

18 MARCH 2004 - BUDGET 2004 BRIEFING FOR GARBETTS CLIENTS

This is a brief summary of yesterday's budget proposals as they impact upon typical clients of Garbetts – as such it is not intended to be a full exposition of all budget proposals. As always, the comments are general in their nature and professional advice should be obtained before entering into or refraining from entering into any particular course of action.

Wars and Rumours of War

This budget was one of the most anticipated for many years amongst the small business community? Why? A paragraph in the pre budget report in December 2003, known as IR591, "...*The Government will therefore bring forward specific proposals for action in Budget 2004, to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company...*".

After a couple years of a benign régime for small companies following the 2002 reduction in corporate tax rates, the question on everyone's mind was not only "is it all over?", but "could this be an aggressive new tax on all small businesses?" NI on dividends? Removal of dividend tax credit? Investment Income Surcharge (remember that from the 1970s?). A Healesque style "Pip Squeaking" budget attack on small businesses?

Well, what did we get? At face value, very little – a minimum 19% on profits withdrawn as dividend. Annoying? Yes. A partial reversal of previous Government policy? Yes. Loss of face for the Chancellor? Yes. Devastating for small business? No.

But, look again:

- Merger of Inland Revenue and Customs & Excise. On one level a useful cull of some civil service posts? However on the other level a stronger, more coordinated approach to tackling tax compliance? A visit from the tax man or vat man is bad enough, but the stress of having them pour over everything at once?
- The threat of a "discussion paper" on "the issues raised by the interaction with the tax system of definitions of income of self-employment, and the remuneration paid to owner-managers". In other words, they haven't finished with small businesses yet.
- New statutory requirements to register the use of certain – legal it should be noted – tax avoidance schemes with the revenue departments.

So, we have little by way of definite action now, but all the time this tinkering with the tax system and chipping away at avoidance schemes, with new regulations here, forms there, registration requirements, clearances, etc. Any scholar of tax law will be able to quote to you Lord Clyde (*Ayrshire Pullman Motor Services & Ritchie v CIR*) "*No man in this country is under the smallest obligation, moral or other, so to arrange his ... business or ... property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow—and quite rightly—to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Inland Revenue.*"

But, not content with this, we now have a Government policy which can best be described as "Because you're winning you must be cheating, and the law must be wrong to allow this, so we will change the law to make sure we win".

The strap line, Wars and Rumours of War comes from Matthew 24, foretelling end times. Could this be the end times for a (relatively) easy life for small business in the UK? Or could it be the end time of Gordon Brown's reign as it becomes apparent its one lot of regulation and tinkering too far? Time will tell.

Income Tax

- Rates unchanged. Some allowances indexed, other frozen:

	2003-04	2004-05
Personal allowance (under 65)	£4,615	£4,745
Personal allowance (65-74)	£6,610	£6,830
Personal allowance (74 and over)	£6,370	£6,950
Married couples allowance (born pre 6/4/35)	£5,565	£5,725
Married couples allowance (over 75)	£5,635	£5,795
Tax bands:		
0%	£1,960	£2,020
22%	£1,961 to £30,500	£2,021 to £31,400
40%	over £30,500	over £31,401

- For more detail on tax rates visit www.inlandrevenue.gov.uk/rates/index.htm

- 100% capital allowances on IT equipment not extended beyond 31 March 2004, but first year allowances now at 50% on all plant and machinery after 1 April 2004:

	2003-04	2004-05
Year of purchase		
IT Equipment	100%	50%
Other Equipment (including vans)	40%	50%
Cars *1	25%	25%
Industrial Buildings	4%	4%
Subsequent years		
IT Equipment	n/a	25%
Other Equipment (including vans)	25%	25%
Cars *1	25%	25%
Industrial Buildings	4%	4%

*1 maximum £3,000 pa

- Increase in Enterprise Investment Scheme and Venture Capital Trust scheme investment thresholds/allowances.

- New landlords energy saving allowance, gives immediate tax relief on insulating a dwelling house.

- Pensions tax regime simplification put back from 6 April 2005 to 6 April 2006; proposed simplification allows for a life time fund of £1.5m initially, rising each year, and a annual allowance cap at £215k, again rising each year.

National Insurance

- No changes in rates, thresholds indexed:

<u>Employees</u>	2003-04	2004-05
Lower earnings limit	£77 week	£79 week
Employers and Employees primary threshold	£89 week	£91 week
Employees upper earnings limit	£595 week	£610 week
Employees rate on earnings between primary threshold and upper earnings limit (i.e. £91-£610 a week)	11%	11%
Employees rate on earnings over the upper earnings over £610 a week)	1%	1%
Employers rate on earnings over primary threshold	12.80%	12.80%
 <u>Self employed</u>		
Lower profits limit for self employed	£4,615 pa	£4,745 pa
Upper profits limit for self employed	£30,420 pa	£31,720 pa
Class IV (self Employed) rate on profits between upper and lower limits	8%	8%
Class IV (Self Employed) on profits over upper limit	1%	1%
Class II contribution	£2.00 week	£2.05 week

- For more detail on tax rates visit www.inlandrevenue.gov.uk/rates/index.htm

- No other significant NI changes published.

