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2007 Budget Report

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Going Out In Style?

(Budget 2007 Analysis)

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On Wednesday 21st March 2007, the UK's longest serving Chancellor of the Exchequer for almost two centuries delivered his 11th Budget Statement to a packed House of Commons and an anxious nation.

We are, of course, talking about Gordon Brown, heir apparent to Tony Blair's throne and Budget 2007 was, perhaps, his last big chance to demonstrate his election-winning potential to his colleagues before the long-anticipated Labour leadership contest.

All of this was already well known before the Chancellor began his Budget speech in its new lunchtime slot at 12.30pm. What few people knew before that moment, however, was just what a radical shake-up he had in store for us. I, for one, had anticipated little else but political spin in the speech and reams of technical gobbledegook in the press releases which followed. (I'm the poor sap who has to read, digest and explain those press releases, after all!)

Well, I wasn't entirely wrong; the speech certainly did contain its fair share of political spin. The Chancellor began with a few jokes about his long service in the post (he is the longest-serving Chancellor since 1827) and some interesting comments about his 'comrades' at the Treasury.

But references to his earlier comparison with Josef Stalin soon faded away as he began to announce some fairly major tax reforms and even one or two headline tax cuts (more of that later). When he also announced that he was proposing to sell off £36 Billion in State-owned assets over the next three years, I began to wonder if the last twenty years had been just a dream and it was actually still 1987 after all.

Amazing, isn't it, just when you think the Government has sold off everything they can, they still keep scraping up a few more things from the bottom of what must surely be an endless barrel. The student loan book, worth £6 Billion, is apparently now up for sale. It makes me wonder how long it will be before our sons and daughters find that they are now in debt to some rather unsavoury characters in New Jersey, Nevada or Sicily!

Amongst the political spin and flowing rhetoric, however, it must be admitted that this year's Budget had more real substance than we have seen for several years. Taxation's place at the heart of the Budget speech

seemed to be restored after an enforced absence of several years. "If that's the size of the tip", I thought, "I'd better brace myself for the iceberg!" I wasn't disappointed – as soon as the Chancellor had sat down, the Treasury immediately released a staggering 81 press releases together with more than 40 pages of Budget notes, more than 230 pages of technical material in all.

So it seems that for this, surely his last Budget, Gordon Brown has rediscovered the power of the tax system to win over the electorate (or so he must hope) and, as he closed his speech with the shock announcement of a two pence in the pound reduction in Income Tax, to its lowest rate in 75 years, I had to admit (grudgingly), that he is certainly going out in style!

But who is going to pay for it?

Income Tax & National Insurance: Jam Tomorrow?

In the immediate future, for the next tax year ending 5th April 2008, we will see little change, with only the customary inflationary increases to personal allowances and tax rate bands:

- Personal allowance up £190 to £5,225
- Lower rate band increases from £2,150 to £2,230
- Basic rate band increases to give a new higher rate tax threshold of £34,600, (increased from £33,300)
- Upper threshold for primary National Insurance up from £33,540 to £34,840

Combining the personal allowance and the new basic rate band, we see that most people will only begin to pay higher rate Income Tax in 2007/8 when their income exceeds £39,825. Next year, therefore, we will still see a band of income, between £34,840 and £39,825, where the combined rate of Income Tax and National Insurance falls from 33% (22% + 11%), for employed earners, to just 23% (22% + 1%) before rising again to 41% (40% + 1%).

So, it's pretty much business as usual for 2007/8. The following few years, however, will see some rather more significant changes:

- Basic rate income tax to reduce from 22% to 20% from 6th April 2008.
- 10% starting rate band to be abolished for earned income and pensions from 6th April 2008.
- Upper threshold for primary National Insurance Contributions to increase by £3,900 more than inflation for 2008/9.

- Age-related personal allowances for all taxpayers aged 65 or more to increase by £1,180 more than inflation in 2008/9.
- Personal allowances for taxpayers aged 75 or more to be increased to £10,000 by 2011/12.
- Higher rate Income Tax threshold to increase by £800 more than inflation for 2009/10.
- Upper threshold for primary National Insurance to be aligned with the point at which taxpayers begin to pay higher rate Income Tax from 6th April 2009.

