A new season, a new Budget

As autumn arrives, the next Budget is not far away.

2020 will see something that normally only occurs when an election is imminent: two Budgets in one calendar year. The last Budget, on 11 March, now belongs to a different (pre-pandemic) era. Back then, the Chancellor Rishi Sunak announced £12bn of "temporary, timely and targeted measures to provide security and stability for people and businesses" in response to Covid-19.

But matters have moved on considerably since then. The latest estimate from the Office for Budget Responsibility (OBR) is that the direct effect of pandemic-related government decisions, in terms of increased spending and tax reductions, will amount to £192.3bn in 2020/21. Meanwhile the other side of the government balance sheet has been hit by lower tax receipts due to the recession.

So far, the Chancellor has won plaudits for his do-whatever-it-takes approach to supporting the economy, but the next Budget could be less well received as he begins to address the financial consequences of his actions. The current state of the UK economy, which shrunk by 20.4% in the second quarter of the year, makes it highly unlikely that Mr Sunak will reveal any significant direct tax increases in his Autumn Budget. However, he may well start the long process of book-balancing by reducing some tax reliefs and exemptions. As Parliament resumed in September, the Chancellor was already trying to quell backbench unease while simultaneously talking about "short term challenges" and a plan "to correct our public finances".

There are several obvious revenue-raising candidates, about which the government is already in the midst of consultation: inheritance tax (IHT), tax relief on pension contributions, capital gains tax (CGT) and yet another review of business rates. Lurking in the background is the possibility of some form of wealth tax, although this might just be cover for the alternative of raising more revenue from IHT and CGT.

The date for the Budget had not been announced at the time of writing, although the present expectation is that it will be in November. Ahead of the Chancellor returning to the despatch box, it would be advisable to talk to your financial adviser about whether any plans you have – such as making a lifetime gift or realising capital gains – could be brought forward.

Who pays capital gains tax?

HMRC has published some interesting research into capital gains tax (CGT).

Here are three CGT questions for you to ponder:

1. *How many individuals made enough capital gains in 2018/19 to face a CGT bill?*

   The answer is just 256,000, according to the latest provisional figures from HMRC – 9,000 *fewer* than in the previous tax year. Viewed another way, that is less than 1% of all income taxpayers. However, over the 10 years since 2008/09 the number of CGT payers has nearly doubled.

   Now you know that individual CGT payers numbered only about a quarter of a million, try the next question…

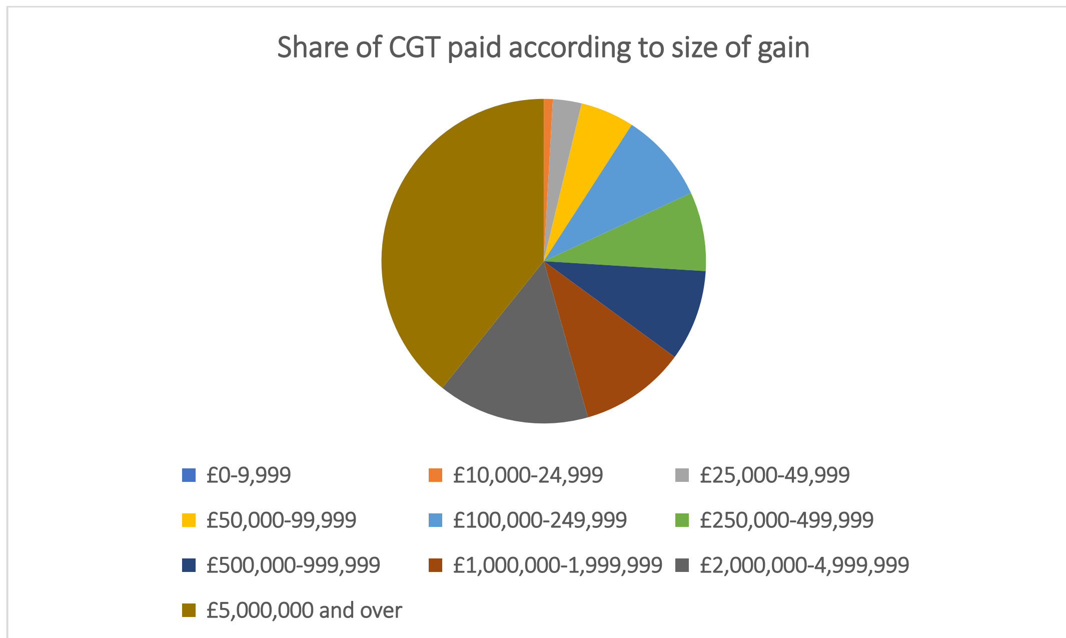
2. *How much tax did they have to pay in total?*

   The answer is £8,805m, which is over £3,400m more than was collected in inheritance tax (IHT) in 2018/19. IHT and CGT are both capital taxes, often levied on the same asset, albeit usually at different times. Yet CGT attracts much less criticism than IHT, which has been rated as the UK's most-hated tax.

