# budget 2016
## briefing

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## OVERVIEW AND ANALYSIS

With the EU Referendum looming and Conservative divisions playing out daily in the media and Parliament, the Chancellor of the Exchequer, George Osborne faces a real challenge to grab the headlines with this Budget. He will be disappointed that he has already had to retreat on the reforms to pension tax relief that looked likely to form the centre-piece of his Budget after Conservative MPs made clear they would not stand for it. In the absence of this potentially controversial policy many commentators are now expecting the budget to be a damp squib, but we shouldn't underestimate Osborne's ability to pull a rabbit out of his hat.

It is not just the EU referendum that will define this Budget. When Conservative party members were asked in a recent ConservativeHome poll who they would prefer as their next leader, 33% voted for Boris Johnson, 20% for Michael Gove and George Osborne was languishing in fourth on 11%, behind former Defence Secretary Liam Fox. Though any leadership contest is likely to be a long way off, George Osborne's leadership ambitions are clearly being dented by the EU referendum and his U-turn on tax credits. Appealing to Conservative backbenches and grassroots will naturally be in the back of his mind.

A reported £18 billion black hole that opened up in the economy since November will compel him to tighten the squeeze on public spending. Despite the pressure on him from backbenches to carry out tax cuts, he will be tempted to postpone these to a later date.

Another factor to consider is the weakness of the Opposition. With Labour bitterly divided and the Lib Dems all but wiped from the map, the opposition that matters to the Chancellor is his own backbenches.

His priority therefore is to avoid any further division in his party and this Budget is widely tipped to be a quiet one as a result. But despite all of this, George Osborne has proved himself in recent years to be a master of set pieces, cleverly using them for his own political machinations. Connect will be watching this Budget as closely as ever because it is sure to shape the political scene in the year ahead.

## PUBLIC SPENDING

With government debt increasing at a record rate, the Chancellor remains concerned about balancing the books. In February, he warned that he may have to make further cuts to public spending in this Budget to keep the Government on course to meet its deficit targets.

It is been widely predicted that growth forecasts will be downgraded and the Chancellor is expected by some to raise his borrowing forecasts. Bank of America Merrill Lynch is forecasting that the Office for Budget Responsibility (OBR) will revise their growth forecasts for this year and next, down to 2% for both years. Currently the OBR is forecasting 2.4% growth this year and 2.5% next year. The bank predicts that the Chancellor may have to raise his borrowing forecasts but this is problematic in the context of the Chancellor's own fiscal charter, introduced last year, dictating that the UK has to run a surplus every year from 2019-20 in *"normal times,"*. The Institute for Fiscal Studies warned last month that the Chancellor may be forced to raise taxes or impose further austerity "*with very little notice*" to meet the fiscal rule.

HSBC has also argued that this Budget will be a *"delicate one"* for the Chancellor, with *"scant room for giveaways"* given that growth is slowing and borrowing has probably overshot forecasts. HSBC has listed other possible measures the Chancellor may look at to balance the books, including potentially raising fuel duties, given the plunge in oil prices since mid-2014, and selling off its stake in Channel 4. In February he told the BBC political editor Laura Kuenssberg he would rather look for extra cuts now than risk breaking his own manifesto commitment to achieve a surplus in the budget by the end of this Parliament, in 2020. If the Chancellor does decide now is the time for further cuts, he is likely to start with efforts to find further 'efficiencies' within government departments rather than targeting specific programmes or areas of spending.

The Chancellor is also expected to announce that the retail offer of shares in Lloyds Banking Group is back on. The Treasury still owns around £4.7 billion of Lloyds shares and the Chancellor has earmarked *"at least £2 billion"* of that for the public sell-off. It is also probable that he will announce the £16 billion sale of the former Bradford & Bingley loan book.

## TAX

There has been much speculation that George Osborne is considering raising the level at which people start paying the higher rate of tax after scrapping plans for a raid on pensions tax relief. The Sun on Sunday has suggested that the Chancellor wishes to *"take a step"* towards a £50,000 target by 2020. The 40p income tax threshold is currently set at earnings of £42,385 and is due to rise to £43,000 from April before it hits £43,300 in 2017.

There is also speculation that he will cut the top rate of tax from 45p to 40p, as it was before 2010. Osborne recently told the House of Commons that reducing the top rate of income tax from 50p to 45p in the previous Government raised an additional £8 billion in its first year alone. Lowering the top rate of tax may be too controversial in the current political climate and may remain an aspiration for the longer term rather than a concrete announcement in the budget.

The Chancellor is also reportedly examining a quicker increase in the personal allowance, which is due to rise to £10,800 from April and £11,000 in 2017, to reach £12,500 by 2020. The Resolution Foundation published analysis in the Observer, finding that these changes will not benefit low-income families on Universal Credit.