Now, to the layman, that last point may not sound very radical. To me, however, it spells out the potential for a major change to the UK tax system: the abolition of National Insurance!

This is because of the fact that once the primary National Insurance threshold is aligned with the point at which higher rate Income Tax cuts in, for most people we will effectively have a simple two-tier tax system.

All basic rate taxpayers will also pay primary National Insurance contributions (currently 11% for employees and 8% for self-employed taxpayers) on all of their earned income and all higher rate taxpayers will be paying National Insurance at just 1% on their earned income in excess of the higher rate threshold. This will create just two effective tax rates from 2009/10 onwards. For employees these rates will be 31% and 41% and, for the self-employed, 28% and 41% (as things currently stand).

But, who knows, after 2009 we may see a total integration of the two taxes so that everyone pays 41% in higher rate tax and, perhaps, 31% in basic rate tax. Once the Income Tax and National Insurance thresholds are aligned this would be easy to do. The vast majority of the electorate, with mostly employment income, would not see much change, so it would be politically acceptable.

The self-employed, pensioners and landlords would all suffer effective tax increases however, as the benefit of paying lower, or no, National Insurance Contributions would be eradicated.

Amongst these groups, pensioners would generate the most sympathy, but we can see the counter-argument to that one coming already in the shape of higher age-related personal allowances.

OK, this is all speculation at present (but if Ladbrokes are giving odds on the abolition of National Insurance, put me down for a tenner). Piecing together what we do know, however, I have been able to produce the following table of combined Income Tax and National Insurance rates for employed earners over the next few years (for taxpayers aged under 65).

	2007/2008			2008/2009			2009/2010		
	%	Band	Cum	%	Band	Cum	%	Band	Cum
Personal Allowance	0%	£5,225	£5,225	0%	£5,375	£5,375	0%	£5,535	£5,535
Starting rate band	21%	£2,230	£7,455	n/a			n/a		
Basic rate band	33%	£27,385	£34,840	31%	£34,345	£39,720	31%	£37,400	£42,935
Basic rate band	23%	£4,985	£39,825	21%	£1,255	£40,975	n/a		
Higher rate	41%	thereafter		41%	thereafter		41%	thereafter	

Notes to the table

1. 'Cum' = cumulative income for allowances and bands up to that point.
2. The starting rate band is subject to Income Tax at 10% plus National Insurance at 11%.
3. The first part of the basic rate band is subject to both Income Tax and National Insurance at 11%.
4. The second part of the basic rate band is subject to Income Tax plus National Insurance at just 1%.
5. Higher rate income suffers Income Tax at 40% plus National Insurance at 1%.
6. The above table applies only to employment income. The National Insurance rate applying to self-employed income in the starting rate band and the first part of the basic rate band is 8% instead of 11%, reducing the total effective rate by 3%.
7. Rental income and pensions are not subject to National Insurance but do suffer the same rates of Income Tax as employment income.
8. Dividend income is subject to a different regime.
9. Other savings income is exempt from National Insurance and is already subject to basic rate tax at 20%. This income will also continue to be subject to a starting rate band taxed at 10% after 2007/8.
10. The allowances and tax bands quoted above for 2007/8 are accurate. Those quoted for 2008/9 and 2009/10 are projections based on the changes we are aware of combined with an estimated inflation rate of 2.8%.

As we can see, within the next three years the current system of a personal allowance followed by four different effective rate bands, with a peculiar reduction in the tax rate for the third band, will evolve into a simpler system with just two rate bands for most forms of income.

From a purely technical perspective, this does seem like a sensible rationalisation of the Income Tax system, but what will it do to your tax bill?

In the tables which follow, I have used the above table to calculate the total annual tax bills on different types of income.

Employed Earners

The combined annual Income Tax and National Insurance burden for employed earners will be as follows:

Annual Earnings	Tax & National Insurance 2006/2007	Tax & National Insurance 2007/2008	Tax & National Insurance 2008/2009	Tax & National Insurance 2009/2010
£10,000	£1,380	£1,308	£1,434	£1,384
£20,000	£4,680	£4,608	£4,534	£4,484
£30,000	£7,980	£7,908	£7,634	£7,584
£40,000	£10,934	£10,724	£10,706	£10,684
£50,000	£15,034	£14,824	£14,611	£14,491
£50,000+		+ 41% of excess in each year		

Amazingly enough, for a supposedly socialist Government, the only ones losing out here are the ones with the lowest income whose tax burden increases in 2008/9.