   With the information on how many taxpayers and how much tax was collected, the third question might look easy…

3. *What proportion of that £8,805m was paid by the top 5,000 CGT payers?*

   The top 5,000 – about 2% of all CGT payers – contributed 54.4% (£4,789m) of all CGT paid. They all had gains of at least £2,000,000. Expand the band a little and 18,000 individuals, with gains of at least £500,000, accounted for just under three quarters of the CGT paid. The spread of gains and tax paid is shown in more detail in the pie chart below.



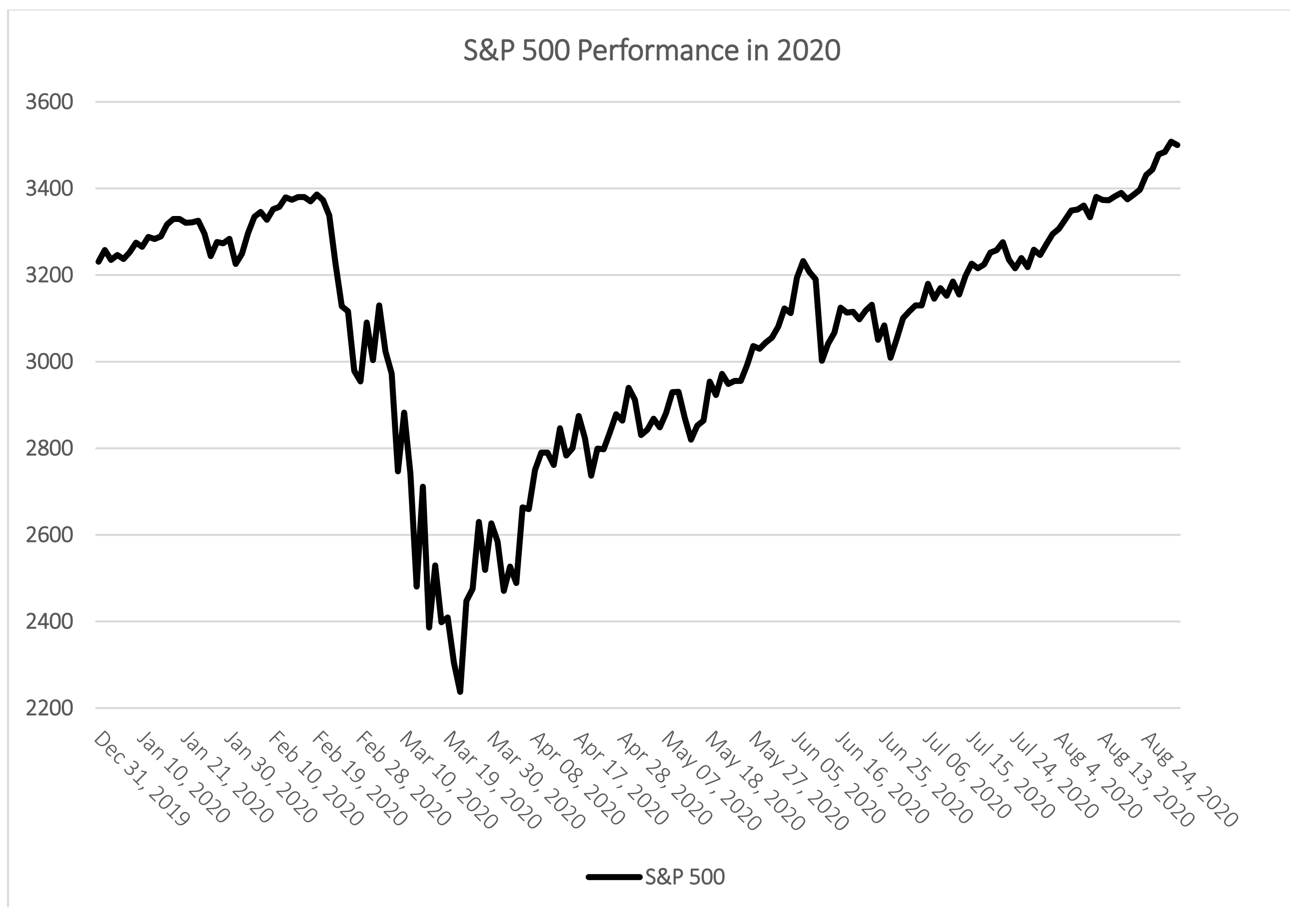
The answers to these three questions highlight two points which give pause for thought, one for the Chancellor and the other for you as an investor:

