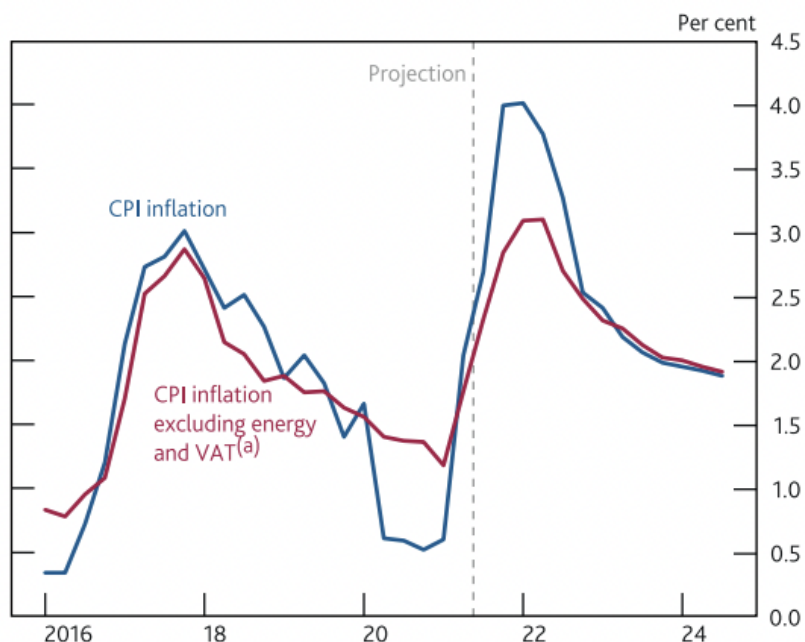


A hint of rising interest rates?

The Bank of England has suggested that interest rates may rise sooner than expected.

Quarterly CPI inflation including and excluding energy and VAT



Sources: ONS and Bank calculations.

After its August meeting, the Bank of England (BoE) was never expected to announce any change in base rate from the 0.1% set in response to the pandemic. The BoE, like its counterparts in the US, Eurozone and Japan, wants to be convinced of the strength of the economic recovery before moving rates off the floor. However, the August meeting was not as much of a steady-as-she-goes affair as had been predicted.

For a start, the BoE revised its estimate for the peak of inflation to 4% around the end of the year. It had previously pencilled in 2.5%, but that rate was reached in June (July's figure dropped to 2.0%, widely seen as a statistical blip). As the graph shows, the BoE expects a decline from its new peak to be almost as sharp as the inflationary rise beforehand. Cynics may note that such a trajectory is necessary to bring inflation back to its 2% target within the BoE's forecast period.

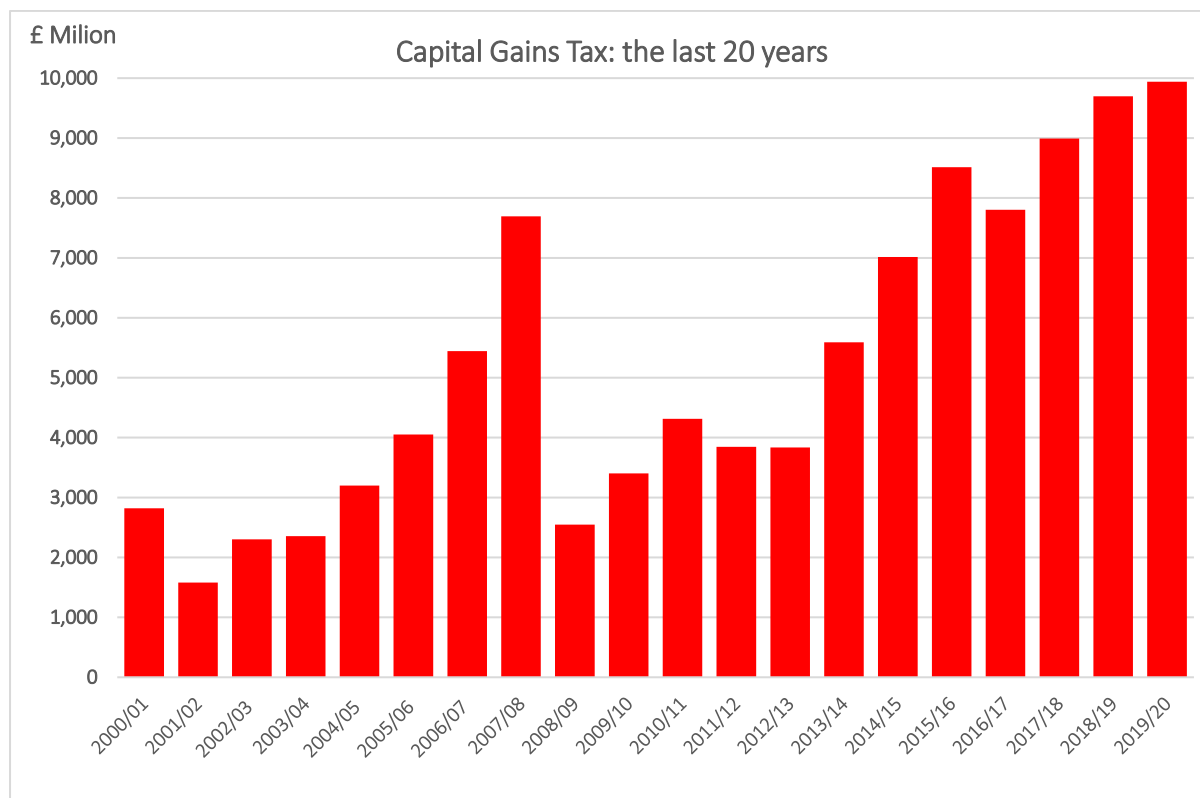
The BoE also announced a change to its £895 billion quantitative easing policy, which has resulted in the BoE owning a significant slice of government debt (gilts). Just over three years ago, the BoE said it would start to unwind quantitative easing by not reinvesting the proceeds of its maturing gilts once the base rate had reached 1.5%. At the time, the base rate was 0.5% and heading up to 0.75% in July 2018. With a 1.5% base rate now a distant prospect, the BoE has reduced the trigger level for starting the run down of its gilt stockpile to 0.5%.

