



**PRE BUDGET REPORT**

**NOVEMBER 2008**

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## COMMENTARY

### GAIN NOW – PAIN LATER

With the economy on the brink of recession, the current Pre Budget Report has been the most important in recent years.

If the surge in business failures and redundancies is to be halted, significant fiscal intervention is required.

As the Prime Minister advised the CBI, “extraordinary times require extraordinary measures”.

Whether measures such as the reduction in the VAT rate, the retention of the 10% basic rate of income tax and the postponement of the increase in the small company's rate of corporation tax, until April 2010, will be sufficient to kick start the economy, only time will tell.

What is known for sure is that this early Christmas present will have to be paid for in the future. The proposed increase in the rate of income tax paid by those earning in excess of £150k per annum, will not be sufficient to reduce the level of government borrowing which is expected to rise by £128 billion within the next 12 months. Services in the future will have to be cut, or taxes increased, to reduce the deficit.

We do however welcome the small business scheme which will, if embraced by the banking community, provide vital cash to our local businesses. A variant of this was attempted before but with mixed results. We will be very proactive in promoting this for our clients.

### **HOW THEN DOES THE PRE BUDGET REPORT AFFECT YOU?**

The main areas of change are detailed below.

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## PERSONAL TAX

### **TAX RATES AND ALLOWANCES**

*From April 2009*

For those on low income the 10% starting rate of income tax for savings income only is to be retained.

The basic and higher rates of income tax are to remain unchanged at 20% and 40% respectively.

The threshold for paying tax at the higher rate is to be increased from £34,800 to £37,400. In addition the income tax free threshold is to be increased by £440 to £6,475. Thus individuals can earn approximately £44k per annum without having to pay tax at 40%.

The NIC upper earnings limit will be aligned to the higher rate band for income tax purposes.

*From April 2010*

People earning over £100k per annum will see their personal tax free allowance reduced by up to 50%, so that it is worth the same as to a basic rate tax payer.

Personal allowances are to be abolished completely for those earning in excess of £147k.

*From April 2011*

A new higher rate of income tax of 45% will be introduced for incomes above £150k.

All NIC rates are to be increased by 0.5% for employers and employees. In addition the top rate for Class 4 NIC's will increase to 8.5% (nominal rate) and 1.5% (higher rate).

### ***Effect of Changes***

The increase in NIC rates means that an individual earning £40k per annum will be £100 worse off from 2011 onwards.

The abolition of personal allowances for those earning more than £147k per annum will see their tax liability increase by £200 per month.

### ***Comment***

*We are very disappointed that the rate of employers NIC was not reduced. This is still a huge cost for small business.*

### **BENEFITS**

Assistance is to be given to households facing financial difficulties, through the establishment of a new Lending Panel. Individuals can expect:

- Help through mortgage rescue and support for Mortgage Interest Schemes,
- A commitment from major lenders not to initiate repossession action within at least 3 months of an owner occupier going into arrears, and
- Free and impartial debt advice through increased government funding.

The annual increase in family allowances is to be brought forward from April 2009 to January, worth an additional £22 on average to families.

In addition to a £5 increase per week in the state retirement benefit, all pensioners will receive a one off payment of £60 in the New Year.

### **PERSONAL PENSIONS AND PENSION CONTRIBUTIONS**

#### **Lifetime allowance**

The lifetime allowance for the current tax year is £1.65m and is due to grow to £1.75m for 2009/10 and £1.8m for 2010/11. The Chancellor has announced that the allowance will then be frozen at £1.8m for 2011/12 through to 2015/16 inclusive.

### **Annual allowance**

For 2009/10 the amount that can be contributed tax free will increase by £10k to £245k, rising to £255k in 2010/11.

However in the PBR the Chancellor has announced that the annual allowance is to be frozen for the tax years 2011/12 to 2015/16 inclusive, at £255,000.

### **Comment**

*The freezing of the lifetime allowance means that it will be even more important for those individuals with pension rights built up in approved schemes before 6<sup>th</sup> April 2006 to protect them, where appropriate, from the lifetime allowance charge. The deadline for doing so is 5<sup>th</sup> April 2009.*

*The potential increase in tax relief on pension contributions for those within the new 45% tax bracket from 2011/12 will mean that those individuals will have an extra 5% tax rebate to either spend or invest. This may explain in part why the pension allowances have been frozen.*

### **DISCLOSURE OF OFFSHORE ACCOUNTS**

Following the success of last year's scheme which netted the Revenue approximately £400 million in unpaid taxes, the Government has announced that HMRC will be giving offshore account holders a new opportunity in 2009 to disclose on their own accord.

## **BUSINESS TAX**

### **CORPORATION TAX RATES**

The proposed increase in the small companies' rate of corporation tax to 22% from next April has been postponed for one year; thus the current rate of 21% will apply for the 12 months to 31<sup>st</sup> March 2010.

The standard CT rate remains unchanged at 28%.

### **CARRY BACK OF TRADING LOSSES**

Businesses can currently carry back trading losses to be relieved against the previous year's profits. Going forward it will be possible to carry back trading losses for a further two years where they have not been fully utilised.

