

## **BUDGET 2011**

George Osborne delivered his second Budget last month and some of the key issues our clients need to be aware of are as follows:

### **1. The Personal Allowance**

The personal allowance has been increased for 2011/12 by £1,000 to £7,475. This represents a modest step in the right direction, but the personal allowance remains way too low given the exceptionally high cost of living in the UK.

For many taxpayers however, the benefit of the increased personal allowance will be reduced or eliminated by the National Insurance increases and the lowering of the 40% higher rate tax threshold to £42,475. It is estimated that an additional 750,000 taxpayers will become liable for 40% tax as a result of this change.

### **2. The Annual Investment Allowance**

The provisions of the Annual Investment Allowance (AIA) mean that 100% capital allowances can be claimed on plant and machinery purchased during the year as a deduction against profits. This is a very valuable relief for the self employed and for the year to 5<sup>th</sup> April 2012, expenditure of up to £100,000 qualifies for this treatment.

As previously advised, most cars do not qualify for this relief (see point 4 below). Vans and commercial vehicles, computers, plant and equipment etc. do qualify however.

The annual limit for the AIA will be reduced to £25,000 per annum for the 2012/13 tax year onwards. If clients are considering major levels of capital expenditure, the timing of this needs to be considered carefully. Please consult us with any queries in relation to this.

### **3. Tax Relief on Pension Contributions**

The vast majority of our clients will still be able to benefit from higher rate tax relief on pension contributions. The annual allowance for tax relief on pension savings for individuals has been reduced to £50,000 per annum from 2011/12 onwards.

For higher rate taxpayers, this remains a hugely valuable tax break, where it effectively costs just £60 to invest £100 into a pension fund. Changes are also being introduced in relation to what taxpayers can do with their pension funds. In many cases, our clients may find the new rules suit them better.

### **4. Low Emission Vehicles**

100% allowances may be claimed by the self employed on the purchase of **new** low emission vehicles up to 31<sup>st</sup> March 2013.

In order to qualify, the vehicles need to have CO2 emissions of 110g per kilometre or lower. Many clients have benefited from this excellent tax relief over the last year and an increasing number of vehicles now satisfy the emissions criteria.

Virtually all the major manufacturers produce vehicles with emissions of 110g of CO<sub>2</sub> or lower. This includes Audi, BMW, Citroen, Fiat, Ford, Honda, Mini, Nissan, Peugeot, Renault, Seat, Skoda, Toyota, Vauxhall, VW, Volvo etc. This list is not exhaustive and further guidance can be obtained by visiting the following website: [www.comcar.co.uk](http://www.comcar.co.uk)

If clients feel they want to benefit from this excellent tax relief, please can they contact us to discuss the precise tax benefits that might accrue in their circumstances.

#### 5. **Lower Taxes for Entrepreneurs/Businesses**

Osborne did throw a few crumbs to the small business community by increasing the lifetime limit on gains eligible for Entrepreneurs' Relief from £5million to £10million. (This can reduce the effective rate of Capital Gains Tax to 10% on the sale of a business). He increased the rate of Income Tax relief on Enterprise Investment Scheme (EIS) investments to 30% and he intimated that the 50% top rate of Income Tax is a temporary measure only. Repeated studies have shown that Income Tax levied at this level reduces the overall tax take, but the Coalition Government did not have the political willpower to reverse this punitive tax rate brought in by their predecessors for political purposes.

#### 6. **Integration of Income Tax and National Insurance**

One of the biggest potential changes to the tax system in the UK was mentioned in the Budget speech. George Osborne said that the Government will "consult this year on the options for integrating the operation of Income Tax and National Insurance contributions".

Successive Governments over the years have avoided this, as it would make the true level of taxation much clearer and would prevent Chancellors from boasting that Income Tax had not risen, at the same time as raising National Insurance. It seems very unlikely that any substantive change will occur any time soon.

## The Economic Outlook. Where are we now?

Liam Byrne, the outgoing Labour Chief Secretary to the Treasury, left a note last May for his successor which accurately summed up Labour's disastrous legacy. It read: "Dear Chief Secretary, I'm afraid there is no money". With Britain's national **debt** currently totalling a mind boggling £909 billion and projected to increase to £1,359 billion by 2015/16, Byrne's comments were, for once, devoid of the usual Labour spin and brutally honest.

George Osborne and the Coalition Government have delivered two Budgets against this backdrop and have taken modest steps to begin restoring some sort of sanity to the public finances and reducing the annual **deficit**. The news media seem to consistently confuse the **deficit** with the national **debt**. The **deficit** measures how much more the Government of the day is spending than it is receiving, whereas the national **debt** represents what has happened in the past and is the accumulated debt. Cutting the **deficit** only reduces the amount by which we are increasing our **debt** overall.

