

Update 2 – 8 March 2001 – Budget Special

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Gordon Brown, the Chancellor of the Exchequer, delivered his 5th Budget speech yesterday, 7 March 2001. This briefing is intended to outline the main points as they impact upon our clients from the point of view of direct taxes, VAT and sundry measures.

As far as businesses and high net worth individuals are concerned – and these are the core of our client base – the budget can really be summarised as “so what?”. If this budget was a computer program it would be sold as “budget-lite 2001 family pack” - a package of vote catching measures for New Labours core voters with minimal impact upon a typical Garbetts client. The lightness of the budget is emphasised by the low number of press releases and briefing notes being issued by the Treasury. Clearly a short Finance Bill is anticipated in advance of an early General Election – quite possibly Blair will now follow John Majors example in 1992 and call the election within days.

This briefing is only intended to be an overview of the relevant measures. Before taking or refraining to take any action based on the contents of this briefing you should discuss the matter with us for specific advice. This briefing only covers points likely to be of interest to our clients – it is not comprehensive.

Economic Background

Gordon Brown claims credit for a strong economy:

- Growth 3%, higher than predicted
- Inflation running at 2.1% - within the 2.5% target
- Long term interest rates in line with Europe and US
- Business investment increased to 14% of national income.
- Unemployment lowest for 20 years
- Budget surplus now forecast at £23bn for 2000-01 compared to a £14bn forecast for the same period a year ago
- Reduction in Government Borrowing (PSBR) – debt repayments of £34bn this year
- Increased public expenditure by 3.7% real terms by 2003/04

Doubtless there is an element of spin on these figures – this close to an election, indeed at any time, that is inevitable, but spin aside it is clear the economy is stronger than many, including the Treasury, thought it would be.

But can Gordon Brown take credit for this? Has the Labour treasury team created this prosperity, or simply been stewards of it? Indeed has this prosperity been in spite of the government and not because of it – many of our clients are reporting that its near to impossible to increase prices in the retail or service sectors, and the only route to small business prosperity is harder work than ever. Business owners say they are working more hours than ever, have more labour supply difficulties, more red tape and are seeing more stealth taxes being levied.

Indeed is the budget surplus wholly or partly because of the stealth taxes introduced? Abolition of tax credit refunds from pensions, PEPs and ISAs; IR35; increases in fuel duty; removal of MIRAS; abolition of Married Couples Allowance – the list goes on.

Yes, the economy is in good shape. But, No, Gordon Brown cannot take the credit for this just yet. If the Labour Government achieve another full term in office then the end of that parliament will be the time when bold claims of fiscal excellence can be made – for now they are riding the coat tails of the economic cycle.

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Income Tax

- Increases to personal allowances and 10% tax band. No change to tax rates.

- Allowance rates:

		2000/01 £	2001/02 £
Personal allowance	under 65	4,385	4,535
	65 – 74	5,790	5,990
	75 and over	6,050	6,290
Income limit for age related allowances		17,000	17,600
Married couples allowance	born before 1935	5,185	5,365
	age over 75	5,255	5,435
Childrens tax credit		nil	5,200

- Tax rates

	2000/01 £	2001/02 £
10%	£0 - £1,520	£0 - £1,880
22%	£1,521 - £28,400	£1,881 - £29,400
40%	over £28,400	over £29,400

Dividends falling into the 22% band are taxed at 10% to tie in with the tax credit given under corporation Tax rules. Dividends falling into the 40% band are taxed at 32.5% with a 10% credit - this creates an equivalent tax charge of 40% when the 10% tax credit is taken into account.

Savings income (non dividends) falling into the 22% band is taxed at 20% to tie in with the tax credit given. Savings falling into the 40% band is taxed at 40% with a 20% credit.

- New regime for averaging the profits of authors and artistes.
- Partial reform of Inland Revenue Authorised Mileage rates (IRAM) (also known as FPCS – fixed profit car scheme) – increases in the rates for the lower two mileage bands to 45p p/m on the first 4000 miles per year and 25 p p/m afterwards. This mean the bands will now be:

Engine size	> 1500 cc	1500 >2000cc	2000cc +
>4000 miles	40p pm	45 p pm	63 p pm
4000 miles +	25p pm	25 p pm	36 p pm

From April 2001 the two higher rates will be abolished and the 40 p p/m and 25 p p/m rates will apply regardless of engine size.

Use of cycle for work can be paid at 12p p/m (20 p p/m from 4/2002)

Use of motorcycle for work can be paid at 24p p/m

Carriage of passengers in car can be paid at 5p p/m from 4/2002

Capital Gains Tax

- Annual exemption rises to £7,500 from £7,200. No change to rates. CGT is added onto other income and taxed at Income Tax rates – 10%/20%/40% according to income band.
- No changes to taper relief rules except enhanced allowances for minority employee shareholders in non trading companies.