Finally, the BoE gave its first real acknowledgement that rates would rise if the economy grew in line with its central forecast: “some modest tightening of monetary policy over the forecast period is likely to be necessary”. Translated from bank-speak, that was taken to mean a 0.5% base rate by 2024.

The conclusion to draw is that inflation will continue to outpace interest rates over the next three years, eroding the value of cash deposits. If you are holding more in banks and building societies than you need as a reserve, an alternative home for the excess could make a lot of financial sense.

Capital gains tax receipts underline tempting target for Chancellor

New HMRC data shows that in 2019/20, £9.9 billion of capital gains tax (CGT) liabilities were created.



In July last year, the Chancellor unexpectedly asked the Office of Tax Simplification (OTS) to review “capital gains tax (CGT) and aspects of the taxation of chargeable gains in relation to individuals and smaller businesses”. The top tax rate currently sits at 28% (limited to residential property and carried interest) with 20% liability more generally.

At the time, there was speculation that Rishi Sunak was looking at CGT as a way of raising extra revenue without breaking the Conservatives’ 2019 manifesto pledge not to increase rates for income tax, VAT and National Insurance. With those receipts of nearly £10 billion, it’s certainly a tempting target.

The OTS produced its first report on simplifying the design of the tax last November, prompting the rumour mill to forecast that CGT changes would appear in the Spring Budget. However, CGT barely received a mention in March beyond the freezing of the annual exemption for five tax years at the 2020/21 level of £12,300. In May 2021, the OTS issued a second report examining “practical, technical and administrative issues” of CGT.

The focus for CGT announcements now is on the next Budget. In theory, it is due in autumn, but in practice, it could once again be delayed until spring. By then, the economic landscape should be clearer as pandemic support measures cease and we weather another winter of Covid-19.

New data released by HMRC in August shows why the Chancellor may be tempted to follow the OTS advice to:

- Reduce the annual exemption to “a true de minimis level ... in the range between £2,000 and £4,000”; and
- More closely align CGT rates with income tax rates. The OTS reckons this could theoretically raise an extra £14 billion, although it accepted “behavioural effects” would significantly reduce this figure in practice.

If you have unrealised capital gains, it could be wise to review them before the next Budget. One option could be to ‘bed and ISA’ – selling existing investments and then reinvesting them in an ISA to shelter any future gains from CGT.

So, farewell then 6 April?

The UK's unusual tax year end date is coming under scrutiny in tandem with potential changes to the tax year basis for the self-employed.

The start of the tax year in the UK is 6 April. It is a date steeped in history – think quarter days and the introduction of the Gregorian calendar in 1752. In the age of HMRC's Making Tax Digital programme, that 6 April legacy date looks rather bizarre. So, why not make the tax year begin on a more sensible date?

The government's financial year (and the corporation tax year) starts on 1 April, a modern quarter day. This summer, a paper from the Office of Tax Simplification (OTS) set out details for a "high level exploration" of bringing the personal tax year into line. The OTS also promised that its work would outline the "additional broader issues" of making 1 January the tax year start date.