In 2000, the UK Government's expenditure totalled £343 billion. If this had increased in line with inflation, by 2010 Government expenditure would have totalled £450 billion a year. However, Labour's decade of irresponsible state spending meant that by 2010, Government expenditure totalled a massive £669 billion, which represented in real terms a 50% increase in state spending during a period where GDP rose by only 17%.

The hate-filled Left like to constantly bleat on about the savage/irresponsible/heartless (delete as appropriate) 'cuts' imposed by the Coalition. As with virtually all Left Wing claptrap, this view does not stand up to scrutiny. Treasury statistics show that total Government spending has risen every month since the Coalition was formed and the Coalition Government expects to spend £300 billion more than it receives between now and the next Election.

In cash terms, spending will **increase** from £710 billion this year to £763 billion by 2015/16. In 'real terms' (adjusted for inflation) the Treasury has confirmed that 'spending on public services in 2014/15 will be **higher** than 2006/07'.

This all seems rather odd, given that back in 2006/07 Gordon Brown was boasting about the wonderful 'investment' he was making in public services as he threw money around like a drunken sailor on shore leave. I don't remember the moronic Union bosses, brain-dead commentators, lunatic demonstrators and economically retarded Left Wing politicians (think Ed Milliband, Ed Balls etc.) complaining back then.

Labour politicians continually peddle the fantasy that Britain's fiscal black hole came about purely because of the actions of the hated bankers. This view also does not stand up to any proper analysis. The Treasury has confirmed that the final short term cost of the interventions which came about from the banking crisis will be £6 billion. This represents loose change when considered in the context of the national debt, which is projected to total nearly £1.4 trillion by the end of this Parliament.

In addition, it is quite possible that the taxpayers' stake in the bailed-out banks will actually be sold at a profit. It is a bare faced lie to claim that those working within the public sector and those receiving its services are being made to pay for a financial mess created by the capitalist system/evil bankers. The financial mess was created by the ridiculous and unsustainable expansion of the state sector during the Gordon Brown years.

## Picking Up the Tab

As a nation, we are already spending £50 billion per year (just under £1 billion a week) on interest payments on our accumulated debt to date. To put this in perspective, this is more than our annual Defence budget and about 40% of our spending on the NHS. Liam Byrne might feel that it's ok to write flippant notes about this atrocious state of affairs, but I think most taxpayers would disagree.

The Taxpayers' Alliance recently calculated that once all the 'off balance sheet' liabilities are factored in, it is quite conceivable that the actual cost of servicing the **debt** could rise to £200 billion a year by the end of this Parliament. Ouch.

Forty years ago, the Labour MP Tony Crosland told the public sector that 'the party is over', but nothing could have been further from the truth. None of our politicians have had the guts in the intervening years to radically reform the public services so that we can have the services we want at a cost we can afford. The Centre for Policy Studies concluded that the public sector pension scheme is a 'Madoff-style pyramid, now collapsing under the weight of insufficient contributions, rises in longevity and an ageing workforce'. The taxpayer provides 80% of all public sector final salary contributions, which will total £10.3 billion per year by 2016. The **unfunded** UK public sector pension liability is estimated at a staggering £47,000 per household.

The UK appears addicted to spending money it doesn't have. A significant proportion of the public appear unaware that Britain faces the choice of imposing some degree of financial constraint ourselves or having solutions imposed from outside (think Greece, Ireland, Portugal etc.). If the international markets lose confidence in the UK's ability to control its spending, Government borrowing costs will rise, the **debt** will increase, interest payments will rise, spending on public services will fall and we could enter a debt spiral.

## 'Cuts', or as I like to call them, 'Savings'

The vast majority of economists agree that the key to building a vibrant economy is to increase productivity, which essentially is a measure of the output obtained for a given input.

Most of our clients will know that the private sector is thoroughly aware of the need to find efficiencies and savings at a time when money is tight and many clients are working harder for the same or sometimes less reward. This represents a pay cut and the vast majority of people in the private sector accept this as part of the economic cycle. It seems very difficult to transplant this sort of rational view into the public sector.

The private sector achieves much higher productivity than the public sector, so it is clearly rational and desirable for the economy as a whole to divert resources from the latter to the former. Of course, this is simple in theory, but much harder to achieve in practice.

