



2004 Pre-Budget Report Summary

Chancellor Gordon Brown presented his Pre-Budget Report on Thursday 2 December. The speech itself may have seemed short on content but as ever, the devil was in the detail of the accompanying Press Releases and other documents. In particular, corporation tax reform, which has been in the pipeline for some considerable time, was the subject of a detailed technical note. We have outlined the proposals for you. In addition there will be consultation on a single tax return to bring together all small business taxes.

One announcement sure to cause upset is the possibility of retrospective legislation being used in the future to block tax schemes! Our summary covers this and the raft of other measures announced in the speech.

Please contact us if you would like to discuss anything in more detail or take action on any of the points raised.

PERSONAL TAX

Rates

The income tax rates and bands for 2005/06 were not announced in the Pre-Budget Report. Details of these are normally made available in the main spring Budget.

Allowances

The Chancellor confirmed the level of income tax allowances for 2005/06. The personal allowance for those aged under 65 is increased in line with inflation to £4,895 for 2005/06. Personal allowances for those aged 65 and over will be increased in line with earnings.

Child Tax Credit

The Child Tax Credit which is means tested is potentially available to families who have responsibility for one or more children. The credit is paid direct to the main carer. There are several elements to the credit but broadly the maximum is an annual amount for 2005/06 of £1,690 per child together with a family element (one per family) of £545 per annum. The amount per child has been increased but the family element has been frozen since the introduction of the credit.

Some credit is likely to be payable for 2005/06 if a family's income is less than £58,175 a year, or £66,350 if there is a child under one year old.

Working Tax Credit

The Working Tax Credit (WTC) was introduced in April 2003 to reward the work of people on low incomes whether or not they have children. It also provides working families with assistance to meet the costs of childcare. The annual income threshold for 2005/06 is £5,220 (up from £5,060 in 2004/05) with a reduction of 37p for every extra £1 of income. The basic maximum benefit is increased for 2005/06 to £1,620.

Childcare costs continue to form part of the WTC calculation at a rate of 70% of eligible costs up to a maximum of £175 per week (£300 if two or more children). This element is paid with Child Tax Credit. Although the limits were frozen for 2004/05 they have been significantly increased for 2005/06. In his speech the Chancellor referred to the percentage of costs covered rising from 70% to 80%. The Press Release confirms that this will not happen until 2006/07.

Child Trust Fund

The Child Trust Fund (CTF) is being introduced for all children born from September 2002. The government will provide an initial award of £250 (£500 for children from low-income families who also qualify for full Child Tax Credit). A child will be eligible for a CTF account if Child Benefit has been awarded for them and they are living in the UK. If these conditions are met the award is made automatically with no need to make a separate application.

Vouchers will be sent to the Child Benefit claimant and should be used to open a CTF account when they become available in 2005.

A further payment will be made to every child for its seventh birthday, again with a higher payment to children from families on lower incomes. The government will now consult on the level of the further payment and is proposing it should also be set at £250 with children from low-income families receiving £500. There will be no need for a child's parents or guardian to make a separate claim for the top-up at age seven. The payments will be made directly into the child's CTF account.

Family and friends of the child can make additional contributions of up to £1,200 a year between them.

The income and gains in the CTF will be tax-free and may be accessed by the child at age 18.

There will be different sorts of accounts available, including cash deposit accounts, unit trusts, life products and a CTF account which will be a low-cost equity account.

Many new parents will welcome the introduction of a tax-free savings mechanism for their children. However those with children born before September 2002 lose out.

Civil Partnership Act

The Civil Partnership Act which gives legal recognition to same-sex couples received

Royal Assent in November. However the Act is not likely to come into effect for about a year. The Act will allow same-sex couples to make a formal legal commitment to each other by entering into a civil partnership through a registration process. A range of important rights and responsibilities will flow from this including legal rights and protections.

The Pre-Budget Report confirms that the tax consequences of the Civil Partnership Act will be dealt with in the 'first available' Finance Bill. For tax purposes, registered same-sex couples will be treated in the same way as married couples.

Pensioners

The Chancellor has announced various increases in respect of benefits for pensioners:

- the basic state pension will rise to £82.05 for single pensioners and £131.20 for couples from April 2005
- the guarantee element of Pension Credit will increase to £109.45 for single pensioners and £167.05 for couples from April 2005
- the government will make a payment of £50 in addition to the existing winter fuel payment and council tax benefit to households with someone over age 70 in 2005.

