

Reaction

Budget 2025

November 2025



The big picture

Today's Budget was an opportunity to tackle tax reform head-on rather than yet more rate tinkering. Some of the Chancellor's announcements are a small step in that direction. But they are less a 'smorgasbord', more a series of nibbles.

This may feel like a 'big Budget' of tax reforms, but that's only because successive governments have done so little in the way of serious reform that we've forgotten what it looks like.

There is still no sense that the government has a vision for a good tax system, let alone a strategy for getting there. In this climate, the risk is that even moves in the right direction – like on Council Tax – still come across as ad hoc revenue-grabs rather than principled efforts to make the tax system fairer and more efficient.

For a government that's supposedly obsessed with growth, we seem no closer to the realisation that our broken tax system is part of the UK's growth problem, and that major structural reforms – not just rate-changes or more bolt-ons – are needed to fix it. Overall, the tax changes announced today are unlikely to move the needle on growth much one way or the other.

A strategy for pro-growth tax reforms is already out there and ready to be picked up. Recently, authors from CenTax and eight other think tanks from across the political spectrum declared agreement on the way ahead. It's regrettable that this Budget contains barely a hint of progress against any of the seven reform packages we proposed.

Outside government, the need for serious tax reform is universally accepted and there is remarkable agreement over how to do it. We must turn our attention to the reasons why successive governments have failed to deliver, despite this consensus. It would be wise to start thinking about this now, because ten weeks out from the next Budget will be too late.

Policies at a glance

High Value Council Tax Surcharge ('Mansion tax')

Explainer

Council Tax in England is based on property values that are almost 35 years old. This means that around half of properties are in the wrong band. Local authorities determine the tax rate for Band D properties in their area, and then the rate on other bands is always a constant multiple of this e.g. Band H always pays twice what Band D pays. Since average house prices have risen fastest among higher value houses, the tax has become 'regressive': the tax rate is higher for low value properties than for high value ones.

Today's reform creates four new bands for properties that in current prices are worth more than £2 million. Those properties will continue paying their existing Council Tax, plus the new surcharge. Whereas revenues from standard Council Tax go to Local Authorities, the new surcharge will go to central government.

Comment

The reform sensibly tackles some of the unfairness created by Council Tax, by revaluing the most valuable properties and levying a top-up tax to partly counteract the regressivity of the standard Council Tax bands. Given there has been no change in the system for over three decades, this is a step in the right direction.

That said, there are some real downsides to the way it has been implemented. The absurdity of using 1991 values for Council Tax remains in place for most properties, with no sign that this will be tackled. The most valuable houses are the hardest to revalue, so this would have been a good opportunity to update valuations across the board.

Even more bizarrely, not updating Council Tax valuations means many of the properties caught by the surcharge are currently not even in the highest council tax band, and it appears that won't change. Maintaining 1991 values also means that across most houses, barring those above £2 million, the regressive nature of Council Tax remains in place.

While this has been presented as a tax on the wealthy, and it certainly is, the impact on the "super-rich" will be much smaller than for the merely affluent. This is because property is only a small share of wealth among the very wealthiest. Reforms to Capital Gains Tax, or to the taxation of partnerships would have raised more money, while improving the structure of the tax system and (if this is a goal) being much more progressive.

Pensions

Explainer

The treatment of pension contributions and withdrawals for Income Tax and National Insurance Contributions (NICs) differs. Pension contributions are always free of Income Tax. Instead, Income Tax is charged when the pension is later withdrawn.

Pension contributions can be subject to NICs, but this depends on how the payments are made. Contributions that individuals make into a private pension are from income that has been subject to NICs. By contrast, contributions made by employers are made free of both employer and employee NICs. There are no NICs on pension withdrawals.

Under 'salary sacrifice', employees can flexibly agree to give up some of their salary in exchange for their employer making higher pension contributions. This allows the contributions to be made without NICs being charged on the amount sacrificed. The Budget 2025 reform limits this mechanism to a maximum of £2,000 worth of salary.

Comment

There is a case for exempting pension contributions from NICs altogether and instead charging NICs on pension withdrawals, the same as for Income Tax. There is alternatively a case for charging NICs on all pension contributions but with no NICs on withdrawals. In principle, both of these approaches are coherent, there is no strong reason to favour one over the other and both would create administrative and transitional challenges.