- As with some other personal taxes, the amount raised from a small number of the wealthiest individuals is a significant proportion of the total. This means that the results of increasing the tax rate(s) will heavily depend upon how those individuals react. If some of them decide not to realise their gains, the overall takings from this tax could fall rather than rise.

- The annual CGT exemption is £12,300 in 2020/21. Investment returns that are received as capital gains are usually taxed more lightly than those received as income. The relatively small number of taxpayers is a reminder of the current generosity of the exemption.

US market storms ahead

The main US stock market index hit several new all-time highs in August.



So far, the US has had a difficult 2020:

- Its performance in the battle against Covid-19 has been widely criticised. In the first part of August the country was still experiencing around 50,000 new cases each day.
- In the second quarter of the year, the economy shrank at an annualised rate of 32.9% (i.e. 9.5% across the quarter), following a 5.0% shrinkage (1.3%) in the first quarter.
- Unemployment in July was running at 10.2%.
- A political logjam in Congress has prevented a second round of financial stimulus, the first round having expired at the end of July.

Despite these headwinds, the main US stock market index, the S&P 500, reached several new highs in August, having risen more than 50% from the low that it plumbed on 23 March 2020 as the pandemic took hold.

On the face of it, the new Wall Street high looks seriously out of sync with life on the ground in Main Street, USA. However, there is some logic in the market's performance:

- ***Wall Street is not Main Street.*** In particular, the performance of the S&P 500 has been driven by a quintet of huge multinational technology companies – Apple, Microsoft, Amazon, Facebook and Alphabet (Google's holding company). Together, these five companies account for just under a quarter of the value of the index.
- ***Interest rates have fallen.*** US interest rates have dropped sharply since the start of the year; the 10-year government bonds now offer an annual return of around 0.7%. As interest rates fall, in theory share prices should rise because a low discount rate is applied to value future profits. For income seekers, the S&P 500's dividend yield of around 1.72% could seem relatively attractive.
- ***The market looks forward, not back.*** Economic data is about the past, but investment is about the future. Investors are considering how US companies' profits will develop from here. As lockdowns and other restrictions are eased, an inbuilt recovery is expected.

Similar arguments apply in other markets: the best investors, like the best drivers, look and think ahead.

Pensions, transfers, death benefits and inheritance tax

The Supreme Court has handed down a long-awaited decision on a complex case.

Mrs Staveley died in December 2006, but it was only in August 2020 that the Supreme Court settled the question of the extent of any inheritance tax (IHT) liability on her pension. In the intervening 13 years, the rules relating to pensions and IHT on death benefits have been changed several times, mostly reducing the impact of IHT.

Mrs Staveley's case was examined at two tiers of tax tribunals and the Court of Appeal before reaching the Supreme Court. It says something of the complexity of the legislation and the various arguments involved that none of this quartet agreed on their decisions. One key question, that all four considered, was whether the transfer of a pension shortly before death could represent a gift for the purposes of IHT. Eventually, the Supreme Court ruled that for Mrs Staveley, it was not. This was widely reported in the national press as an important victory, confirming that pensions are IHT-free.