Pensions

The maximum earnings for which tax allowable pension contributions can be made is increased from £102,000 to £105,600 from 6 April 2005.

ISAs

When ISAs were introduced in 1999 they were guaranteed to run for ten years to 2009. Currently the overall annual investment limit is £7,000 with a maximum of £3,000 in cash and this was guaranteed to run until the end of 2005/06. The government now plans, subject to consultation, to further extend the existing limits until 2009.

Charitable giving

In 2004, around 530,000 employees gave £85 million to charity through Payroll Giving, with one in five employees having access to a Payroll Giving scheme. The Home Office has launched an incentive scheme to encourage more of the UK's 12 million employees in small and medium-sized enterprises (SMEs) to give to charity. The scheme works in two parts:

- SMEs will receive a grant of up to £500, depending on their size, when they establish a scheme and
- the government will match each employee's donation pound-for-pound, up to a

maximum of £10 per month for six months, from when the employee signs up.

To encourage additional Gift Aid donations, the scope of the exemption which allows for the right of free admission to be disregarded as a benefit, will be expanded to allow more types of charities to benefit. In addition, the exemption will be amended, with effect from April 2006, so Gift Aid will apply where the donation is at least 10% more than the normal admission charge, or where the donation results in the unlimited right of admission for a period of not less than 12 months.

Shari'a compliant financial products

The government recognises that individuals and businesses wish to have access to financial products that comply with Shari'a Law. They welcome the progress that has been made in developing suitable products and the contribution that these developments will make to the financial sector, and to the opportunities available for both business and personal customers. The government is consulting on how to encourage further innovation and ensure that tax does not create an impediment to the development of new products in this area, and is considering legislative options for the 2005 Finance Bill.

EMPLOYMENT ISSUES

National Insurance Contributions

The detailed NIC rates, earnings limits and thresholds proposed for 2005/06 are set out below. The thresholds have been increased but the rates of Class 1 and 4 contributions have been held at their existing levels.

National insurance rates		
	2005/06	2004/05
Employees' threshold	£94 pw	£91 pw
Employers' threshold	£94 pw	£91 pw
Upper earnings limit – employees only	£630 pw	£610 pw
Employees' Class 1 rate on earnings between threshold and upper earnings limit	11%	11%
Employees' Class 1 rate on earnings above upper earnings limit	1%	1%
Employers' Class 1 rate on earnings above threshold	12.8%	12.8%
Class 2 – self-employed flat rate	£2.10 pw	£2.05 pw
Class 2 – small earnings exception	£4,345 pa	£4,215 pa
Lower profit limit (for self-employed Class 4 contribution)	£4,895	£4,745
Upper profits limit	£32,760	£31,720
Class 4 rate on profits between lower and upper profits limit	8%	8%
Class 4 rate on profits above upper profits limit	1%	1%
Class 3 – voluntary	£7.35pw	£7.15pw
Note		
Although employees' NICs only become payable once earnings exceed £94 per week, any earnings between £82 and £94 per week in 2005/06 will protect an entitlement to basic state retirement benefits without incurring a liability to NIC.		

Childcare

Measures related to childcare formed the cornerstone of the Chancellor's Pre-Budget speech under the banner of 'a ten year strategy for childcare'.

Much had been made of the government's plans to extend maternity leave and pay ahead of the Pre-Budget Report. The government announced a goal of 12 months paid maternity leave transferable from mother to father. However the first step will be an extension of the current entitlement of 26 weeks to 39 weeks from April 2007. Furthermore the rate of Statutory Maternity (and Paternity) Pay will be increased to £106 a week from April 2005.

Plans were announced to ensure an out of school childcare place for all children aged three to 14 between the hours of 8am and 6pm each weekday by 2010. Free early education will also be extended with a goal of 20 hours free care per week for 38 weeks for all three and four year olds, with a first step of 15 hours a week for 38 weeks by 2010.

In addition the new rules on employer provided childcare previously announced and taking effect in April 2005 were confirmed.