A Treasury clampdown on people who pay their staff through special companies is also expected. According to the Daily Mail, the practice costs the Treasury more than £400 million a year and as many as 100,000 people receive their income through personal-service companies.

More personal and household tax tinkering could be announced. Expect more detail on how the main residence allowance on inheritance tax will work from 2017. The total inheritance tax threshold for those who own a family home will increase from April 2017 until it reaches £500,000 in 2020. This means that married couples and civil partners will be able to pass on assets worth up to £1 million, including a family home, without paying any inheritance tax. But the mechanics of the new rules are complicated. Further explanation and guidance will probably be offered in the Budget.

## BUDGET 2016

In the summer Budget 2015, the Chancellor confirmed that the Office for Tax Simplification would be conducting a review into the closer alignment of Income Tax and National Insurance. Their findings, published on 7 March, concluded that the rise of part-time jobs and self-employment has rendered the UK's national insurance regime *"no longer fit for purpose."* The Office of Tax Simplification recommended that national insurance contributions be calculated on a yearly rather than monthly or weekly basis, aligning it closer with income tax. The Chancellor is likely to take these recommendations on board.

As has become the norm in recent years, George Osborne is expected to use his Budget to announce further measures for tackling tax avoidance and improving transparency. He is also likely to discuss legislation introducing an obligation for large companies to publish their tax strategy and provide an update on the OECD's Base Erosion and Profit Shifting project. A clampdown on companies that siphon profits offshore via debt interest payments is also tipped.

The Chancellor is also expected to reveal further details on the Business Tax Roadmap, which is designed to provide greater certainty and clarity on business taxes. The Director-General of the Institute of Directors, Simon Walker has urged the Chancellor to make business tax rises *"more palatable"* by reversing cuts to investment incentives and reducing tax for middle-income earners. As part of this Roadmap, there will likely be an announcement on the results of the review of the business rates system. There have been predications that there will be announcements on simplifying the business rates system, as well as steps taken to help local authorities prevent empty rates avoidance.

Finally, there are also rumours of an increase in insurance premium tax. Last year the Chancellor raised the rate from 6% to 9.5%, generating an additional £8 billion of revenues. The stealth tax increase would hit an estimated 15 million homes.

## PENSIONS

George Osborne had reportedly been considering plans to make pensions more like ISAs in the Budget. He was also thought to be looking at an alternative option of setting a flat rate of tax relief – something many Conservative MPs feared would have been unpopular with higher earners who would lose their more generous entitlement.

An ISA-style system would have removed the upfront tax relief on contributions, but allowed withdrawals to be made tax-free instead. However, experts said doing so would have reduced the incentive to save and could have meant people felt less inclined to keep their money in their pot. A Treasury source has confirmed that the Chancellor has decided against the idea of making changes, saying he had *"always been clear he would not do anything to damage saving".*

However, while the Chancellor appears to have moved away from these proposals, it seems likely that they could just be delayed for later in the Parliament and a process of consultation could be announced.

There are rumours of other pension changes in the Budget. The lifetime allowance, the total each person can hold in a pension without facing penalties, was once £1.8 million but it will fall to £1 million in April. A further cut could be announced. Treasury officials have reportedly been considering an eventual £750,000 limit.

There are also rumours that the annual allowance on pension contributions may also be changed, depending on the wider proposals. This limit, once as high as £255,000, was reduced from £50,000 to £40,000 in 2014. Experts have suggested a cut to £25,000, although it could be deeper now that changes to the rates of relief have been all but ruled out.

## HOUSING

With a considerable amount of legislation over the previous year on housing, it is unlikely that George Osborne will announce further large scale policy changes.

The Help to Buy mortgage guarantee scheme, a scheme designed to let first-time buyers find loans with a 5% deposit, is due to run out at the end of 2016. Industry experts do not expect this to be continued.

The Independent on Sunday reported that the Budget will *"include a package of measures to tackle homelessness."* According to the paper, a charity source told them that Chancellor could be *"about to do something incredibly good"* to address homelessness.

There is an expectation that there will be more detailed information about the introduction of extra stamp duty on second homes. There may be some tweaks to the scheme, including introducing exemptions for investors with large buy-to-let portfolios or parents who want to buy with their children.

## WELFARE

After the U-turn on tax credits cuts and the passing of the Welfare Reform and Work Bill, it is possible that the Chancellor will keep clear of announcing more cuts to the welfare budget. Chief Economist at the Resolution Foundation, Matt Whittaker predicted that he will shy away from announcing more cuts especially as *"Universal Credit is still being rolled out."*

The Government is planning to introduce a 'Help to Save' scheme for low-paid workers to help them build up a *"rainy day fund."* The Prime Minister, David Cameron revealed the idea in a wide-ranging speech in January focused on boosting life chances and building stronger families for the poorest in society, but the details will not be fully unveiled until the Budget. Some industry insiders think this could be similar to an insurance scheme that pays out if you get ill.