Corporation Tax

- No change in Corporation Tax rates, but introduction of new 19% minimum rate on profits drawn as dividend:

	2003-04	2004-05
Up to £10k	nil	nil
£10k to £50k	23.75%	23.75%
£50k to £300k	19%	19%
£300k to £1,500k	32.75%	32.75%
£1,500k and over	30%	30%
 Minimum Corporation Tax on distributed profits	 nil	 19%

- For more detail on tax rates visit www.inlandrevenue.gov.uk/rates/index.htm

- Compulsion on small companies to register with the Inland Revenue on start up – in reality almost all do anyway, but this puts in place a penalty if they don't, on a similar basis to sole traders/partnerships.

- The 19% minimum tax rate for distributed profits is a response to Government concern that people were incorporating to take advantage of the 10% tax free band. In general incorporation is still favourable for most small businesses:

Sole trader compared to single shareholder company

Income Band £	Tax and NI as Sole Trader £	Tax and NI under old Corporation Tax Regime £	Saving compared to sole trader £	Tax and NI under New Corporation Tax Regime £	Saving compared to sole trader £	Cost of IR591 £
5,000	153	-	153	48	104	48
10,000	1,441	-	1,441	998	442	998
15,000	2,941	61	2,880	1,948	992	1,888
20,000	4,441	1,248	3,193	2,898	1,542	1,650
25,000	5,941	2,436	3,505	3,848	2,092	1,413
30,000	7,441	3,623	3,818	4,798	2,642	1,175
35,000	8,711	4,811	3,901	5,748	2,963	938
40,000	10,555	6,247	4,308	6,773	3,783	525
45,000	12,605	8,388	4,217	8,735	3,870	347
50,000	14,655	10,529	4,127	10,698	3,958	169
55,000	16,705	12,660	4,045	12,660	4,045	-
60,000	18,755	14,623	4,133	14,623	4,133	-
65,000	20,805	16,585	4,220	16,585	4,220	-
70,000	22,855	18,548	4,308	18,548	4,308	-
75,000	24,905	20,510	4,395	20,510	4,395	-
-	-	-	-	-	-	-

Sole trader compared to dual shareholder company

Income Band £	Tax and NI as Sole Trader £	Tax and NI under old Corporation Tax Regime £	Saving compared to sole trader £	Tax and NI under New Corporation Tax Regime £	Saving compared to sole trader £	Cost of IR591 £
5,000	153	-	153	-	153	-
10,000	1,441	-	1,441	97	1,344	97
15,000	2,941	-	2,941	1,047	1,894	1,047
20,000	4,441	121	4,320	1,997	2,444	1,876
25,000	5,941	1,309	4,632	2,947	2,994	1,638
30,000	7,441	2,496	4,945	3,897	3,544	1,401
35,000	8,711	3,684	5,027	4,847	3,864	1,163
40,000	10,555	4,871	5,684	5,797	4,758	926
45,000	12,605	6,059	6,547	6,747	5,858	688
50,000	14,655	7,246	7,409	7,697	6,958	451
55,000	16,705	8,434	8,272	8,647	8,058	213
60,000	18,755	9,597	9,158	9,597	9,158	-
65,000	20,805	10,547	10,258	10,547	10,258	-
70,000	22,855	11,497	11,358	11,497	11,358	-
75,000	24,905	12,447	12,458	12,447	12,458	-

Capital Taxes

- No rate changes. Indexation of thresholds:

	2003-04	2004-05
CGT Exempt Amount	£7,900	£8,200
CGT Rates (dependant on overall income)	10%/20%/40%	10%/20%/40%
IHT Exempt Amount	£255,000	£263,000
IHT Rate	40%	40%
Stamp duty		
Property < £60k	nil	nil
Property £60k to 250k	1%	1%
Property £250k to 500k	3%	3%
Property £500k >	4%	4%
Shares	0.50%	0.50%
	(rounded to nearest £5)	

- For more detail on tax rates visit www.inlandrevenue.gov.uk/rates/index.htm

- Removal of CGT deferral relief on Venture Capital Trusts from 1 April 2004.

- Pre owned asset charge coming in from April 2005 to counter IHT avoidance schemes, but with exemptions to stave off objections concerning unintended or minor benefits.

Value Added Tax

- No rate changes. Indexation of thresholds:

	2003-04	2004-05
Basic Vat Rate (reduced rate)	17.5% (5%)	17.5% (5%)
Registration threshold	£56,000	£58,000
De-registration threshold	£54,000	£56,000
Cash accounting and annual accounting threshold	Entry £600,000 Exit £750,000	£660,000 £825,000

Excise duties

- Requirement for retail containers of spirits to be stamped duty paid, similar to cigarettes.

