



Hugh Davies & Co.
CHARTERED ACCOUNTANTS

Pre-Budget Report 2008 Monday 24 November

Darling takes steps to 'shorten the slowdown'

Set against a backdrop of global economic uncertainty, Chancellor Alistair Darling has announced a raft of measures in this year's much-anticipated Pre-Budget Report that he hopes will stimulate the economy and boost consumer confidence.

Emphasising the wider global recession, and highlighting the crisis in the banking system as the cause of economic slowdown in the UK, the Chancellor announced that borrowing will increase to £78bn this year, and revised his economic growth forecast from 2.5% to 0.75% for 2008.

The Chancellor unveiled an estimated £20bn package of measures supposedly designed to help individuals and businesses to weather the storm. These include a cut in VAT from 17.5% to 15% for a period of 13 months ending 31 December 2009.

The temporary increase in the basic personal tax allowance, worth £120 a year, has also been made permanent, and the tax reduction will rise to £145 in 2009/10. However, after the next election in 2011 those earning in excess of £150,000 a year will be subject to an income tax rate of 45%, and national insurance contributions for employers, employees and the self-employed will also rise by 0.5%.

The Chancellor announced help for businesses, in the form of a postponement of the 1p increase in the small companies rate of corporation tax, new measures allowing businesses to spread the payment of all taxes to HM Revenue & Customs and changes to the loss relief provisions. A temporary small business finance scheme worth £1bn will also be made available, and there will be an increase in the empty property relief threshold.

Other measures announced include: additional support for mortgage holders; early increases in child benefit and the state pension; and a new state supported savings scheme. Meanwhile, duty on fuel, alcohol and tobacco will be increased to offset the reduction in VAT, and new rates of vehicle excise duty will be phased in over time.

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Value Added Tax (VAT)

Changes to the standard rate of VAT

In a move that will affect all businesses registered for VAT, the standard rate of VAT has been cut from 17.5% to **15%**, effective from **Monday 1 December 2008**. On 1 January 2010 it will revert to 17.5%.

Zero-rated supplies, such as basic foodstuffs, children's clothing and books; exempt supplies, such as education and health; and supplies subject to VAT at 5%, such as domestic fuel and power are not affected by this change.

Legislation will be introduced in the 2009 Finance Bill to ensure that businesses are not able to use artificial arrangements to reduce the VAT rate on goods or services to be provided after the VAT rate reverts to 17.5% where there is no current economic activity. Genuine commercial transactions should not be affected.

The measure includes two consequential changes. Firstly, it amends the percentages used in the flat rate scheme for small businesses to reflect the reduction in the standard rate of VAT. Secondly, it introduces a change to the timing of credit notes issued following a change of rate.

Flat Rate Scheme entry rules

With effect from 1 April 2009, the test that requires a business to check that its total income is less than £187,500 for entry into the VAT Flat Rate Scheme will be removed. Instead, eligibility to join the scheme will be determined solely by the taxable turnover of the business, which must be less than £150,000.

Comment

Whilst businesses may appreciate a reduction in the amount of VAT they have to charge many will be concerned by the administrative cost of dealing with the change. Non VAT registered organisations and consumers may also find a reduction in their costs assuming the reduction is passed on. It is debatable whether this measure will persuade consumers to spend.



Measures for business

A wide range of tax and other measures affecting businesses were announced by the Chancellor, with the stated aim of assisting businesses in the difficult economic climate.

Corporation tax: Small companies' rate (SCR)

The Government had planned to increase the small companies' rate (SCR) of corporation tax from 21% to 22% from 1 April 2009. However, this has now been deferred until 1 April 2010.

Legislation will now be introduced in the 2009 Finance Bill to maintain the SCR for all profits, apart from ring fence profits, at 21% from 1 April 2009 and effectively maintain the marginal rate (used to 'smooth' the difference between the main rate of corporation tax and the SCR) at 29.75%. Profits limits will remain the same.