Gordon Brown will no doubt argue that increases in tax credits will more than compensate for this, but that won't apply where the small wage is being received by the lower earner in a couple whose combined household income is too high for them to receive working tax credits.

Self-Employed Earners

We get slightly different figures for the self-employed, as follows:

Annual Earnings	Tax & National Insurance 2006/2007	Tax & National Insurance 2007/2008	Tax & National Insurance 2008/2009	Tax & National Insurance 2009/2010
£10,000	£1,232	£1,165	£1,295	£1,250
£20,000	£4,232	£4,165	£4,095	£4,050
£30,000	£7,232	£7,165	£6,895	£6,850
£40,000	£10,079	£9,835	£9,675	£9,650
£50,000	£14,179	£13,935	£13,580	£13,369
£50,000+		+ 41% of excess in each year		

In addition to the above taxes, most self-employed earners also have to pay Class 2 National Insurance, which is increasing from £2.10 to £2.20 per week from 6th April 2007.

Landlords

For those whose income is derived solely from rental income, the tax burden over the next few years will be as follows:

Rental Profits	Tax 2006/2007	Tax 2007/2008	Tax 2008/2009	Tax 2009/2010
£10,000	£834	£783	£925	£893
£20,000	£3,034	£2,983	£2,925	£2,893
£30,000	£5,234	£5,183	£4,925	£4,893
£40,000	£7,734	£7,414	£6,925	£6,893
£50,000	£11,734	£11,414	£10,730	£10,306
£50,000+		+ 40% of excess in each year		

Remember that National Insurance Contributions are not due on rental income.

Pensioners

As explained above, there are some extra increases in allowances on the way for pensioners. Using the same principles as outlined above, the projected tax burden over the next few years for an unmarried pensioner aged between 65 and 74 is as follows:

Pension Income	Tax 2006/2007	Tax 2007/2008	Tax 2008/2009	Tax 2009/2010
£10,000	£340	£271	£210	£158
£20,000	£2,540	£2,471	£2,210	£2,158
£30,000	£5,234	£5,183	£4,925	£4,893
£40,000	£7,734	£7,414	£6,925	£6,893
£50,000	£11,734	£11,414	£10,730	£10,306
£50,000+		+ 40% of excess in each year		

Tax Credits

Modest inflationary increases are to be made to the main elements of the Working Tax Credit and Child Tax Credit. The family element of £545 and 'baby addition' of £545 are, however, unchanged. Also unchanged are the two main income thresholds at which tax credits start to be withdrawn. For most families with combined household income of over £50,000 this therefore amounts to stealth taxation as inflationary forces will erode the value of the Tax Credits available.

For example, a family with household income of £55,000 in 2005/2006 will receive a tax credit of £212 during 2006/2007. Simply to keep pace with inflation, the same family will need income of £56,980 in 2006/2007 but would then receive a tax credit of only £80 during 2007/2008.

Further ahead, the income threshold at which working tax credit begins to be withdrawn is to be increased from £5,220 to £6,420 from 6th April

2008. However, what the Chancellor gives, he can also take away, as the withdrawal rate will also increase from 37% to 39% from the same date.

Corporation Tax

Gordon Brown can't seem to leave Corporation Tax alone. He brought in a 10% band in 2000, reduced it to a nil rate band in 2002, got cold feet and introduced a penalty on dividends paid by small companies in 2004, in 2006 he decided to put things back how they were and now, in 2007, he has made further major changes.

The main rate of Corporation Tax for large companies with annual profits in excess of £1.5M will reduce from 30% to 28% with effect from 1st April 2008. (This, and all the other Corporation Tax and capital allowances reforms proposed in the Budget will not apply to companies operating in the North Sea 'ring fence' regime.)

"Great", you're saying, another tax cut. "Not so fast", I say.

