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The **Spring** Budget

Overview 2023

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Introduction

The "Back to Work Budget" could create a quiet revolution in financial planning outcomes

Chancellor Jeremy Hunt's Spring Budget 2023 took place against a backdrop of great economic uncertainty, with interest rates rising, inflation stubbornly high and the banking sector beginning to wobble. Uncertainty over inflation, interest rates, the progress of the economy and even the banking sector abounds.

However, despite concerns about how much fiscal power this would leave the Chancellor in the Budget, he managed to introduce a series of measures that could lead to a radical rethink in terms of financial planning strategies.

Jeremy Hunt's decision to scrap the lifetime allowance is arguably the biggest overhaul of the pensions system since pension freedoms in 2015. The measures have the potential to unlock a fresh wave on contributions among higher earners.

Meanwhile, squeezed families could be spared thousands of pounds a year after the Chancellor rolled out free childcare to millions more parents.

Read on to find out more about these changes, and everything else of relevance to wealth management in this year's Spring Budget, from inflation expectations to Government investments and allowance changes.

Budget Summary

Spring Budget 2023 – the key measures

Economic forecasts

The Office for Budget Responsibility (OBR) has issued fresh economic forecasts showing a modestly improved outlook for the UK economy.

It predicts the UK will no longer slip into a technical recession – two quarters of economic retraction – in 2023 but growth will instead flatline, before picking up in the middle of the decade: 1.8% in 2024, 2.5% in 2025, 2.1% in 2026, 1.9% in 2027.

Inflation is set to fall to 2.9% by the end of 2023, according to the OBR, down from a peak of 11.1% in October 2022, while it expects the Bank of England base rate to peak at 4.3% in the third quarter of 2023.

The fiscal watchdog has forecast higher-than-expected employment but predicts unemployment will rise to 4.4% in 2024 from 3.7% at the end of 2022, before returning to a structural rate of 4.1% by 2028.

Employment will increase in the long-term thanks largely to the State Pension age increase in 2028 and other measures in the Budget designed to encourage people back into the workforce, it says.

Real household disposable income is expected to fall by 5.7% over two years (2022-23 and 2023-24), 1.4 percentage points less than previously expected. The fall is thanks chiefly to rising energy costs for households and will be the largest decline since 1956-57.

As for the property market, the OBR sees house prices falling around 10% between the fourth quarter of 2022 and the end of 2025. However, it believes prices will have recovered by the end of 2027.

Meanwhile, it sees mortgage rates peaking much lower than previously, just above 4% in 2027 – 0.8 percentage points lower than it predicted in November.

Business and economic measures

The Government has pressed on with the previously announced hike of corporation tax to 25% from 19%. However, Jeremy Hunt stated that just 10% of businesses would end up paying this level of tax.

He also announced the replacement of the business tax super deduction with a 'full capital expensing' scheme, worth £9 billion a year over three years to businesses. The OBR forecasts this will increase business investment by around 3% a year.

The Ministry of Defence has had a spending boost of £11 billion over five years, while a new potholes fund of £200 million has been created for local councils to fix roads. The Chancellor is also setting £60 million aside to help local pools and leisure centres in financial straits.

Budget Summary

Meanwhile nuclear power will be reclassified as sustainable for tax purposes alongside wind and solar, while a new 'Great British Nuclear' institution will be created to oversee a transition to more nuclear power for the country. The government will also tender for the provision of small nuclear reactors.

Personal taxation

Big change comes for pensions. The pensions annual allowance is rising 50% - from £40,000 to £60,000.

The big rabbit from Jeremy Hunt's hat came with the abolition of the pensions lifetime allowance. It had been expected to be raised from £1.073 million to £1.8 million but it has been removed completely. The charge has been cancelled from the new tax year 2023-24, while it will be abolished entirely in a future finance bill.

Alongside this, the money purchase annual allowance (MPAA) and tapered annual allowance (TAA) have been hiked from £4,000 to £10,000.

Plus, the adjusted income level required for the tapered annual allowance to apply to an individual increases from £240,000 to £260,000. However, the pensions tax-free lump sum has been capped at 25% the original lifetime allowance or £268,275.

All these changes will take effect from 6 April this year. There are no changes to income tax thresholds or ISA allowances for the new tax year. There are also no new reductions to dividend or capital gains tax allowances, other than those already announced for the new tax year.

Households, lifestyle and sins

Among the Chancellor's banner announcements were big changes to how childcare provision is funded and regulated in England and Wales. The childcare staffing ratio is being aligned with Scotland at 5:1 while nurseries will receive a significant funding uplift and all schools will begin to offer wraparound care from September 2026.

Hunt also announced a giveaway worth more than £6,500 a year on average for young families with the extension of free childcare hours to children aged nine months and over.

Any child over two years old will be able to receive 15 hours of free childcare a week from April 2024. From September 2024 this will be extended to nine months and over and from September 2025 this will increase to 30 hours. The policy is expected to cost the Government around £4 billion a year, according to the OBR.