Comment

A welcome measure but companies will be aware that the rate rise will be implemented in the future and if the company makes a loss this will make no difference!

Extension of trading loss carry back

The period for which current trading losses from businesses can be carried back against previous profits is to be extended from the current one year entitlement, to a period of three years, with losses being carried back against later years first.

The amount of losses that can be carried back to the preceding year is unlimited. After carry back to the preceding year, a maximum of £50,000 of the balance of unused losses is then available for carry back to the earlier two years.

This is a temporary measure for one year only. A company may make a loss relief claim under the new rules when it makes its return for an accounting period ending in the period 24 November 2008 to 23 November 2009.

Unincorporated businesses may make a loss claim under the new rules as soon as they have calculated their losses for their basis period for the 2008/09 tax year.

HMRC will make repayments arising from loss relief claims received under the new rules on or after Budget Day 2009.

Comment

This may help businesses recover tax paid from earlier and therefore help cashflow. The announcement does provide an opportunity for businesses to consider maximising their losses by using the new Annual Investment Allowance. The more relaxed rules apply for only one year's results and are limited to £50,000.



Finance for SMEs

The Chancellor announced various measures designed to help SMEs with working capital and investment needs.

Early in 2009, the Government will launch a Small Business Finance Scheme – a new temporary guarantee scheme to enable up to £1 billion of Government supported lending by banks.

The Export Credits Guarantee Department, in conjunction with the banks, will introduce a temporary guarantee scheme to support a £1 billion facility providing smaller exporters with better access to short-term working capital. The Government will also make available a capital fund of £50 million to convert SMEs' debt into equity.

Earlier in November 2008, Advantage West Midlands, a Regional Development Agency (RDA), launched a transition fund for viable SMEs facing financial difficulties. Other RDAs will launch similar loan funds, now totalling £25 million, to help businesses over the next six months.

The Government has said that it 'welcomes the commitment' of UK lenders to approach the European Investment Bank (EIB) to access these funds. Following negotiations between UK banks and the EIB, £1 billion of EIB funds will be available to SMEs in the UK by the end of 2008.

Early in 2009, the Government will launch, in conjunction with Business Link, a new portal to help credit-worthy SME's find suitable financing/support.

Comment

We will need to see the details when they are published early in 2009 before we can assess the effectiveness of these measures.

Empty Property Rate Relief

The Government is temporarily increasing the threshold at which an empty property becomes liable for business rates. For the financial year 2009/10, empty properties with a rateable value of less than £15,000 will be exempt from business rates – exempting an estimated 70% of empty properties.

Interest-free payment schedule for backdated business rates bills

To reduce the cash flow strain on businesses, given current economic difficulties, the Government will legislate to give more time to pay certain backdated business rates bills issued before 31 March 2010. Businesses facing such bills will be able to pay their liability for previous years in equal interest-free instalments over 8 years, rather than immediately. Beneficiaries will include several occupiers of ports who have been affected by recent rating reviews.



Comment

Some commentators had hoped for the rate relief relaxation to apply to all empty properties. An interest free payment schedule will certainly assist businesses affected by backdated rates.

Income shifting

The controversial proposed legislation designed to prevent 'income shifting' will not now be introduced in April 2009.

However, the Government has restated that it 'firmly believes it is unfair' to allow a minority of individuals to benefit financially from shifting part of their income to someone else who is subject to a lower rate of tax.

Comment

This is a welcome announcement on a matter causing much concern to small businesses. There is a hint however that the Government may try again once the economy has recovered and they have discovered a viable method for dealing with it.

Taxation of foreign profits

The Government will bring forward a package of reforms to the taxation of foreign profits, with the object of making the UK a 'more attractive location' for multinational business. Measures will include an exemption from tax for most foreign dividends received by large and medium sized groups, regardless of the level of shareholding. The Government will also continue to examine options for reform of the Controlled Foreign Company (CFC) rules. Any reform will aim to improve the way the CFC rules achieve their objective of taxing profits diverted from the UK.