However, whichever approach is favoured, it is impossible to justify having different NICs treatment for different *kinds* of pension contribution simply depending on how they are made (although, as below, this may be unavoidable for Defined Benefit schemes to an extent). This reform goes some of the way to equalising NICs treatment across all pension contributions. However, unfortunately it stops significantly short of full equalisation, and in doing so adds considerable complexity and scope for avoidance.

The planned reform retains NICs relief on employer contributions, while trying to limit through regulation the amount that can be paid via the 'salary sacrifice' mechanism specifically. This will reduce the circumstances in which employees can exchange salary for pension contributions whilst still receiving full NICs relief. But, as the [OBR Economic and Fiscal Outlook](#) makes clear, it will remain possible for some employers to restructure contracts or adjust future wage growth by holding down salaries and making additional employer contributions instead. This is functionally equivalent to salary sacrifice.

To take a (relatively) simple example: suppose an employer currently makes an employer contribution of 5%, and employees are defaulted to salary sacrifice of 3% as their employee contribution. Next year the employer could say: instead of a 2% salary increase, we will increase our employer contributions from 5% to 7%, and also change the default salary sacrifice to 1%. The effect is simply to shift contributions from the employee side to the employer side, thereby avoiding the NICs increase.

Transferability of Inheritance Tax allowances

Explainer

At the Autumn Budget 2024, the government restricted Agricultural Property Relief (APR) and Business Property Relief (BPR) for Inheritance Tax (IHT). Prior to that budget, qualifying assets – largely farms, private businesses and Alternative Investment Market (AIM) shares – were completely exempt from IHT with no cap. Last year's reform reduced the relief to a 100% relief (i.e. no tax) on the first £1 million of (non-AIM) assets, and 50% thereafter. Today the Chancellor announced that these reliefs, like the other main IHT reliefs (the Nil Rate Band and the Residential Nil Rate Band) will be transferrable between spouses.

Comment

This reform is a very positive step and should be welcomed. The government has previously emphasised the value of the APR and BPR to a couple. However, for both members of a couple to receive full benefit from the relief, specific drafting of wills would typically be needed. Today's reform does away with that need.

As we have previously written, transferability reduces the administrative burden on taxpayers (and HMRC), by removing the need for couples to engage in tax planning, and reducing the number of deaths on which HMRC requires valuations from executors.

Income Tax threshold freeze

Explainer

Income Tax thresholds have been frozen since April 2022, and this has now been extended for a further three years to 2030–31 alongside the National Insurance Contributions (NICs) secondary threshold. Previously, these thresholds had been expected to rise again in 2027–28. The extended freeze comes after more than a decade in which thresholds were uprated annually in line with Consumer Price Index (CPI) inflation. With thresholds held constant while wages continue to rise, more people are being brought into higher tax bands and are paying more tax as a result.

Comment

There are several economic reasons why a threshold freeze is a bad way to raise Income Tax. The scale of revenue raised is uncertain and arbitrary, depending almost entirely on the future path of inflation: something the government does not control. The effect is also to increase tax in a way that is less progressive than rate increases of equal revenue, and it creates large increases in marginal tax rates for those close to a threshold.

However, there is a reasonable case at this point for freezing the Personal Allowance in particular. During the 2010s, the Personal Allowance was increased significantly above inflation several times, nominally more than doubling over this period. This is a large part of the reason why Income Tax is now so dependent on higher earners.

This historic increase in the Personal Allowance was arguably a mistake, but nominal cuts would be both politically unpopular and create immediate hardship for some through large upfront changes in net income for taxpayers. Freezing this threshold instead allows for a more gradual reversal, giving time for taxpayers to adjust.

The same defence cannot be mounted for freezes to the other Income Tax thresholds. In particular, although it may feel hard politically to justify raising the threshold at which the Personal Allowance is tapered away and childcare allowances are withdrawn, holding this fixed at £100,000 will have ever worse [economic consequences](#) as more people enter this income range.