Yes, sure, large companies will be paying less Corporation Tax, but small companies with annual profits of £300,000 or less are to pay more.

The rate of Corporation Tax applying to companies with annual profits of no more than £300,000 is to increase from the present rate of 19% to 20% from 1st April 2007, then 21% from 1st April 2008, and then 22% from 1st April 2009. In all, this will produce a 16% increase in the total Corporation Tax bill paid by the vast majority of companies in the UK.

So, whilst the Chancellor's friends in bug business can celebrate their tax cut, the vast majority of hard-working small company owners in the UK are being asked to pay for it with a 16% tax increase!

For companies with profits between £300,000 and £1.5M, there is an effective marginal rate band, which is currently 32.75%. The following table sets out the effective Corporation Tax rates over the next few years:

Company Profit Band:	2006/2007	2007/2008	2008/2009	2009/2010
Up to £300,000	19.00%	20.00%	21.00%	22.00%
£300,000 to £1.5M	32.75%	32.50%	29.75%	29.50%
Over £1.5M	30.00%	30.00%	28.00%	28.00%

The total Corporation Tax payable at various levels of profit will be as follows:

Company Profits:	2006/2007	2007/2008	2008/2009	2009/2010
£50,000	£9,500	£10,000	£10,500	£11,000
£100,000	£19,000	£20,000	£21,000	£22,000
£300,000	£57,000	£60,000	£63,000	£66,000
£500,000	£122,500	£125,000	£122,500	£125,000
£1,000,000	£286,250	£287,500	£271,250	£272,500

As we can see, smaller companies with profits not exceeding £300,000 suffer a steady tax increase, whereas a medium-sized company with profits of £500,000 fluctuates around the existing level of Corporation Tax, with little overall change and the larger company with profits of £1M gains from the proposed changes.

The situation for very small companies with annual profits under £50,000 is worst of all, as these companies have only just lost the nil rate Corporation Tax band, which was abolished on 1st April 2006, and now face the further increases proposed over the next three years.

For example, a small company with an annual profit of £20,000 and which pays dividends of £10,000 each year, would have annual Corporation Tax bills over the period from 2003/2004 to 2009/2010 as follows:

	Tax
	£
2003/2004	£2,375
2004/2005	£3,088
2005/2006	£3,088
2006/2007	£3,800
2007/2008	£4,000
2008/2009	£4,200
2009/2010	£4,400

He's no Robin Hood our Chancellor, it seems that he's robbing the poor to feed the already rich!

Each of the above three tables are based on a single company with no associated companies.

Capital Allowances

A large number of reforms to the system of capital allowances claimed by businesses are proposed, as follows:

- The 50% first year allowance for qualifying expenditure by small businesses will continue for 2007/8.
- From 2008/9 onwards, small and medium-sized businesses will be eligible for a 100% first year allowance on the first £50,000 of eligible expenditure each year.
- The rate of writing down allowance on plant and machinery will reduce from 25% to 20% from April 2008.
- Writing down allowances on long-life assets increase from 6% to 10% from April 2008.
- Industrial and Agricultural Buildings Allowances are to be phased out by 2010/11.
- Certain defined fixtures and fittings within commercial buildings will be eligible for an annual writing down allowance of just 10%.
- A payable tax credit (i.e. money back) will be given for expenditure on certain 'green' technologies.

Property Taxation

Some useful improvements to the Landlord's Energy Saving Allowance are to be introduced with effect from 6th April 2007, as follows:

- Floor insulation is to be added to the list of eligible expenditure.
- The £1,500 annual expenditure limit is to apply per property rather than per building. This is very useful for landlords owning flats, as each flat will now qualify for up to £1,500 of relief annually.
- The relief, which was due to end in 2009, will be extended to 2015.

It is also proposed that the relief will be made available to landlord companies at some future date when our Government has finally got permission from Brussels!

The business premises renovation allowance, originally proposed in 2005, will finally come into effect from 11th April 2007. This allowance will give immediate 100% relief for expenditure on the renovation or conversion of vacant property in disadvantaged areas which is then brought back into business use. The property must have been vacant for at least a year and certain types of business use are excluded from the relief.