New Business Payment Support Service

HMRC has introduced a new Business Payment Support Service, which is designed to assist those businesses whose cash flow has been adversely affected by the economic downturn.

The service allows business owners who are concerned about making their tax, national insurance and other payments, to contact HMRC to discuss a range of payment options tailored to their business needs.

The scheme includes a Business Payment Support Line for new enquiries, which is available on **0845 302 1435**, and is open from 8am to 8pm Monday to Friday, and 8am to 4pm at weekends.

Comment

*The service is only for new enquiries **NOT** for amounts that are already late. HM Revenue & Customs has always allowed payment by instalments in cases where taxpayers were in difficulties. Interest will be charged on late tax, but the new scheme will give exemption for late payment surcharges.*



Personal measures

Income tax

Following the compensation arrangements arising from the abolition of the 10% rate band, the Government will make permanent the £600 increase in the personal allowance with a further increase of £130 above indexation, meaning basic rate taxpayers pay £145 less a year in tax in 2009/10.

The basic rate limit for 2009/10 will be increased by £800 above indexation to £37,400 (2008/09 - £34,800).

From 2010/11, those with gross income in excess of £100,000 will lose some or all of their personal allowances. The basic allowance will be scaled back in two stages:

- where gross income is between £100,000 and £140,000, to a minimum of 50%, and
- where gross income exceeds £140,000, the remaining personal allowance will be reduced to nil..

The scaling will be achieved by reducing the allowance by £1 for every £2 by which gross income exceeds the £100,000 and £140,000 thresholds.

Also announced for 2011/12 are new higher rates of tax:

- for those with higher incomes, a tax rate of 45% will apply to savings and non-savings income over £150,000
- a new 37.5% rate of tax will apply to taxable dividend income above £150,000
- the rate of tax for trusts will be increased to 45%, with trust dividend income liable at 37.5%.

Comment

Making the compensation arrangements permanent is an admission that they got it wrong abolishing the 10% starting rate of Income tax. The above inflation increases in personal allowances and the basic rate limit are particularly welcome measures to reduce most taxpayers' tax bills. The sting in the tail for taxpayers with income over £100,000 is the promise of much bigger tax liabilities to come and the increases in national insurance do offset the savings.



National Insurance Contributions

For 2009/10 the Upper Earnings Limit (UEL) for primary Class 1 National Insurance Contributions (NICs) will be aligned with the level at which people start to pay higher rate income tax. The UEL will therefore be £43,875 (2008/09 £40,040). This is equivalent to earning £844 per week (2008/09 £770).

The Class 1 and Class 4 rates of contribution remain unchanged until April 2011.

Class 2 NICs increase by 10p to £2.40 per week and Class 3 voluntary contributions go up by £3.95 to £12.05 per week. The Government is to reduce the burden on the self-employed by aligning the payment dates of Class 2 NICs with those for Self Assessment liabilities. This will reduce the number of bills issued. There will also be improved information to contributors.

For 2011/12, and thereafter, the Chancellor announced an increase of 0.5% to the main NIC rates:

- the Class 1 primary (employee) rate increases to 11.5% on earnings between the primary and upper thresholds and to 1.5% thereafter
- the Class 1 secondary (employer) rate increases to 13.3% on earnings over the primary threshold
- Class 1A and Class 1B NICs will also increase to 13.3%
- Class 4 NICs will increase to 8.5% (1.5% above the upper limit).

Comment

A drawback of the above inflation increase in the basic rate tax threshold is the increase in national insurance due to the upper earnings threshold being raised. Again there is the promise of higher liabilities in the future particularly for higher rate taxpayers who see the national insurance on amounts over the upper threshold increase by 50%!

Pension savings

The limits on annual and lifetime investment have risen each year since 2006/07 and will continue to do so until 2010/11. The Chancellor announced that the limits will stay the same for the following five years – at £255,000 and £1.8 million.

