How fiscal drag could harm your finances as the government extends tax freezes

When chancellor Rachel Reeves delivered the Budget in November 2025, you might have breathed a sigh of relief that Income Tax rates weren't increasing. However, fiscal drag could still harm your finances over the long term.

Fiscal drag occurs when tax thresholds aren't increased in line with wages or inflation, and is sometimes dubbed a "stealth tax". Over time, more people are dragged into a higher tax bracket, so tax revenues increase without the government officially raising tax rates.

Income Tax thresholds are frozen until April 2031

In the Spring 2021 Budget, then Chancellor Rishi Sunak announced that the Personal Allowance and the higher-rate threshold would be frozen for four years.

This freeze has been extended several times, most recently by Reeves. The latest update means the thresholds for paying Income Tax will remain as they are until April 2031.

In the 2025/26 tax year, the Income Tax thresholds in England, Wales, and Northern Ireland are:

Band	Taxable income	Tax rate
Personal Allowance	Up to £12,570	0%
Basic rate	£12,571 to £50,270	20%
Higher rate	£50,271 to £125,140	40%
Additional rate	More than £125,140	45%

On the surface, freezing the thresholds might seem as though it will make little difference to your Income Tax liability.

However, the Office for Budget Responsibility (26 November 2025) calculates that freezing personal tax thresholds will raise an additional £8.3 billion in tax revenue by 2029/30, with £7.6 billion of this coming from Income Tax.

It's estimated that the freeze will push around 920,000 workers into the higher-rate rate Income Tax band, and an additional 4,000 workers into the additional-rate band.

Fiscal drag could affect other areas of your finances

It's not just the Income Tax thresholds that are frozen.

During the Budget, Reeves announced she had also extended the freeze on Inheritance Tax (IHT) thresholds by a year to April 2031.

This means that as the value of your assets rises, more of the wealth you leave behind for loved ones could be liable for IHT. So, it might be important to review your estate plan and consider how you might pass on wealth tax-efficiently.

In addition, the total ISA subscription limit is also frozen at £20,000 until 2031. Notably, there were greater changes affecting Cash ISAs unveiled in the Budget. From April 2027, the amount you can place in a Cash ISA each tax year will fall to £12,000 for savers under 65.

The Junior ISA subscription limit is also frozen at £9,000 until 2031.

The Budget documents suggest the IHT threshold freeze will raise £2.355 billion in tax by 2029/30, while the ISA subscription limit freeze will boost the Treasury by £605 million over the same period.

Other tax thresholds haven't officially been frozen but have failed to keep pace with inflation.

For example, the annual exemption is an amount you can gift each tax year and will be considered immediately outside of your estate for IHT purposes. In 2025/26, the annual exemption is £3,000 – it's been at this level since 1981.

According to the Bank of England's inflation calculator, if the annual exemption had increased by inflation each year, it'd be worth more than £11,600 in November 2025.

A financial plan could help reduce your tax liability

You can't change the tax thresholds, allowances, or freezes, but there might be steps you can take to reduce the effect they have on your finances.

For example, you might choose to increase your pension contributions to reduce your taxable income. This could prevent you from being dragged into a higher Income Tax band. While your take-home pay would be lower, it could support your retirement goals and manage your tax liability.

We can help you understand your current tax position and what steps you might take to reduce your overall tax liability, with your circumstances and goals in mind.

Please contact us to speak to a member of our team.

Please note: This article is for general information only and does not constitute advice. The information is aimed at individuals only.

All information is correct at the time of writing and is subject to change in the future.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

The Financial Conduct Authority does not regulate tax planning.

An ISA is a medium to long term investment, which aims to increase the value of the money you invest for growth or income or both. The value of your investments and any income from them can fall as well as rise. You may not get back the amount you invested.

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