Self-employed year basis change?

Somewhat ironically in the following month, HMRC announced a consultation on changing the basis year period used for calculating self-employed tax liabilities. At present, if you are self-employed, you are normally taxed on the profits made in your trading year that ends in the tax year. So, for example, if your trading year ends on 30 June, then in 2021/22, it is the profits for your trading year ending on 30 June 2021 that are taxed.

HMRC wants to scrap this principle and tax the self-employed on their actual trading profits *in the tax year* starting from 6 April 2023. This would mean pro-rating the profits of two trading years. It also implies some difficult problems in the 2022/23 transitional year. For somebody with a 30 June year end, it could mean taxing profits from 30 June 2021 to 5 April 2023 all in the one tax year.

Fortunately, HMRC does suggest that there would be an optional spreading of "excess profits" over five years. However, the consultation paper made no reference to any revisions to the tax year end date, despite what looks like a golden opportunity...

Meanwhile, back in 2021, do not forget that if you file a paper tax return, your 2020/21 return is due by 31 October. File online and you have another three months.

Pension age steps closer to 57

The government has published draft legislation to raise the minimum age for drawing pension benefits from 55 to 57.

At present, the normal minimum pension age (NMPA) at which you can draw benefits from a pension scheme is 55. That age ceiling took effect in April 2010 and was subject to a limited range of transitional rules if you previously had the right to draw pension benefits earlier than age 55.

Back in February, the government published a consultation paper on raising the NMPA to 57. The paper came as no surprise, except for the time it took to emerge. A NMPA of 57 was originally announced in 2014, but then apparently lay dormant until about a year ago when the Treasury was forced to confirm it in response to a question posed by the Chair of the Work and Pensions Select Committee.

The consultation paper has now been followed up with draft legislation that will appear in the Finance Bill 2021/22. Although only one digit is being changed – 5 to 7 – that draft legislation stretches to just over three pages:

- It confirms that the new NMPA will take effect on 6 April 2028, by which time the State Pension Age will have risen to 67.
- The NMPA will remain at 55 for members of “uniform services” (i.e. armed forces, police and fire services).
- There is no phasing: if you were born on 5 April 1973, in theory you can draw benefits on your 55th birthday but leave it 24 hours and you will have to wait another two years, unless you can take advantage of the various transitional provisions.
- The existing transitional provisions for the change to 55 remain in place.
- A new set of transitional provisions will allow pre-57 access if, on 11 February 2021, your pension scheme rules gave you an unqualified right to draw benefits before age 57. To qualify, you must have joined the scheme by 5 April 2023.

In practice, retirement at age 55 or even 57 is a huge challenge financially. For example, the rate for an RPI-linked annuity at 55 is about £16.50 per £1,000 of pension fund, so even a fund equal to the current lifetime allowance (£1,073,100) would not produce £18,000 of inflation-proofed income. As with all pension changes, the devil is very much in the detail.

Widening gender pension gap with a Covid-19 twist

New research has highlighted a growing retirement income gap between men and women, which has been exacerbated by the pandemic.

According to the Office for National Statistics (ONS) life expectancy calculator, at age 55:

- Men have a life expectancy of 84 years, with a 1 in 4 chance of surviving to 92.
- Women have a life expectancy of 87 years, with a 1 in 4 chance of surviving to 94.

The three year longer life expectancy means that a woman aged 55 who stops work at the age of 67 – the State Pension Age following the next increase – will, on average, spend 20 years in retirement, over a sixth longer than her male counterpart. You might therefore expect that on average, women would need to make greater pension contributions and have correspondingly larger pension pots.

Recent research by the Centre for Economics and Business Research (Cebr) found that women aged 55 and over contribute more to their pensions than men – 9.4% of income against 8.3%. However, the Cebr also discovered that women's prospective pension pots are much smaller than men's because their average earnings are 35% less.

In terms of the total pension income they will receive, the Cebr calculates women will be nearly £184,000 worse off than men come retirement, despite living longer. That gap is over £26,500 wider than just one year ago. A likely cause of the increase is the pandemic, which has had a greater economic impact on women than men. For example, HMRC data shows that there was a consistently higher number of women than men furloughed between July and December 2020, even though men are more than twice as likely to be employed than women. In part, the higher women's furlough coverage reflects the fact that more women than men worked in sectors hardest hit by lockdown, such as retail.

Whatever your gender, monitoring your projected pension benefits is a vital part of retirement planning. If you are not sure how much your pension benefits currently amount to, we can help you find an answer.