The energy price guarantee (EPG) has been extended for a further three months. This will cap the average household energy bill at £2,500.

Budget Summary

It is expected that the price of energy will fall below the guarantee level in the intervening period, making further guarantees from the Government unnecessary as average bills reach £2,200 by year end according to the OBR. mproved outlook for the UK economy.

Fuel duty has been frozen for another year while the 5p reduction – introduced last year amid soaring prices – has been maintained for another 12 months.

Meanwhile, it sees mortgage rates peaking much lower than previously, just above 4% in 2027 – 0.8 percentage points lower than it predicted in November.

As for sin taxes, alcohol duty is increasing in line with RPI. The Government is increasing draught relief – the level of tax on fermented alcohol bought from a pub (i.e., beer, cider and wine) - giving pubs an 11p tax advantage over supermarkets. Tobacco duties are increasing again by RPI + 2%.

Budget Analysis

In depth

Government tackles two major life moments – retirement and education

The cornerstone of the 2023 Spring Budget has been encouraging people back to work. This matters for the Government as releasing more workers back into the economy eases labour change market shortages and improves GDP - and by extension, tax receipts and relative Government debt levels.

The two policies that have caught the most attention then are Hunt's changes to both pensions and childcare

Taken together these reforms look to ease two considerable pinch points in the labour market – parents returning to work after having children, and older workers on a retirement glide path.

Only time will tell if these policies have the desired effects, or whether they last with a change of political leadership in years to come. Here are the ins and outs of each.

Key changes to pensions

- » Pensions annual allowance increase to £60,000
- » Pensions lifetime allowance abolished
- » TAA & MPAA increased to £10,000 psum
- » Tax-free lump sum capped at 25% of current LTA (£268,275)

What's changed and why?

The Government has tackled one of the big overhanging wealth planning and pensions issues in the country and enacted some major simplifications in the process.

Hunt announced sweeping changes to the tax treatment of pensions, chiefly with older workers in mind.

The pensions lifetime allowance been widely criticised for punishing savers and driving them into retirement. With many of these being NHS doctors and our health service in a bad way, Hunt felt action needed to be taken.

The major changes Hunt has announced include a big uplift in the pensions annual allowance – rising 50% from £40,000 to £60,000. This will enable workers to contribute much larger sums each year to their pension pots, with any unused allowances able to be brought forward for three previous tax years as was already the case.

Budget Analysis

The biggest surprise came in the form of the abolition of the pensions lifetime allowance (LTA). The current lifetime allowance is £1.073 million, with heavy tax penalties for those that exceed it.

The media had trailed an increase in this limit to £1.8 million but Hunt abolished it completely. This greatly enhances the incentive to save into a pension as there is no limit on either contribution or investment growth potential for a pension with no limits in place.

It will also create a considerable incentive for tax planning and mitigating the effects of inheritance tax (IHT).

In practice, the charge on the LTA will be removed as of April 2023, while the limit will disappear completely from April 2024 under a new finance bill.

In line with this, the money purchase annual allowance (MPAA) has been increased from £4,000 to £10,000.

When someone accesses their pension the MPAA kicks in to limit relief on ongoing contributions. The increase to £10,000 is designed to encourage people back into the workplace and improve the amount they can get relief from if they contribute back into a pension when working again, taking advantage of valuable employer contributions.

The tapered annual allowance (TAA) has also been increased from £4,000 to £10,000 and will take effect from 6 April 2023. The adjusted income threshold for the TAA has been increased from £240,000 to £260,000.

There is however a caveat to this significant giveaway from the Treasury.

The tax-free pension lump sum has been capped at 25% of the current LTA. This means in practice that no one can take more than £268,275 as a lump sum.

It is also open to tinkering from a future Government that wishes to salami slice the allowance away to earn more cash from pension holders.

What do these changes mean in practice?

The focus from the Government on these changes is to encourage people back into the workforce who may have decided, for a number of reasons in recent years, to leave the workforce despite being ostensibly fit and healthy.

The analysis from the OBR on how effective this will be is circumspect, however. It says that the boost to the labour market could be as much as 240,000 workers returning, or as low as 55,000. In short, it is unsure how effective these tweaks will be.

However, there is a big upside to these pension changes. They make this form of tax wrapper look much more attractive again, perhaps the most attractive it has been since the introduction of pension freedoms in 2015.

Budget Analysis

In removing the LTA completely, the Government has essentially said there is no limit to ambition for someone using a pension to build their lifetime of wealth, particularly in regard to growth. The IHT mitigation incentives are also eye-opening.

ISAs have been unencumbered by limits (other than annual contributions) since their introduction over 20 years ago. However, this change puts pensions back onto a much more favourable footing, especially when you factor in the tax relief you can accrue when contributing at the front end.

That tax relief gives contributions a 20-40% head start over ISAs at the starting line, so by removing many of the restrictions at the withdrawal point takes away one of the biggest drawbacks for pensions as a wealth growth product.