Income Tax on property income

Explainer

Property income (rent) is subject to Income Tax at standard rates, but is not subject to National Insurance Contributions (NICs). As a result, property income generally faces a lower overall tax rate than investment in businesses, where individuals pay dividend rates of Income Tax on profits that have already been subject to Corporation Tax. Rental income also faces lower rates than income from work, where both Income Tax and NICs are payable. For landlords buying with a mortgage, there is only 20% relief on interest costs.

At Budget 2025, the government announced the creation of separate tax rates for property income, which are 2pp higher than the equivalent Income Tax rates on income from work. From April 2027, the property Basic Rate will be 22%, the property Higher Rate will be 42%, and the property Additional Rate will be 47%.

Comment

On its own, the changes for landlords are a step in the right direction. A more complete reform would have fully equalised the tax rate on rental income with the rates applied to business investment and to income from work to remove the bias in favour of investing in property. This would imply a larger increase, of a further 7pp at the top rate.

One drawback of increasing the tax rate on property without wider reform is that it widens the distortions between letting property directly, where landlords cannot fully deduct mortgage interest, and letting property through corporate structures, where they can. It also increases the existing tax bias favouring owner-occupation relative to renting.

While a more comprehensive reform would be preferable, it is important to recognise that the current tax system has multiple boundaries, making it difficult to equalise treatment of income across sources. Introducing a mortgage-interest deduction on its own, without a broader Investment Allowance, would further bias investment toward property at the expense of other businesses.

Income Tax for dividends

Explainer

Dividend income is subject to tax at a lower rate of Income Tax than most other income. This is to account for the fact that dividends are paid out of corporate profits which have (at least for UK companies) already been subject to Corporation Tax (CT). The headline CT rate is either 19% or 25% depending on the total profits, although the effective rate can be lower.

The multiple rates of CT, and the fact that the economic 'incidence' of CT on shareholders also varies, means that there is no single rate for dividend income that consistently aligns with other sources of income.

At Budget 2025, the government announced a 2p increase to the rates of Income Tax on dividends for people who are on the Basic and Higher Rates of Income Tax. This applies from April 2026. There is no change to the dividend tax rate for taxpayers on the Additional Rate.

Comment

After accounting for CT already paid, the rise in the Basic Rate for dividend income brings the taxation of business profits closer to that of employment income. Although there are a range of CT rates depending on the company's total profits, in all cases this is a move in the right direction. It sensibly reduces – but does not eliminate – incentives to set up 'personal service companies' (converting labour income into dividends) just to save tax.

For the Higher and Additional Rates, the effective tax rate was already close to the rate on earnings. Depending on the marginal CT rate facing the business from which the dividends were paid, the overall effective rate after the reform could be above or below the equivalent rate for income from employment. It is not clear why different choices were made for the Higher and Additional Rates, with the former rising while the latter unchanged.

While it is rarely possible to do comprehensive reform in one step, one consequence of the changes to dividend rates is that establishing an unincorporated business (as a sole trader or partner) is increasingly attractive relative to working as the owner-manager of an incorporated business.

Income Tax on savings

Explainer

Savings income (interest) is subject to Income Tax at standard rates, but not National Insurance Contributions (NICs). This means it generally faces a lower tax rate than investment in businesses, where individuals pay dividend rates of Income Tax on post-Corporation Tax profits. Savings income also faces lower rates than income from work, where both Income Tax and NICs are payable.

Basic Rate and Higher Rate taxpayers have a Personal Savings Allowance on top of the Personal Allowance, giving them up to £1,000 of interest tax free. Additionally, all interest on savings held within an ISA are tax free without limit, although there is a limit on annual subscriptions). This means most savers have no tax to pay on their interest.

At Budget 2025, the government announced increases a 2p increase in all rates of Income Tax applying to savings income. The annual subscription limit for cash ISAs was also reduced from £20,000 to £12,000, though only if you're under 65.

Comment

Whether savings income should be taxable at all is a matter of some debate. Savings are a low-risk way to delay spending, so taxes on saving can distort choices of whether to spend money today or in the future. This leads some to argue that the return on saving should be exempt from tax altogether. However, if higher earners tend to save more then savings rates are higher for people who have higher potential earnings, for example, then there is an optimal tax case for taxing savings.