- Increase in duties for tobacco, beer, still wine.

- Frozen duties on spirits, cider, sparkling wine, road fund (VED), air passenger duty, insurance premium tax.

Other business measures

- Extension of Community Amateur Sports Clubs tax exemptions
 - Tax and NI exemption of £50 per week of childcare for employees
 - Package of anti-avoidance tax proposals
 - Inland Revenue requirement that certain defined tax avoidance schemes be registered in advance of their being used – definitions of schemes caught, are awaited.
 - Customs and Excise requirement for businesses turning over £600,000 pa to register if they are using certain defined avoidance schemes.
- Note the above measures do not make the schemes illegal or stop them being used, they just help the Revenue Departments to keep closer tabs on them.
- Prohibition of offshore partnership arrangements.
 - Restrictions on tax benefits from trading in life assurance policies.
 - Commercial buildings for exempt bodies.
- Business links to be devolved to management by Regional Development Agencies. Will anyone notice?

Other personal measures

- Extension of trial on simplified Self Assessment return – but you still have to disclose everything, even if the return doesn't ask.
- Increase in tax rates for trusts, but exemptions for certain trusts where tax saving isn't their purpose.
- Change to law on how jointly owned shareholdings in small companies are attributed to each spouse. This is a technical measure to counter some proposed work arounds for S660a challenges.
- £100 grant to pensioners against increased council tax bills.

Mileage rates, allowances & benefit in kind charges

Mainly static, adjustments in vat scale charge rates:

	2003-04	2004-05	
Income Tax:			
Car mileage rate first 10k miles	40 ppm	40 ppm	
Car mileage rate over 10k miles	25 ppm	25 ppm	
Car passenger miles	5 ppm	5 ppm	
Motorcycle miles	24 ppm	24 ppm	
Cycle miles	20 ppm	20 ppm	
Van benefit (less than 4 years old)	£500	£500	
Van benefit (over 4 years old)	£350	£350	
VAT: Scale charge vat due pa			
< 1400 cc	Diesel	£134.04	£128.82
	Other	£141.48	£138.51
1400cc to 2000 cc	Diesel	£134.04	£128.82
	Other	£178.72	£175.00
2000 cc >	Diesel	£169.04	£163.08
	Other	£263.61	£257.65

- An alleged "major de-regulation" of tax on the private use of company vans, which will see the tax cost of using a van privately increase six fold from April 2007. With de-regulations like this, who needs regulations?

Tax credits

	2003-04	2004-05
Working Tax credit		
Basic element p/a	£1,525	£1,570
Couple and lone parent element p/a	£1,500	£1,545
30 hour element p/a	£620	£640
Childcare element 1 child p/w	£135	£135
Childcare element 2 children p/w	£200	£200
Child Tax Credit		
Family element	£545	£545
Family element, baby addition	£1,090	£545
Child Element	£1,445	£1,625
First income threshold - WTC & CTC claimants	£5,060	£5,060
First income threshold - CTC only claimants	£13,230	£13,480
Withdrawal rate over first threshold	37%	37%
Second income threshold (CTC family element only)	£50,000	£50,000
Withdrawal rate over second threshold	6.67%	6.67%

Public expenditure & economics

- Clearly this was a pre-election budget – jam today, pay the shopping bill tomorrow – look at the governments forecast of tax receipts as a percentage of gross domestic product:

2002-03	35.6%
2003-04	35.7%
2004-05	36.5%
2005-06	37.3%
2006-07	37.8%
2007-08	38.1%
2008-09	38.3%

- A 2.7% change over 7 years is equivalent to a 7.6% increase in taxes over all – quite a jump, more so when the increased percentages are for a period when the economic cycle is predicted to be positive, i.e. the tax base itself increases.

- Public borrowing is forecast to come down – presumably as the effect of higher taxes cuts in:

2003-04	£37bn
2004-05	£33bn
2005-06	£31bn
2006-07	£27bn
2007-08	£27bn
2008-09	£23bn

- Will we all rue the day civil servants learned to use spreadsheets?

Conclusions

As with so many of Gordon Brown's budgets, the devil is in the detail, not the headlines.

The tax regime is becoming increasingly complex as more focused tax breaks in one year, become next years loopholes, and the year after anti-avoidance campaign.

Tax "avoidance" is increasingly the battle ground of a moral campaign by the government.

The personal tax regime for high net worth individuals has not been simplified, neither has the absurdly complex tax credit regime.

Meanwhile the public sector balloons away, overall taxes rise, the government spends more, interferes more, and still thinks it can reduce its borrowings.

General Election in 2005? Pre-pre election budget? Cut and run whilst it still looks reasonably good? Who knows whats on the Chancellor's mind?

PRG
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