## COST OF LIVING

The wine and spirit industry are lobbying the Chancellor, with support from the Chair of the Business, Innovation and Skills Committee, Iain Wright, to announce further cuts in excise duty to protect jobs and improve competitiveness for British made wine and spirits. They are urging the Chancellor to cut in duty by a penny for the fourth consecutive year after beer sales plunged by 1.5% last year. The Chancellor is also tipped to introduce a minimum price for cigarettes.

# BUDGET 2016

## EMPLOYMENT

The Treasury and HMRC have consulted on a number of measures affecting employment taxes and further details are expected at Budget 2016.

PricewaterhouseCoopers (PwC) has predicted an announcement regarding the current termination payments scheme. They said that the Chancellor *“may look to bring these payments into the scope of national insurance, and introduce a 'per year of service' tax free amount in this Budget.”* PwC also predicts salary sacrifice arrangements, which enable employees to choose between cash and benefits including pensions, annual leave, childcare and other benefits, could be targeted to raise revenue.

The CBI made a last-minute plea to soften the impact on business of the National Living Wage and the apprenticeship levy. It argued that the two measures would cost business £9 billion a year by the end of the decade.

## UTILITIES

The oil and gas industry expects changes to be made to the North Sea tax regime, following a decline in oil prices. Head of Oil and Gas Tax at Ernst and Young predicted that *“We may see announcements for a reduction in the tax rates for oil producers with the aim of encouraging much needed investment.”* Head of Energy and Resources Tax at Deloitte, Roman Webber added that reducing the effective rate of tax for new discoveries could also encourage exploration.

## INFRASTRUCTURE AND TRANSPORT

The National Infrastructure Commission (NIC) published its third report, *High Speed North* arguing that HS3 needed *“kick-starting”* and integrating it with HS2, in addition to the redevelopment of *“gateway”* stations in the North of England such as Manchester Piccadilly. The Commission also suggested that development of the HS3 line should prioritise *“those links likeliest to provide the strongest benefits for the North”*, starting with the Trans-Pennine route between Manchester and Leeds. The Commission advise that Network Rail, in conjunction with Transport for the North and the Department for Transport, should prepare this plan by the end of 2017. George Osborne is expected to welcome the Commission’s findings and give the go-ahead for HS3 and Crossrail 2 in the Budget. He is expected to provide £60 million to fund plans for HS3 with an additional £80 million to be set aside for Crossrail 2.

The Sunday Times has reported that George Osborne will announce the creation of a £100 billion British sovereign wealth fund. The Chancellor is also expected to hail the progress of a scheme to merge council pension funds, which will be used to fund infrastructure projects. The paper also reported that he will lay out his plans to part-privatise Network Rail in order to move some of the organisation’s £38 billion of debt from the Government’s balance sheet.

A report by the High Speed 1 Chief Executive, Nicola Shaw on Network Rail’s future is set to be published alongside the budget. She is expected to recommend selling several rail lines, such as Greater Anglia and Wessex, under long-term concessions.

## BUDGET 2016

The rumour mill is also indicating that the Chancellor is calculating a possible increase in petrol and diesel duty to fill the gap in Treasury plans after the postponement of the overhaul to the pension tax relief system. Saga has been putting forward the argument that this would be a golden opportunity to replace car tax with an increase in fuel duty.

However, this move would be controversial amongst backbench Conservatives. A week before the Budget, Jason McCartney handed a report to Exchequer Secretary to the Treasury, Damian Hinds, making the case against an increase in fuel duty, which backbenchers fear would play badly with voters, particularly in rural areas. Jason McCarthy claims to have the backing of more than 140 MPs.

The Financial Times also predict that George Osborne will use the Budget to announce that there will be tests of driverless trucks and lorries in "road trains" on British motorways. According to the paper, the tests are likely to be done on the M6 in Cumbria at night, where traffic is lighter. Apparently, the companies in the tests include Volvo, Scania, Mercedes, Iveco, MAN and DAF. Nissan wants to have driverless lorries on the road by 2020.

## DEVOLUTION

The Financial Times has reported that at least one group of English counties will be granted new powers, with the paper reporting that an *"Eastern Powerhouse"* of Norfolk, Suffolk, rural Cambridgeshire and Peterborough is likely to be revealed. According to the paper a second grouping of Southampton, Portsmouth, the Isle of Wight and parts of Hampshire could be announced, as could Cumbria.

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