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National Insurance

- No changes reported in the budget
- Rates 2000/01

Class 1	Employers	11.9% on earnings above £87 per week No upper threshold
	Employees	Earnings up to £72 per week – exempt Earnings £72 to £87 per week – 0% (no NI due, but still get a benefit entitlement) Earnings £87 to £575 per week – 10% Earnings over £575 per week – no further charge
Class 2	Self employed	£2 per week. Small earnings exception £3,955 pa
Class 3	Voluntary	£6.75 per week.
Class 4	Self Employed	7% of business profits between £4,535 and £29,900 pa

Corporation Tax

- No change to main rates. For 2001-02 these are:

Profits	> £10,000	10%	(the 22.5% band claws back the 10% starting rate by the time profits reach £50k)
	£10,000 - £50,000	22.5%	
	£50,000 - £300,000	20%	
	£300,000 - £1,500,000	37.5%	
	£1,500,000 +	30%	

- New regime to be introduced to give tax relief for expenditure on intellectual property – principally goodwill (this will only apply to Companies, not individuals/partnerships).

VAT

- No change in basic vat rate.
- VAT refund scheme for museums allowing free entry.
- Changes to zero rate cycle helmets, reduce vat on car child seats, and change rules relating to zero rating of childrens clothing.
- Zero rating threshold for passenger transport reduced from 12 seat vehicles to 10 seat vehicles.
- Increase in upper limits for annual accounting scheme and cash accounting scheme to £600k from £300k – compulsory withdrawal threshold now £750k.
- Increase in registration threshold to £54,000 (was £52,000) and de-registration threshold to £52,000 (was £50,000) from 1 April 2001.
- Reduced vat rate on urban regeneration measures – renovation of houses empty for three years or more; conversion of a residential property into flats; conversion of a commercial property to residential.
- Consultations on an optional flat rate vat scheme for businesses with a turnover of £100k or under – vat would be paid as percentage of sales rather than on a strict calculation of outputs and inputs.

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Inheritance Tax

- Increase in threshold to £242k from £234k.
- Rate remains at 40%. No changes to reliefs.

Stamp Duty

- Stamp duty on property sales unchanged.

Excise duties

- Vehicle Excise Duty (Road Fund Licence) – frozen for cars, reductions for lorries and abolished for tractors.
- No increases on petrol and diesel - reductions in duty on ultra-low sulphur petrol, and temporary reductions on all fuel pending national availability of ultra-low sulphur fuels.
- Alcohol duties frozen; tobacco increased.
- Reform of duty regime for betting and gaming.

Business Measures

- Proposal to align financial accounting policies with tax accounting policies for small businesses (turnover less than £2.8m, less than 50 employees) so that the tax charge would be based on the accounts. In theory this does away with the need for tax computations to adjust accounting profit to taxable profit, but in reality the impact of this change will be minimal in most instances. In particular the Inland Revenue state they wish to retain the benefit of targeted reliefs such as 100% capital allowances for IT investment, 40% initial capital allowances and R&D tax credits – these items cannot be included in financial accounts outright so an adjustment schedule would still be required.
- R&D Tax Credits to be extended to large firms as well as small firms.
- Extension of film tax relief – something for the budding Spielburgs out there!
- Extension to reliefs for employee shareholdings via Enterprise Management Initiative (EMI) and All Employee Share Ownership Plans (AESOPs). Lightening of rules on CGT taper relief for employee shareholders without material interests.
- Increase in exemption for business gifts to £50 from £15 – gifts of below £50 can be given away without a deemed supply arising which needs to be accounted for in terms of Income Tax or VAT.
- Technical amendments to Self Assessment legislation to facilitate easier resolution of enquires and disputes.
- 100% capital allowances on converting space above commercial premises to residential use.
- Accelerated tax credits for cleaning contaminated land.

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Family Measures

- Increase in Working Families Tax credit and Childrens Tax Credit and Child Benefit.
- Increase in National Minimum Wage to £4.10 per hour from October 2001, and provisionally £4.20 per hour from October 2002.
- Measures to help the long term unemployed back to work (as contained in every budget since politicians were conceived).
- Increases in Maternity and Paternity entitlements and allowances – entitlement to 26 weeks paid maternity leave and two weeks paid paternity leave (costs normally reimbursed to smaller employers by Social Security system as before) – these changes do not apply till 2002 or 2003, well into the life of the next parliament (hence they will be a manifesto pledge by the Labour party)
- Increases in Social Security benefits and entitlements for families and pensioners.

What was missing?

- A surprising omission from the budget yet again is mention of any major reform of Inheritance Tax – this must be a high priority for a new Labour government
- There were rumours of measures to minimize the impact of IR35 – no such luck for people grappling with this inordinately complicated legislation.

Summary

This budget is lighter and less detailed than most, suggesting an early general election. Most of the business measures are froth rather than substance – they will do little to improve the lot of the hard pressed business suffering from the impact of IR35, National Minimum Wage, CIS, or countless other “Red Tape” initiatives. Gordon Brown is aware of this; depressingly most of his civil servants are not – doubtless many Inland Revenue and VAT staff think they are being generous and helpful to their “customers” – you and I would probably not agree.