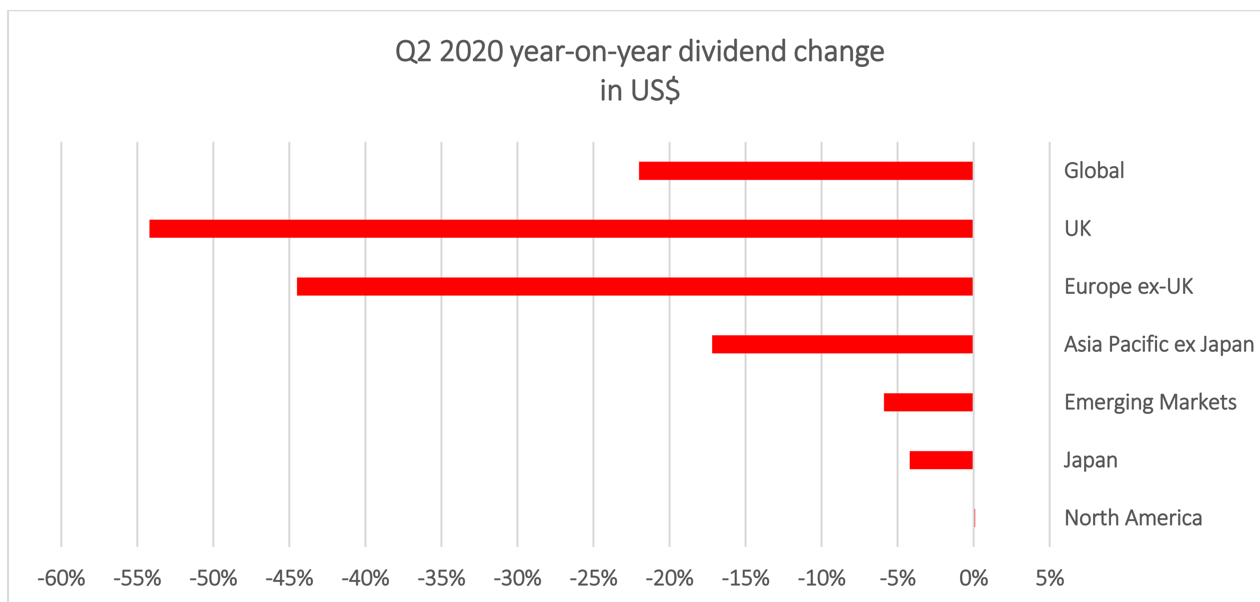
Unfortunately, much of the coverage represented a significant – and potentially dangerous – simplification. For a start, Mrs Staveley's pension did end up being subject to IHT, albeit as a consequence of legislation which was amended in 2016, retrospective to 2011. Secondly, and more importantly, the Supreme Court's decision, like any legal judgement, was based on the facts of the particular case.

In this instance, the pension transfer was effected primarily to make as certain as possible that Mrs Staveley's ex-husband could *not* benefit from her pension fund on her death; in many close-to-death situations, the focus of the transfer is on ensuring who *will* receive the benefit of the pension value. Another difference from today's norm was that Mrs Staveley's transfer was from an old style of individual pension policy (a section 32 plan) rather than a final salary occupational scheme.

Pension arrangements can play an important part in estate planning and, under the law as it stands in 2020, will normally provide death benefits free of IHT (although income tax could apply on death at or after age 75). Clearly, advice is essential, especially if making pension transfers or contributions in a close-to-death scenario.

Global dividends fall less than in the UK

Dividends paid by overseas companies fell less sharply than their UK counterparts in the second quarter of the year.



Source: Janus Henderson

The impact of the Covid-19 pandemic on corporate dividends has been dramatic in the UK. Total dividend payments from quoted companies fell by over half in the second quarter, according to research published in July by Link Asset Services. However, the picture is rather different on a global scale, as other research published in August by Janus Henderson (JH) revealed.

The JH report showed that overall dividends (in US$ terms) fell by 22% between the second quarter of 2019 and the same period in 2020. As the graph shows, the UK as a geographic region came bottom of the pile by a wide margin. In individual country terms the UK was not the worst affected – both France (-65%) and Spain (-70%) suffered larger dividend cuts. The Europe ex-UK region was supported by Germany, which saw dividends drop by 23%.

Japan, where companies have traditionally paid out a low proportion of their profits as dividends, fared well, benefiting from that conservative financial approach. 80% of the Japanese companies covered in the JH research either held or increased their dividends.

As shown on the graph, North America (US and Canada) produced miniscule dividend growth. This needs to be treated with caution as USA Inc goes its own way with dividends. Typically, US companies set their dividends once a year and pay them in four equal instalments, beginning with the fourth quarter.

As a result, most of USA Inc is paying out dividends decided in the pre-Covid-19 era. The impact of the pandemic will arrive in the fourth quarter of 2020, when the next four quarters of dividends are set.

Funds investing in the UK have often been the first port of call for investors wanting share-based income. Partly this has been because the UK stock market has had a higher dividend yield than most overseas markets. The JH global dividend figures are a reminder that non-UK sources of dividend income should not be ignored: as ever, diversification of investments can make sound investment sense. Fortunately, there is now a wide choice of overseas equity income funds to choose from, covering global, regional and single country markets, but be sure to seek advice before committing.