There is of course a caveat to this in the new cap on the tax-free lump sum limit of £268,275. For those able to take the full sum, anything beyond that will still be subject to taxation (unlike an ISA withdrawal).

With careful active financial planning the incentives are all there that greatly enhance the possibilities with a pension.

Childcare

Key changes to childcare

- Free childcare extended to children 9 months+
- More funding and incentives for nurseries and child minders
- Minimum staffing ratios increased to 5:1
- All schools to offer wraparound care by September 2025

What’s changed and why?

The Government has heeded calls from across the political spectrum to ease the burden on parents who wish to return to work but are prevented from doing so by punishing childcare costs.

The UK has the highest childcare costs in the entire developed world according to the Organisation for Economic Co-operation and Development (OECD).

Budget Analysis

This is a massive issue for a number of reasons, but the Government is chiefly concerned with those who are unable to return to work because the cost of childcare outweighs what they can earn if they do re-enter the labour market.

With that, Hunt has announced the extension of free childcare hours to all children over the age of nine months. This will ensure in most cases that parents (typically mothers) can transition seamlessly from parental leave to working and sending young children to childcare.

There are however some practical caveats to this.

In order not to overwhelm childcare providers straight away the new policy is being implemented in stages:

» From April 2024 any child over two years old can get 15 hours free childcare per week extended to children 9 months+

» From September 2024 the 15-hour offer will be extended to children over nine months

» From September 2025 this will increase to 30 hours for all children over nine months

For parents of older children, the Chancellor announced that all schools will offer wraparound care from September 2025. This means that those who reduce their working hours to meet the needs of childcare will no longer be forced into such a choice.

This is all going to cost the Government around £4 billion annually, ultimately. Hunt also announced fresh funding for nurseries and cash incentives for new child minders in order to stimulate supply in the face of fresh demand creation.

What do these changes mean in practice?

According to the Government's own estimates this care will be worth around £6,500 a year to families – per child. This is a big saving for families and removes one of the big disincentives for mothers in particular looking to return to the workforce.

However, there are deeper financial implications for parents and mothers in particular to this policy.

The gender pay gap, and as a consequence the gender pension gap, between men and women is relatively small until women take a break from working to raise children, when it gets considerably worse.

According to ONS data, it begins to increase once women turn 30, and gets considerably worse over time as they fail to catch up with male counterparts.

Budget Analysis

While the impact of the policy won't be immediate, especially considering its staggered introduction, it is certainly a step in the right direction in improving the gender pay and pension gaps for women.

A secondary consideration too should be made for the added benefit this will add to the ability to save for those who can return to work faster. Not only will there be less rigamarole around ensuring that National Insurance Credits (NICs) are being accrued by those not in work, but returning to work earlier means less time away from contributing to a pension.

A worker on an average wage that can return to work two years earlier if they're unburdened by childcare provision could see a long-term pension pot boost of around £16,000[1] – no inconsiderable sum.

So, while the short-term effects are evident – unleashing parents back into the workforce, the long-term wealth implications could also be demonstrable given enough time for the benefits to feed through.

A major issue, however, is that it creates a bigger income tax cliff edge at £100,000 of earnings. Earners over this threshold face a 62% marginal tax –rate because the income tax personal allowance is withdrawn.

A parent of a young child will also lose tax-free childcare, 30 hours a week of nursery for one- and two-year-olds, and 15 hours a week of nursery for three- and four-year-olds.

The only way around it would be for the high earner to defer more of their pre-tax income into (the now more generous) annual pension allowance.

There are more potential positive financial implications though when we consider other major wealth growth facets such as home ownership. The boost to income for young parents could conceivably improve metrics such as mortgage affordability and enhance their ability to save for onerous deposits.

Through a complex mix of contributing factors, Hunt's tweaks to childcare could prove much more lucrative for families in future than even he might have considered. Just not if one parent earns over £100,000.

[1] Based on the difference between a worker on an average salary of £30,628 with £162.59 in monthly contributions and 5% pot growth over 30 years, versus the same scenario over 28 years. Does not factor in wage growth adjustments. ore of their pre-tax income into (the now more generous) annual pension allowance.

Conclusions

The Spring Budget, after the fireworks of September's ill-fated mini-Budget, was a calm and measured set of policy introductions from a Government that is looking to project authority and responsibility.

It has made some extremely interesting tweaks to policy areas that were creating significant choke points for those wishing to work and earn a living while still ensuring their long-term wealth and prosperity.

While lacking upfront giveaways we've often come to expect through income tax or other direct policy tweaks, resolutions to questions around long-term financial prospects are to be welcomed.

However, the key to unlocking this potential is careful, considered and ambitious financial management. Only through this approach can anyone interested in maximising the lifetime potential of their earnings and wealth truly be achieved.

If you would like to discuss more about how the financial landscape has changed thanks to the Spring Budget 2023, please don't hesitate to get in touch as we'd be happy to show you how to take full advantage of the new lay of the land.

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