Conversely, commercial property left vacant for 6 months will lose business rate relief. The permitted vacant period is reduced to just 3 months for offices and retail premises.

The owners of a company which exists solely to hold a private residence overseas will be exempt from any benefit in kind Income Tax charge in the UK on their personal use of the property. This measure is to be given retrospective effect meaning that the Revenue should now refrain from attempting to collect any tax in these circumstances. Certain conditions must be met to qualify for the exemption and it is worth remembering that foreign taxes may still arise in these circumstances.

For a five year period from 1st October 2007, new homes costing no more than £500,000 and meeting the 'zero carbon' standard, will be exempt from Stamp Duty Land Tax. For more expensive houses, there will be a £15,000 reduction in the tax.

A new framework is being set out to govern the taxation of Authorised Investment Funds investing in property.

The VAT rate on qualifying housing alterations for elderly homeowners will be cut from 17.5% to 5%.

Cars and Fuel

- The rate of writing down allowances on cars owned by companies and/or used for business will be based on CO2 emissions rather than price from unspecified future date.
- A 2% discount will be given on the rate of company car tax for cars running on high blend biofuel from April 2008.
- Car tax will increase by £5 each year for the next three years for most cars. The 'cleanest cars' (not exceeding 120g/km of CO2) will get a reduction to £35 but, for the 'dirtiest' cars (over 225g/km of CO2) tax will increase to £400.
- Car tax rates for diesel and petrol cars are to be aligned at the same level.
- Fuel duty will go up by 2p per litre in October 2007 and again in April 2008.
- Fuel scale charges for private use of cars owned by businesses for VAT purposes are in future to be based on CO2 emissions rather than engine capacity. The changes to the scale are broadly neutral overall, but there will inevitably be both winners and losers.

VAT

- The VAT registration threshold increases from £61,000 to £64,000.
- VAT on anti-smoking products will be reduced to 5% for one year from the commencement of the smoking ban in England on 1st July 2007.

- The Chancellor proposes to reduce VAT on qualifying energy saving equipment to 5%.

Other Changes In Brief:

- The CGT annual exemption increases from £8,800 to £9,200.
- The Inheritance Tax nil rate band, already announced for 2007/8 to 2009/10 will increase further to £350,000 from 6th April 2010.
- The 10% dividend tax credit currently applying to UK dividends is to apply to foreign dividends also from 6th April 2008. The credit is withdrawn, however, if the recipient owns 10% or more of the paying company's shares or receives foreign dividends totalling more than £5,000 in the year.
- The National Minimum Wage increases to £5.52 per hour from October 2007.
- A new tax penalty regime is to be introduced from 2009.
- From 2008, the self-assessment filing deadline will be brought forward to 31st October for paper returns, but remains 31st January for returns filed online.
- Businesses are to be forced to file tax returns and pay tax liabilities online. These measures will affect PAYE from 2009, VAT from 2010 and Corporation Tax from 2011.
- The annual investment limits for Individual Savings Accounts ('ISA's') will increase to £3,600 for cash and £7,200 for shares and securities (also the overall limit) from 6th April 2008.
- New rules will block relief for capital losses which do not arise on genuinely commercial transactions from 6th December 2006 onwards. An example might be a man selling a dilapidated property to a friend at a deliberately reduced price.
- Landfill Tax on 'active waste' will increase from £21 to £24 per tonne from 1st April 2007, with further increases of £8 per tonne each year until at least 2010/11, giving a rate per tonne of £48 by 6th April 2010. The rate on inactive waste increases to £2.50 per tonne from 1st April 2008. These increases will affect the entire UK economy.
- Managed Service Companies which operate to bring a number of sole traders under one umbrella in order to avoid the 'IR35' regime are to be penalised. In future, each of the participating traders will be taxed as if they were an employee of the company, with PAYE and National Insurance being deducted directly from their income at source. The Revenue will also have powers to collect the tax due from the company's directors, the deemed employees themselves or certain other people connected with the company.

- R&D (research and development) tax credits are to be increased from 150% to 175% and made more widely available.
- Late elections to treat 'pre-owned assets' as still being in the donors estate, thus avoiding the Income Tax charge, are to be allowed.