Comment

At this time it is impossible to determine the impact of this freeze. It may be relevant to well funded final salary schemes and a few high earners who want to make substantial pension contributions to avoid the new 45% tax rate.



Child benefit

The Chancellor announced that the increase in child benefit rates due in April 2009 will be brought forward to 5 January 2009.

The weekly rate for the first child will increase to £20, with the rate for other children increasing to £13.20 per week.

Child tax credit

Bringing forward promised increases in CTC, the Chancellor announced that the child element will increase to £2,235 from April 2009, while the disabled child element will increase at the same time to £2,670.

Comment

These are welcome advances of three months in two child related reliefs.

State Pension

The Chancellor announced that although the full State Pension will not rise to £95.25 per week until April 2009, it will make a payment of £60 to pensioners "in the new year", equivalent to bringing forward the rise.

Also, the standard minimum income guarantee in Pension Credit will rise by £5.95 to £130 per week for single pensioners and by £9.10 to £198.45 a week for pensioner couples.

Saving Gateway scheme

A new state supported saving scheme, the Saving Gateway, is to be rolled out nationally in 2010, in a bid to encourage up to eight million low income earners to save money.

Under the scheme, the Government will contribute 50p for every £1 that is saved. A maximum payment of £300 will be made once an account holder has been saving for two years, and the contribution will only be applied for those months in which no withdrawals have been made.

The Saving Gateway will be available through a range of banks, building societies, credit unions, and the Post Office.

Comment

This is another Government scheme to be introduced much later for lower earners. It has been trailed since 2001 and was announced in the budget earlier this year. The scheme is likely to be available to people who receive certain benefits and tax credits that perhaps do not have surplus money to make regular savings.



Mortgages

The Government has said it is committed to supporting households, through:

- increasing the generosity of the Support for Mortgage Interest scheme
- extending the Mortgage Rescue scheme to cover second charge lending
- obtaining a commitment from major lenders not to initiate repossession action until at least three months after an owner occupier goes into arrears
- better access to free and impartial debt advice.

Comment

With many banks now partly owned by the Government it will be interesting to see whether they can ensure that the banks implement these measures

Green measures

Fuel Duty

The Chancellor announced that the reduction in pump prices means the 2p per litre increase on fuel duty will take effect from 1 December 2008. Further increases of 1.84p per litre from 1 April 2009 and 0.5p per litre above indexation from 1 April 2010 will go ahead, as planned.

Comment

The Government appears to be returning to their planned regular increases in fuel duty, although this was linked in the speech to the reduction in VAT.

Vehicle Excise Duty

Six new bands of VED will be introduced in 2009, the Chancellor announced, taking the total to 13. By 2010 the rate bands will start to separate out, with increases of up to £30 that year. Also due in 2010 is the First-Year Rate – the new higher Year One VED rate for new cars.

Comment

The Government are determined to follow through with this measure in the 2008 Budget although responding to pressure from the backbenches the increases will not be significant until 2010.

Air Passenger Duty

New air passenger duty rates will apply from 1 November 2009, based on four distance bands, and increase from 1 November 2010, when the maximum standard rate will stand at £170.

Comment

The new bands are set by reference to the distance from London to the capital city of your destination country at intervals of 2,000 miles. The increase in 2010 is a doubling of the new rates that particularly affect journeys of more than 4,000 miles.



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What they said...

In these exceptional economic circumstances, I want to take fair and responsible steps to protect and support businesses and people now – while putting the public finances on the right path for the future.

Chancellor of the Exchequer, Alistair Darling

Listening to the Chancellor's speech, no one can be in any doubt that the Prime Minister's claim to have abolished boom and bust is one of the biggest deceits ever told to the British public.

Shadow Chancellor, George Osborne

If I were marking the Chancellor's report card, I'd say 'could do better'.

David Frost, British Chambers of Commerce

Many of these measures [...] will give small businesses a welcome breather from the taxman and allow them to concentrate on sustaining their business, supporting their staff and growing the economy in the long term.

John Walker, Federation of Small Businesses