For companies the new rules apply for accounting periods ending between 24<sup>th</sup> November 2008 and 23<sup>rd</sup> November 2009 and for unincorporated businesses for the tax year 2008/09.

The maximum relief that can be carried back to the two preceding periods is limited to £50k of losses.

### **FINANCIAL ASSISTANCE**

Measures including a new Small Business Finance Scheme will be introduced to provide assistance to small and medium sized companies facing credit constraints.

The scheme will provide support of up to £1 billion to allow banks to lend to businesses. An additional £1 billion will be available to guarantee bank loans to small exporters, with a further £50 million being available to convert businesses' debt into equity.

**Comment**

*As mentioned above, this is to be welcomed but we hope the detail of the scheme will make it more attractive than its predecessor which was swamped in red tape.*

**FOREIGN INCOME**

Provisions in Finance Act 2009 will exempt large and medium sized groups from UK corporation tax on (most of) their foreign dividends but there will be an anti-avoidance rule restricting the level of tax deductible interest on world-wide debt.

**INCOME SHIFTING**

Proposals to introduce income-shifting rules for husband and wife companies have been deferred indefinitely.

**Comment**

*This good news and is in line with our comments on this, in our earlier newsletter*

**PAYMENT OF TAX**

Small and medium sized companies will be allowed to spread business tax payments to help ease cash flow and credit constraints.

**Comment**

*The postponement of the introduction of the 22% Corporation Tax rate and measures aimed at guaranteeing bank loans and giving businesses time to pay tax will, in the short term, improve cash flow.*

*These measures will not however encourage businesses to invest in new products and capital expenditure. There has been no increase in capital allowances which could have stimulated growth.*

**CAPITAL GAINS TAX (CGT)**

After the complete overhaul of the Capital Gains Tax regime announced in last years PBR, it was not unexpected that the only announcement made this year was the increase in the tax free annual exemption to £10,100.

The gain on the disposal of all assets will be subject to a flat rate tax of 18%.

Businesses' desire for the reintroduction of the 10% tax charge on the disposal of business assets has not been fulfilled, nor has there been any increase in the £1m lifetime allowance for Entrepreneurs *Relief*.

## INHERITANCE TAX (IHT)

As previously announced the IHT threshold is to be increased to £325k (£650k for married couples) from 6<sup>th</sup> April 2009.

## VALUE ADDED TAX (VAT)

### RATE OF TAX

With effect from the 1<sup>st</sup> December 2008, for a 13 month period only, the standard rate of Value Added Tax (VAT) is to be reduced from 17.5% to 15%.

### Comment

*Whilst this measure will put money in consumers' pockets in time for Christmas, it is not clear what impact this will have on spending or overall economic growth.*

*Businesses will be faced with the practical issues of implementing a new tax rate. There will inevitably be difficulties involved in the re-pricing of goods and determining what rate to charge for goods delivered and subsequently returned. These difficulties may result in the 2.5% reduction not being fully passed on to the consumer.*

*The reduced rate will neither impact on zero rated goods (such as basic foodstuffs and children clothing) nor on supplies such as domestic fuel which is currently subject to VAT at 5%.*

*The average family will be better off by only £200 per year following the cut. Rather than spending the money they may prefer to reduce their existing borrowings or invest.*

## STAMP DUTY LAND TAX (SDLT)

In an attempt to help the property market, the Chancellor announced in September that for a one year period until 2<sup>nd</sup> September 2009, residential properties costing less than £175k would be exempt from SDLT.

It was hoped that the PBR would not only increase the tax free threshold but also extend the relief to commercial properties. Unfortunately no extension was announced.

The rate of SDLT will remain unchanged for 2009/10.

## OTHER ISSUES

- **Fuel Excise Duty:** With the reduction in the VAT rate and the continued fall in the price of oil, the government has decided that the 2 pence per litre increase in fuel duty that had previously been postponed is to be introduced with effect from 1<sup>st</sup> December 2008. There will be a further increase of 1.84 pence per litre with effect from 1<sup>st</sup> April 2009.
- **Air Passenger Duty (APD):** The proposal to replace air passenger duty (APD) with aviation duty has been scrapped. Instead, in order to ensure greater stability and to protect competitiveness at a time of economic uncertainty, the existing

APD framework will be amended with four new geographical bands being introduced. The changes will have effect on any travel which commences on or after 1<sup>st</sup> November 2009, irrespective of when the ticket for travel was booked or purchased.

- **Excise duty on alcohol** will increase by 8% as of 1<sup>st</sup> December 2008. This change follows the 6% increase which took effect from 17<sup>th</sup> March 2008. This will result in a 3 pence increase on a pint of beer and 52 pence on a bottle of spirits.

**Comment**

*These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15%.*

Whilst every effort has been made by Cavanagh Kelly to ensure the accuracy of the information in this Pre Budget Letter, it cannot be guaranteed and neither Cavanagh Kelly nor any related entity shall have any liability to any person who relies on the information thereon. If having read the above and you would like to discuss further; one of our taxation staff will be pleased to help you.