Unfortunately, achieving real savings and actually spending less money, is something that national and local Government systems are not set up to achieve. It is the nature of Government departments that they become accustomed to year on year real term increases in their budgets and many departments became used to seeing their budgets increase each year by around about 4% over and above the rate of inflation. With time finally being called on these unaffordable increases, the Unions have started howling unjustifiably and somehow see this as justification for strike action.

Against this backdrop, the Tory party's politically motivated promise not to reduce the NHS budget looks foolish to say the least. The 2010/11 NHS budget totalled £122 billion and this will increase to £126 billion this year. With over 1.43 million employees (an increase of over 30% during the Labour years) it seems very hard to believe that vast savings could not be made.

The reality is of course that there is more than enough money spent by the Government to have first class services across the board, but the inefficiencies, low productivity, lack of competition, overmanning, bureaucracy and unaffordable public sector pension liabilities mean that any improvement in 'outputs' is usually only achieved by a disproportionate rise in 'inputs'.

One of the main problems with diverting resources from the public sector to the private sector is that any change like this would have to be sanctioned by politicians and civil servants. Turkeys tend not to vote for Christmas, do they?

## **Conclusion**

The problems facing the UK are massive and are not going to be resolved quickly. The nation's finances can only be improved by allowing the private sector to grow unencumbered by administrative burdens, red tape and high taxes. Osborne proudly boasted about reducing the complexity of our tax system in his Budget speech as he abolished 43 tax reliefs. This will have the effect of reducing the 12,000 pages of tax legislation by 100 pages. Big deal.

There are numerous issues, over which our Government has little control, which could derail any genuine economic recovery. These include the following:

### 1) **Trouble in the Eurozone**

The inevitable collapse of the Euro and the resultant chaos and banking crisis is likely to have grave consequences here in the UK. Quite when this will occur, we just don't know. It seems highly likely that the currency will stagger through many more crises and rescues before the end point is reached. Sarkozy and Merkel can grandstand all they like about how they will never give up on the Euro, but in reality it's not in their hands.

I read an article recently which highlighted how Portugal and Greece have reneged on their debt 5 times since 1800 and Spain 7 times. Why do these clowns think it will be any different this time? The Euro has been an unmitigated disaster for countries such as Ireland, where it allowed economic reality to be suspended. Heard the one about the Irishman who borrowed 1 million Euro on a bus driver's income to build up a property portfolio? I did, the other day and it wasn't a joke. Needless to say, this budding property magnate is now bust.

### 2) **Inflation**

There appears to be a strange conspiracy whereby inflation is ignored by policymakers. All clients will have noticed the significant inflation affecting so much of our essential, unavoidable expenditure, such as fuel, food and clothing.

High inflation eases the debt burden as the real value of debt is reduced. So taken simplistically, inflation might be good for a heavily indebted nation such as the UK.

However, high inflation would inevitably cause debt interest costs to rise sharply and the real value of public spending to fall. We would all face sharper decreases in living standards as earnings and Government income fails to keep pace with increasing prices.

### 3) **House Prices and Negative Equity**

We have talked endlessly about overvalued property in the UK. House prices have been propped up by lax and irresponsible lending and artificially low interest rates, which have been used to save the profligate at the expense of the prudent.

House prices will fall in the UK, it's inevitable. The banks have now decided that their lending policies were flawed and have tightened their lending criteria massively. At some stage, interest rates will rise, pushing many householders into financial trouble.

Homebuyers today still have to borrow on average 5 times national earnings to buy a home. This is down from the peak of 6.4 times in October 2007, but still not at the long term average of 4 times earnings. It seems quite possible that prices will fall at least another 20%.

The media only seem to like increases in house prices and will portray this as a disaster. However, lower prices will be good news for first time buyers. Why is this so rarely mentioned?

### 4) **Welfare Dependency**

The vast expansion of welfare dependency over the last decade, a deliberate Labour policy to gerrymander electoral support, has led to the 'Social Protection' budget totalling £200 billion per year. This represents 28% of all Government spending annually. Massive savings are required, but the political difficulties in achieving this with a Coalition Government appear insurmountable.

The Coalition faces a well nigh impossible task in shrinking the size and cost of the State whilst at the same time maintaining the services people want. Every week we hear stories of how councils (of all political colours) are slashing desirable/vital services (libraries, transport, care etc) at the same time as keeping extravagant offices, salaries, junkets, pointless bureaucracy and handing the blame back to the Government.

Against this backdrop and the problems listed above, it seems likely we will need to prepare ourselves for a very bumpy ride over the coming years. Let's hope our politicians have the necessary courage, vision and fortitude to see it through.