More pragmatically: the vast majority of savers already do not pay any tax on their interest, so this reform will not affect them. Moreover, other, riskier forms of investment do not receive any deduction for the 'risk-free' rate of return which is roughly equivalent to an exemption on savings income). Under this system, the status quo ends up incentivising saving over riskier investments, so bringing the savings rate closer to the effective dividend rate is a reasonable step.

Employee Ownership Trusts

Explainer

An Employee Ownership Trust (EOT) is a business structure that allows a company to be owned on behalf of its employees. The shareholders – usually the founders of the business – sell at least 51% of the company's shares into a trust, which then holds them for the long-term benefit of all staff. The sale price is typically funded by a loan from the sellers themselves, who are then repaid out of the dividends that the company generates. Under current rules, this way of selling a business gets 100% relief from Capital Gains Tax (a tax saving of up to 24%). The government is reducing the relief to 50%.

The official purpose of the relief is 'to promote awareness and encourage the creation of indirect employee-ownership structures'. There is some evidence that employee-owned businesses on average outperform other firms, although it could be that businesses that were better-run to begin with are more likely to convert. EOTs are not unambiguously positive: the sale is typically funded from future dividends, which could reduce cash available for reinvestment; there are concerns that employee control is sometimes more formal than real; and the structure can make subsequent sales more difficult.

Comment

This is good reform; indeed, the Government should have gone further and abolished the relief entirely. 'EOT relief' is a symbol of everything that is currently wrong with our overengineered and evidence-free tax system. When announced at Budget 2013, it was originally forecast to cost less than £50 million per year, but the government now expects this to balloon to almost £2 billion. It is a horrendously complicated bolt-on to our standard Capital Gains Tax (CGT) system. Evidence that it was being abused had already led to a raft of anti-avoidance measures at last year's Budget. But the problems with the relief run deeper than this.

To justify spending £2 billion per year, there should be robust evidence that the relief leads to significantly better economic outcomes overall – yet there is none, and there are some clear downsides as well as upsides. For over a decade, governments have been spending all this money just hoping (or assuming) that it works.

EOT relief is also a textbook example of governments thinking that every problem requires a tax fix. If giving employees a greater say and stake in their company is a good thing, then it's not obvious why we would want to do this only for businesses whose owners are thinking of selling out. And more fundamentally, reforms to the tax system should focus on getting the basics right, not designing a new tax relief for every new thing the government decides it wants to encourage. In the case of

CGT, we have proposed a package of reforms that would remove existing distortions that are harmful for growth, whilst also raising additional revenue.

EV road pricing

Explainer

Road pricing is a way to charge for wear and tear on roads, pollution, and (indirectly) congestion. Alongside a fixed annual road tax (Vehicle Excise Duty), petrol and diesel cars face a tax based on the amount of fuel they use (Fuel Duty). Electric vehicles (EVs) do not have tailpipe emission, but do still release particulate pollution, contribute to congestion and to wear and tear. Despite this, they have not historically faced any tax relating to the amount they are used. Today the Chancellor announced that from April 2028, electric cars will face a new “Electric Vehicle Excise Duty” (eVED) which applies at 3p per mile driven.

Comment

There is a reasonable case to bring EVs into road pricing, to account for the negative consequences on particulate pollution, congestion, and road wear and tear. It also tackles a long-term fiscal challenge that successive governments have ducked: the gradual erosion of revenue from Fuel Duty as motorists switch to EVs.

The trade-off is that by taxing EVs more heavily, they become less attractive relative to petrol and diesel vehicles. This is particularly problematic for drivers who do not have access to home charging facilities, as prices at commercial facilities already make EV miles more expensive than fossil fuel miles. Other Budget measures are intended to improve EV take up, largely by encouraging businesses to purchase them. However, it is an open question whether these will be enough to offset the demand reduction from a higher cost per mile.

Charging more per electric mile driven without increasing Fuel Duty would further worsen the incentives to purchase EVs. Successive governments kept Fuel Duty frozen in cash terms since 2011, and cut it ‘temporarily’ in 2022. If the increase in Fuel Duty from April 2026 is actually implemented, the government should be commended. While this staged approach feels more realistic than previous promises, the plan for the forthcoming rise to only begin in April leaves open the possibility of further delay.