DRAGGED DOWN BY DEBT

MARCH 2022

In his 2022 Spring Statement, Chancellor Rishi Sunak announced headline grabbing tax cuts against a backdrop of a looming Government debt crisis that has blown a hole in his 2021 Budget. Key measures include:

- A temporary 12-month cut of 5p per litre on fuel duty from today. This has been prompted by the 'cost of living' crisis, as illustrated by the Office Of Budget Responsibility's ("OBR") forecast that CPI inflation will peak at 8.7% in Q4 2022, the highest level for 30 years.

- An increase in the annual National Insurance (NIC) Primary Threshold and Lower Profits Limit from £9,880 to £12,570, from July 2022. This will align the Threshold/Limit with the income tax personal allowance, equalising them in one go. However, despite intense political pressure, the controversial 1.25% increase in NIC will still go ahead in April as planned. Therefore, the combined starting rate of income tax and NIC on employment income will now be 33.25% from July 2022, for incomes above £12,570.

- A plan to reduce the basic rate of income tax from 20% to 19% from April 2024. Forecasting two years ahead has been futile in recent times, so it is not clear whether this aspirational tax cut will actually come to pass. Nevertheless, income tax cuts have traditionally occurred just before elections, indicating that the current thinking of the ruling Conservative Party may be to call the next General Election in May 2024.

- There were no jaw dropping announcements from the Corporate Tax side - those happened last year with the increase of the corporation tax rate to 25% from April 2023, partially offset by the 130% capital allowances super deduction until that time. Instead, there is signposting via the Government's "Tax Plan" on how legislation may change from April 2023.

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- The Tax Plan shows a commitment to increasing capital investment by businesses by making this more tax effective, noting that, absent the super deduction, the UK's capital allowances regime lags behind other countries. Reforms to the capital allowances legislation may therefore be proposed from April 2023, with the Government suggesting that this could be in the form of a permanent increase in the Annual Investment Allowance, and an increase in writing down/first year allowances.

- The Government committed to legislating from April 2023 to make the R&D tax regime more UK-centric, unless there are specific circumstances (geographical/regulatory) that mean the R&D work cannot be done in the UK, and also to modernise the regime by allowing certain cloud computing, data and mathematics costs. A future increase in the generosity of the R&D Expenditure Credit scheme was also mooted.

- There were no announcements in relation to capital gains tax, inheritance tax or stamp duty land tax.

In relation to the UK economy, the Spring Statement confirmed that it had recovered to its pre-pandemic level late last year, with real GDP regaining its February 2020 level by November 2021. The OBR now expects UK real GDP growth to be 3.8% in 2022; 1.8% in 2023 and 2.1% in 2024, meaning that an economic boom is expected this year, with more normal growth levels resuming from 2023.

The biggest surprise of the Spring Statement was the revelation that the cost of servicing Government debt is now threatening to overwhelm Government spending plans - debt interest is forecast to reach £83 billion next year, the highest nominal spending ever. This is nearly four times the amount spent on debt interest last year, and exceeds the budgets for day-to-day departmental spending on schools, the Home Office and the Ministry of Justice combined.

Indeed the Government's forecast last autumn for next year's debt interest payments was short by a huge £42.2 billion, blowing a large hole in the Chancellor's 2021 Budget. The OBR state that this "is our largest forecast-to-forecast revision to debt interest on record." In fact Government debt is now so high that the OBR considers that the first-year fiscal impact of a 1% rise in interest rates is six times greater than it was just before the 2008 Financial Crisis, and almost twice what it was before the pandemic.

The nightmare scenario for the Chancellor is therefore that any further significant increases in interest rates could completely blow away his budgetary plans, and potentially end any scope for future tax cuts, including his mooted 1p cut in income tax.