Currently employees are exempt from both tax and NICs where an employer provides a place in a workplace nursery. In addition childcare vouchers and childcare arranged by the employer are specifically exempt from NICs. The new measures taking effect in April 2005 include:

- a new tax exemption to cover any formal registered childcare or approved home childcare contracted by the employer such as a local nursery, out of school club or childminder

- a tax exemption for childcare vouchers
- a rule that where schemes operate they should be open to all employees.

The new exemption will cover the first £50 per week and will apply for both tax and NIC purposes.

Company car tax

Currently a company car is taxed according to the level of CO₂ emissions. If the car has a diesel engine there is a 3% supplement unless the car meets the Euro IV emission standards in which case the

supplement is waived. From 6 April 2006, the waiver will cease for cars registered on or after 1 January 2006. The waiver was introduced to encourage early take up of Euro IV technology and has achieved that purpose. Euro IV emission standards will become mandatory for all new diesel cars registered from 1 January 2006. The waiver will be retained for the life of diesel cars that meet the Euro IV standards and were registered before 1 January 2006.

Researchers acquiring shares in spin-out companies

Universities and public sector research establishments which own intellectual property (IP) often develop that IP further through companies created in association with the researcher from the institution who worked on the project. The shares in the spin-out company held by the researcher increase in value on introduction of the IP into the spin-out which creates an immediate income tax and NI charge on the value of the benefit before cash is available to meet the bill. This has significantly reduced the creation of new spin-out companies.

The government will introduce legislation effective from 2 December 2004 to remove the income tax and NI charge if certain conditions apply. A Technical Note has been issued to enable consultation.

BUSINESS AND CORPORATION TAX

Corporation tax reform

A Technical Note takes forward the government's commitment in this year's Budget to publish further legislative proposals on the reform of corporation tax, following the two measures (extension of relief for management expenses and reform of the rules on transfer pricing and thin capitalisation) included in Finance Act 2004. The note covers topics addressed in previous consultation documents:

- the reform of the schedular system for companies
- the tax treatment of capital assets
- the taxation of leasing transactions
- the tax differences between trading and investment companies.

Schedular reform

There are proposals to modernise the schedular system for companies, including draft legislation. The changes would create a new source of income, with a single set of basic computational rules and a single set of loss relief rules, for the whole of a company's 'operating business'. The operating business would include trading income and expenses,

letting income and expenses, and certain items of miscellaneous income currently within Schedule D Case VI. This would provide a more generous treatment for losses than currently available but will be balanced with provisions to prevent avoidance. In addition, changes would be made to the way tax relief is given for payments currently treated as 'charges'.

Taxation of capital assets

As announced in Budget 2004, the government has concluded that capital allowances should be retained, rather than being replaced by relief for commercial depreciation, but continues to consider ways in which the system could be modernised. For example, complex provisions are required so that the capital gains and capital allowance regimes can operate together on one transaction. A new regime could remove these complexities by providing that profits and losses on the disposal of plant and machinery assets are dealt with solely through the capital allowances regime. The note includes options to modernise the capital allowances system for cars (eg removing the need to track separately each car costing more than £12,000 by pooling the expenditure and giving a writing down allowance lower than the normal 25%).

Leasing of plant and machinery

The current tax rules treat loan finance and leasing finance differently even though the commercial effect – that the business uses the asset while another party finances its purchase – may be virtually the same. The government wants to ensure that the choice between different forms of finance is driven by commercial rather than tax considerations. The government has therefore decided to reform the system and has produced draft legislation. The proposal is that an asset defined in the legislation as a 'long funding lease' will be treated in broadly the same way as an asset that is purchased with a loan.

Trading and investment companies

There are a number of differences in the tax treatment of trading and investment companies both within the company and for shareholders. The proposals on schedular reform are a step forward in reducing these distinctions, bringing trading income and property investment income within the same 'operating business' source.

A further issue, highlighted by business, was the current scope of the substantial shareholdings exemption introduced in Finance Act 2002. In the light of the responses received, the government will continue to consider the case for extending the exemption to disposals by shareholding companies that are not within the definition of a trading company (or a trading group). But no changes are contemplated at the present time.

New small business unit at HM Revenue and Customs

The Commissioners for Revenue and Customs Bill which will provide the authority to integrate the Inland Revenue and HM Customs & Excise and create HM Revenue and Customs (HMRC) was introduced to Parliament on 25 November. The Chancellor announced his decision to create HMRC in Budget 2004.

