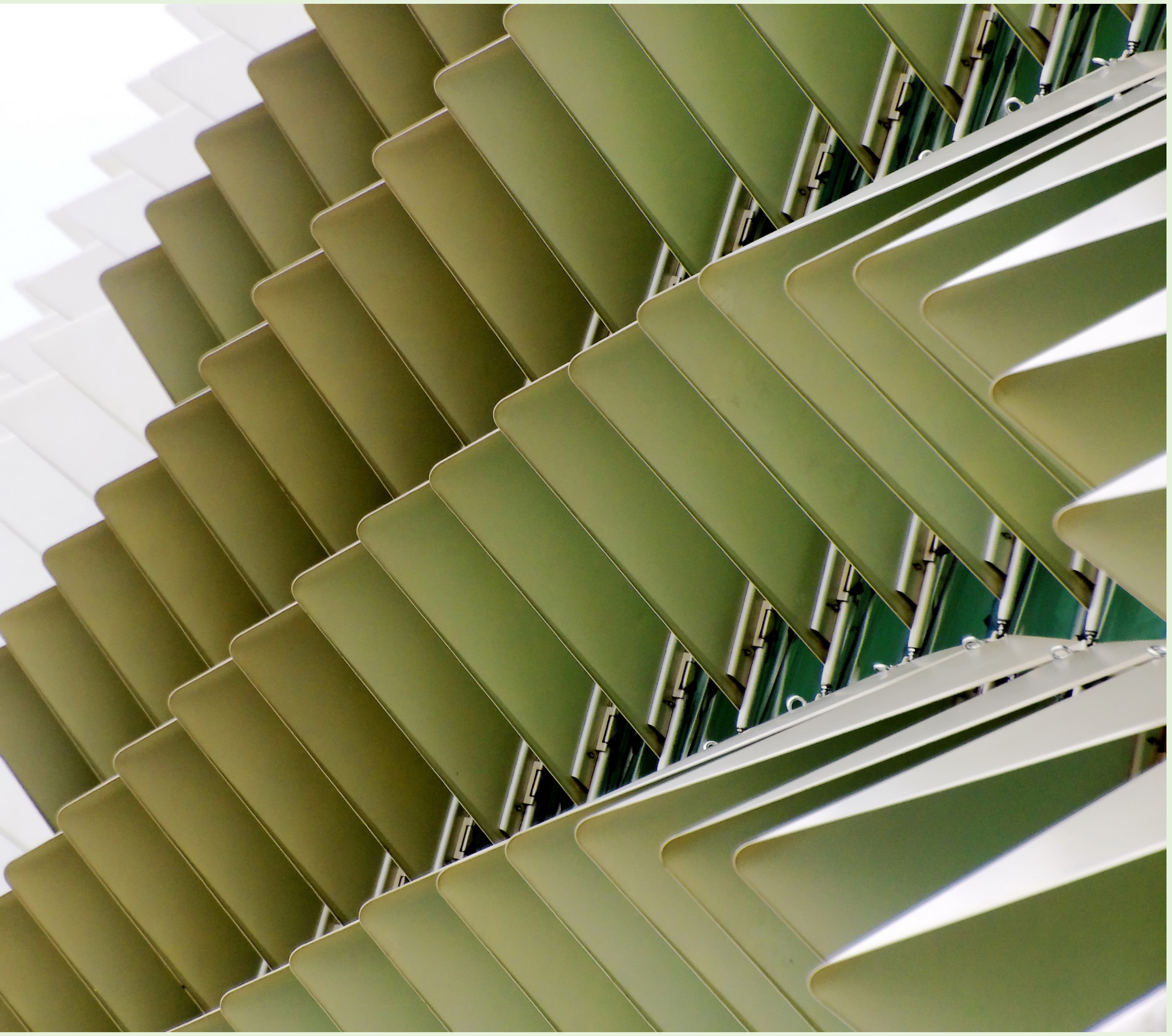
VAT and other indirect taxes



VAT on school fees

The Labour party has pledged that there will be no increase in the UK's current two rates of VAT and has not sought to change the current VAT registration threshold of £90,000. As identified in their core policies, Labour plan to end VAT-exemption and charitable business rates relief for all independent schools across the UK.

With the planned introduction of VAT on independent school fees (which was first announced in 2019), it appears that the expected future increase in school fees (of between 2% and 20%, depending upon which school you ask) may push many parents to move their children to state schools.

Labour state that they should generate £1.51 billion from both the collection of 20% VAT from independent school fees and making independent schools pay 100% business rates, having previously said that the additional tax revenues raised would be used to increase state school spending and would be targeted at pupils from disadvantaged backgrounds.

Based upon Rachel Reeves' comments made on 20 June 2024 at The Times CEO Summit, it appears that the first fees to be affected should be for the 2025-26 academic year at the earliest. However, it is currently unclear as to from which date the new VAT law will kick-in. Could the new law impact advance payments for the 2025-26 academic year (and later years) made before (i) the 4 July election date, (ii) the date of the expected September 2024 budget, (iii) the date that the new VAT law is first published in draft for consultation or (iv) some other date?

Labour has confirmed that exemption will remain for fees charged for the education of children with legally-binding education health care plans who are in fee-paying schools, due to a shortage of provision in the state sector. But what about the thousands of children in independent schools with special educational needs and disabilities and the children from disadvantaged backgrounds whose fees are met through bursary payments received from independent charitable bodies?

As a result, many schools are now trying to:

- accurately calculate the increase to future fees necessary to at least cover the expected VAT amounts payable to HMRC, after a reduction for VAT recoverable on expenditure incurred
- accurately calculate (i) the one-off VAT recovery achievable on capital projects that are currently underway and that are due to be completed after the date that VAT is introduced on fees and (ii) the regular future annual VAT recoveries on capital projects completed in the past 10 years
- configure their systems to be able to (i) issue future fee payment requests that split out VAT amounts for transparency, (ii) not charge VAT on any income that remains VAT-free under other parts of the VAT Act, and (iii) identify and reclaim as much VAT as possible on future expenditure following the introduction of VAT on fees.

Collecting more VAT

Whilst indirect taxes like VAT have always been self-assessed taxes, that does not mean that they are easy-to-understand and many businesses do not pay much attention to them due to the long-standing lack of indirect tax inspections carried out by HMRC. As a result, significant amounts of indirect taxes go uncollected each year from businesses that are not trying to evade or avoid such taxes, but are just getting their calculations wrong and/or not understanding how to apply law/HMRC guidance.

Only time will tell if Labour's planned £855 million investment in HMRC increases future indirect tax revenues. £billions of VAT/indirect taxes are lost each year due to ignorance of confusing VAT law (just think about all the VAT cases on food items) and the general confusion as to what HMRC currently thinks is the correct VAT treatment of certain income and expenditure due to the significant amount of out-of-date guidance on HMRC's website.

Brexit freedoms

Taxes on different forms of consumer spending (e.g. on private education for their children) provide the second-biggest source of revenue for government, with VAT by far the biggest of those. However, there is nothing else in Labour's manifesto about VAT (unlike in other parties' manifestos).

The Labour party is only able to collect VAT from independent school education because the UK is no longer a member of the EU. Now that the UK has left the EU and has no plans to rejoin, there is the potential to collect more VAT on 'luxury' expenditure (e.g. caviar and business class air travel, which are both currently zero-rated) and reduce the VAT rate on 'essentials' (e.g. children's toothbrushes and toothpaste which are both currently standard-rated). Only time will tell if more changes are made to UK indirect tax laws in future that would otherwise be prevented by over-riding EU VAT law.

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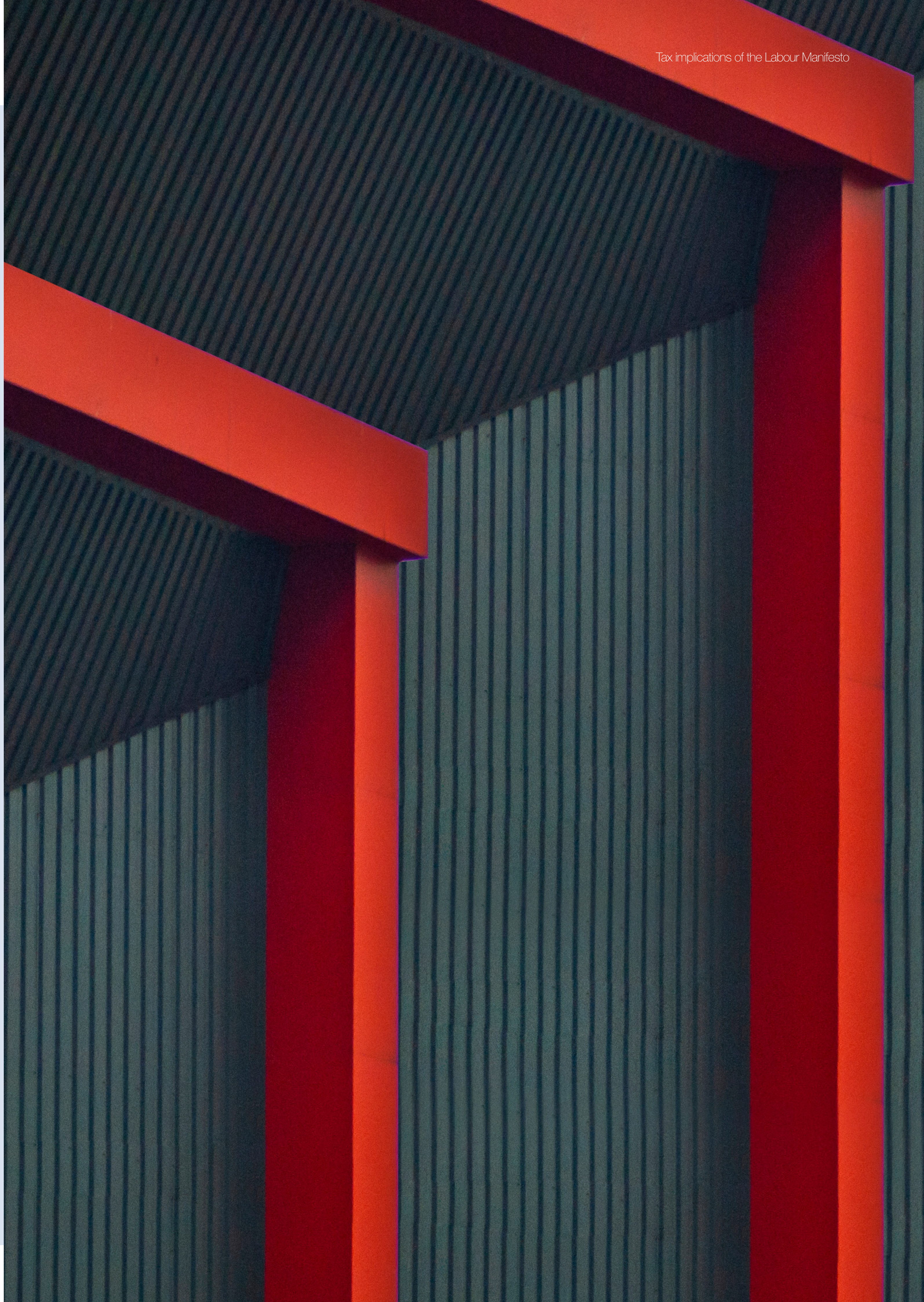

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