Details of a new small business unit of HMRC have been announced. It will be charged with improving customer experience and compliance as well as reducing costs – for both businesses and HMRC.

The long term goal for HMRC is to enable its support and compliance staff to take a 'whole view' of each customer, by providing:

- joined-up systems so that a business needs to provide information only once, where possible through a single form
- integrated audits covering direct and indirect taxes
- a single account through which all payments and repayments may be made.

As a first step the Inland Revenue and Customs and Excise will now begin consulting on the scope for a single tax return that would bring together all small business taxes.

Proposed Business Premises Renovation Allowance (BPRA)

In their aim to raise investment in Enterprise Areas the government has issued a consultation document in respect of a BPRA scheme.

This scheme would provide 100% first-year capital allowances for costs of converting or renovating business property in Enterprise Areas. To qualify, the property:

- must be in a designated disadvantaged area
- may be owned or leased
- must have previously been unused for 12 months
- and the costs must be incurred in order to bring it back into business use.

The allowance will be given through the normal capital allowances system and is due to be introduced in 2005 subject to State Aid approval. It will run for five years from the date of introduction.

Small businesses – discussion paper

The government is keen to encourage the growth of small businesses. It recognises that they should have flexibility in their choice of business structure.

However earlier this year the government introduced the much publicised 19% minimum rate of corporation tax on profits distributed to non-corporate shareholders. In the government's words this was to address its 'concerns about the increasing numbers of self-employed individuals adopting the corporate legal form for tax reasons rather than as a step to growth'. The government intends to monitor this area to ensure that its objectives for the tax system continue to be met.

The discussion paper is intended to invite comments on the strategic development of the personal and corporation tax regimes as they relate to small businesses.

Property Investment Fund

Budget 2004 announced the launch of a consultation on the most appropriate structure for a new Property Investment Fund, a UK version of the successful US Real Estate Investment Trusts. The aim of such a fund would be to encourage more efficient investment in property and help to boost the private rented sector.

Following consultation, the government continues to believe that tax reform in this area has the potential to improve the efficiency of the property market. However there will not be legislation in 2005 but a discussion paper will be issued in time for the 2005 Budget.

Community Amateur Sports Clubs (CASCs)

Following a review launched in the 2003 Pre-Budget Report, the Inland Revenue will now work with Supporters Direct to provide guidance and dedicated support for Football Supporters' Trusts to set up charities or CASCs to run their community activities, and to help them take advantage of the range of tax reliefs available to such bodies.

Common commencement dates for legislative changes

Following the success of the DTI pilot for employment law, the government will now extend common commencement dates. It will start with health and safety, company and consumer legislation in 2005. The effect will be to limit the dates when regulatory changes can be made. New regulations in these areas will in future be introduced on two dates each year, 6 April and 1 October, unless there are exceptional reasons for not doing so.

International Accounting Standards

Some companies will adopt International Accounting Standards from 1 January 2005. The government has considered the transitional adjustments arising from the changes and will defer any tax effects arising until the impact can be determined and managed.

Anti-avoidance measures

A number of measures have been announced aimed at tackling fraud and avoidance. Some of these measures arise from the disclosure of tax scheme rules introduced in Finance Act 2004 to provide early warning to the Inland Revenue and Customs and Excise of schemes.

Schemes which have been blocked with effect from 2 December 2004 include:

- schemes which seek to sidestep the rules that deal with rewards paid to employees in the form of shares and other securities
- schemes used by companies to avoid tax on debt securities by manipulating 'repo' and stock lending arrangements
- measures to end abuse of tax reliefs for qualifying British films

- schemes which create capital losses for CGT by the exercise of options at uncommercial prices
- measures blocking specific VAT schemes.

In addition, the Paymaster General has announced that retrospective legislation may be used to stop other tax schemes arising in the future which attempt to avoid rewards to employees being taxed. When the government becomes aware of such arrangements, it will introduce legislation to close them down, effective if necessary from 2 December 2004.

Environmental measures

There were a number of announcements in this area in the Pre-Budget Report including:

- the forthcoming launch of the UK climate change programme consultation
- the launch of a joint Energy Efficiency Innovation Review with Defra
- continuation of the freeze on the main road fuel duties
- narrowing of the duty differential between rebated oils and main road fuels by 1p per litre
- measures to help the development of biofuel
- plans to align the VAT fuel scale charge with the company car benefit charge.

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